Non-market strategies and firm performance : Three Essays on Firms' Political Linkages and Their Impact on Financial Performance

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ECOLE DOCTORALE
Sciences du Management

Gestion – Organisation
Décision - Information

ECOLE DES HAUTES ETUDES COMMERCIALES DE PARIS

Ecole Doctorale « Sciences du Management/GODI » - ED 533
Gestion Organisation Décision Information

NON-MARKET STRATEGIES AND FIRM PERFORMANCE
Three Essays on Firms' Political Linkages and Their Impact on Financial Performance

THESE
présentée et soutenue publiquement le 5 décembre 2013 en vue de l'obtention du
DOCTORAT EN SCIENCES DE GESTION
Par

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Acknowledgements

The writing of this dissertation has probably been the most challenging, and the most manic-depressive activity of my life until now. It would have never been possible to complete this dissertation without the help and support of the people around me. I would like to give particular mention to some of them here.

First and foremost, I would like to thank my advisors, Bernard Garrette and Kristina Dahlin, who patiently provided the vision, encouragement, and advice necessary for me to proceed through the doctoral program and complete my dissertation. Their steadfast support and intellectual guidance over the years have been invaluable. Bernard, with his calmness and amazing analytical thinking ability, has always been an anchor, specifically at times I was feeling stumped about the direction of my research. Kristina, on the other hand, gave me her hand at a very critical point during my doctoral journey. Without her great mentoring and push, this dissertation would never have been completed.

I would also like to express my gratitude to the members of my committee, Bernard Leca, Géraldine Schmidt, Tiziana Casciaro and Tobias Kretschmer, for accepting to be part of my dissertation committee and taking the time to read this dissertation. I am sure their feedback will be extremely valuable and contribute deeply to my future research.

Another debt of gratitude must go to Rodolphe Durand. He has been a very generous mentor for me throughout all these years, and has always supported me via all possible means. He has offered me his intellectual guidance, life and career related advice without hesitation. Also thanks to him I have been part of the Society and Organizations Research Center and got access to part of the data in this dissertation, which was indispensible for its completion.

I would also like to thank all the professors at the HEC Strategy Department, specifically Bertand Quélin and Pierre Dussauge for sitting on my dissertation project committee; Denisa Mindruta for co-teaching and coordinating our "Grande Ecole" course, and Thomas Astebro and Tomasz Obloj for their data related advice.

I would also like to acknowledge the academic and technical support of the HEC PhD program. The kind support and help of the prior head of the PhD program Laoucine Kerbache, and of our current program head Ulrich Hege; and finally of the great team consisting of Marie-Laure Dage, Caroline Meriaux, Cécile Marty, and Françoise Dauvergne were indispensible and made my PhD journey much smoother. I am also grateful to the generous financial support of the HEC Foundation, which financed a huge part of my expenses during all these years. From the administration, I would also like to have a special thank to Anne Delanoy, who has always been kind and helpful to me.

Apart from HEC two other institutions, and colleagues there, have been of great help and support for me, and changed the course of my PhD journey. First, I would like to thank Joël Broustail and Michel Antoine at Paris IV (Sorbonne) for providing me with a great opportunity to teach for two years at Sorbonne. I would also like to acknowledge the extremely valuable support of Frédéric Teulon and my colleagues at IPAG, who have welcomed me at their institution, and made the completion of this dissertation possible.

My fellow PhD colleagues with whom I have shared both the pleasure and pain of being a PhD student deserve special thanks: Birgul Arslan, Navid Bazzazian, Marco Clemente, Moumita Das, Panikos Georgallis, Martin Goossen, Anne Jacqueminet, Julien Jourdan, Ali Reza Keshavarz, Ilze Kivleniece, Daniela Laurel, Yi Li, Lionel Paolella, Joao Pimentel, Thomas Roulet, Anisa Shyti, Tatiana Sokolova and Shiva Taghavi. Apart from my fellow PhD colleagues at HEC, there are many other fellow PhDs that I have met during conferences, with whom I have shared intellectual and friendly moments. Even though I can't mention them all here, I would like to specially thank some: Daniel Armanios, George Chondrakis, Cata Ratiu, Arjan Markus and Tatiana Mikhalkina.

It goes without saying that completion of this dissertation would never have been possible without the great friends I have in Paris, who made me feel at home, and who have been steady sources of laughter, joy and support: Ayça Borbély, Adrian Borbély, Alex Carter, Aysegul Dilsizoglu, Onur Dogan, Shora Moteabbed, Anna Pappa, Pinar Sener, Murat Senol Hamid Tabarraei, and Pavlos Vasilopoulos. I would have never made it without them, and without all the "balance" they brought to my life. Not only my friends in Paris, but also some others in various cities around the world have been of great support during these years. Special thanks go to Devrez Karabacak and Sena Oyman. Devrez has been always there for me whenever I was "confused" in no matter what, and has provided tremendous help to me with the Matlab program when I was collecting my data. Sena, on the other hand, welcomed me various times at her Brussels' home in the past years, and has offered me the warmth of her great friendship, for more than 20 years now. Finally, I would like to thank Evin Acan, Gurcan Cetin, HJ Min, Eren Ozduzen, Tamara Pavlovic, Demet Summeoglu, Esra Ulku, Pinar Yagri and Dilek Yilmaz for being always very close to me even though they were literally thousands of kilometers away.

To finish, I would like to thank the closest people to me, without whom I would have never reached this day.

Among all the people, Sam has been the biggest source of joy and support for me. His unconditional support and love were indispensible during this period, especially since the last few months of the completion of a dissertation is never known to be an easy ride. Apart from that, needless to say, my time in Paris would never have been the same, and so memorable, without him.

My grandma Havva Ak, who is the strongest woman I have ever met, and who always inspired me to fight back, when life brings about difficult times, deserves special thanks. Throughout these years, she persistently wanted to know why I would not return to my country and start "working for the State"; however I am sure she will be very proud with the completion of this dissertation. I would also like to thank my cousins Sinem Ak and Zekai Ak, who have been a sister and brother to me all my life, and who supported me greatly during these years, as they always did.

Finally, my biggest and undeniable debt of gratitude goes to my parents, Aliye & Tevfik Kozan, for all their love and encouragement. They had told me as a child that education is the only thing they might be able to offer me, and that I should take it "seriously". I am not really sure whether what they had in mind was endless years (about 25 years!) of education, however my parents never even once questioned my choices over my life. Thanks mom and dad, for being the most caring, loving, supportive parents.

This dissertation is devoted to my beloved parents, Aliye & Tevfik Kozan; and also to my beloved uncle Suat Anarat, who passed away in the very last months of this dissertation's completion, at a very young age. I hope to always carry his big smile to life, like he did, even at the very last moment.

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1 CHAPTER 1: INTRODUCTION

Strategy research has paid little attention to the implications on firm performance of the so-called "non-market" environment of the firm, until recently. Non-market environment of the firm consists of the forces that shape and constrain the markets firms operate in. Baron (1995: p.48) defines the non-market environment as "(the) set of forces [that] are manifested outside of markets but often work in conjunction with them [and] consists of the social, political, and legal arrangements that structure interactions among companies and their public".

While "market" strategies aim at shaping interactions with competitors, customers and suppliers in the market place, non-market strategies consist of actions "specifically designed to influence the institutional players" that determine public policy, and shape the "rules of the game" that govern interactions among firms, competitors and consumers in their market environment (Holburn & Vanden Bergh, 2002). Firms are constrained by institutional players that determine the rules of the game, be it regulators, political actors, or the society. For the purposes of simplicity, in this dissertation, the "non-market" term will be used as it pertains to the relationship between firms and politicians; and firms and society. Firm strategies targeted towards those players in the non-market environment may have important consequences on firms' performance in the market environment, since non-market actors have the power to change the business landscape and the competitive positions of firms. Therefore, designing and deploying strategies towards those non-market players is crucial for a firm, and by no means less important than "traditional" strategic actions.

At a very broad level, this dissertation is going to focus on performance implications of firms' non-market strategies. Before defining the gaps in the literature, in the next section, I will first discuss the importance and relevance of firms' relations with the political and social environment.

1.1 FIRMS AND THE POLITICAL ENVIRONMENT

Political environment of firms is a source of uncertainty for the firm. A firm's political environment poses uncertainty for the firm for three reasons: First, the firm has limited ability to predict accurately the future state of governmental policies. There are two dimensions to this sort of inability: perceived inability to predict effects of future policy states on the firm, and perceived inability of managers to predict consequences of response choices. Second, regulators may disagree on regulatory direction and uncertainty may also arise as a result of this disagreement on how to implement regulations, as well as from definitions, measurements, and rules (Haley & Schuler, 2011). Third, key interest groups in a firms' non-market environment, such as NGOs and trade unions may disagree on the targets of regulators, i.e. what should be achieved through regulations, and how to achieve those targets; and apply strategies to affect these policies, putting the firm under the pressure of competing demands (Haley & Schuler, 2011; Pfeffer & Salancik, 1978).

Uncertainties created by the political environment, as well as the discretion of political actors over the markets result in firms' dependency on the political environment. Managing this dependency can have important implications for the competitive position of a firm. Policies may directly impact industries, as well as macro-economic conditions, which will consequently impact an individual firm's survival chances and performance. Specifically firms which operate in industries that are highly regulated, or firms which are highly dependent on the government, such as firms with a high proportion of sales to, or contracts with the government (e.g. defense contracts), or with heavy cost burdens imposed from public policy will be more impacted by this uncertainty created by the political environment; and will be more inclined to engage in political action to shape public policy (De Figueiredo & Tiller, 2001; Hansen & Mitchell, 2000; Hillman, Keim, & Schuler, 2004; Schuler, Rehbein, & Cramer, 2002).

To manage their dependency on the political environment, and to obtain firm-specific benefits, firms deploy various strategies, both individually and collectively with other firms. Firms form political action committees (PACs), operate a government relations office, contribute to politicians' campaigns, appoint politicians on the board of directors of the firm, form coalitions (such as trade associations), get into advocacy advertising, among others. Political strategies may provide firms with various benefits, such as first mover advantages in foreign markets (Frynas, Mellahi, & Pigman, 2006). "Domestic" benefits are also obtained through exchange relationships firms build with politicians: For instance in exchange for private gains, politicians may provide benefits to firms, through price fixing, restrictions on the market entry, or policing cartel agreements (Stigler, 1971). Firms may mitigate regulatory risks in merger and acquisitions through their political strategies (Clougherty, 2003, 2005). Holburn and Vanden Bergh (2013) show that utilities companies increase their election campaign contributions to politicians the year before they announce a merger, targeting to secure regulatory merger approvals.

In extreme cases, firms may try to penetrate the political environment, and co-shape regulations with the government, "blurring" the distinction between business and political institutions (Dieleman & Sachs, 2008). Co-shaping regulations with the legislators might alter the competitive positions of certain groups and distribution of profits within an industry, as a result of inter-firm variability towards the impacts of those regulations (Pashigian, 1984; Thomas, 1990).

1.2 FIRMS AND THE SOCIETY

One other component of a firm's non-market environment that creates uncertainty for the firm is society, which can be defined as the community of people living in a particular region and having shared customs, laws, and organizations, in the simplest sense. Strategy research has been primarily concerned with obligations of firms to their shareholders, i.e. to maximize shareholder wealth. Given the current way capital markets operate, this prioritization is inevitable for a firm if it wants to survive. However, this does not mean that firms do not have other obligations they need to fulfill to survive.

Apart from fulfilling their obligations to the shareholders, and to the regulatory institutions, firms need to secure a "social license" to operate. Social license "governs the extent to which a corporation is constrained to meet societal expectations and avoid activities that societies (or influential elements within them) deem unacceptable, whether or not those expectations are embodied in law" (Gunningham, Kagan, & Thornton, 2004). Meeting the expectations of the society is primarily about the perception of whether the firm is doing "good enough" as a result of its actions. In other words, the society "evaluates" the means firms use when conducting business and assesses whether the business itself can be justified with the benefits it provides to the society. Actions by firms that are deemed "unacceptable" will be sanctioned; and firms may face direct revenue losses as well as reputation losses as a result of those unacceptable actions (King, 2008; Pruitt & Friedman, 1986; Pruitt, Wei, & White, 1988).

On the other hand, in exchange for the "benefits" provided by a firm to society, the society may in return award the firm with more willingness for providing resources the firm needs (Backhaus, Stone, & Heiner, 2002; Frooman, 1999); such as legitimacy (Heugens, van den Bosch, & van Riel, 2002; Selsky & Parker, 2005); reputational capital (Fombrun, Gardberg, & Barnett, 2000); and greater tolerance if the firm suffers from negative events (Godfrey, Merrill, & Hansen, 2009).

Therefore, how firms manage their social environment will have implications for firms' performance in the market environment.

1.3 RESEARCH GAPS

Prior research has investigated firms' relations with their non-market environment, both in terms of firms' relations with political actors and with society. However, there are many issues that remain to be further investigated to provide a more fine-grained analysis of firms' non-market strategies as well as the performance implications of those strategies. Below, I will discuss three main gaps in the literature on firms' non-market strategies and the research questions that arise from these gaps, which this dissertation addresses.

First of all, before moving into the performance implications of firms' non-market strategies, there is a need to provide a more granular analysis of the actors in the firms' non-market environment, as well as of how these actors interact with the firm. No matter how strong a firm's desire or motivation to manage its non-market environment, this will not necessarily match with its ability to do so. Many attributes related to the firm and the players in the non-market environment will moderate the outcome of any interaction between the parties. To understand why a firm acts the way it does, we need to more carefully consider the attributes that make this action possible (King, Felin, & Whetten, 2010). Likewise, to understand what the outcome of any interaction between a firm and its non-market environment will be, we need to carefully consider the attributes of the players on both sides, and the conditions under which the interaction between the firm and the non-market player takes place.

As a first step, we need to define the actors in the non-market environment in a more granular way. For example, firms' relations with "government" have been of interest to scholars, specifically in international business literature. The government is taken as a "variable, rather than a constant or a given", since government has an impact on multinational firms' entry, operation and exit decisions (Boddewyn & Brewer, 1994). Most of the time, however, political strategy literature considers the government as a unified body, an individual level actor on its own (Shaffer & Hillman, 2000), whereas firms do not really interact with a "government" but rather with politicians within the government. This politician level interaction has only recently started to get attention from scholars (Faccio, 2006; Gehlbach, Sonin, & Zhuravskaya, 2010; Hillman, 2005). Once we shift the focus to firm-politician dyads, then we will be able to provide a more granular analysis of the interaction between a firm and a politician, taking into account both parties' attributes and how these attributes will interact with each other within the dynamics of the relation as well as the context. Firms differ in their capability to successfully manage their political environment, but also differ in their susceptibility vis-a-vis the politicians in terms of being subject to rent extraction. Rent extraction by politicians is inherent in relationships between the firm and the politician, since these relations are based on exchanges between the parties, and exchanges by nature consist of transfer of resources from one party to another. Therefore, it is crucial for us to understand the factors that may lead to rent extraction by politicians, to be able to assess whether political strategies will be "effective" without compromising the firm's financial performance. If not well understood and foreseen, such rent extraction by politicians may result in ex-post poor firm performance. Therefore, one research question that this dissertation addresses is:

What are the factors that impact politicians' rent extraction from firms?

Second, a common perspective in the literature is that firms that have linkages with politicians use these linkages to manipulate the economic and legislative environment in the best interests of the firm. So linkages with politicians are supposed to serve as means to "absorb" the uncertainty arising from the political environment and to shape and create a more "favorable" environment for the firm (Hillman & Hitt, 1999; Hillman et al., 2004; Pfeffer & Salancik, 1978). Even though such linkages might aim to manage the dependency of a firm on the political environment, the risks arising from a partner's potential misappropriation of firm resources is disregarded (Katila, Rosenberger, & Eisenhardt, 2008). In other words, the literature focuses on the ex-ante conditions for building linkages with politicians, assuming that once the exchange is in place, firms are able to derive positive returns from those exchanges. However, linkages with politicians may backfire as politicians who hold the power to bestow benefits to the firm also hold the power to extract benefits for themselves. The question regarding whether firms draw positive financial returns from political linkages therefore remains a relevant one. Moreover, prior literature does not distinguish between the different types of linkages firms can build with politicians[1], whereas political linkages might take many forms and different forms might have different implications in terms of their implications on firms' performance. Therefore, there is a need for a more granular analysis of the impacts of different types of linkages, and their characteristics in terms of how they impact the exchange between a firm and a politician, to better understand the eventual financial performance consequences for the firm. So, another research question this dissertation addresses is:

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[1] One exception is Okhmatovskiy (2010) who distinguishes between government ownership linkages and board linkages.
[2] In alphabetical order: France, Germany, Greece, Ireland, Latvia, Lithuania, Poland and the

Do firms draw positive financial returns from their political linkages, and if so, through what types of linkages?

Third, while both the political environment and the social environment of firms have received attention in terms of how they impact firms' financial performance, the integration of different strategies addressing different dimensions of the non-market environment has received very limited attention in the management literature (Doh & Lucea, 2013). Some theoretical work suggests that firms should simultaneously target different non-market actors through their strategies, and should diversify their non-market strategies (Baron, 2001a, 2003, 2011; Lord, 2000). However, systematic investigation of the joint use of different non-market strategies and the implications of this simultaneous deployment of strategies on financial performance of a firm remains to be conducted. Such integration of non-market strategies is particularly relevant given the changes in the few last decades: Firms, civil society and the public sector have increasing interactions among them. With the rise of global interconnectedness, as well as improved communication means, civil society has more power on firm actions, since firms may be directly targeted through social protests, shareholder resolutions, consumer boycotts, in other words, through what is conceptualized as "private politics" (Baron, 2003; Baron & Diermeier, 2007; Davis, Morrill, Rao, & Soule, 2008). Civil society has also more power on the governments. Civil protests became part of modern life. They occur with greater frequency, and with more diverse constituencies, and claims are of a wider range. Governments' power is challenged by many new international actors such as NGOs, regional blocs, scientific networks, epistemic communities, which focus both on post-material issues such as consumer issues, environmentalism and minority rights, as well as economic issues such as import duties, manpower training or price support (Berry, 1999). This changing business landscape, increasing co-dependence between business, politicians and society and a "rebalancing of power" among those actors is an important characteristic of the last decades (Doh & Lucea, 2013). And it calls for a more systematic investigation of how strategies towards different actors in the non-market field interplay among each other and how this interplay impacts firms' financial performance. A final research question the dissertation addresses is:

What is the impact of integrating non-market strategies targeting different non-market fields on firms' financial performance?

1.4 MAIN RESEARCH QUESTION AND THE ESSAYS

Through the above three research questions, this dissertation aims to answer the following main research question:

What impact do non-market strategies have on firms' financial performance?

This dissertation consists of three essays, each one addressing a separate research question defined above. It draws attention to the double-edge nature of non-market strategies, and the importance of forming a right portfolio of such strategies. The first essay discusses theoretically the contingency factors that are likely to result in a firm's exposure to rent extraction by politicians. The second essay, through empirical investigation, looks into the relation between a firm's political engagement and financial performance while distinguishing between different types of political linkages the firm has. Finally, the third essay analyzes the impact of simultaneous deployment of strategies targeting multiple fields of the non-market environment, i.e. strategies towards politicians and society at the same time, on firm performance.

Essay 1 provides a conceptual framework on rent extraction by a politician as determined by a multitude of factors which all change the power dynamics between a firm and a politician. Rent extraction by politicians is inherent in the relationship between a firm and the politician, and if not well calculated, such rent extraction by the politician may result in deterioration of firm performance. Therefore the research question this paper aims to answer through the conceptual framework, i.e. what factors are likely to result in rent extraction from a firm by a politician, is a relevant one to be able to assess whether a linkage with a politician will indeed prove to be beneficial. The aim of the conceptual framework is to shed light first into the variation among both firms and politicians in terms of their power within the exchange relationship they build, and then to understand how the dynamics of the relationship as well as the characteristics of the political environment change the rules of the game within the exchange. In other words, I first look into the exchange partners' characteristics, i.e. firm characteristics and politician characteristics, which determine the resources the exchange partners may potentially bring into the exchange, thus the potential dependence of the exchange partners on each other, hence the power each party will hold over one another. Then I discuss the exchange characteristics, i.e. relationship dynamics, which determine whether the power the parties behold will translate into the use of this power. I additionally take into consideration the political environment characteristics, which may change the rules of the game between the parties through dispersing the power in the political arena, and which change the power-dependence dynamics between the exchange partners; and therefore impact rent extraction by politicians.

Drawing on work from multiple fields, with this framework, I hope to shed some light on the relationship between firms and politicians, since "*understanding the relationship between business and politics remains an enigma.*" (Lux, Crook, & Woehr, 2011).

Essay 2 investigates whether firms draw positive financial returns from their political linkages. This essay looks into the relation between firm political linkages and financial performance through distinguishing between different types of political linkages. It argues that the potential reach of firm influence, and whether the firm is going to achieve positive outcomes through its political linkages is going to be determined by whether a linkage creates incentives for the politician to reciprocate, while limiting ex-post dependencies between the firm and the politician. Put more specifically, this essay argues that linkages that create a pseudo lock-in situation and decrease incentives for the politician to reciprocate since they reduce the uncertainty about continuity of future exchanges, will decrease the benefits the firm may draw from the exchange and increase the rent extraction by the politician from the firm; and thus will impact the firm's financial performance negatively. Linkages that create incentives for the politician to reciprocate since they preserve the uncertainty regarding future exchanges, and that limit the ex-post dependency of the firm on the politician, on the other hand, will increase the likelihood for the firm of obtaining benefits and decrease the rent extraction by the politician from the firm; hence will impact the firm's financial performance positively.

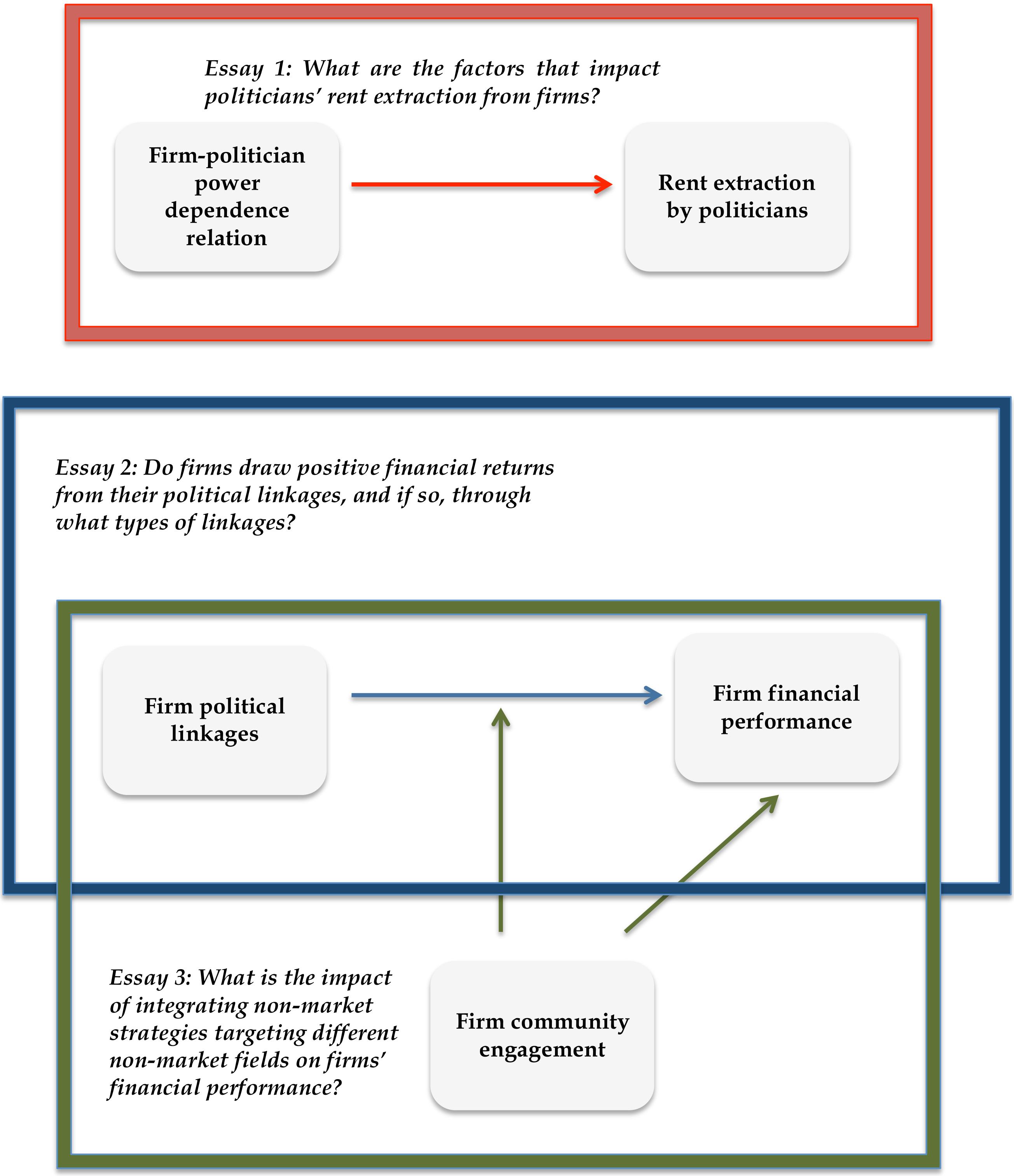
I test the proposed relationships in the second essay using a unique longitudinal dataset (2002-2011) covering different types of linkages between politicians and all publicly listed firms in the UK. Three different types of linkages to politicians are investigated: board directorship of politicians; gift giving to politicians; and sponsorships provision to politicians. These three types correspond to different points of a continuum in terms of the uncertainty regarding future exchanges they inherit and the ex-post dependencies they create. The findings confirm the predictions and have important strategic implications. They imply that by choosing ex-ante which types of linkages to establish with politicians, firms can actually avoid the negative consequences of having political linkages and may be able to draw positive financial returns from such linkages.

Finally, Essay 3 analyzes how the integration of non-market strategies targeting two different dimensions of the non-market environment, namely politicians and society, impact the financial returns for a firm. This essay explicitly takes into account the portfolio like nature of non-market actions and looks into the impact of simultaneous deployment of political linkages and community engagement on firms' financial performance. The essay investigates how community engagement targeting the social environment of the firm may serve as leverage in other non-market fields, such as the political environment of the firm. It argues that community engagement by firms may actually increase the likelihood of the linked politician's reciprocity through increasing the value of the "package" offered by the firm within the exchange; and also alter the asymmetry of dependence between the parties in favor of the firm, since it increases the likelihood of the firm to find alternative sources to obtain benefits in the political arena. This essay takes a step to treat the external environment of the firm "as the multi-faceted concept it is", and does not consider the social and political environment of the firm as conceptually discrete (Henisz & Delios, 2002). Moreover, it argues that firms' community engagement acts as a complement to their political linkages.

I empirically assess the financial implications of such integration of two non-market strategies using data collected on political linkages of UK firms from 2002 to 2011, which is combined with community engagement data provided by an extra-financial rating company, Asset4. As predicted, the findings indicate that firm actions in one non-market field, such as community engagement targeting the social environment, serves as leverage in other non-market fields, such as the political environment. Therefore, through community engagement, while firms secure resources from the society and avoid sanctions, they also improve the returns from their political linkages.

Through these three essays, first by investigating the factors that determine rent extraction from firms by politicians, then looking into the consequences of political linkage characteristics on the value drawn from them, and finally analyzing the complementary nature of political and social engagement, the final goal of this dissertation is to contribute to identifying the boundary conditions for firms' ability to manage their dependencies on their non-market environment. By taking into account the potential risks and costs arising from dependency management moves and investigating the consequences of these moves, firms' non-market actions offer us a fertile context to contribute to resource dependence perspective, and investigating the limitations of the theory, as called for (Hillman, Withers, & Collins, 2009).

Figure 1-1: Structure of the dissertation



1.5 EMPIRICAL SETTING AND DATA

1.5.1 Empirical Setting

The empirical setting used in this dissertation is the United Kingdom. Most studies on firms' political linkages have been conducted using the North American context or emerging economies. The UK provides an interesting case for analysis of linkages between firms and politicians for various reasons:

First of all, the legislative environment in the UK results in a high level of transparency of linkages between firms and politicians. The members of the parliament (MPs) are required since 1974 to disclose any type of linkage with firms that may result in the clash of interests, meaning any exchanges with firms that may actually raise doubts about the MPs' complete fulfillment of their public duties. The disclosure levels in the UK stands out compared to other European countries. In a recent report by Transparency International, it is stated that 11 of the 25 European countries do not cover all relevant aspects of MPs' interests and/or disclose only partial information (Transparency International, 2012). Only 8 of the 25 countries have a code of conduct for parliamentarians[2]. Since 1996, the requirements in the UK for disclosure have become stricter, and been defined more clearly (Torres-Spelliscy & Fogel, 2012). Throughout time, some minor changes have been made and new requirements such as the requirement of the declaration of any family member employed by MPs are added[3]. In sum, in the UK, any benefits received by the Members of the Parliament, and in some cases by the family members of the MPs, both in terms of value and sources are disclosed extensively (Djankov, Porta, Lopez-de-Silanes, &

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[2] In alphabetical order: France, Germany, Greece, Ireland, Latvia, Lithuania, Poland and the UK.

[3] The most recent version of the rules regarding the declaration can be found here: http://www.publications.parliament.uk/pa/cm/cmcode.htm

Shleifer, 2009). Failure to disclose any sort of relation with firms may result in suspension of the MP from the House of Commons as well as a reputational scandal for the MP and his/her party[4].

Apart from disclosure, the availability of disclosure information to public is another factor that makes the UK a valuable setting to collect data. In many countries, even though disclosure by politicians is required, the information is not publicly available in almost half of the cases (Djankov et al., 2009). France, for instance, has disclosure requirements, however by law they are not publicly available. The UK ranks as the top European country in terms of disclosure and the public availability of this disclosed information, and the first country in Europe to make this information publicly available. Therefore the disclosure levels in the UK as well as its public availability makes it possible to collect data on linkages between firms and politicians that go far beyond information based on firms' disclosure of such linkages.

Moreover, the legislation in the UK allows for direct corporate spending from the corporate treasury for politicians and political parties. The Companies Act of 1985[5] has been amended in 2000. Starting from 2000, firms were required to disclose political contributions made by the firm to their shareholders.[6] This amendment required publicly traded firms to disclose any political spending of over £2000 in the directors' annual report (equivalent of US S.E.C. annual reports). A further amendment in 2006[7] resulted in even more shareholder control over political spending, since it required publicly traded firms to obtain shareholder

[4] Examples are numerous in the past, such as scandals of Mo Mowlam and Robert Wareing of the Labour Party in the late 90s, or Keith Vaz of the Labour Party very recently.

[5] Companies Act is an Act of the UK, which sets out comprehensively the responsibilities of the companies, their directors, and secretaries.

[6]Companies Act, 1985, c. 6, § 235(3), sched. 7 (U.K.); Explanatory Notes to the Political Parties, Elections and Referendums Act, 2000, c. 41, ¶ 246, http://www.legislation.gov.uk/ukpga/2000/41/notes/division/5/9

[7] Companies Act, 2006, c. 46 (U.K.)

consent for political spending over £5000 before the firm money is spent. Unless shareholders do not consent, firms are prohibited to do any such political spending, for a period that could go up to 4 years. And any directors who make unauthorized spending are required to compensate for the amount spend, plus interest, plus any loss or damage resulting from the unauthorized expenditure (Torres-Spelliscy & Fogel, 2012). Torres-Spellicy and Fogel (2012) show that, after the 2000 amendments, some well-known publicly traded companies stopped or decreased to a wide extent their political spending in terms of sponsorships, such as Rolls-Royce and British Airways; and there has been an observed shift from publicly listed to privately held companies in terms of contributors. These amendments have important implications for the analyses in this dissertation, since such political spending by UK firms, as they require shareholder consent, do not typically represent an "agency" problem within the firm, i.e. firm executives fulfilling their personal taste for politics through spending the firm's money. They rather seem to constitute "strategic" actions by firms to obtain benefits for the firm from the politicians.

Second, the mobility between business and politics in the UK is quite vivid since there exists no regulatory prohibition against movement of politicians to private domains and firm executives to public domains. Current politicians are allowed to take a seat at the board of directors of firms, or work as consultants to firms, as long as they declare these posts. There exists only an advisory body for advising on the mobility of politicians to private sector, which is ACOBA, however ACOBA is not a statuary body and just an advisory one, meaning that it has no discretion over the choice of the politician to serve in the private sector. Actually, this extremely flexible mobility has been subject to criticisms since MPs were seen as "cabs for hire", whose outside directorships and employments raise questions about the fulfillment of their role as MPs (Transparency International, 2011). A very recent report from The Guardian states that over the last session of the British

Parliament, the MPs have declared earnings more than £7 million from "outside" jobs such as directorships[8]. According to the report, some of the MPs have worked more than 1000 hours during the last parliament session of 2012-2013, and made ten times more money than the parliamentary salary. Given this flexibility of the MPs for taking posts within companies, and given the amount of financial benefits the MPs obtain from such posts, the UK becomes a really appropriate and interesting setting to analyze the linkages between firms and politicians, and to investigate what the firms gain from those linkages.

Third, and finally, the UK provides an appropriate context to analyze the strategic value of linkages between firms and politicians at the firm level, since alternative political strategies such as lobbying are less relevant than in many other countries, such as the US. Relations between firms and their political environment may be multi-layered, i.e. firms may adopt strategies towards their political environment both individually and collectively with other firms. In some countries such as the US, lobbying, which many firms in the same industry usually do collectively, is quite effective and the lobbying industry reaches numbers such as 3 billion USD per year, whereas the lobbying industry in the UK is much smaller than its US counterpart (Vidal, Draca, & Fons-Rosen, 2011). Therefore, firm level political linkages as means to manage the political environment become relevant and important in the UK context.

1.5.2 Data on Linkages Between Firms and Politicians

I have hand collected data on linkages between firms and politicians from 2000 to 2011, i.e. from the date that the disclosure legislation has changed and the MPs' linkages

[8] http://www.guardian.co.uk/politics/2013/may/27/mps-declare-income-other-jobs, retrieved on May 28th, 2013.

with firms are disclosed extensively, up to 2011[9]. This period covers three general elections, which took place in 2001, 2005 and 2010. Whereas from 2000 to 2010, Labor Party was in power, in the 2010 elections, the Conservative Party came into power.

The information disclosed by the MPs is extensive and covers information regarding any board directorship of MPs; as well as remunerated employment of the MPs; sponsorships received in the form of financial contributions; gifts and benefits received; or expense coverage for overseas visits; as well as shareholdings of the politicians in firms; and finally miscellaneous relations between MPs and firms. The disclosed information covers both public and private firms, individuals, organizations as sources of any "benefits" received by the MP; as well as by the MP's spouse in some cases such as gifts received and overseas visits that are paid for; and by the MP's children in the case of shareholdings. These types and their detailed definitions of are provided in Appendix A at the end of the dissertation.

To identify the publicly listed firms that have any sort of linkage with an MP, I have scanned the parliament registers that contain information disclosed by the MPs, and I have matched the names of all publicly listed firms[10] in the UK with the names of firms mentioned in the registers of the British Parliament. For details of the identification process, please refer to Appendix B.

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[9] In the empirical analyses in Essay 2 and Essay 3, only linkages between 2002 and 2011 are used for regressions, since the other databases merged with political linkages information (i.e. financials and community engagement data) lacked information for before 2002. In this chapter, I still describe the whole time period from 2000 onwards, since the focus here is on political linkages.

[10] For a firm to be included in the dataset, it is sufficient that it has been publicly listed at least during one year during the investigated time window.

There are 1148 MPs that hold office during the time window from 2000 to 2011, and I identify 2500 unique linkages between all publicly listed firms and MPs, covering various types of relations. The most frequently observed type of linkage between publicly listed firms and the MPs are the shareholdings of the MPs, followed by expense coverage by firms for the MPs' overseas visits. Figure 1-2 provides the total frequency of each identified type of linkage between firms and MPs, and Figure 1-3 shows the evolution of the frequency of those types over the time period, from 2000 to 2011.

Figure 1-2: Frequency of all types of identified exchanges between firms and politicians, 2000-2011

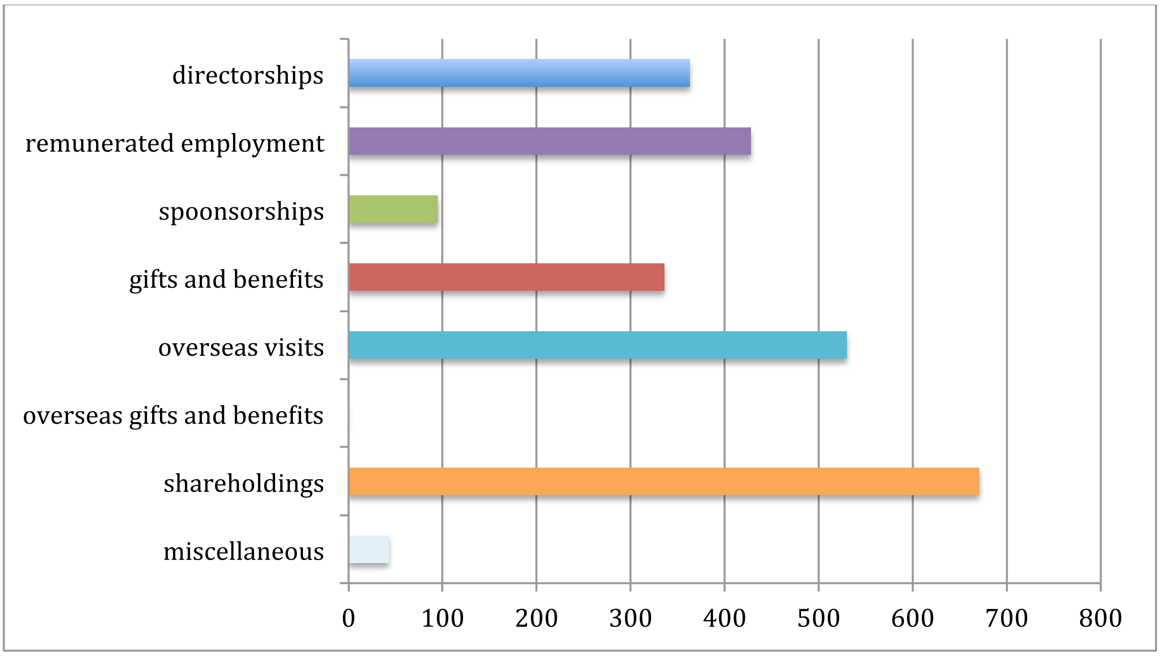
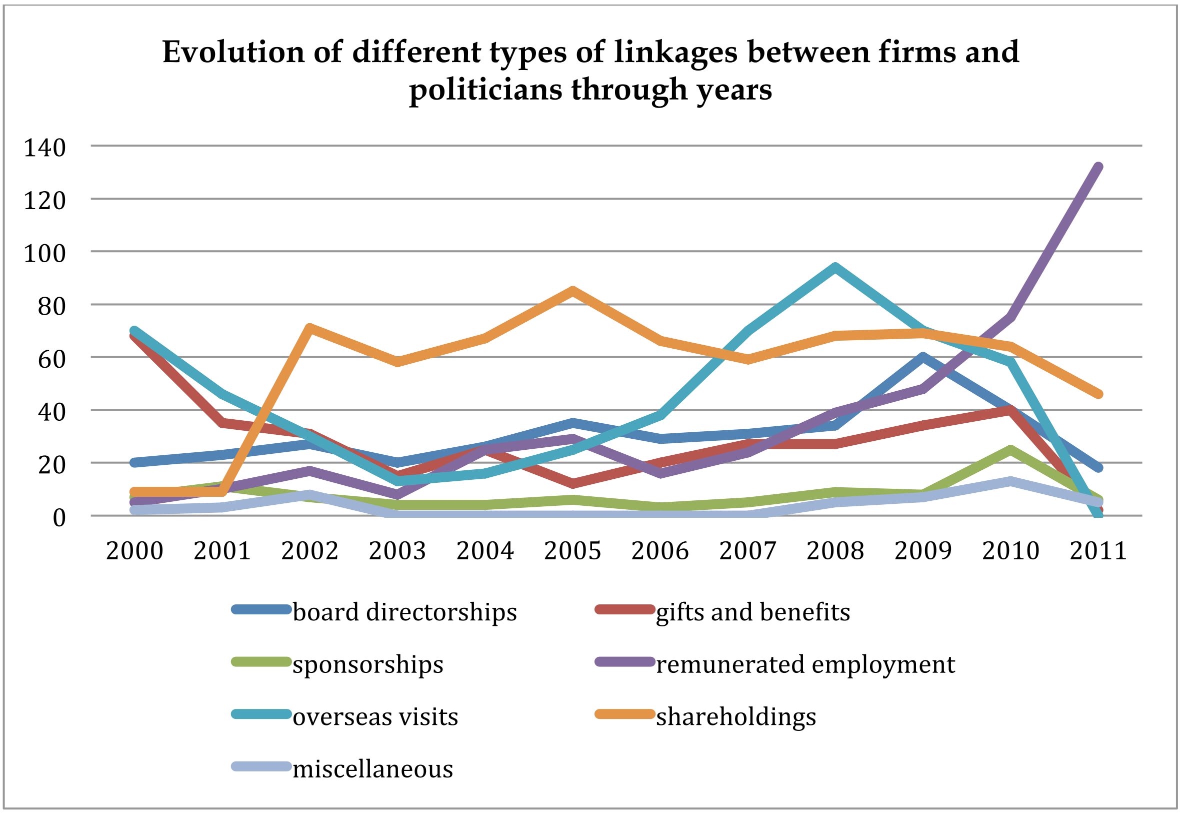


Figure 1-3: Evolution of the frequency of all types of exchanges between firms and politicians, 2000-2011



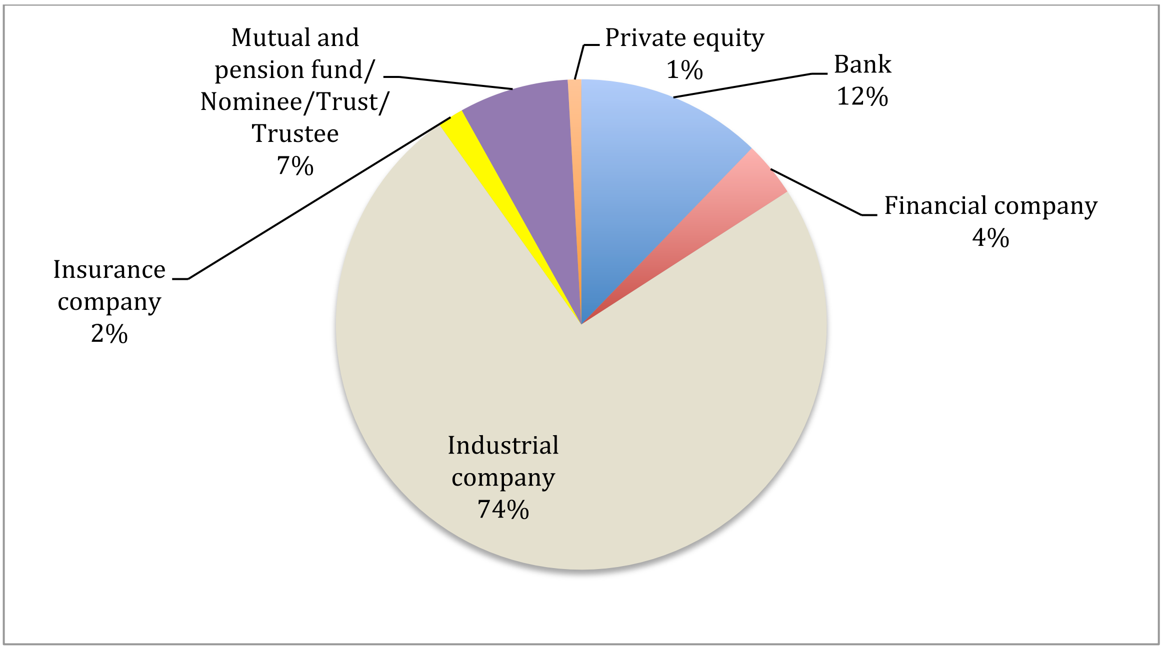
When these 2500 unique linkages between firms and MPs from 2000 to 2011 are inspected more closely, we see that there are 248 different companies that are at least once declared by an MP for the existence of a relationship, and 390 different MPs who declare at least one sort of relationship with a firm. The MP whose name appears the most within the 2500 linkages is Jonathon Djanogly of the Conservative Party, who has served as the Trade and Industry Spokesman shadowing the Department for Business, Enterprise and Regulatory Reform. When further investigated, we see that he has shareholdings in more than 10 companies, and holds these shares throughout the time window. Dominic Grieve of the Conservative Party ranks as the second name, again as a result of his shareholdings. Ian Taylor of the Conservative Party, on the other hand, ranks the third with 47 directorship linkages throughout the time period, in addition to other types of linkages he has. The firm name that appears the most (132 times), on the other hand, is British Airways, since the company's name is disclosed many times under the gifts and benefits section, as a result of free flights or class updates provided to MPs. Royal Dutch Shell ranks as the second firm (with 104 linkages), with approximately 75 percent of its linkages in the form of financial support for overseas visits of MPs. Barclays ranks as the third (with 103 linkages) firm, with its linkages with politicians in various forms, such as overseas visits support, shareholdings, gifts, remunerated employment and sponsorships. British Petrol (79 linkages), GlaxoSmithKline (61 linkages) and National Grid (58 linkages) follow these companies in the rankings in terms of the number of times their names are disclosed under a linkage.

As shown in Figure 1-4, we see that of these linkages between firms and politicians, approximately 75 percent are with industrial firms, whereas 12 percent are with banks, and the rest are with financial companies, insurance companies or mutual and pension funds, and private equity firms[11]. Approximately 95 % of the firms that are identified to have linkages with politicians are "very large" companies, whereas 4 percent are "large" companies and only 1 percent is "medium sized" and "small" companies (0.05 percent each).[12]

[11] Those are publicly traded private equity firms.

[12] The classification of companies according to their size is made based on financial data provided by Orbis: Companies that match one of the following criteria are considered as *very large*: Operating revenue bigger than or equal to (>=) 100 million euros (130 million USD); total assets (>=) 200 million euros (260 million USD); or number of employees (>=) 1000 people. *Large* companies are those ones that are not "very large" and still have either an operating revenue of (>=) 10 million euros (13 million USD); or total assets (>=) 20 million euros (26 million USD); or number of employees (>=) 150 people. *Medium sized* companies include those that have either an operating revenue (>=) 1 million euros (1.3 million USD); or total assets (>=) 2 million euros (2.6 million USD); or employees (>=) 15 people. *Small* companies are those that do not fall into any of these categories in terms of their financials.

Figure 1-4: **Types of firms that appear in the identified linkages between firms and politicians, 2000-2011**.



This dissertation is going to focus on only a subset of these identified linkages: The second essay and the third essay (first and second empirical paper of the dissertation) focus on board directorships of politicians, gifts given to politicians, and sponsorships provided to politicians. All other types of linkages are also included in the analyses as controls; however do not constitute the focus of the dissertation since they are not considered as "exchange" interfaces between firms and politicians:

First, I do not investigate the impact of *remunerated employment* linkages, since after investigation of the data, I realize that more than 50 percent of those declarations relate to paid TV appearances or royalties for articles written in journals, and do not really constitute a strategic link between a firm and a politician allowing for an "exchange". Among the rest, most also relate to fees paid to the politician for a seminar or speech. Otherwise, and only in a small percentage of those declarations, these linkages relate to the expertise of an MP, such as in judicial services, and although debatable, do not constitute a clear strategic non-market action by the firm but rather an outsourcing of a task to experts, including politicians. These linkages are still included in the analyses to control for omitted variable bias though.

Second, *overseas visits*[13] linkages are also not treated as a main variable of interest. The data show that these benefits are mainly provided with either through a group of UK companies (rather than individual firms) that operate in the country of visit, most probably for strategic purposes that may serve their overseas subsidiaries; or by foreign firms that are not listed in the UK. Therefore this type of linkage does not allow for soliciting out firms' individual level linkages, and does not constitute a dyadic relation between the firm and the politician. Whereas it could be interesting to look into this more "collective" type of political linkage establishment, and maybe analyze the impact of these linkages on those firms' subsidiary performance in foreign markets, this is beyond the purpose of this dissertation, which looks into the impact of firm-level linkages to politicians. The total number of overseas visit funding that a firm has provided to politicians during a given year is still used as a control variable though.

Third, one other category of linkages that is not included in the analyses as a focal variable is *shareholdings*. Shareholdings by MPs within companies are interesting and relevant, but within the framework of this dissertation this category of linkages does not imply a direct "exchange" between a firm and a politician. A politician holding shares in a company may not have any sort of exchange with this company, therefore shareholdings of MPs do not constitute a strategic "act" by the firm, unless the firm allocates shares to the politician for a specific purpose. The data do not indicate any such allocation of shares, but rather represent cases where the MP has shares in companies as a part of his/her personal

[13] "Overseas gifts and benefits" category, which was one of the initial categories defined by the British Parliament registers, is dropped out since there was only one case of overseas "gifts" reported to have been received from publicly listed UK companies.

wealth. Whenever the MP holds more than 15% of issued shares of the firm, or when the value of the shares exceed parliamentary salary, the MP has to declare these shareholdings. Most of the time in the declarations, the MPs purely give the name of the company and not any further details. As a result, this category of linkages is used to proxy interest alignment within the exchanges between the firm and the politician.

Finally, miscellaneous category is also not considered as focal in the essays, since this category includes very different types of linkages such as support from a company for the organization of a summer school initiated by an MP; or shareholdings of the MP less than the registrable value. Moreover, in some cases, there exists no information regarding the "interest" declared but just the company's name. By definition, this category covers miscellaneous linkages between firms and politicians that do not fall into any other categories of linkages. It is not possible to draw any predictions regarding the impact of such linkages that are so diverse in content. Still, these linkages are included in the analyses, to control for any omitted variable bias.

The fact that these above categories of linkages are not used as focal points of interest for the analyses in this dissertation does not mean that they lack potential for future research. For instance, the overseas visits (funding) linkages might have some effects for overseas subsidiary performance, which could be interesting to investigate. However, for the purposes of this dissertation, I will focus on the priory mentioned three linkages: board directorships, gifts and sponsorships. When we look into the focal types of linkages that are investigated in this dissertation, we see that these three types of linkages correspond to different points of a continuum in terms of the number of firms vs. number of politicians on the two sides of the exchange relation. To be more specific on this: When we look into board directorships of politicians, as indicated in Appendix C, we see that MPs tend to sit on the board of directors of more than one company, whereas firms usually do not have more than one MP on their board of directors[14]. Actually, the number of firms having a board linkage is far above the number of MPs sitting on the boards of companies, i.e. multiple firms have the same type of linkage with the same MPs. In other words, on average an MP has more than one board directorship[15]. Gifts, on the other hand, stand on the other end of the continuum when we look into the data: Although I identify very similar number of cases for both directorship linkages and gifts received by the MPs from firms, i.e. their total frequency is very close; these two different linkages differ a lot in terms of the comparison of the number of MPs and number of firms that are in the linkage. As also indicated in Appendix D, over the time period of the data, there are 336 cases of gifts received by 122 MPs from 50 companies. This implies that companies give gifts to multiple politicians, on a rough average to at least 2 different MPs. Finally, the data point out interestingly to the fact that whereas some companies have multiple sponsorships, in almost all cases politicians receive sponsorships from a single company, i.e. companies may provide multiple sponsorships to the same MP, however not to multiple MPs. As also indicated in Appendix E, 95 sponsorship cases take place during our time window, between 43 MPs and 31 companies. In terms of comparison of the number of firms vs. politicians within the linkage type, i.e. the number of firms that provide sponsorships vs. number of politicians who get sponsorships, the ratio is the closest one to 1 among all identified linkage types.

These three linkage types also differ in terms of the distribution of sectors to which the firms with those linkages belong to; as well as their evolution in terms of numbers throughout the years. For a comparison of these three different linkages across sectors,

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[14] Some firms do have multiple MPs on their boards, but this is not a general trend in the data.

[15] The only linkage type that is similar in terms of the ratio of numbers of politicians over firms is the case of shareholdings.

please see Figure 1-5 and for the evolution of these linkages across years, please refer to Figure 1-6.

Figure 1-5: Frequency of board directorships, gifts and benefits, and sponsorships across sectors

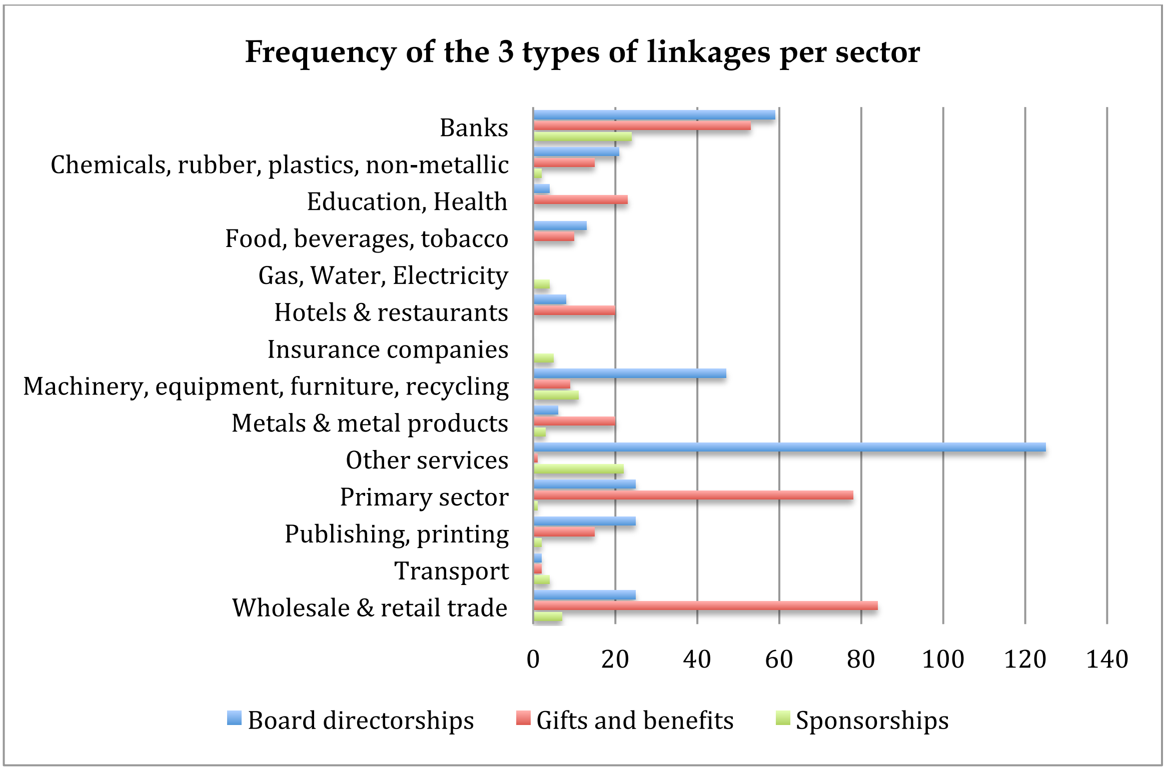
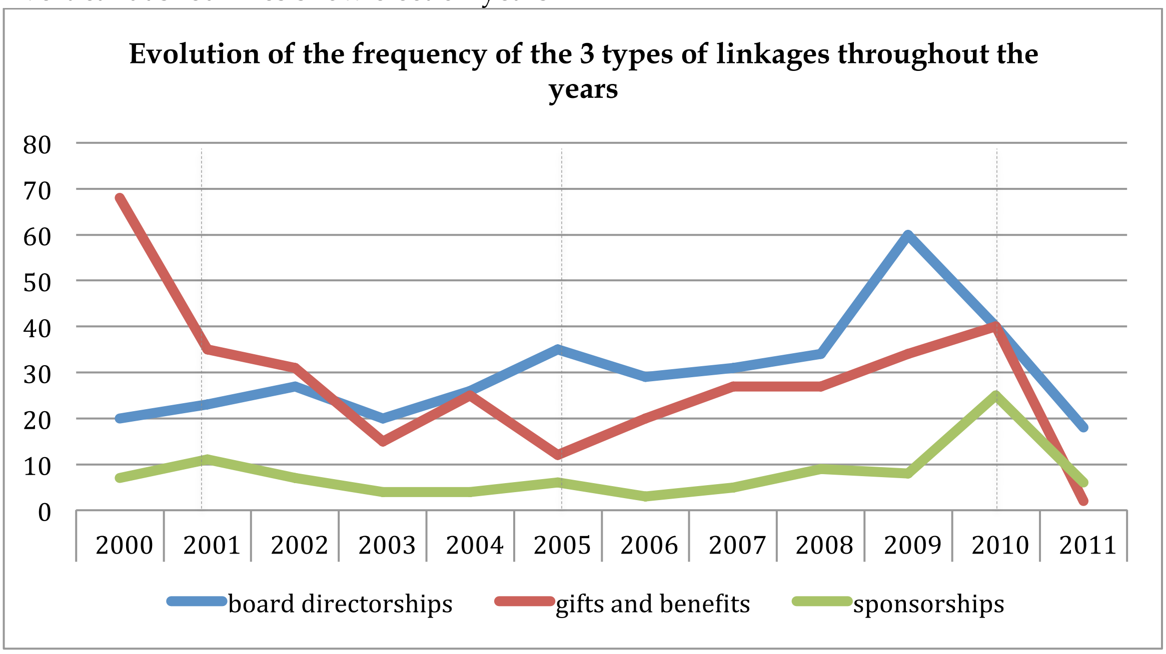


Figure 1-6: Evolution of the frequency of board directorship, gifts and benefits, and sponsorships between firms and politicians, 2000-2011*

* vertical dashed lines show election years



1.5.3 Data on Financial Indicators

Corporate financial information comes from the Orbis (Bureau van Dijk) database, which covers extensive information on around 80 million companies in the world, using numerous sources of information such as Datamonitor, Lexis-Nexis, Thomson Reuters among others. The database provides one of the best available coverage of financial data for the European countries, including the UK. However, there are still limitations that the Orbis data brings: Details on the limitations of the data are discussed in the methods parts of the essays as well as in the limitations section of the dissertation.

1.5.4 Data on Community Engagement

Community engagement data is based on the ratings provided by ASSET4 database. ASSET4 is a subsidiary of Thomson Reuters, which provides extra-financial ratings of companies worldwide since 2002. The database provides objective, comparable and auditable extra-financial information using environmental, social and corporate governance related information from publicly available sources (e.g. annual reports, NGO websites, CSR reports). The ratings consist of assessments of company performance based on over 250 key performance indicators. These ratings are then normalized to position the scored between 0 and 100%. The database provides an overall extra financial rating for each company, which can be decomposed in 4 category ratings, one of which is the “social category” rating that measures a company's capacity to generate trust and loyalty within its workforce, customers and society. The other category ratings correspond to the “environmental rating”, “governance rating”, and “economic rating”. In each category, there are sub-category ratings, which reflect different dimensions of the relevant category. For the social category, the sub-categories are as follows: *employment quality; health and safety; training and* *development; diversity; human rights; community* and finally *product responsibility*[16]. In Essay 3, as a measure of corporate community engagement, I use the sub-category rating for "community", which directly measures the performance of a company in terms of its community engagement.

[16] Please see Figure 4-1 in Chapter 4 for the Asset4 data structure.

2 CHAPTER 2: A CONCEPTUAL FRAMEWORK ON POLITICIANS' RENT EXTRACTION FROM FIRMS

2.1 ABSTRACT

This paper provides a conceptual framework on factors that impact rent extraction from firms by politicians. Using insights from social exchange theory, resource dependence theory and political economy, the paper explores first the sources of power for firms and politicians within an exchange relation they build, and the impact of those power sources on potential rent extraction by the politician; and then discusses how relationship characteristics act as constraints to the use of power by the politician to extract rents from the firm. The paper also discusses environmental level factors, such as the characteristics of the political environment that also impact the level of rents extracted from a firm by a politician. The conceptual framework aims to shed light first into the variation among both firms and politicians in terms of their power within an exchange relationship, and then how the dynamics of the relationship as well as the characteristics of the political environment change the rules of the game within the exchange; and finally how all these are translated into rent extraction by politicians from firms.

Keywords: political linkages, resource dependence, social exchange, rent extraction

2.2 INTRODUCTION

Firms deploy various strategies to influence the political environment they operate in: Firms lobby, form political action committees (PACs), take part in coalitions (such as trade associations), run a government relations office, get into advocacy advertising, and last but not least, establish linkages with politicians. In other words, firms adopt strategies to influence the institutional players that determine public policy, such as legislatures, regulatory agencies and courts. Through these political strategies, firms seek benefits, i.e. firms aim to capture economic value through political means. For instance firms may lobby for a regulation that would hamper the competitive position of their foreign rivals in the domestic market; they might seek to obtain certain "privileges" such as subsidies and price fixing (Buchanan, Tollison, & Tullock, 1980; Krueger, 1974). Benefits obtained through political strategies may change the competitive position of firms radically. Inter-firm variability towards the impacts of regulations influence the competitive positions of certain groups and may result in the re-distribution of profits within an industry (Pashigian, 1984; Thomas, 1990). Through their political linkages, firms might gain first mover advantages. For example, Frynas, Mellahi and Pigman (2006) show by a case study how Shell-BP established first-mover advantages in Nigeria thanks to their political networks with British colonial officials, and how even after the departure of the colonial officials from Nigeria, Shell-BP remained as the firm having the largest share of the market as a result of the initial asymmetry built through its political networks.[17]

[17] There is an ethical perspective to such benefit seeking behavior by firms through political strategies. For instance Shell has been much criticized because of its close relations with the Nigerian former military government in the 90s, and the firm has been alleged for its "collaboration" in the assassination of the Nigerian activist Saro-Wiva. Although it is of extreme importance, to discuss the ethical (and social) dimensions of firms' political strategies is beyond the purposes of this dissertation.

Benefits obtained through political strategies of firms come at a cost. When seeking to obtain economic benefits through their political strategies, firms also bear the costs of those activities. Political activities impose direct costs on firms, apart from the opportunity cost of directing firm resources elsewhere. Direct costs arise as a result of the so-called rent seeking behavior of politicians. Intervention of politicians in business is divided into two classes of actions: rent seeking vs. market making (Schneiberg & Bartley, 2008; Stone Sweet & Fligstein, 2002). Politicians provide benefits to private parties, special interest groups or firms (through price fixing, restrictions on the market entry, or policing cartel agreements, among others) in exchange for private gains (Stigler, 1971). Politicians may aim to extract private benefits through their power over these private parties, interest groups or firms, even though this does not align with their legitimate responsibilities, one of which is to create and oversee efficient economic markets. Extreme rent seeking by politicians may result in very high levels of corruption and could hamper altogether the functioning of a market (Djankov, La Porta, Lopez-de-Silanes, & Shleifer, 2002; Habib & Zurawicki, 2002).

Specifically when firms build direct linkages with politicians, i.e. when firms and politicians exchange resources through direct interaction with each other, they might be exposed to the rent-seeking behavior of those politicians they have linkages with, i.e. politicians ask private gains in return for providing benefits to those firms. These costs arising from the exchange relationship should not be underestimated: For a firm, if the costs arising from the exchange exceed the value of benefits the firm gets out of its exchange relationship with a politician, the firm would be worse off than not having this relationship in the first place. Therefore, if we look at political linkages from the firm's perspective, and adopt a skeptical approach, we need to ask whether firms really draw value out of their political linkages, specifically when considered what those linkages cost them. To be able to answer this question, we first need to understand the factors that will determine the rent extraction by politicians from firms within the exchange relationship built among the parties. In other words, considering that politicians seek rents, what are the factors that will impact their rent extraction out of their linkages with firms?

In this paper, I try to answer this question, and focus on direct linkages between firms and politicians, through which parties enter an exchange relationship and both parties seek private gains. For the purposes of the framework, I define a politician as a democratically elected individual who is actively in service, such as a member of the parliament. I consider a firm, on the other hand, as an individual player, and assume that all individuals within a firm are sufficiently similar so that they can be considered as a "whole" (Klein, Dansereau, & Hall, 1994). One of the starting points of this paper is the fact that firms differ in their capability to reap off benefits from politicians, but also differ in their susceptibility vis-a-vis the politicians in terms of being subject to rent extraction. Therefore, to investigate the conditions under which individual firms would be subject to rent extraction by politicians would contribute to our understanding of the value of political linkages, and thus the literature on political strategies of firms; and also exchange theory, within the context of firm-politician exchanges.

Direct linkages that allow for exchanges between firms and politicians have recently gained a lot of attention in management literature. A common perspective is that firms, which have linkages with politicians, use these linkages to manipulate the economic and legislative environment in the best interests of the firm, to consequently improve firm performance. So, linkages with politicians are supposed to serve as means to "absorb" the uncertainty arising from the political environment; to shape and create a more "favorable" environment for the firm (Hillman & Hitt, 1999; Hillman et al., 2004; Pfeffer & Salancik, 1978); and eventually improve firms' performance in the market area. However, while seeking benefits through the political arena, and specifically when entering exchange relationships with politicians, firms get in touch with politicians that have power and who want to and are able to extract rents from the firms. Thus linkages with politicians have a double-edge nature where a firm may actually "lose" more than it gains, which has been overlooked until recently. The ability of firms to reap off benefits from politicians has only been recently questioned (Aggarwal, Meschke, & Wang, 2012; Hadani & Schuler, 2013; Igan, Mishra, & Tressel, 2011). The ability of politicians to extract rents from firms, on the other hand, have been subject to investigation by economists and political scientists, however naturally at a macro-level, i.e. not at the firm level. Historic antecedents, political structures, or cultural traits have been investigated to explain the differences in rent extraction levels by politicians across countries (Husted & Estudios, 1999; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1999). By looking at rent extraction by politicians at the firm level, this paper distinguishes itself from prior literature, which looks into rent extraction by politicians at a general level. Moreover, in terms of exchange relationships, this paper focuses on a different context, and discusses the exchange relationship among an organization, i.e. the firm and an individual, i.e. the politician. The behavior of actors engaged in an exchange relationship and the effects of various factors on the outcomes of the exchange are investigated in prior literature, but either among individuals or among organizations. Both resource dependence theory (RDT) (Pfeffer & Salancik, 1978) and exchange theory (Emerson, 1972, 1976) have been used in the investigations of economic outcomes of strategic alliances, mergers, vertical integration, interlocking directorates, as well as diffusion of innovative practices within networks (Cook, Cheshire, & Gerbasi, 2006). Through the different context, i.e. the dyadic relationship between the firm and the politician, this paper aims to bring in a more fine-grained understanding of exchange theory as well as resource dependence theory as they apply to the relationship between firms and politicians.

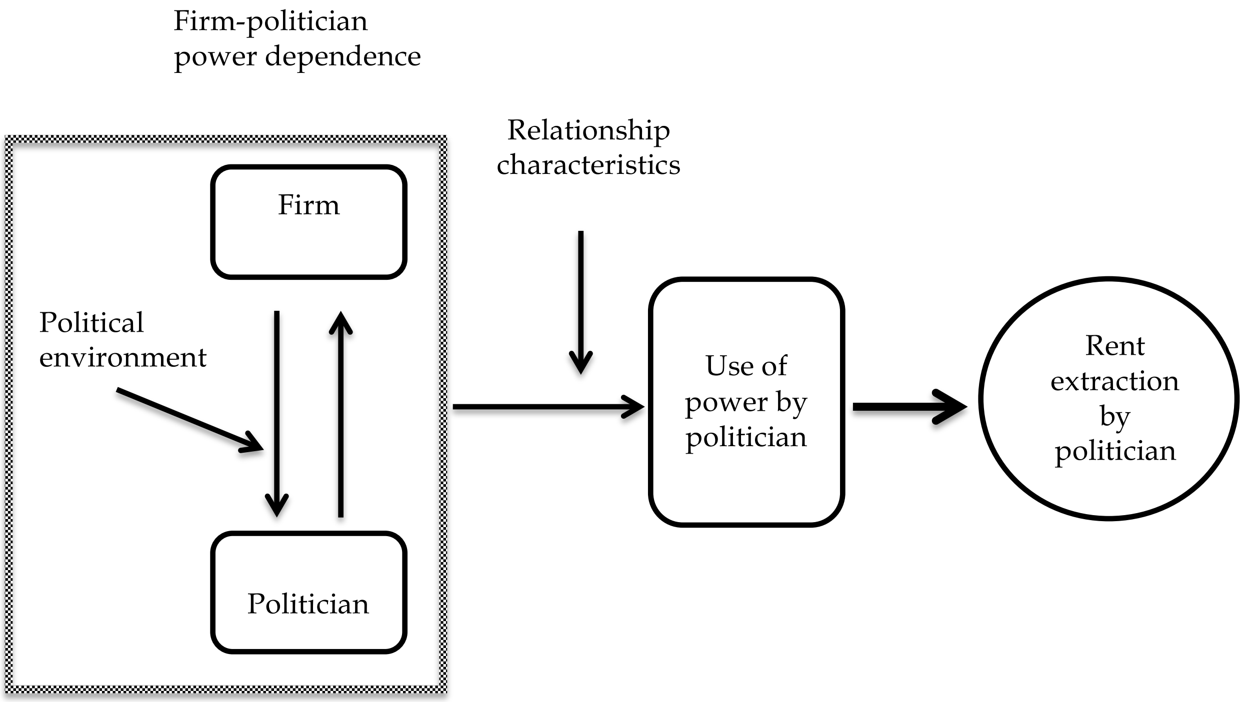
Using insights from both RDT and exchange theory, I provide a conceptual framework on the contingency factors that will determine rent extraction from firms by politicians. I investigate rent extraction by politicians as the interplay between multiple factors relating to power, i.e. I look into the exchange relation between firms and politicians based on the notion of power. Following Pfeffer and Salancik (1978), I define power as the ability of an actor to influence the behavior of others in ways that produce outcomes favored by the focal actor. In line with exchange theory, I consider power as deriving from the relation and do not consider it as an attribute of the actor itself (Emerson, 1962; Emerson, 1976). Within this framework, I first look into the exchange partners' characteristics, i.e. firm characteristics and politician characteristics, which determine the resources the exchange partners may potentially bring into the exchange, thus the potential dependence of the exchange partners on each other, hence the power each party may hold over one another. Then I discuss the exchange characteristics, i.e. relationship dynamics, which determine how and whether the power the parties behold will translate into the use of this power. I additionally take into consideration the political environment characteristics, which may change the rules of the game between the parties through dispersing the power in the political arena and which change the power-dependence dynamics between the exchange partners. In other words, I first discuss the resources from which the exchange partners may derive their power; thus sources of power for the exchange parties, both the firm and the politician. Then I look into the confrontation of the two parties' power within the exchange dynamics, and the relation-level factors that will determine whether and to what extent the power behold by the parties (focusing on politicians in our case) is going to be used to extract rents out of the exchange. Finally I discuss as well as the impact of the political environment on the dispersion of power, and how this impacts the power-dependence relation between the firm and the politician.

"The decision to engage in political activity is a complex one driven by a multitude of factors across different levels of analysis."(Lux et al., 2011). So are the outcomes of exchanges between firms and politicians, and the likelihood of rent extraction from the firm by politicians. This is why I believe it is necessary to take into account both the characteristics of the individual parties, the relationship dynamics between the parties, as well as the context where the exchange between the parties takes place. The conceptual framework in this study aims to capture the interplay between these multitude of factors from the lens of power-dependence relations.

Understanding the contingency factors that determine rent extraction by politicians has important implications for firm strategy, since rent seeking thus rent extraction by a politician is inherent in the exchange relationship between a firm and the politician, and if not well calculated, such rent extraction by the politician may result in ex-post poor firm performance. Rent extraction by politicians is a cost for firms, and unless the value drawn from the exchange relationship with the politician exceeds the rents extracted by the politician, such relationships can be considered as "bad" investments. In other words, from the firm's perspective, the exchange between the firm and a politician is desirable as long as the firm is able to reap off benefits as a result of its relationship with the politician, and the value of those benefits exceed the value of what the politician extracts from the firm. Therefore the research question this paper asks, what factors impact rent extraction by politicians from the firm, is a relevant one to be able to assess whether linkages with politicians will indeed prove to be beneficial.

The paper is organized as follows: The first section elaborates on exchange theory and then the concepts of benefit seeking by firms through political linkages and rent extraction by politicians from firms. In the second section, I discuss politician characteristics and firm characteristics in terms of the potential resources they may bring into the exchange, which will impact the dependence of the parties on each other, thus the power behold by the parties: A politician's political power and industry capital; and a firm's social power and political capital. In the third section, I delve into relation level characteristics of the exchange, and discuss how the imbalance of power between the parties; mutuality of dependence; repetition of exchanges; time horizon of the relationship; and finally interest alignment between the parties play a role in the use of power, and thus rent extraction by the politician. Following this, I turn the spotlight on the political environment, and discuss how the characteristics of the external environment, i.e. political pluralism; interest group strength and coherence, shape the power dependence relations. The fifth and final section is the discussion.

Figure 2-1: Conceptual Model



2.3 BENEFIT SEEKING BY FIRMS AND RENT EXTRACTION BY POLITICIANS: AN EXCHANGE THEORY PERSPECTIVE

Through linkages, firms and politicians exchange resources and provide benefits for each other. Through this exchange relationship with politicians, firms may access to private information about future policies; knowledge about how to navigate through bureaucracies; or may obtain favorable regulations, which will improve their competitive positions (Goldman, Rocholl, & Jongil, 2009). Politicians, on the other hand, through their linkages with firms, may access to information that they can use for private gains, such as information that they can use for private investment decisions (Cohen, Frazzini, & Malloy, 2008); may access to current as well as future employment opportunities (Eggers & Hainmueller, 2009); and obtain financial benefits such as campaign contributions, sponsorships. Politicians may also obtain indirect benefits through their relations with firms, such as employment for their constituents, which would create externalities beneficial to politician's re-election prospects. Exchanges may also bring about non-material benefits for the parties, such as approval or prestige, which might be valuable for the exchange partners (Homans, 1958).

Economists see this relationship between firms and politicians as a market-like exchange (Stigler, 1971), where politicians and firms get into transactions and trade resources[18]. However, a market exchange perspective cannot explain exchanges between firms and politicians. Different from market transactions among firms, where both parties are mere players in the market, and the transaction is governed by rules, when a firm gets into an exchange with the politician, there are no "contracts" to enforce the parties neither

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[18] Sociologists are also interested in these linkages, perceiving firms and politicians as "power elite" groups, that have a collective ideology (Useem, 1980) and they see these linkages between firms and politicians as channels through which exchanges occur between those power elite groups.

there are institutions to oversee and regulate the parties to fulfill their "responsibilities". Exchanges between firms and politicians show characteristics of a social exchange (Blau, 1964; Emerson, 1972, 1976). The exchange between firms and politicians is characterized by expected reciprocity and an uncertainty about the future returns. A social exchange perspective may provide us with useful tools to better understand the dynamics and consequences of exchanges between firms and politicians (Lux et al., 2011).

In an exchange between two actors, the behavior of the exchange partners is motivated by the desire to increase gain and to avoid loss (Molm, 1997). Since both parties aim to maximize the gain for themselves, there are costs of the exchange relationship for both actors. One of the purposes of this paper is therefore to disentangle the factors that impact the operation of the exchange between a firm and a politician, and theorize on the conditions under which the firm will be subject to rent extraction through this exchange. While doing this, I benefit also from the resource dependence perspective, since RDT works well for describing organizational behavior, whereas social exchange theory "is more descriptive of individuals"(Davis & Cobb, 2010). Therefore I see it as a necessity to combine the two perspectives while investigating the relationship between firms and politicians. In short, treating exchanges between firms and politicians as a social exchange, and using insights from RDT, I now turn to explain the costs involved in these exchanges between firms and politicians:

Building on Emerson's (1962) and Dahl's works on power (1957) and Selznick's work on co-optation (Selznick, 1949), Pfeffer and Salancik (1978) define organizational success as maximization of power. Firms rely on exchanges with external parties to obtain resources they need. Within these exchanges, the potential contributions of the parties are rarely symmetrical, since each party views the potential costs and benefits of the exchange differently (Inkpen & Beamish, 1997). Unequal resources held by the parties will result in dependencies and power differentials. Power arises as a result of the differential dependence among actors (Pfeffer & Leong, 1977). Therefore power is an attribute of the relationship rather than the actor itself. To put it more clearly: Actor A is dependent on Actor B for resources held by Actor B, and this dependence of Actor A on B gives Actor B its power on Actor A. So the Actor B's power on Actor A is negatively related to Actor B's dependence on Actor A, while positively related to Actor A's dependence on Actor B (Emerson, 1962). A firm's dependence on a partner is a source of power for that partner and the "asymmetric" dependence between two actors in an exchange relation constitutes the essence of the concept of power dependence (Kim, Hoskisson, & Wan, 2004).

Until very recently, prior work had this implicit assumption that firms building exchange relationships with politicians through political linkages are likely to benefit from those relationships. I do not argue that firms are not likely to benefit from their linkages with politicians, however I argue that the "double-edge" nature of the exchange between a firm and a politician has largely been underestimated. It is true that firms build linkages with politicians to seek benefits, however, when we turn the coin, we see rent-seeking behavior of the politicians. Politicians who hold the power to bestow benefits to the firm also hold the power to extract benefits from the firm for themselves. Politicians use their power in the political arena to provide legitimate or illegitimate benefits to special parties, such as firms, but they also use the same power to provide rents to themselves from those parties or firms. They may provide advantages to specific firms, which is inconsistent with their public duties. In return, they extract rents from those firms. This "rent extraction" by politicians may take many forms. Just as firms may obtain private information through politicians, politicians also receive private information from firms that may help them in their private and professional life. Politicians may see future employment opportunities as potential rents they will extract. However, most rents are more immediate, since firms are willing to "pay back" to politicians in exchange for the benefits they seek to obtain, through campaign contributions, gifts and benefits, sponsorships, and even the most basic form of corruption, which is bribery. Politicians may extract rents from firms not only for the benefits they provide, but also for not taking action. In other words, politicians may receive payments or benefits in return for a promise not to take or destroy private wealth, such as for not imposing destructive taxes or regulations (McChesney, 1997). Significant legislative changes prepare the ground for such rent extraction. For example, each time the health care system is under revision in the US, pharmaceutical companies start directing funds to the congressional pockets to "combat the possibility of price controls". Thus, "legislative threats cause the destruction of firms' wealth even when they ultimately are retracted" (McChesney, 1997). In fact, most of the political activities by firms actually are related to blocking destructive regulations.

Rent extraction by a politician is not a "loss" for the firm per se. As long as the value of benefits obtained by the firm through the exchange relationship exceed the rents extracted by the politician from the firm, i.e. as long as those benefits the firm gets exceed in value what they cost to the firm, the firm still may benefit from this exchange with the politician. But it should not be ignored that politicians seek rents and extract rents from firms. What are the factors that impact a particular firm's being subject to rent extraction by politicians?

To answer this question, we need to consider the potential for the exchange partners to provide resources valued by the other partner; however also the context within which the exchange takes place; and the dynamic nature of the exchange process which may impact how the power behold by the parties is actually used within the exchange. In the next sections, I will outline the factors that will impact the potential rent extraction from a firm by a politician.

2.4 POLITICIAN CHARACTERISTICS: SOURCES OF POWER FOR THE POLITICIAN

When explaining rent extraction from firms by politicians, one conceptual fallacy would be to treat all politicians alike. To whom a firm is linked will matter in the potential value drawn from that linkage since not all politicians possess the same resources to provide through the exchange. Consequently, it will also determine the potential level of rent extraction by the politician from the firm, i.e. the cost of the linkage to the firm, or in other words what the firm willingly or unwillingly needs to provide the politician within the exchange relationship. Politicians have different levels of power, as a result of the resources they behold and the dependency of the firm on those resources: Depending on their party affiliations, positions they hold, and tenure in politics, as well as their prior experience with firms, politicians will have differing resources to exchange with firms. And different firms have different degrees of dependence on those resources behold by politicians. Therefore politicians wield differing levels of power over the firm that determine the rents they will be expecting and are able to extract from the firm, all else being equal. The more powerful politicians are, the more rents they can ask for and will be able to extract them from firms.

In this section, I will first discuss the political power of a politician that he/she derives from political affiliation, position and tenure; and then another source of power for the politician, which is the politician's industry capital, i.e. the politician's industrial knowledge and networks.

2.4.1 Political power of a politician

Political power of a politician is derived from the interplay of some political resources. Three characteristics of a politician would help us understand the political power the politician beholds: (a) affiliation with the governing party, (b) position within a political party and within the government (c) tenure. It should be noted that none of these dimensions alone determine the political power of a politician. The politician derives his/her political power through the complex interaction of these factors, which I will explore below.

a) Affiliation with the governing party: Politicians affiliated with the ruling party can be considered more resourceful than politicians affiliated with other parties. A governing party has discretion over new legislation, and legitimately holds the right of formulating economic as well as social policies. While relative legislative discretion of a governing party depends on the political system, in most countries with a parliamentary system, the governing party has the main discretion over legislation. Therefore governing party, and thus politicians affiliated with the governing party, constitute the "gate" to pass through for firms seeking benefits through their political linkages.

b) Position of the politician: Being affiliated to the governing party alone cannot determine the political power of a politician. Sometimes politicians of the opposition party may also be in the government, or be as strong. Or the head of the opposition party may have more political power than an ordinary MP affiliated with the governing party. Not because he/she is able to block legislations (which might also be the case) but because he/she may be the next head of the government in the next elections. In other words, expected future political power may translate into current power. On the other hand, politicians holding ministerial positions have more political resources at their discretion than politicians serving as MPs only, both as a result of their responsibilities and also because they interact with the widest number of other political decision makers on both national and international stages (Mann & Smith, 1981).

c) Tenure of the politician: Politicians also differ in their tenures. Politicians with tenure are supposed to have wider networks, and possibly stronger influence over these networks, which provides them with more political power. Experience that comes with tenure is a sign of political power since tenured politicians are likely to know better how to navigate through the bureaucracies, possible risks and gains of policies compared to inexperienced politicians. Tenure is a sign of the profundity, depth of human and social capital of a politician, and thus a sign of resources the politician beholds and the potential provision of those resources to the firm, hence increases the attractiveness of the politician for firms (Hillman & Dalziel, 2003; Lester, Hillman, Zardkoohi, & Cannella Jr, 2008).

As stated above, all these dimensions *together* determine the political power of a politician. All dimensions impact the political power in a positive way; they are intertwined and can compensate partly for lack of each other. A politician who is affiliated with the governing party, holding a ministerial position and having tenure would reach the maximum amount of political power. And as the political power of a politician increases, the politician is more able to provide benefits for the firm, however this increases the "costs" of having a linkage with that politician for the firm: First, in return for potential benefits he/she is able to provide, the politician will be expecting and be able to extract more rents from the firm. Second, the politician will be a "valuable" exchange partner for other firms as well, thus the politician's dependency on the firm will decrease. This will increase the power of the politician within the exchange relationship and therefore the potential for rent extraction by the politician.

Hence the likelihood of rent extraction by the politician within the exchange is going to increase with increasing political power of the politician.

Proposition 1: As the political power of a politician increases, ceteris paribus, the rent extraction by the politician increases.

2.4.2 Industrial capital of a politician

Some politicians come from a business background, meaning that they had professional experience working for firms, or have run businesses themselves. The "revolving door" does not only function from politics to business but also turns from business to politics. In the late fifties, businessmen started to enter politics primarily "to act as a countervailing force against trade union power and socialistic legislation" (Hacker & Aberbach, 1962). Through time, with developments in technology and specifically telecommunications, industry experience has been regarded as a valuable asset for many businessman candidates running for office. In recent decades, the shift in the trend regarding the professional background of politicians has become more noticeable. In the UK parliament, about 10% of the politicians have previously worked in financial services, whereas around 12 % have had experience as management consultants.[19] In Canada, more than 30% of politicians in the parliament have business or consultancy backgrounds, shifting the trend from lawyer-politicians to businessmen-politicians.[20] Of the 20 last presidents of

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[19] "Parliament's 2010 intake shows swing towards private sector", *The Guardian*, May 10th, 2010, http://www.guardian.co.uk/politics/2010/may/10/mp-intake-private-sector

[20] "Politicians now more likely to be businessmen than lawyers", *The Star*, February 1st, 2013, http://www.thestar.com/news/insight/2013/02/01/politicians_now_more_likely_to_be_businessmen_than_lawyers.html

the U.S., 5 of them had significant business experience before going into politics.[21] Worldwide, business background ranks the second among all possible professional backgrounds for politicians, coming only after lawyers, but ahead of journalists, economists, or academics.[22]

Politicians that have experience in business have a stock of business capital that derives from two things: (a) knowledge of industry, which can be considered as the politicians' human capital and (b) networks in industry, which can be considered as the politicians' social capital. This business capital a politician has will determine how attractive and thus how powerful the politician will be in his/her relationship with a firm.

a) The politician's expertise, experience, knowledge and skills acquired in various firms, boards and industry contexts are defined as the politician's human capital (Becker, 1964; Sturman, Walsh, & Cheramie, 2008). Potential benefits the politician may bring in the exchange will be determined by the human capital of the politician, among other things. This human capital, along with the political power of the politician, enables the politician to provide the firm with valuable advice that may critically influence strategies of the firm (Kroll, Walters, & Le, 2007). Therefore the industry knowledge politicians have acts as a valuable resource within the exchange relationship, and the higher the industry knowledge, the more powerful is the politician in the exchange relation.

Moreover, the demand for those politicians who have business experience will be higher. Since the demand for politicians with industry knowledge and expertise will be

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[21] "Sorry Mitt Romney, Good Businessmen Rarely Make Good Presidents", *USNews*, February 17th, 2012, http://www.usnews.com/opinion/articles/2012/02/17/sorry-mitt-romney-good-businessmen-rarely-make-good-presidents

[22] "Selection bias in politics. There was a lawyer, an engineer and a politician...", *The Economist,* April 16th, 2009, http://www.economist.com/node/13496638

higher, the politician becomes less dependent on the firm within the exchange. Hence, this will increase the power of the politician in the exchange. Finally, since the politician already possesses information regarding constraints and opportunities in the business environment, the private information that many firms offer to the politician, as part of the exchange with the politician, may turn irrelevant or lose its value. In other words, the private information potentially to be provided by the firm becomes less interesting and less scarce as a resource for the politician, again increasing the power of the politician in the exchange.

b) On the other hand, politicians that have been businessmen have a network among managers, which may also act as a valuable resource. Politicians derive power from this so called social capital, which is defined as "the sum of actual and potential resources embedded within, available through, and derived from, the network of relationships possessed by that individual" (Nahapiet & Ghoshal, 1998). Put simply, the networks the politician is already a part of act as social capital of the politician and increase the ability of the politician to access resources (Adler & Kwon, 2002). When the politician has a business network, i.e. access to key industry players at various levels, such as suppliers, distributors, and customers, the politician has a valuable asset to offer to the firms (Gimeno, Folta, Cooper, & Woo, 1997; Hitt & Duane, 2002).

The firm's resources in terms of networks, on the other hand, may turn out to be less valuable. Once again, the information or the business/managerial network, which are supposed to be provided by the firm are already within reach for the politician, through his/her networks. As a result, in case the politician wants to look for information or alternative exchange partners, as a result of the politician's social capital, the costs of searching information and finding alternative partners will be less than the cost of the same actions for a politician with not as much social capital. Hence the value offering from the firm's side becomes less interesting and again the dependence of the politician to the firm will decrease. Consequently, the relative power of the politician increases vis-a-vis the firm.

Hence, I propose that a politician's industry capital will also determine the level of power he/she holds, and thus impact potential rent extraction by the politician. With increasing levels of industry capital a politician holds, he/she will be more capable of extracting rents from the firm, as a consequence of increased power.

Proposition 2: As the industry capital of a politician increases, ceteris paribus, the rent extraction by the politician increases.

2.5 FIRM CHARACTERISTICS: SOURCES OF POWER FOR THE FIRM

Just as not every politician has the same level of resources to provide benefits to a firm within an exchange, not every firm has the same level of resources to bring into the exchange. The power of a firm in an exchange with a politician will be determined by its "social" power as well as the political capital the firm already beholds. In this section I will discuss how legitimacy and political capital of a firm may act as valuable resources that determine the power position of the firm vis-à-vis the politician. In turn, these characteristics of the firm will determine the potential for rent extraction for the politician.

2.5.1 Legitimacy of a firm

Legitimacy is *"a political resource which must be secured prior to the attainment of economic goals."(Shaffer, 1995).*

The most widely used definition of legitimacy is the "generalized perception or assumption that the actions of an entity are desirable, or appropriate within some socially constructed system of norms, values beliefs and definitions" (Suchman, 1995). Firms are legitimate as long as they have the acceptance of the society in order to operate, i.e. as long as they are provided with a social license. Social license "governs the extent to which a corporation is constrained to meet societal expectations and avoid activities that societies (or influential elements within them) deem unacceptable, whether or not those expectations are embodied in law" (Gunningham et al., 2004). Social license and thus legitimacy of a firm is about the perception of whether a firm is doing "good enough" as a result of its actions. The society evaluates the means firms use when conducting business and assesses whether the business itself can be justified with the benefits it provides to the society. Being or appearing illegitimate can lead to economic sanctions (Dowling & Pfeffer, 1975), whereas legitimate firms benefit from increases access to resources and increased survival chances (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Pfeffer & Salancik, 1978).

A firm's legitimacy enhances the firm's power vis-à-vis the politician within the exchange. First of all, the "value offering" from the firm to the politician includes the "non-monetary" benefits arising from the firm's legitimacy. Actually, as Emerson (1962) puts it, "the power to control or influence the other resides in control over the things he values, which may range all the way from oil resources to ego-support, depending upon the relation in question." It would be not unrealistic to think that politicians value legitimacy. Politicians are legitimate holders of power, which arise from the "approval" of the society. They are democratically elected by the society, and represent the will of the public. In a similar fashion, a firm's legitimacy is also derived from acceptance of the firm in the society. Both politician's and firm's legitimacy may be considered as similar constructs in the sense that both of them are assets derived from the public and that both the politician and the firm value. In other words, public acceptance is an asset, thus a source of power, which both politicians and firms tackle.

A linkage with a legitimate firm as opposed to a non-legitimate firm will increase the politician's legitimacy among the public. Linkages with non-legitimate firms are riskier for politicians, since they are more likely to be overseen by and be subject to scrutiny from the public. In case the politician builds a linkage with such non-legitimate firms, the rents he/she is going to seek for will be higher. Therefore linkages with legitimate firms are more attractive for politicians and therefore it will "cost" less for a legitimate firm to have those linkages with politicians. Legitimacy of the firm will act as a valuable resource for the politician, and account for at least partly, even if not fully, for what the politician would like to gain from the exchange relationship. In other words, the "other" rents extracted by the politician from the firm will be less for more legitimate firms compared to less legitimate ones.

On the other hand, a firm's legitimacy can also act as a countervailing power against a politician's power, through indirect ways. As a source of power, legitimacy gives the firm the possibility to challenge the politician in case it is necessary, through social mobilization for instance. Support from the community may in some cases be used to thwart the politicians seeking rents (Bach, 2010). Aware of this, a politician will be less inclined to extract excessive rents from the firm and go into a public battle. Therefore legitimate firms will be less vulnerable to rent extraction by politicians compared to illegitimate firms.

In short, legitimacy acts both as a value offering from the firm's side that may please the politician, and decreases the likelihood that the politician will seek for extra rents directly from the firm; and on the other hand it acts as a buffer towards rent extraction by the politician.

Hence I propose that legitimacy of a firm will decrease rent extraction by a politician.

Proposition 3: As the legitimacy of a firm increases, ceteris paribus, the rent extraction by the politician decreases.

2.5.2 Political capital of a firm

Firms vary in the levels of political resources they behold. Boddewyn and Brewer (1994) define political resources as '*intelligence and cognitive maps about non-market environments, better access to decision makers and opinion makers, and better bargaining or non-bargaining skills*". Frynas et al (2006) define political resources as "*any firm attributes, assets, human resources, or any other resources that allow the firm to use the political process to improve its efficiency and profitability.*"

Firms accumulate different types of knowledge through their interactions with the politicians (Bonardi, Bergh, & Holburn, 2011). They may accumulate knowledge about how to navigate through bureaucracies, how policies are formulated and implemented, how to best approach politicians. Moreover, as stated before, the revolving doors between firms and politicians operate in two directions: firms may have ex-politicians, bureaucrats who serve as employees after they leave their political service, which also contributes to the stock of political knowledge those firms have. These former politicians provide valuable perspectives on issues, public policy process, and access to key decision makers (Hillman, Cannella, & Paetzold, 2000). Moreover, a firm could also have access to political knowledge through "buying" this knowledge from organizations that provide political consultancy.

Both through prior experience with politicians, and through the knowledge gained through ex-politicians or consultancy organizations, firms increase their political capital. In sum, (a) prior experience with politicians, (b) ex-politicians as employees, and c) cooperation with organizations that provide political advise increase the political capital of a firm.

This political capital will increase the power of a firm vis-a-vis a politician, just as industry capital increases the power of a politician vis-a-vis a firm. The firm's political capital act as a valuable resource, since the firm may actually bring in the exchange this resource that may help the politician in his/her political agenda. Specifically for politicians with low levels of political experience, this sort of capital might prove to be crucial. Moreover, since the firm already possesses some political capital, the relative value of potential benefits provided by a politician decreases. The firm is more capable of using the political processes for its own benefits, and also what the politician may offer to the firm becomes less valuable and this decreases the dependence of the firm on the politician. Hence, the increase in the firm's power. As a result of this increase in the firm's power, the politician becomes less likely to be able to extract rents from the firm.

Therefore I propose that political capital of the firm will impact the rent extraction by the politician negatively.

Proposition 4: As the political capital of a firm increases, ceteris paribus, the rent extraction by the politician decreases.

Up until now, I have discussed politician level and firm level characteristics and resources the parties behold, and how this resource-positioning vis-à-vis each other determine the parties' dependence on (and power over) each other. I have explored how a politician's political power and industry capital and how a firm's legitimacy and political capital act as sources of power and impact rent extraction by politicians.

The power derived from resources the parties behold does not always directly translate to the "use" of that power in an exchange relationship, rent extraction in our case. Prior work notes that some other factors come into play for the power to actually be exerted. Lawler and Yoon (1993, 1996, 1998) look into such factors such as commitment and normative considerations. In this paper, I will look into relationship characteristics that can moderate the use of power by the politician, thus actual rent extraction by politicians. The characteristics of the actual exchange between the parties shape how the confrontation of two powers, that of the politician and that of the firm, have consequences in terms of rent extraction by the politician. In other words, certain factors related to the dynamics of the exchange relationship may avoid the politician to use the power he/she beholds, at least to the full extent, thus impact the level of rent extraction by the politician. In the following section, we will discuss these factors.

2.6 RELATIONSHIP CHARACTERISTICS: LIMITS TO THE USE OF POWER BY THE POLITICIAN

The resources behold by the exchange partners determine what the parties potentially may bring in the relationship, and therefore the relative dependence of the actors on each other. Neither a firm's potential to obtain benefits from its relationship with a politician nor a politician's potential to extract rents from a firm will not necessarily match with the actual benefits or rents extracted from the exchange. Relational context will play an important role in outcomes of any exchange between two parties (Das & Teng, 2002).

Up to now I have focused on how the resources held by the parties determine the dependency (and thus power) of an actor on another. This power positioning of the actors vis-à-vis each other determines the potential for rent extraction by the politician. However, in a specific firm-politician dyad, relational factors may change the dynamics of the power-dependence relations among the actors, and whether the power behold by the politician is actually going to be used for rent extraction. In other words, there are dyad-specific factors that act as constraints to the use of power by the politician to extract rents from the firm. The imbalance of power; mutuality of dependence; the repetition of the exchange in the past; as well as the time horizon provided by the exchange; and interest alignment between the parties act as constraints to the use of power by the more powerful party. Below I will discuss these factors in more detail.

2.6.1 Imbalance of power

In a firm-politician dyad, there is a difference between the dependency levels of the parties, thus a power imbalance between them, resulting in a power advantage for the less dependent actor. Imbalance of power is the power differential between the firm and the politician. Consider a highly mobile industry such as apparel, and an industry that has limited or no capacity to relocate, such as mining. Imbalance of power between firms from these two industries and politicians will differ (Coen, Grant, & Wilson, 2010), since the industry characteristics hardly allow for unilateral dependency management tactics[23] for firms from the mining industry, whereas firms in the apparel industry could relocate their operations in other countries, hence to other political environments rather easier. This imbalance of power between parties eventually will impact the appropriation of benefits among exchange partners (Kim et al., 2004). In other words, the imbalance of power will

[23] Unilateral tactics involve" bypassing the source of constraint by reducing the interest in valued resources, cultivating alternative sources of supply, or forming coalitions" (Casciaro & Piskorski, 2005). Other tactics target directly the other party in the relationship, whereas unilateral ones are about finding alternative "solutions" to the resource constraints, thus relocation of an industry for instance.

dictate whether firms are likely to obtain the benefits they seek for and whether politicians are likely to extract rents from the firm. In a private sector-state dyad, for instance, unfavorable imbalance of power for private sector results in minimal extent of "state capture" by the private sector (Hellman, Jones, & Kaufmann, 2003); in other words obtaining benefits through its political linkages becomes less likely for a firm.

Although the imbalance of power between certain industries and politicians has an impact on the imbalance of power between a particular politician and a particular firm; at the firm level, the imbalance of power is going to be determined by the differentials in the power derived from the priory mentioned resources of the parties: A politician's political power as well as industry capital is going to be weighed with a firm's social power plus its political capital. The difference or ratio of these two poles of power, on the other hand, will determine the imbalance of power between the parties (Casciaro & Piskorski, 2005).

Increasing asymmetry of the power behold by the parties reduces the constraints on the use of power of the more powerful party and reduces the "*the structural impediments inhibiting the more powerful firm's opportunistic behavior, self-serving exercises of power, and punitive actions*" (Kumar, Scheer, & Steenkamp, 1995). A favorable balance of power for a firm will make it more likely for the firm to benefit from its relation with the politician and will decrease the potential for rent extraction by the politician. An unfavorable imbalance of power for the firm, on the other hand, puts the firm under more political rent extraction, since the firm becomes more susceptible to the politician's coercive use of his/her power.

Therefore, I propose that the imbalance of power in favor of a firm decreases rent extraction by a politician.

Proposition 5: As the imbalance of power in favor of a firm increases, ceteris paribus, the rent extraction by the politician decreases.

2.6.2 Mutuality of dependence

Mutuality of dependence is the existence of bilateral dependencies regardless of whether the two actors' (in a dyad) dependencies are balanced or imbalanced. It can be conceptualized as the sum of each party's dependence on the other. Whereas power imbalance captures the difference in the power of each actor over another, i.e. the difference in the dependency of each actor with the other; mutual dependence captures the total of the dependencies of the actors on each other (Casciaro & Piskorski, 2005)[24].

Within the context of firm-politician exchanges, at the aggregate level, mutuality is existent. Politicians are dependent on firms since firms may provide the tools to accomplish politicians' policy agendas, as well as private goals, whereas firms are dependent on politicians since the politicians frame the regulatory environment as agents of and along with legislative bodies. The dependence of the firm on politicians and of the politician on firms push them into an exchange relationship.

[24] In earlier work, the power dependence relations were analyzed through the concept of interdependence. Emerson (1972) and Lawler and Yoon (1996) talk about relational cohesion, which arises as a result of the total interdependence of both partners in an exchange relation. According to Pfeffer and Salancik, mutual dependence and power imbalance together create interdependence. Casciaro and Piskorski (2005) have reanalyzed this concept of interdependence. They challenge this "combination" approach by distinguishing between and separately measuring mutual dependence and power imbalance. They argue that a critical determinant of whether an actor can manage its dependencies in a favorable way would be determined by the extent to which the dependence to be managed is mutual and power is imbalanced, and have shown that these two have opposing effects on the propensity of engaging in dependency management actions, such as M&A activity.

However, when taken at the dyadic level, the extent of the total dependency of the parties on each other varies, or in other words the degree of mutuality of dependence becomes a question mark. It comes down to the question whether the firm and the politician have alternative sources of resources they need. The inability of one party to replace a partner would increase the party's dependence on the partner (Heide & John, 1988). In other words, the (ir)replaceability of a partner would be an indication of the party's dependence on the exchange partner (Heide, 1994; Heide & John, 1988). Hypothetically, there are plenty of politicians that firms could build linkages with, and it is the same for politicians, i.e. there are plenty of firms to establish linkages with; to provide the resources the parties seek for. Moreover, both parties may build multiple relationships of similar kind. Therefore, mutuality of dependence between the parties in a specific dyad is going to be weakened by the existence of alternative politicians or alternative firms, i.e. alternative partners to link with. When for instance, the firm can access to alternative politicians that could create value for the firm, this will bring about a credible threat of withdrawal (Pfeffer & Leong, 1977) and impact the firm's dependence on the exchange partner (Adegbesan & Higgins, 2011), thus the total dependence of parties on one another. In short, the existence of alternative politicians that may provide the firm with same or similar resources, as well as the existence of alternative firms that the politician can get into an exchange relationship decrease the mutual dependence between the parties.

In reality, it may not be that easy for a firm to find a politician as an exchange partner, who will be able to provide the firm with specific benefits the firm needs. Or a politician may not be able to link with alternative firms, either because those firms are not eager to get into an exchange relationship with politicians in the first place, or because the resources the politician holds are not sufficient for providing the benefits those other firms seek for. Therefore the lack of alternatives would enhance mutuality.

When mutuality is high, i.e. when the exchange partners are both highly dependent on each other, the parties are going to be more likely to collaborate and provide benefits for each other, i.e. to reciprocate so that the relationship continues. As the mutual dependence gets higher, the relational cohesion increases (Cook et al., 2006), and parties become more likely to avoid engaging in opportunistic behavior, negative tactics or coercion, since both parties have a lot to lose (Kumar et al., 1995). Relatively high exit barriers motivate the parties to maintain and strengthen the relationship. Since otherwise both parties may have to face more costs looking for alternative sources of those resources they need, and be worse off than the case of continuity of the relationship, they are less likely to use their power in a coercive way. Therefore, even though the relative power of the politician over the firm is high, if the stakes are high in the exchange relationship, this will bring about less rent extraction by the politician.

Hence I propose that mutuality decreases the rents a politician may extract from a firm.

Proposition 6: As the mutuality between a firm and a politician increases, ceteris paribus, the rent extraction by the politician decreases.

2.6.3 Repetition of the exchange

Social exchanges are inherently more uncertain than economic exchanges and the emergence of trust is highly related with reciprocity and past experience (Molm, Takahashi, & Peterson, 2000). Through repeated exchanges, the parties are more likely to develop trust (Gulati, 1995) and this trust built through repeated exchanges may lead both parties to become more tolerant of perceived imbalance in the exchange relationship (Flynn, 2003). For instance the parties would be eager to maintain a relationship that is repetitive even though in time it provides fewer of the needed resources than it initially did (Blau, 1964; Cook, 1977). Perceived trustworthiness of the exchange partner is linked to increased rates of commitment (Kollock, 1994). As a result of this commitment, the parties will be more willing and able to exchange information and resources (Bouty, 2000; McFadyen & Cannella Jr, 2004).

Therefore repeated exchanges are likely to result in trust and commitment in the relationship between the firm and the politician. This trust and commitment in turn, serve to reduce the use of power by the more powerful actor in the power imbalanced exchange relationship (Cook et al., 2006). In other words, repetition of the exchange acts as a mechanism that constrains the use of power by the politician, which shall decrease the rent extraction by the politician.

There is also a second order effect of repetition on the use of power, through learning. Just like two firms, or two individuals, firms and politicians may also engage into repeated exchanges, and the repetition of these exchanges will result in learning (Mayer & Argyres, 2004; Zollo, Reuer, & Singh, 2002). Through repeated interactions, exchange partners will develop similar knowledge stocks (Coleman, 1988). Exchanges among parties that are repetitive in nature reduce the asymmetry of information between the parties. Information asymmetry is a source of power imbalance (Tsang, 1999); and when the parties acquire sufficient knowledge or skills to eliminate or reduce dependency to a partner, there occurs a shift in the balance of power (Inkpen & Beamish, 1997). Therefore, learning through repetitive exchanges plays a role in changing the imbalance of power between the parties, therefore the likelihood of power to be used coercively, although not as directly as trust and commitment do.

Hence I propose that repetition of an exchange will reduce the rents extracted by a politician.

Proposition 7: As the repetition of the exchange between a firm and a politician increases, ceteris paribus, the rent extraction by the politician decreases.

2.6.4 Uncertainty regarding the continuation of the exchange

Apart from the fact that past exchanges with the same partner (the firm in this case) may have an impact on the use of power thus rent extraction by the politician, the uncertainty regarding future exchanges also has an impact on rents extracted by the politician, through acting as a constraint for the use of power by the politician.

Most exchanges between politicians and firms are on a voluntary basis and are "motivated by the returns they are *expected to bring* and typically in fact bring from others" (emphasis added) (Blau, 1964). Parties get into an exchange with each other with the expectations of reciprocity and anticipated gains from mutual cooperation. Uncertainty and the rational calculation of benefits and costs are part of the initial framing of social exchange theory. It is formulated in various ways: such as the subjective probability of concluding a satisfactory exchange with any partner (Cook & Emerson, 1978), or in terms of the quality of resources being exchanged (Kollock, 1994). It is shown that in both formulations of uncertainty, commitment of the exchange partners actually increases with increased uncertainty (Cook et al., 2006). For the purposes of this study, I will focus on the uncertainty regarding the continuity of exchanges with the partner, i.e. the lack of certainty over the probability of having future exchanges with the current exchange partner.

I argue that as long as the politician values future exchanges with the firm, the politician will tend to limit the use of his/her power on the firm to extract rents. In other words, the "shadow of the future" creates a self-enforcement mechanism that limits the use of politician's power, thus rent extraction (Parkhe, 1993). The immediate rents that can be extracted from the firm will be compared to the possible sacrifice of future gains from the relationship (Telser, 1980). Actors will be motivated by future gains and avoidance of anticipated losses or costs (Cook et al., 2006). Of course this self enforcement mechanism will work as long as the politician puts sufficient value on future returns and on the politician's perception of the time horizon for future exchange (Axelrod, 1984). However, it would not be unrealistic to assume that politicians would not build relations with firms in the first place unless they seek rents. It is in their interest to continue exchanges with the firm, in order to be able to extract rents in the future. Therefore, assuming that the politician will be eager to continue the exchange with a firm, the rent extraction by the politician is going to decrease, since the politician is going to be focused more on future exchange possibilities with the firm and will want to decrease the uncertainty regarding future exchanges. Reduced uncertainty regarding future exchanges, on the other hand, could incentivize the parties for a "gold rush" where both parties will have little concern about the stability of the relationship (Das & Teng, 2000). This "temporal orientation" in the relationship between a firm and a politician is crucial, specifically since the continuation of the relationship, i.e. the continuity of future exchanges, is ambiguous most of the time, since there is no contract between the politician and the firm[25].

[25] One exception would be linkages that are built through formal employment contracts, such as board directorship of a politician or short-term employment of a politician.

Proposition 8: As the uncertainty regarding the continuity of the exchange between a firm and a politician increases, ceteris paribus, the rent extraction by the politician decreases.

2.6.5 Interest (goal) alignment provided by the exchange

Another factor, which acts as a constraint to the use of power, thus, which impacts the politician's rent extraction from the firm will be the interest alignment between the firm and the politician. In other words, the politician's incentives to extract rents from the relationship using his/her power depend also on the alignment of the politician's goals with those of the firm.

Ex-ante incentive alignment between the partners improves the chances for cooperation (Adegbesan & Higgins, 2011). If a firm's interest in a public policy aligns with that of the politician, there exists an incentive for cooperation, and a constraint on the use of power by the politician; hence rent extraction by the politician will be less likely to be observed. Let's consider a firm that performs well on reducing its CO2 emissions. This firm is likely to benefit from a legislation that increases taxes on CO2 emissions, just as a politician from a green party is likely to benefit from such legislation, as it will please the politician's constituencies. Under such interest alignment, rent extraction by the politician is going to be less: since the cooperation between the parties is likely to benefit both sides, and since the politician already gets some benefits out of this relationship, he/she will be less inclined to use his/her power over the firm to extract rents. On the other hand, when alignment between a firm's and a politician's interests weaken, rent extraction by the politician is more likely to occur since the politician sees less value in the outcomes of the linkage with the firm, and is more interested in the rents that he/she can extract from the firm using the power he/she beholds.

There are other mechanisms that provide interest alignment between the parties. A politician will be interested in investment by the firm in serving his/her electoral region since it is likely to increase the chances of the politician to be re-elected (Chin, Bond, & Geva, 2000). A relationship with a firm that already invests or operates in the politician's electoral region thus provides an interest alignment between the firm and the politician, since the firm's growth or competitive success will in return increase the employment opportunities and welfare in the politician's electoral region. In this case, the politician's interest is aligned with firm performance. Another alignment mechanism could arise as a result of a politician holding shares of a company. When a politician is a shareholder of the company, he/she is directly affected by the performance of the company, thus the politician is less likely to use power to extract rents from the firm within an exchange relationship. Such stock ownership allocation has been suggested as an incentive mechanism used by shareholders, to align the interests of managers with those of the firm (Jensen & Meckling, 1976).

Therefore, no matter through which of the above means, I propose that increasing interest alignment will decrease the rent extraction by politicians.

Proposition 9: As the interest alignment within an exchange between a firm and a politician increases, ceteris paribus, the rent extraction by the politician decreases.

In this section, I have discussed relationship level characteristics that constrain the use of power by the politician; hence impact rent extraction from firms by politicians. I will now delve into the context within which the exchange between the firm and the politician occurs, i.e. the characteristics of the political environment that result in the dispersion of power among political actors, and therefore change the power dependence relation between the firm and the politician.

2.7 POLITICAL ENVIRONMENT CHARACTERISTICS: DISPERSION OF POWER

Exchanges between firms and politicians occur in an institutional and political configuration that impact how the power of the parties interplay against each other, and the outcome of the relationship between the firm and the politician, i.e. the rents extracted by politicians, as well as benefits obtained by firms. Public choice theories highlight the role of the characteristics of the political environment in enabling or preventing the potential for firms to obtain benefits through the political arena (Treisman, 2000). Despite this, strategy research has paid little attention to firm differences in being exposed to (and responding to) threats and opportunities stemming from the political environment (Henisz & Zelner, 2003a).

Different political structures have different ways of distributing power among political actors, which include politicians. Apart from politicians, there are other political actors in a firm’s political environment that hold power, such as NGOs and unions; and those actors also apply strategies to affect policies (Haley & Schuler, 2011; Pfeffer & Salancik, 1978), which consequently impact the potential benefits that politicians may bring into the exchange with the firm. Moreover, these political actors may disagree among themselves on regulatory direction and on how to implement regulation, measurements, and rules (Haley & Schuler, 2011), which further complicates the ability of the politician to provide the firm with the benefits sought for.

In the following section I will discuss the characteristics of the political environment that result in dispersion of power among political actors, thus change the likelihood that the politician will be able to provide the firm with benefits and thus the power dependence relations between the firm and the politician: political pluralism; and interest groups' strength and coherence.

2.7.1 Political pluralism (vertical distribution of political power)

The consequences of firms' exchanges with politicians are not independent from the configuration of political institutions in a given context (Bonardi, Hillman, & Keim, 2005; Henisz & Zelner, 2003a). Management scholars have recently started to use positive political theory to investigate firm responses to government behavior (Henisz & Delios, 2001; Vaaler, 2008). Political systems vary across countries. They range from democracies to militaristic dictatorships. Political systems have different degrees of contestation and accountability, which impact the way the system functions.

Political pluralism is one such characteristic of the political environment that will impact the dispersion of power among political actors, thus the dependence of the firm on politicians, and therefore the likelihood of a firm to be subject to rent extraction by politicians. Pluralism may be defined *as "an institutional arrangement wherein the political orientations of national and subnational policy makers differ"* (Kozhikode & Li, 2012). Pluralism implies a fragmentation of government power, which reduces the power of any single politician. Political pluralism results in control of the power of politicians and provides checks and balances for public benefit. Such fragmentation of power presents additional challenges for the exchange relationships between firms and politicians (Holburn & Vanden Bergh, 2008; Ring, Bigley, D'Aunno, & Khanna, 2005). Firms are less likely to obtain their policy preferences through exchanges with politicians since there are other politicians at other levels who may actually react to influence attempts by firms (Ingram & Rao, 2004). On the other hand, the firm's dependency on its exchange partner decreases as a result of this fragmentation of power. In other words, political pluralism also brings about opportunities for a firm to find alternative exchange partners, since political power and thus power of a politician is dispersed; and the number of "entry points" for a firm increases, meaning that firms may actually target political actors at different levels to achieve their policy-related goals. The whole idea behind pluralism is to limit the concentration of power in the hands of a few and to account for the divergent interests of different groups (Lijphart, 1996), which a firm may also benefit from.

Given that under a pluralist system dispersion of power and checks and controls decreases the power of a politician; and increases the number of alternative exchange partners for a firm; I propose that under a pluralist system firms will be less subject to rent extraction by the politician.

Proposition 10: As a political system becomes more pluralist, ceteris paribus, the rent extraction by the politician decreases.

2.7.2 Interest groups (horizontal distribution of political power)

Just as political pluralism determines the extent to which power is concentrated; the interest groups within a political system also impact the distribution of power to other actors, other than politicians. Public policy-process may be seen as an outcome of the interactions between "demanders", such as firms, interest groups, activists; and "suppliers", such as politicians, bureaucrats, regulators (Stigler, 1971). There are many types of interest groups: occupational, ideological, public, ethnic, economic interest groups, among others. These groups may demonstrate their power through strikes, protests, lobbying and mass media. Their power derives from financial resources, information they hold, voting power, grassroots mobilization capability and litigation (Dur, 2008). Key interest groups in a firm's political environment, such as NGOs and unions may disagree on politicians' decisions and may act to challenge and affect the policies proposed by politicians. Actually, it is almost impossible that all interest groups agree on public policies. "There is no such thing as a uniquely determined common good that all people could agree on or be made to agree on by the force of rational argument" (Schumpeter, 1942). Thus, it has been long acknowledged that different actors and interest groups impact public policy process, however they hold different levels of power (Baron, 2001a, 2003; Lord, 2000).

Depending on the power different interest groups hold and the degree of conflict among them, politicians' power will be dispersed at different degrees. In other words, there will be two dimensions related to the interest groups, which will impact the horizontal distribution of political power within a political environment: (a) the strength of the interest groups (b) the coherence among the interest groups.

The strength of interest groups refers to their ability to effectively achieve their targets, in other words their power over other groups and politicians. The variation in union effectiveness in getting public policy concessions for instance, results mainly from strategic interactions that "*crucially depend on power dynamics between the main actors*" (Avdagic, 2005). As the power of an interest group increases, the relative power of a politician on policy making may decrease, which decreases the politician's power over the firm too. Since the politician may no longer make abundant use of its political power, the politician's potential provision of policy manipulation for a firm becomes less likely. This deteriorates the politician's power position vis-à-vis a firm, since the firm is less dependent on the politician to achieve the outcomes it aims for. In addition to this, a firm may benefit from the horizontal distribution of this power, similar to the way it benefits from political pluralism, i.e. the firm may use alternative entry points to the political arena, which reduces the dependency of the firm on the politician that it has an exchange relationship with.

I therefore propose that as interest group power increases, the dispersion of power lessens the power of the politician, and this will give the politician fewer chances to extract rents from the firm.

Proposition 11a: As the strength of the interest groups increases, ceteris paribus, the rent extraction by the politician decreases.

Another dimension of interest groups that impacts the dispersion of power is the coherence among the interest groups. Successful policy coordination among interest groups may limit the potential for rent-seeking of politicians (Olson, 1982). Coherence among different groups facilitates resource exchanges between them, and increases their relative power in the political arena. Coherence brings along a "combined" power, which improves the bargaining position of interest groups against politicians, and which diminishes politicians' power. Hence coherent interest groups will reduce a politician's rent extraction opportunities from the firm, since it reduces the power of the politician that derives from the potential resources he/she may bring into the exchange relationship.

Therefore I propose that coherence is also going to decrease the potential of rent extraction from a firm by a politician.

Proposition 11b: As the degree of coherence among interest groups increases, ceteris paribus, the rent extraction by the politician decreases.

Figure 2-2: Full conceptual model with proposed relations to rent extraction by politician

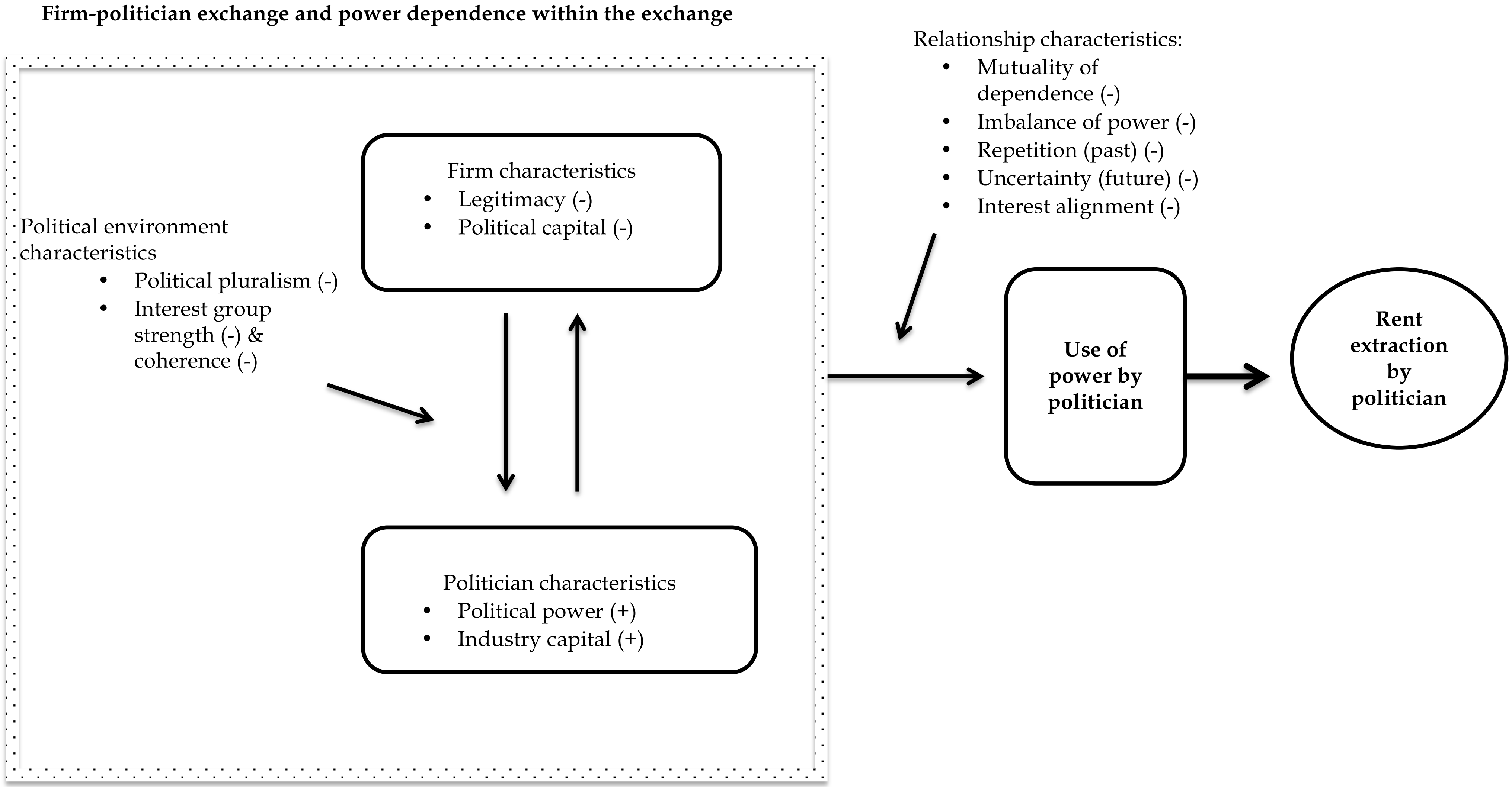

Table 2-1: Summary of propositions

	Propositions	Impact on rent extraction
Politician characteristics	P1: Political power	(+)
	P2: Industry capital	(+)
Firm characteristics	P3: Legitimacy	(-)
	P4: Political capital	(-)
Relationship characteristics (constraints on the use of power)	P5: Imbalance of power	
	P6: Mutuality of	(-)
	dependence	(-)
	P7: Repetition	(-)
	P8: Uncertainty regarding future exchanges	(-)
	P9: Interest alignment	(-)
Political environment characteristics (dispersion of power)	P10: Political pluralism	(-)
	P11: Interest group strength and coherence	(-)

2.8 DISCUSSION

In this paper, I look into firm-politician linkages that allow for exchanges between the parties, and outline the factors that determine the level of rent extraction from firms by politicians. I take a social exchange perspective and also use insights from resource dependence theory to build a conceptual framework, which aims to explain rent extraction by politicians at the firm level. Looking at rent extraction by politicians at the firm level, this study distinguishes itself from prior literature, which looks into likelihood of rent extraction by politicians at more macro levels, such as at the industry or at the country levels. Shifting the focus of analysis to the firm level, I examine rent extraction by a politician as determined by a multitude of factors which all change the power dynamics between a firm and a politician: I first explore the political power of a politician and the politician's industry capital. I then juxtapose a firm's social power derived from its legitimacy and the firm's political capital, to a politician's political power and industry capital; and discuss how these sources of power may actually impact rent extraction by the politician. Then I look into how relationship level factors within a firm-politician dyad; namely imbalance of power, mutuality of dependence in the exchange, repetition of the exchange, uncertainty regarding future exchanges and interest alignment within the exchange, act as factors that constrain the use of power by the politician, therefore moderate the rent extraction from the firm by the politician. Finally, I delve into the political environment characteristics, such as political pluralism and interest group strength and coherence, and how these play a role in dispersing the power of politicians, and how this dispersion of power impacts the rent extraction from the firm by the politician.

Drawing on work from multiple fields, with this framework, I hope to shed some light on the exchange relationship between firms and politicians, since "*understanding the relationship between business and politics remains an enigma.*" (Lux et al., 2011). The framework aims to provide a more realistic picture on political strategies by firms such as building linkages with politicians, and draws attention to the double-edge nature of such linkages. As Hillman, Withers and Collins (2009) states, *"The interaction of interdependent organizations and their environment is a dynamic, complex process requiring robust perspectives that can explain a broad range of outcomes."* The risks of engaging into direct exchange relations with politicians are underestimated, whereas studies have recently shown "disincentives" for firms to adopt strategies towards policy makers (Hargadon & Douglas, 2001; Rao, Morrill, & Zald, 2000). This study also aims to at least partially address the call from Galang (2012) on integration of multiple levels of analysis such as firm level factors, political resources and political/social institutions to explain corruption, which is a form of rent extraction.

In the end, in real life, a possibly far more complex model operates in determining the outcomes of exchanges between politicians and firms, and potential rent extraction by the politicians. However, this framework may provide a first step in explaining the interplay of multiple-level factors in the likelihood of rent extraction by politicians at the firm level.

2.8.1 Limitations and further research

This paper has its limitations. In terms of exchanges between firms and politicians, it focuses only on firms' direct linkages with politicians. Future work could provide a more comprehensive analysis of such exchange relationships, apart from political linkages, and how the interplay of not just dyadic but multiple-level exchange relations impact rent extraction by politicians. For instance when firms combine their power to form lobbying groups, they actually aim to change the power dynamics between the firm and the politicians. Such collective strategies have also outcomes at the firm level. Or there might be personal level exchanges between firm executives and politicians. A more fine-grained analysis of the dynamics of multiple-simultaneous exchange relations could enhance our understanding of rent extraction by politicians.

Furthermore, even though the paper takes into account the configuration of political systems in terms of the dispersion of power of politicians, in reality, the configuration of political systems are far more complex. Political pluralism in a federal structure may have different implications than a pluralist configuration in a centralized government. Legal pluralism on the other hand may also impact the dispersion of power among the legislative bodies, which are among the political actors. Moreover, transparency within a political system will impact how the parties use their power. On top of that, the political system itself has a direct impact on whether firms are going to actively pursue political strategies such as going into exchange relations with politicians (Henisz, 2000; Henisz & Zelner, 2003a; Luo, 2003). Distinguishing between the impacts of different configurations of pluralism and integrating other elements of the political system in the framework would make the paper more comprehensive.

2.8.2 Managerial Implications

Understanding how different levels of factors interplay in the political rent extraction firms face have important strategic implications. Firms may ex-ante consider the different factors which will impact rent extraction by a politician and consider these factors before building linkages with politicians. For instance they may refrain from building linkages with politicians, with whom the firm would have a high differential in power; or they might try to sustain relations with politicians that the firm is already linked with, so that the firm benefits from the repetition of the exchanges. Given that exchanges might actually harm firms' performance as a result of rent extraction by politicians, exchange relations with politicians should be considered very carefully.

3 CHAPTER 3: QUESTIONING THE VALUE OF BEING POLITICALLY CONNECTED: IMPACT OF POLITICAL LINKAGES ON FIRMS' FINANCIAL PERFORMANCE

3.1 ABSTRACT

This paper questions the potential value firms may draw from their political linkages. Using insights from resource dependence theory and social exchange theory, it theorizes on how different types of linkages between firms and politicians, which inherit different levels of uncertainty on the continuity of the exchange and create different levels of ex-post dependency expose firms to differing levels of potential benefits to be drawn from the exchange and differing levels of rent extraction by politicians; and how this eventually relates to firms' financial performance. The paper focuses on three different types of linkages that firms have with politicians: Board directorship of a politician, gift giving to a politician, and sponsorship provision to a politician; and investigates the impact of these different types of linkages on firms' financial performance. The predictions are empirically tested using a unique longitudinal dataset covering linkages between politicians and all publicly listed companies in the UK, for the period from 2002 to 2011. Findings show that while board directorship of a politician and sponsorship provision to a politician are associated with negative financial returns, gift giving to a politician is associated with positive financial returns.

Keywords: political linkages, board directorship, gift giving, sponsorship, rent extraction

3.2 INTRODUCTION

Management scholars show an increasing amount of interest in firm-level outcomes of having political linkages. Firms' political linkages have many forms, but in general, they might be defined as contact interfaces that allow for exchanges between a firm and a politician. For instance, when a firm appoints a politician to its board of directors, or contributes financially to the election campaign of a politician, or provides gifts and benefits to a politician, then this firm is considered as having a political linkage. Political linkages may also take the form of top officers or large shareholders of a firm holding political positions; or having close relationships with politicians. In the extreme case, the government itself may own the firm, and this may also be considered as a political linkage.

One stream of literature points at the positive value firms might draw from their political linkages. Studies have shown that appointment of ex-politicians to company boards[26] (Bertrand, Kramarz, Schoar, & Thesmar, 2007; Goldman et al., 2009; Hillman, 2005); top officers or large shareholders of the firm holding political positions (Faccio, 2006; Faccio, Masulis, & McConnell, 2006; Gehlbach et al., 2010) or simply having board members with close relationships with politicians (Faccio, 2006; Fisman, 2001; Johnson & Mitton, 2003) have a positive impact on firms' financial performance. Firms with political linkages earn higher market shares and are more profitable than firms with no such linkages (Hillman, Zardkoohi, & Bierman, 1999; Peng & Luo, 2000), especially in heavily regulated industries (Hillman, 2005). Political linkages might provide firms with easier access to critical resources such as credit (Charumilind, Kali, & Wiwattanakantang, 2006; Cull & Xu, 2005; Dinc, 2005; Joh & Chiu, 2004; Johnson & Mitton, 2003; Khwaja & Mian, 2005; Leuz & Oberholzer-Gee, 2006); and access to government bailouts when firms are under financial distress (Faccio et

[26] Appointment of current politicians to company boards are prohibited in many countries, hence the appointment of ex-politicians.

al., 2006). Firms with political linkages are shown to be more likely to get government contracts (Goldman et al., 2009).

While many scholars found a positive impact of having political linkages on firms' financial performance, there is also an emerging literature that questions the value of political linkages and shows their negative impact on firms' financial performance. Political linkages do not come for free, there are costs associated with such linkages, and thus linkages do not always bring positive outcomes for the firm. Since this is a multi-sided market, with firms, politicians, and the public all being potential beneficiaries and payees, firms also bear the costs of being politically linked. "Favors" usually operate in both directions and firms need to provide private gains to politicians in different ways, such as creation of jobs for the politicians' constituencies, or financial contributions to politicians to be used in political advocacy. For example, in their study on the linkages between firms and politicians, Bertrand and colleagues (2007) show that as a result of managers' political linkages, firms may end up having to create employment that would normally be economically unprofitable for the firm. Furthermore, even when political linkages may have proved to be beneficial for some period, they may eventually harm firm performance. Having linkages to the governing party for instance, may benefit the firm, but only as long as the party is in power. When the governing party is no longer in power, this may turn the tables on the firm, and the firm might suffer from negative consequences because of its prior links with the ex-government. In other words, linkages may turn into a liability in case of a regime change or if power changes hands (Siegel, 2007) or in case of health problems of an important political figure connected to the firm (Fisman, 2001). Through investigation of the automobile industry in China, Sun, Mellahi and Thun (2010) show that even in the absence of exogenous political shocks, the value of political linkages vary over time, and may not stay consistently positive, since firms with tight political networks might get "locked into" those networks and fail to adapt to a rapidly changing business environment under a stable political regime. The market may account for all these scenarios, and actually punish firms with political linkages. In a very recent study, Hadani and Schuler (2013) show that firms' political investments in the form of financial contributions to politicians and appointing ex-politicians on the board of directors are both negatively associated with firms' market performance.

Therefore, a relevant question to ask is: Do firms draw positive financial returns from their political linkages?

Drawing on resource dependence theory (RDT) (Pfeffer & Salancik, 1978), this paper sees political linkages as strategic means through which firms try to decrease their dependency on the political environment; as well as to manipulate the political environment in the favor of the firm. However, there are two points that necessitate further research on political linkages and the returns firms may get through those linkages:

First, according to RDT, firms build linkages with politicians to manage their dependency on the political environment, and with the expectation of access to some contracts, private information, or to be able to take an active role in the formulation of a favorable regulation, among others. However, potential risks that arise as a result of building those linkages are not always fully considered. Actually, RDT has been much used to explain the rationale for building linkages as dependency management tactics, however the risks arising from those tactics, such as the risk of misappropriation of firm resources by the partner, are rather disregarded (Katila et al., 2008). When a firm forms a linkage with a politician, first, there is a risk that the politician with whom the firm has a linkage does not provide the firm with what the firm asks for, i.e. the firm may not obtain the benefits it seeks through the political linkage. Second, even when the politician provides the firm with benefits that the firm seeks for, in exchange for the benefits he/she provides, the politician may be able to extract rents, i.e. private gains, whose value exceed the value of the benefits the firm gets. So, if a politician does not provide the firm with benefits that the firm seeks for, while he/she extracts rents from the firm; or even when the politician provides some benefits to the firm, if the costs for the firm of securing these benefits exceed the value of benefits the firm obtains from the linkage, then the political linkage may become harmful for the firm's performance. In other words, political linkages may be detrimental to firms' financial performance as opposed to improving it. Therefore this paper takes into account such potential risks arising from firms' political linkages, and is built on the premise that while firms may get benefits from politicians through their linkages, politicians too, obtain private gains from firms in return, and impose costs on the firms.

Second, there are few studies that distinguish between different types of linkages between firms and politicians[27]. Political linkages might take many forms and different forms might have different implications in terms of the potential benefits that firms might obtain from them and potential costs those linkages bring to the firm. Therefore, apart from taking a critical stand on the positive financial value to be drawn from political linkages, this paper investigates the relation between firms' political linkages and firms' financial performance through distinguishing between different types of political linkages: those that increase the ex-post dependency of the firm on the politician, while reducing the uncertainty for future exchanges; and those that limit ex-post dependencies while preserving the uncertainty regarding the continuation of the exchange. This study argues that linkages that increase the ex-post dependency of the firm on the politician, through locking the firm in with the

[27] One exception is Okhmatovskiy (2010) who distinguishes between government ownership linkages and board directorship linkages.

politician, i.e. making it hard for the firm to terminate the relationship or to switch to alternative partners, while reducing the uncertainty regarding future exchanges, increase the likelihood of negative financial returns for the firm. On the other hand, linkages that create no ex-post dependencies, both through providing the possibility of immediate termination of the relationship and changing of exchange partners in case of need, while preserving the uncertainty regarding the continuity of the exchange between the parties, increase the likelihood of positive returns for the firm. Hence whether political linkages will have a positive or negative impact on firms' financial performance will be determined by whether the linkage increase ex-post dependencies and whether uncertainty regarding future exchanges is preserved or not.

Using a unique longitudinal dataset covering different types of linkages between firms and politicians in the UK, from 2002 to 2011, this paper empirically assesses the relationship between political linkages and financial performance of a firm, distinguishing between three different types of linkages: board directorship of politicians, gift giving to politicians, and the provision of sponsorships to politicians. The study focuses only on direct linkages between firms and current politicians, who are democratically elected and serve as Member of the Parliament (MP), and looks into how these linkages will impact firms' financial performance. The analysis provides robust evidence that both board membership of politicians and sponsorship provision to politicians are significantly and negatively related to firms' financial performance, whereas gift giving to politicians is significantly and positively related to firms' financial performance.

This study aims to contribute to the literature on firms' political strategies, by distinguishing between different types of political linkages and analyzing their performance implications. It also aims to contribute to RDT, by analyzing potential risks arising from dependency management tactics, and by investigating the factors that may impact the success of dependency management tactics, through using insights from social exchange theory.

3.3 THEORETICAL FRAMEWORK

The roots of resource dependence theory (RDT) lie in sociology and political science. The theory uses concepts that reach back to Weber (1947), but as it is known now, the theory belongs to Pfeffer and Salancik (1978). Pfeffer and Salancik (1978) build on Emerson's (1962) and Dahl's works on power (Dahl, 1957) and Selznick's work on co-optation (Selznick, 1949), and define organizational success as maximization of power. The unit of analysis in RDT is the firm and its relation to its larger environment. The theory posits that organizations (firms in our case) are not self-contained or self-sufficient and that they rely on their external environment to provide support. RDT has the following two basic assumptions (adapted from Ulrich and Barney (1984)): (a) Organizations are comprised of internal and external coalitions, which emerge from exchange relations; (b) The environment contains scarce and valued resources essential to organizational survival; and organizations face uncertainty with regard to the acquisition of those resources. The theory is based on the premise that all firms need resources, be it financial, capital, or human. No firm is self-sufficient, and all are forced into exchange relations with other actors in their environments to obtain the resources they need. These actors may be other firms, suppliers, buyers, customers, society, and politicians, among others. This dependence of the firm on its external environment makes the firm vulnerable to demands and even to coercive use of power by external parties. For providing the firm with what it needs, external actors may demand in return certain actions or resources from the firm. For instance, in case of exchanges with politicians, politicians, on whom the firm is dependent, may provide regulatory favors, only if the firm provides private gains to them. As a result of these external constraints, control of firm behavior by external parties becomes "both possible and almost inevitable" (Pfeffer & Salancik, 1978).

3.3.1 Managing firms' dependencies

Resource dependence theory is an open-systems theory[28], which states that environmental factors and dependencies shape the form and behavior of firms; however it also emphasizes the strategies firms can use to limit those constraints and dependencies. Aware of their dependencies, firms try to protect the level of discretion necessary to adjust to contingencies as they develop. They aim to minimize their own dependence on external actors and/or to increase the dependence of external actors on themselves.

Dependency management actions involve both the recognition of the social context and constraints within which the firm must operate, and the choice of organizational adjustments to these social realities; and shaping and creating an environment more favorable to the firm. In other words, dependency management can be achieved in a uni-lateral, adaptive fashion or bi-lateral, manipulative fashion. Uni-lateral dependency management can be described as actions where the dependency of the firm on the environment is altered, e.g. through diversification or through use of alternative resources. When a firm is highly dependent on one resource, such as a single raw material provided by few suppliers, then the firm may decrease its relative dependence on this single raw material as well as the suppliers by either finding a substitute raw material for its operations or by diversifying into other industries. Alternatively, dependency management can also take a bi-

[28] Open systems theories conceptualize organizations as "open", adaptive systems, rather than closed systems (Katz & Kahn, 1966). An open system implies not only "that it engages in interchange with the environment, but that the interchange is an essential factor underlying the system's viability" (Buckley, 1967).

directional form, which is a more pro-active strategy aiming at re-defining the two-way dependence between the firm and its external environment. The absorption of the constraints through growth and mergers; establishing collective structures of inter-organizational behavior by using joint ventures, industry associations; co-optation and political action are put forward as various ways through which firms can achieve such bi-lateral dependency management (Pfeffer & Salancik, 1978).

3.3.2 Political linkages as a tactic to manage firms' dependence on the political environment

As stated above, when a firm's dependency on external actors increases, the firm's discretion, which is necessary to adjust to contingencies as they develop, decreases. The firm therefore will try to protect the level of discretion it has, and aim to manage its dependence on external actors. Politicians are among those external actors on whom the firm is dependent, and whom the firm will aim to manipulate through dependency management tactics. Political environment, and the conditions created by this environment may have important implications for the competitive position of firms. Policies formulated by politicians may directly impact industries, as well as macro-economic conditions, which will consequently impact firms' survival chances and performance. Therefore, firms will seek to manage their dependencies on those politicians.

One way to manage firms' dependencies on the political environment is to build linkages with politicians, who create uncertainty and dependence (Hillman, 2005). Building linkages with an external entity is likely to be used as a tactic when total control of the dependence on an external actor through ownership is legally proscribed. It is also a strategy when control of the dependence on external actors is impossible due to resource constraints, or when partial inclusion is sufficient to solve the organization's problems of dealing with the external organizational context (Pfeffer & Salancik, 1978; Selznick, 1949).

Firms tend to use political linkages as a way to limit dependence on the political environment and to have more discretion on politicians' current and future actions. For example, as part of managing a firm's dependency on the political environment, politicians and other individuals with access to or influence on the government may be employed or elected to the firm's board of directors and this way they are *partially* "absorbed" into the firm, reducing environmental uncertainty (Boyd, 1990; Pfeffer, 1972). In line with the predictions of RDT, it has been shown that firms that are highly dependent on government, such as firms with a high proportion of sales to, or contracts with the government (e.g. defense contracts), or with heavy cost burdens imposed from public policy are more likely to engage in political action to shape public policy (De Figueiredo & Tiller, 2001; Hansen & Mitchell, 2000; Hillman et al., 2004; Schuler et al., 2002). Through building political linkages, those dependent firms may gather information about how to navigate through government bureaucracies, insights in government actions, ability to enlist the government for the firm's interest at the expense of competitors (Goldman et al., 2009).

In short, RDT views linkages with external parties as a mechanism to manage the uncertainty and dependence created by those external parties, and political actors are such external parties that are sources of uncertainty and dependency for firms. Therefore linkages with politicians are supposed to help a firm manage its dependence on the political environment, and furthermore help enact favorable conditions for the firm.

Certainly RDT is not the only approach that admits this capability of firms to change, to manipulate their environment. Recent work in institutional theory focuses on such capability as well (Castel & Friedberg, 2010; Fligstein, 2001; Galaskiewicz, 1991; Leblebici, Salancik, Copay, & King, 1991; Lounsbury & Rao, 2004). However, RDT appears as a suitable framework to investigate firms' political strategies: RDT explicitly acknowledges the discretion firms have in shaping and enacting their political environment and the tactics firms use for this, such as building linkages with politicians. Moreover, RDT has an explicit emphasis on power when suggesting a repertoire of tactics available to firms, and this emphasis on power distinguishes it from other theoretical approaches such as transaction cost economics, among others (Davis & Cobb, 2010). *"Organizations may use political means to alter the condition of the external economic environment. In turn, economic power may build political power in the external environment, to be used at some future time for the organization's interests in survival and resource acquisition."* (Pfeffer and Salancik, 1978, p 190).

However, RDT should be developed further to take into account the risks arising from such dependency management actions. Along with social embeddedness, the theory has been used as a primary theoretical explanation of tie formation and network evolution (Ozcan & Eisenhardt, 2009), but studies focusing on the consequences of dependency management actions have been rare. Dependency management actions by firms inevitably result in new patterns of dependencies and thus new allocations of power between a firm and organizations or groups in its external environment. In other words, RDT focuses much more on the ex-ante power dependence conditions, and not ex-post power dependence relations once the firm engages in a dependency management action. If we go back to the basics of RDT and thus basics of power-dependence relations put forward by Emerson (1962) however, we have to take into consideration that the power conditions in an exchange relation are rarely stable. Both actors within an exchange are motivated to increase or at least maintain their power in the relationship, and this brings about change in the ex-ante power-dependence conditions (Cook et al., 2006). Underestimating this instability, RDT focuses more on the rationale for dependency management tactics, such as building linkages, rather than on the risks arising from these tactics, such as the risk of misappropriation of firm resources by the partner (Katila et al., 2008). In other words, the theory focuses on the ex-ante conditions for building linkages with politicians, however disregards the ex-post consequences of those linkages once they are built, assuming that once the linkages are there, firms are able to derive positive returns from them. The factors that impact whether the firm will successfully manage its dependence or not are not fully investigated.

Firms' political actions offer us a fertile bi-lateral context to contribute to resource dependence perspective, by taking into account the potential risks arising from dependency management moves and investigating the consequences of these moves. Next sections therefore elaborate on political rent extraction, which is a cost arising from forming political linkages as a dependency management tactic; and put forward which factors can moderate this cost.

3.3.3 Rent extraction by politicians

Politicians too, benefit from their linkages with firms and they extract rents from those linkages in various ways. Being linked to a firm may provide politicians with valuable information about an industry that would facilitate their political decisions, and increase their constituency support. Politicians' linkages to firms may also provide them with private information that they can use in their personal investment decisions (Cohen et al., 2008). In other words, through their linkages with firms, politicians can have access to private information about the potential gains and risks of a project, for which other investors do not have access to; and may obtain private gains through this information.

In addition to information, politicians may extract other private benefits from their linkages with firms, such as future employment opportunities. Examples are numerous: EU Commissioner Martin Bangemann – once in charge of regulating the telecommunication industry – was hired as a consultant by Spanish Telefonica at the end of his term of office (Choi & Thum, 2007). Sir Kevin Tebbit joined the board of Italian aerospace and defense manufacturer Finmeccanica after many years of service in the UK Ministry of Defense (Transparency International, 2011). Eggers and Hainmueller (2009) show that serving in the parliament would increase -almost double- the chances of an individual to be a director of a publicly traded firm in the future. The longer politicians stay in office, typically, the larger their earnings potential once outside of government (Kaiser, 2009). Linkages with firms increase this future employment and earning opportunities.

Linkages with firms also have some immediate monetary benefits for politicians, such as through remunerated employment. Politicians may serve as consultants to firms while still holding office. In some countries this is perfectly legal, whereas in some others it may not be considered legal or legitimate, but may still exist. Not long ago, several German politicians had to step down from public office when it became public that they were still on the payrolls of big German companies (DW, 2005). Such immediate gains for politicians may also take the form of donations and gifts.

Finally, politicians may extract rents from firms through receipt of payments or benefits in return for a promise not to take away or destroy private wealth. In other words, politicians can extract rents from firms in exchange for not imposing destructive taxes or regulations (McChesney, 1997). This can have even the most basic form of corruption. Firms with linkages to politicians may be more likely to be exposed to this sort of rent extraction since the first step of "access" to the firm by the politician is already achieved.

Not all rents politicians extract from a firm result in a loss for the firm. As long as the rents extracted by the politician do not exceed in value the benefits that the firm draws from the relation, this does not constitute a problem for the firm. But once the politician extracts "excessive" rents from the firm, i.e. the rents extracted by the politician exceed in value the benefits that the firm draws from the relation, and then the linkage will prove to be too costly for the firm and will result in deterioration of the firm's financial performance. It is not easy for a firm to predict ex-ante the rents the politician will want to and be able to extract from the firm. However, as shown in Table 3-1, firms will achieve positive financial returns from their political linkages only in cases where the value of benefits obtained from the linkage exceeds the value of rents extracted by the politician from the firm. When the value of the benefits obtained through the linkage is higher than the rents extracted by the politician from the firm, i.e. in the scenario represented by the bottom-right corner of the matrix, firms will have positive financial returns from the linkage. In the opposite case, where the rents extracted by the politician from the firm is high, whereas the value of benefits obtained by the firm is low, the firm will face a loss and thus negative financial returns. In certain cases though, such as where the benefits obtained by the firm and rents extracted by the politician are both low, or both high, the financial returns from the linkage are going to be even harder to predict, even though they will still be determined by the difference in the value of benefits obtained by the firm minus rents extracted from the firm.

Table 3-1: Financial Returns from Linkages with Politicians as the Difference Between Benefits Firms Obtain and Rents Politicians Extract

Benefits obtained by the firm / Rents extracted By the politician	LOW	HIGH
HIGH	(-)	(?)
LOW	(?)	(+)

A firm is required to very carefully manage its political linkages: while trying to benefit from political linkages, the firm also has to protect itself from excessive political rent extraction. In other words, while trying to capture value out of the political linkages, a firm needs to find means to mitigate the risk of excessive political rent extraction.

3.3.4 Protection strategies against rent extraction by politicians

Firms have alternative means to mitigate the costs arising from rent extraction by politicians. Acting through a united front, i.e. joining forces with other firms and forming a lobbying group, is one such tactic. Building a united front gives the firm the chance to pool information with other firms reducing, sharing the costs of obtaining relevant information (Coen, 2007), as well as avoiding direct linkages with politicians, hence reducing the costs arising from political rent extraction. Apart from lobbying, litigation and other influence activities targeted towards regulatory bodies as well as politicians can function as means of hazards mitigation (Henisz & Delios, 2002), such as political rent extraction. As an example, firms may start litigation against the government in case of rent extraction risk, may mobilize social support to influence politicians, or may collaborate with international bodies to impact the political environment in a country (e.g. fight against corruption).

Many of these solutions, however, are indirect ways of managing the political rent extraction, and may not apply to cases where the firm has (and prefers to have) a direct linkage with the politician. Alternatively, firms can pro-actively manage rent extraction by politicians through choosing carefully the types of linkages to be built with politicians**.** One possible way to achieve this is to avoid high ex-post dependencies while preserving the uncertainty regarding the continuity of the exchange with the politician. Therefore, by carefully selecting ex-ante political linkages that limit the ex-post dependencies while creating incentives for the politician to provide benefits for the firm, firms may also limit excessive political rent extraction, thus avoid negative financial consequences of having political linkages. Below, I will discuss this in more detail:

3.3.5 Uncertainty of the continuity of exchange, ex-post dependency, and the degree of political rent extraction

As already stated before, firms build linkages with politicians that allow for exchanges, to manage their dependence on the political environment, and to obtain benefits from politicians. However, there is no guarantee that firms with will achieve the expected benefits through their political linkages. To achieve positive outcomes from their political linkages, firms need to assure two things: First, the politician needs to provide the firm with benefits; and second what the politician takes from the firm should not exceed in value what he/she provides to the firm. Only under these conditions the firm is going to achieve a positive outcome from its linkage with the politician.

Since the relationship between the firm and the politician constitutes a social exchange, rather than a market exchange, whether the politician is going to provide the firm with benefits is highly ambiguous. The basic difference between market exchanges and social exchanges is that "social exchange entails unspecified obligations" (Blau, 1964). As opposed to a market exchange, in a social exchange there is no third party enforcement. Unlike market exchanges, exchanges with politicians involve "the exchange of political resources for unspecified favors (e.g., beneficial policy, contracts, information, etc.) at some time in the future" (Lux et al., 2011).

How to incentivize the politician to (fairly) reciprocate while allowing the firm enough room to quit the exchange relationship if necessary? In other words, how to incentivize the politician to bring in benefits for the firm, while making sure that the ex-post dependency of the firm on the politician is not so high that it will avoid the firm to get out of the exchange in case of non-reciprocity or "unfair" reciprocity of the politician. This approach can be very much interpreted through the original framework of power-dependence relations. The aim of any actor A in an exchange relationship with an actor B is to acquire the necessary resources without increasing its dependence on actor B.

First, let's look into reciprocity by the politician: When firms provide resources or benefits that are valued by politicians, politicians will tend to reciprocate these benefits as long as they seek for repeat exchanges, i.e. if the politician is motivated to continue exchanges with the firm in the future. Reciprocity is a main factor that encourages the continuity of any exchange relationship (Meeker, 1971). The anticipated gains from reciprocity will impact the current behavior of the politician, i.e. whether the politician is going to provide benefits to the firm or not. In other words, "the future casts a shadow back upon the present" (Parkhe, 1993), and expectation and motivation for continuity of exchanges will incentivize the politician to reciprocate the favor of the firm. Of course reciprocity will depend on sufficient value placed on future returns (Axelrod, 1984), i.e.

potential returns from the continuity of the relationship. And reciprocity per se does not guarantee the continuity of exchanges; it has to be perceived as "fair" by the party receiving the benefits from reciprocation. Therefore, the more uncertain the continuity of exchanges between the firm and the politician, the more likely the politician is to provide benefits for the firm to decrease this uncertainty and to increase the likelihood of future exchanges. The non-elimination of uncertainty regarding the continuity of exchanges is therefore crucial in the sense that it will determine the incentives for the politician to reciprocate, i.e. to provide benefits for the firm.

On the other hand, even when the politician provides benefits to the firm, the politician may still extract rents from the firm that exceed the value of benefits he/she provides to the firm. To avoid this, the ex-post dependency of the firm on the politician should be limited to constrain the politician's power in the relationship; hence the likelihood of excessive rent extraction by the politician. Think about the scenario that Actor A and Actor B enter into an exchange relationship with each other since they both depend on each other, but to varying degrees. Once the exchange relationship is established, if the nature of the linkage between the two makes it harder for Actor A to get out of the exchange relation compared to Actor B, i.e. if they have asymmetric constraints in terms of terminating the relationship and finding other exchange partners, Actor A faces an increased dependency on Actor B. In other words, the ex-post dependency of Actor A on Actor B is actually higher than the ex-post dependency of Actor B on Actor A, as a result of their asymmetric constraints to exit the relationship. Within the context of firm-politician linkages, firms may build different types of linkages with politicians that will have differing degrees of ex-post dependency. A firm and a politician's ex-ante dependence on each other force them to enter into an exchange. But the type of linkage through which this exchange is going to take place matters in determining the ex-post dependence of the parties on each other, since different types of linkages will bring about different levels of constraints for the parties to get out of the exchange if they wish to.

In short, linkages that do not eliminate the uncertainty for future exchanges and that limit the ex-post dependency of the firm on the politician may incentivize the politician to reciprocate; while giving the firm the opportunity to switch exchange partners or at least to retaliate, i.e. to terminate the relationship in case of excessive rent extraction by the politician, thus helping to limit the costs arising from the linkage. On the other hand, firms establishing linkages that lessen or eliminate the uncertainty regarding future exchanges actually jeopardize the likelihood of reciprocity by the politician. Specifically when those firms have high ex-post dependencies on politicians, this increases the power of the politician in the relationship, which makes it harder for the firm to actually terminate the relationship and even switch to other politicians in case the politician does not reciprocate. Consequently the costs of having those linkages with politicians increase.

In the following section, I will elaborate on the mechanisms mentioned above, and develop hypotheses on how board directorship, gift, and sponsorship linkages provide different cases in terms of incentives they create for (fair) reciprocity of the politician and ex-post dependency of the firm on the politician that they bring about.

3.4 HYPOTHESES DEVELOPMENT

In this paper, I will investigate the impacts on firm performance of three different types of linkages to politicians: board directorship of politicians; gift giving to politicians; and sponsorships provision to politicians. These three types correspond to different points of a continuum in terms of the uncertainty regarding future exchanges they inherit and ex-post dependencies they create.

I will discuss further on in detail how these three types of linkages differ from each other in terms of uncertainty regarding continuity of exchanges and ex-post dependencies they create, however, if briefly summarized:

Board directorship of a politician is employment of the politician in a firm as a member of the board of directors, which embeds the politician to the firm in the most extensive and formal way. It decreases to a great extent the uncertainty of the continuity of exchanges between the firm and the politician, at least for a specific period of time ranging from a year to multiple years. On the other hand, it creates high ex-post dependency of the firm on the politician, both because of the formal contract between the parties, and also because it brings along asymmetric constraints to the firm and the politician in terms of terminating the relationship.

Gift giving, on the other hand, is on the opposite side of the continuum when compared with board directorships. Gift giving is a linkage that provides no formal contract, no lock-in situation, and that does not guarantee continuity of the exchange or any reciprocity by the politician ex-ante. Neither it creates a high ex-post dependency for the firm once the linkage is established.

Sponsorship has de facto high uncertainty of the continuity of exchanges, since it is a form of exchange that occurs with very low frequency, and in terms of ex-post dependency it creates, it stands somewhere in between board directorship and gift linkages.

One common point about these three types of linkages between firms and politicians is that they all constitute direct linkages between firms and politicians, which allow for the exchange of resources. However they have different characteristics. Thus they provide a good context to assess the performance implications of direct linkages with politicians. Hypotheses are developed for the impact of all of these types, distinguishing between their characteristics regarding the uncertainty they inherit about the continuity of the exchanges, and ex-post dependencies they create.

3.4.1 Board directorships of politicians and firms' financial performance

According to RDT, board members provide the firm with resources that will enhance the firm's performance. The board members may act as channels of communication between the firm and external organizations through which firms can obtain valuable information, and improved access to resources (Carpenter & Westphal, 2001; Hillman et al., 2000). As an example, directorship linkages with politicians may allow firms to have prior information regarding future policy changes, and consequently be more "ready" for future policies than firms having no access to such information. Politician board members may be helpful in acquiring resources from important elements outside the firm, such as political bodies, communities (Hillman & Dalziel, 2003); and bring in legitimacy and prestige to the firm, which eventually may enhance firm performance (Certo, Daily, & Dalton, 2001; D'Aveni, 1990).

I argue that whether the politician will actually provide the "potential" benefits to the firm, i.e. whether politicians sitting on the board of directors of a company actually will bring along those benefits, and even though they do, whether the value of those benefits will be below the costs they create are questionable. RDT focuses on the presence of such potential benefits and excludes consideration of incentives that might actually encourage or discourage the provision of those benefits to the firm (Hillman & Dalziel, 2003).

When a firm appoints a politician on its board of directors, both the firm and the politician are bound with a contract that is for a fixed length of time to exchange resources. Given that the continuity of the exchange is fixed for at least a specified amount of time, usually from a year to multiple years, the politician may not have the incentives to reciprocate. In the worst-case scenario, the politician will actually bring no private information to the firm, or any valuable resources to help out the firm in the regulatory arena. This does not mean that the politician does not fulfill his/her role to reserve a part of his time and expertise for the firm, like any other director, but there is no guarantee that the politician will bring in something that will actually improve the position of the firm through political means.

On the other hand, board directorship linkages create a type of exchange through which the ex-post dependencies between the firm and the politician increase. However, the ex-post dependency of the firm on the politician is likely to be more than the ex-post dependency of the politician on the firm. If the politician wants to terminate the exchange, he/she can always do so easily since the politician's primary duty is in politics, and such a termination would not be considered as a bad signal. However, if the firm wants to terminate the relationship, it is harder to justify and the firm may suffer negative consequences as a result, since the politician may retaliate through the political arena. This asymmetry in ex-post dependence of the firm on the politician may actually result in an increase in the power of the politician, and fewer benefits drawn from the linkage with the politician, and higher costs of the linkage for the firm. Moreover, ex-ante, it is difficult for a firm to calculate the costs that will incur as a result of appointing the politician to the firm's board of directors. First, it would be plausible to assume that politicians might have high discount rates (Kroszner & Stratmann, 2005). There is uncertainty on whether a politician will hold a political position through the next elections, and any investment for a politician "outside" of the "political arena" would come with high discount rates. Knowing that he/she is supposed to provide the firm with his/her expertise for a specified period of time, instead of investing this time in political causes, the politician may actually be inclined to ask for and extract rents from the firm that will exceed the value of benefits that he/she provides. In other words, to compensate for the "opportunity cost" of sparing his/her time to political causes, the politician will ask for more rents from the firm. And since as a result of asymmetric ex-post dependence the politician's power increases, the politician is more likely to extract those rents. Second, linkages through appointing the politician to the board of directors are considered as "co-optation" strategy, i.e. "a situation in which a person, or a set of persons, is appointed to a board of directors, advisory committee, policy making or influencing group, or some other organizational body that has at least the appearance of making or influencing decisions" (Pfeffer & Salancik, 1978). Given that the politician has the decision and influence rights over the firm, he/she might be inclined to use these rights to extract private benefits for himself. The politician may push the firm for investment decisions that may not be economically optimum but which will create rents for the politician in the political arena (Bertrand et al., 2007).

Shortly, benefits firms may get from politician board members may actually be less than what they have aimed for, as a result of decreased incentives for the politician to actually provide benefits to the firm; and moreover the costs may be more than what the firm predicts, as a result of higher ex-post dependency on the politician and the politician's increased power within the exchange. In this case, financial returns from such linkages will be negative.

Hence I propose that board directorship of a politician is going to be negatively associated with firm performance.

Hypothesis 1: Board directorship of politicians is negatively related to firms' financial performance.

3.4.2 Gift giving to politicians and firms' financial performance

Gift giving to politicians is observed in many countries, under various names and forms, including illegal forms. Gifts are seen as means to "buy" access to and favors from politicians (Mitchell, 1996). Gift giving by firms provides immediate and personal benefits to politicians. When a firm provides gifts to a politician, reciprocal action from the politician is likely to take place as long as the politician desires the continuation of such benefits. Gift giving does not ex-ante provide any specified or contracted period of exchange between the firm and the politician. It is characterized by 'unspecified reciprocity' (Kennett, 1980; Tonkiss & Passey, 1999). Therefore the politician will reciprocate the favor as long as he is eager to continue having exchanges with the firm. Through reciprocating the gift of a firm with a favor for the firm, the politician will make the most out of this supposedly one-off transaction and give incentives to the firm to continue its gift giving actions. If firm gifts are not reciprocated, the exchange relationship is going to be damaged. Resource flows between exchange partners are highly contingent on reciprocity (Blau, 1964; Emerson, 1976). These resource flows evolve slowly, and reciprocation is indispensible for them to continue and for the gradual expansion of exchanges with the other party (Blau, 1964). In other words, exchanges are contingent upon the reactions of others, such as reciprocity, and over time may turn into mutually rewarding relations (Cropanzano & Mitchell, 2005).

In the case of gift giving, the inherent uncertainty of the continuity of exchanges increases the incentives for the politician to provide the firm with benefits. The politician will provide something of “fair” or “more” value to the firm to increase the chances of future exchanges. Specifically when we consider that the politician would not have accepted a gift in the first place if he/she had no intentions to reciprocate, acceptance of the gift can be considered as a sign for willingness to reciprocate. These increased chances of reciprocity will increase the likelihood of the firm to obtain benefits from the linkage.

On the other hand, if we consider the cost side of the exchange for the firm: in case of no reciprocation on behalf of the politician, the firm can easily retaliate and not anymore give gifts to the politician and get away form the exchange relationship with minor costs in its budget avoiding any future and long term costs. Gift giving does not create ex-post dependencies between the firm and the politician. Moreover, there is no asymmetry of constraints among the exchange partners in terms of terminating the relationship. The firm may even switch to alternative politicians as exchange partners, i.e. to alternative providers of the resources the firm needs, assuming that there are other politicians to provide benefits to the firm. In contrast to convincing politicians to take a seat at the board of directors of a firm, finding and convincing politicians to accept gifts is easier[29]. Therefore, this sort of linkage with a politician will provide an opportunity for the firm to actually get into an exchange with the politician without creating any ex-post dependencies between the parties; and gradually “testing” the politician through a low initial level of cooperation, which has prospects to increase to a higher level if the initial phase is successfully passed without termination (Ghosh & Ray, 1996). This way, the costs arising from excessive rent extraction by the politician will be avoided and firms will be more likely to achieve positive returns from the exchange relationship.

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[29] The data I have supports this intuition. See Appendix C and D for the number of firms vs. number of politicians that enter exchanges through board directorship and gifts. Whereas number of firms that have politicians as their board members exceed the number of those politicians, the number of politicians who accept gifts far exceed the number of firms which give away gifts.

In sum, through gift linkages, the firm incentivizes the politician to provide benefits to the firm, i.e. to reciprocate, since uncertainty of future exchanges is maintained. In case of no reciprocation, on the other hand, the firm can draw out of the relationship with minor costs since gift linkages create no significant ex-post dependency.

Therefore, I hypothesize that gift giving to politicians will positively impact firm financial performance.

Hypothesis 2: Gift giving to politicians is positively related to firms' financial performance.

3.4.3 Provision of sponsorships to politicians

Political sponsorships are financial contributions from firms to politicians for electoral campaigns and political cause related support[30]. Firms invest in politicians through sponsorships so that the politician will "pay back" in the future through providing either direct benefits to the firm or more favorable conditions for the firm.

There is a wide literature with mixed results on the impact of political sponsorship on firms' financial performance. Even though some studies have found a positive relation between political sponsorships and firms' financial performance (Claessens, Feijen, & Laeven, 2008; Cooper, Gulen, & Ovtchinnikov, 2010; Ferguson & Voth, 2008), some other have shown a non-effect or negative impact of political sponsorships. For instance, Hersch, Netter and Pope (2008) find no significant impact of campaign contributions on financial returns for a firm, and argue that contributions by firms do not build political "capital", and

[30] The term as used in this paper implies no « patronage », but only financial support from firms to politicians, either for election campaigns or for issue related spending.

that capital markets consider campaign contributions as an "expense" rather than capital expenditure that should be awarded with financial returns. Other work also shows that political sponsorship might actually harm firms' financial performance and indicates "agency" problems within the firm (Aggarwal et al., 2012; Hadani & Schuler, 2013).

I argue that political sponsorship constitutes a specific case of political linkage between firms and politicians, which provides few chances of such "pay back" for firms.

First of all, political sponsorship by its nature establishes a linkage between the firm and the politician with very low frequency of exchanges. Most sponsorship is provided for the electoral campaigns of politicians, thus takes place once every 4 or 5 years, depending on the country's electoral legislation. Unlike many other types of exchanges between politicians and firms, it is quite short-lived, and less likely to establish an ongoing exchange. Given these de facto low chances of establishing an ongoing exchange, the politician will be less likely to see reciprocity as a mechanism that reduces the uncertainty regarding the continuity of exchanges. Moreover, private gains for the politician through political sponsorships are ambiguous. Even when contributions are provided directly to a politician, the "benefit" that goes to the politician is not that direct as in other types of linkages such as employment of the politician or gifts provided to politicians. Electoral success may be considered as a private gain, however, contributions by an individual firm is not likely to change the course of the electoral success of a politician, even though the total amount of contributions from all firms and other contributors such as individuals, associations and other organizations might actually increase the chances of electoral success[31]. This ambiguity as well as the relative unimportance of individual firms' contributions may decrease the likelihood that the

[31] Individuals and private firms provide sponsorships that far exceed in value those provided by publicly listed companies (Torres-Spelliscy & Fogel, 2012). Therefore one could argue that the amounts provided by publicly listed firms to politicians are not likely to change the dynamics of the electoral process.

politician provided with sponsorship will reciprocate the favor and provide the firm with benefits that will improve its financial performance. Interestingly, firms might be aware of the low chances of reciprocal action by the politician that will be brought about by political sponsorship. Ansolabehere, de Figueiredo and Snyder (2003) point out to the fact that very few firms contribute the maximum amount legally allowed for political sponsorship, which might be considered as a sign that firms themselves are skeptical of the financial returns from their sponsorship engagements.

On the other hand, political sponsorship creates asymmetric ex-post dependencies between the firm and the politician. It is very plausible and "normal" that the politician receives sponsorship from multiple firms; while for the firm the politicians to support would be more limited. When a firm supports two politicians running for office from the same constituency area, the firm risks a negative reaction or at least may find it hard in the near future to incentivize a politician whose rival it supported. Therefore once the firm sponsors a politician, this creates an ex-post dependency of the firm on the supported politician. Specifically since the supported politician has an increased political power thus increased power on the firm once elected, we could assume that the firm's ex-post dependency on that politician is likely to be higher than the politician's ex-post dependency on the firm, causing an asymmetry.

In sum, the specificity of sponsorship as a linkage that provides very low frequency of exchanges; and ambiguity of the direct benefits provided to the politician decrease the incentives for the politician to provide benefits to the firm. On the other hand, the ex-post dependency of the firm on the politician, as a result of such a political "investment", increases the cost of the politician to the firm within the exchange. Therefore I argue that political sponsorship by firms to current politicians will have a negative impact on firms' financial performance.

Hypothesis 3: Sponsorship provision to politicians is negatively related to firms' financial performance.

Up to this point, I have investigated how firms establish political linkages in order to manage their dependence on the political environment, but also how these linkages might also expose them to excessive political rent extraction. I have argued that the uncertainty of continuity of the exchanges the linkage inherits and the ex-post dependence created by the linkage determine both the incentives for a politician to reciprocate, thus the value of benefits drawn from the linkage; and the costs of the linkage, thus the rents extracted by the politician. Differentiating between three different linkages based on these two characteristics mentioned above, I hypothesize on a positive association between gift linkages to politicians and firms' financial performance, and a negative association between board and sponsorship linkages and firms' financial performance.

In the following section, I will test the hypothesized relations using a unique dataset of firms' political linkages.

3.5 DATA AND METHOD

The empirical setting of this paper is the United Kingdom, a developed and quite transparent economy. The legislative environment of the UK provides a rich and convenient setting for investigating the impact of firms' political linkages on financial performance, for various reasons:

First, in the UK, Members of the House of Commons are subject to strict disclosure requirements regarding their linkages with firms, which makes it possible to collect data beyond what companies disclose. Disclosure of exchanges between firms and politicians is quite established, putting the UK among the few top countries in terms of disclosure of the interests of the politicians (Djankov et al., 2009). Any benefits received by the Members of the Parliament, both in terms of value and sources are disclosed extensively (Djankov et al., 2009). This allows for identifying many types of linkages between firms and politicians that would otherwise be not possible.

Second, the political system in the UK allows for politicians to move into private domains and vice versa, without any regulatory prohibition.[32] Current politicians are allowed to sit on the boards of companies and to be employed by companies, as long as this relationship with a company, as well as the financial benefits drawn from the post are disclosed.

Third, the UK provides an appropriate context to evaluate the value of direct linkages between firms and politicians at the firm level, since alternative political strategies such as lobbying are less relevant than in many countries, such as the US. The UK lobbying industry is much smaller than its US counterpart (Vidal et al., 2011). Therefore, direct linkages between firms and politicians gain more importance in managing the political environment.

[32] There is only an advisory body for advising on the mobility of politicians to private sector, which is ACOBA, however ACOBA is not a statuary body and just an advisory one.

The paper exploits a very rich hand-collected dataset, which covers various types of linkages between the Members of the British Parliament (MP) and all the publicly listed[33] companies from 2002 to 2011. The parliament registers are scanned for extracting company names that have any sort of relation with the Members of the Parliament (MPs), through various types of linkages which also include employment of the politicians on the board of directors; gift giving to politicians; and sponsorship provision to politicians. For details of the matching process, please refer to Appendix B. Once the matching was finalized and coding of all political linkage information was done, the data was converted into a firm-year format: every unique linkage between a firm and a politician during a certain year was counted as 1 for the firm, and then aggregated for every firm-year, under different types (board directorship, gifts and sponsorships, among others). For companies that had no match in the registers, the number of those linkages was coded as zero.

Whereas data on political linkages are extracted from the public registers of the British Parliament, financial information is obtained from the Orbis (BvD) database.

The yearly per-industry distribution of the firms in the final sample is provided in Table 3-2.

Insert Table 3-2 about here

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[33] For a firm to be included in the dataset, it is sufficient that it has been publicly listed at least during one year during the time window.

Most companies in the final sample are large firms but this is not surprising given that large firms are more likely to engage in political activity compared to small ones (Schuler, 1996).

3.5.1 Measures

Corporate financial performance (DV)

Corporate financial information comes from the Orbis (Bureau van Dijk) database, which covers extensive information on around 80 million companies in the world, using numerous sources of information such as Datamonitor, Lexis-Nexis, and Thomson Reuters among others. However it should be noted that Orbis has its limitations as well. While information provided on large companies is extensive, unfortunately Orbis does not provide financial information on the full list of companies in the UK. It covers financial information quite extensively for approximately the first 2000 publicly listed firms, whereas for the rest of publicly listed firms (more than one third of the whole population), it covers much less information. On the other hand, it still provides one of the best available coverage of financial data for the European countries, including the UK.

The measure of financial performance (dependent variable) in this study is Return on Assets (ROA). Many studies on the financial impact of corporate political strategies, including political linkages, use this accounting based measure of firm performance[34]. ROA might also be considered as a valid performance measure for the purposes of this study, since financial information gathered is for companies in a single country, and therefore the analysis would not suffer from any bias in terms of differences in accounting principles.

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[34] See Lux and colleagues (2011) for a review of measures.

Corporate political linkages (IVs)

The definitions of the different types of political linkages, i.e. board directorship of politicians, gift giving to politicians, and sponsorship provision to politicians are provided below[35]: For each type, following Cooper, Gulen and Ovtchinnikov (2010), I use a total count of that type of linkage the firm has with MPs during a given year.

Directorships: Remunerated directorships of the MPs in public and private companies including directorships which are individually unremunerated, but where remuneration is paid through another company in the same group.

Gifts: Any gift to the MP or the MP's spouse or partner, or any material benefit, of a value greater than one per cent of the current parliamentary salary from any company, organization or person within the UK which in any way relates to membership of the House or to a Member's political activity.

***Sponsorships**:* (a) Any donation received by an MP’s constituency party or association, or relevant grouping of associations which is linked either to candidacy at an election or to membership of the House; and (b) any other form of financial or material support as a Member of Parliament, amounting to more than £1,500 from a single source, whether as a single donation or as multiple donations of more than £500 during the course of a calendar year.

One advantage of using political linkage data based on the parliament registers is that the data possibly give more fine-grained information on firms’ political linkages, compared to what firms might disclose- firms would tend to report sponsorships for all

[35] Code of Conduct for the Register of Interests of the MPs, British Parliament, May 2010, http://www.publications.parliament.uk/pa/cm200809/cmcode/735/735.pdf

politicians supported as an aggregate expense, for instance; or would report no special expense item for a gift to a politician.

Controls

I first include in the models some firm level controls. Since bigger firms might be more likely to engage in political action, and thus build linkages with politicians, I use *size* as a control. *Size* is measured by operating revenue. Risk of the firm (*leverage)* is included as another control variable, which will affect both the propensity of the firm to build political linkages, and also the financial returns of the firm. *Leverage* is measured by total debt divided by total assets. *Firm slack* is also included as a control variable since there are "internal" limits, such as availability of slack resources, to whether a firm will attempt to and succeed in managing its dependencies. Strategies aiming at managing dependencies on the political environment require substantial resources and firms have limited resources to allocate to this purpose (Bonardi, 2008; Shaffer & Hillman, 2000). *Firm slack* is measured by cash flow divided by operating revenue.

Regarding firms' political linkages, I include various controls: I first include dummies for having linkages to the governing party (party in power): I create two *dummies* for having linkages with the governing party, distinguishing between the Conservative Party and Labor Party, which have been the two parties in power in the UK during the period of the study. Whereas politicians who belong to the party in power may be more able to provide the firm with benefits, the demand for these politicians will be more as well, i.e. the number of firms aiming to establish linkages with these politicians will be more, giving those politicians a power advantage vis-à-vis the firm. Therefore politicians belonging to the governing party may also extract more rents from the firm as a result of decreased dependency on the firm. Moreover, for instance when a political party has the majority, thus in power, the risks of future electoral defeat will be smaller, and this will reduce the value that politicians will put on political sponsorship provided by the firm (Ansolabehere et al., 2003), reducing the dependence of the politician on the firm within the exchange. On the contrary scenario, though, the value of such campaign contributions increase since the value of incremental votes for politicians increases (Bonardi et al., 2005; Holburn & Vanden Bergh, 2013).

I also control for all other types of political linkages between firms and politicians, such as *remunerated employment linkages, overseas visits funding*, and "*miscellaneous" linkages*[36]. Even though for theoretical reasons this paper is only interested in the impact of linkages that actually constitute a direct "strategic linkage" which allow for exchanges between firms and politicians, and their impact on financial performance; I still include other types of linkages in the models as controls, since not including them in the estimations may result in omitted variable bias.

I furthermore control for the relationship characteristics by taking into account the number of firm's linkages that are *repetitive*, and the number of linkages that are part of a *portfolio* of linkages with the same MPs: Repetition of the same type of linkage with the same MP and having multiple types of linkages with the same MP (thus again a sort of repetition of exchanges) may act as constraints to rent extraction by the politician. Non repetitive exchanges, on the other hand, deprive the firm from informational and relational benefits that might be brought along through repetitive exchanges with politicians, such as reduced information asymmetry (Coen et al., 2010); trust (Flynn, 2003; Gulati, 1995); and learning (Bonardi et al., 2011; Mayer & Argyres, 2004; Zollo et al., 2002), which may all impact the benefits the firm may draw from its linkage with the politician. I also control for the number

[36] For reasons explained in the introduction chapter, these linkages are not of interest to us for the purposed of this dissertation. However, they should still be controlled for to avoid any omitted variable bias.

of linkages with politicians where the politician is also a *shareholder* of the company. For instance the politician might actually be a large shareholder of the firm he/she sits on the board of directors. Then the incentives for the politician to extract rents from the firm may actually be lower, since the firm's and the politician's interests are aligned. Such interest alignment therefore would have implications on the rent extraction by the politician, and consequently on financial performance of the firm.

Moreover, I include a control for the *tenure of the politician*, since it will matter to whom the firm is linked when assessing the financial performance consequences of political linkages. Politicians with more tenure will be more powerful and be more in demand, which may increase the likelihood of the politician's rent extraction from the firm.

Finally, one assumption in the argumentation of this paper is that, all else being equal, firms can seek for the resources they need from alternative sources, such as alternative politicians. It might be the case that the resource the firm needs might not be so immediately available from alternative politicians and this may create a pseudo lock-in situation for the firm, even though the type of the linkage it builds with the politician is not the source of this lock-in. On the other hand, an opposite scenario might hold as well: some politicians might be more dependent on some firms, as a result of whether the MP has other "alternatives" than the firm he/she has a linkage with. To control for this, I include a variable to control for *dependence asymmetries* between the parties, and use the ratio of the number of firms' all linkages to the number of the connected MPs' all linkages as a proxy for this comparison[37].

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[37] Interestingly, this ratio turns out to be never higher than 1, which means that in all cases in the data, the politician has more number of firms that he/she is linked with compared to how many politicians the focal firm is linked with. Therefore we could assume that the more the ratio approaches to 1, the less asymmetrical the dependence of the firm on the politician is.

These controls allow us to isolate the effect of the proposed relations in the hypotheses, by controlling for certain firm, politician, and relation level factors that may actually impact the relation between different types of political linkages and firms' financial performance.

The final model to estimate is therefore as follows:

$$Firm\ performance_{t+1} = \beta + \beta_1.directorships_{it} + \beta_2.gifts_{it} + \beta_3.sponsorships_{it} + controls_{it} + \eta_i + \varepsilon_{it}$$

where i represents individual firms, t represents time, and η_i represents the time-invariant unobserved characteristics of the firm that may account for the variation in firm performance; and $\varepsilon_{it}$is the error term.

3.5.2 Analysis & Results

I use a panel data estimation technique that allows for controlling for time-invariant firm characteristics that may account for higher or lower financial returns, i.e. fixed effects estimation (at the firm level). Managerial quality is one such characteristic that may account for higher/lower financial returns. I also use year dummies to control for any time period effects. All predictor variables are lagged by one year. Estimations are done with robust standard errors, with sector clustering.

Descriptive statistics and correlations among the variables are provided in Table 3-3 and Table 3-4.

Insert Table 3-3 & Table 3-4

about here

Number of directorship linkages a firm has during a given year range from 0 to 4. Number of gifts given by a firm to politicians, on the other hand, ranges from 0 to 15. Number of sponsorships provided by a firm to politicians during a given year ranges from 0 to 9.

3.5.3 Hypotheses support

I first estimate the model with the control variables (Model 1). Leverage and firm slack are positively and significantly related with financial returns of the firm (+8.933, $p<0.001$ and +0.045, $p<0.05$ respectively). The ratio of firms' dependence to politician's dependence (dependence asymmetry) is also significantly and positively related to financial returns (+3.452, $p<0.05$), meaning that decreasing asymmetry of dependence improves the returns from linkages. Linkages with politicians that are also shareholders are negatively and significantly related to financial returns (-1.813, $p<0.10$).

In Model 2, I start to test the hypotheses. Hypothesis 1 predicts that directorship linkages are negatively related to firms' financial returns. I find a negative and significant coefficient (-1.562, $p<0.01$) for directorship linkages. This supports Hypothesis 1, i.e. directorship linkages are negatively related to firms' financial returns. Model 3 tests Hypothesis 2 and the coefficient of gift linkages, which is positive and significant (+1.051, $p<0.05$) provides support for it, i.e. gift giving to politicians is related to positive financial returns for the firm. Model 4 tests the Hypothesis 3, which predicts that sponsorship linkages are negatively related to firms' financial performance. The negative and significant coefficient for sponsorship linkages (-2.187, $p<0.001$) supports this prediction. In Model 5 the impact of all three types of linkages, board directorship, gifts, and sponsorships are estimated together. The result of the regression confirms that directorships have a significant and negative coefficient (-1.281, $p<0.01$,); whereas linkages through gifts have a significant and positive (0.760, $p<0.05$,) coefficient; and sponsorship linkages have a significant and negative (-2.134, $p<0.001$) coefficient. Thus all of the hypothesized relations find support through the empirical analysis. Please see Table 3-5 for the reported results.

Insert Table 3-5 about here

3.5.4 Robustness checks

The model used for the empirical analysis accounts for any time-invariant firm characteristics that may impact financial performance of the firm. The use of lagged predictors on the other hand, lessen the concerns about causality of the relationship, even though does not entirely eliminate them. I hereby run some additional tests as robustness checks.

First, I include in the model a control for regulated industries. Industry controls may be considered as important in analyzing the linkages between firms and politicians. Firms in different industries have different degrees of dependency on the politicians. Firms in regulated industries for instance, are more dependent on politicians and tend to engage more in political activities (Boies, 1989; Masters & Baysinger, 1985; Masters & Keim, 1985; Schuler et al., 2002). Hence I include in the model a dummy for regulated industries (=1 if the firm's industry is a regulated one and =0 if not). Following Grier, Munger and Roberts (1994), I consider the following industries as regulated industries: banking; utilities (gas, water, electricity); telecommunications; transport; insurance. Since fixed effects estimation does not allow for industry controls, I use random effects estimation. Results of the regression (not reported here) remain consistent. Coefficient signs for both gifts and sponsorships linkages remain the same: the coefficient is positive (+0.761) and significant at the $p<0.10$ level for gifts (i.e. at a slightly lower significance level than the initial model) and negative (-2.084) and significant at the $p<0.001$ level for sponsorships. Coefficient sign for board directorship on the other hand, stays the same, i.e. negative, however is slightly insignificant (-0.820, $p<0.113$). I still keep the initial model with fixed effects estimation since the Hausman test suggests the use of fixed effects instead of random effects estimation.

Second, it could be argued that poorly performing firms are more likely to seek political linkages. In other words, board membership of politicians, as well as gifts or sponsorships provided to politicians may actually arise from poor past performance. Even though I use lagged values of the independent variables in my fixed effects estimation, I still conduct some additional estimations to check for reverse causality: I use Granger's (1969) causality tests, and I predict whether past performance of a firm predicts its board, gift or sponsorship linkages to politicians. I estimate a negative binomial model with past performance (one year lagged ROA) as a predictor of firm's total number of board, gift and sponsorship linkages to politicians. Past performance does not have a significant coefficient (results not reported). Therefore for this dataset, reverse causality does not seem to be a primary concern. I am aware that neither this method nor any other statistical test can definitively address causality concerns, however sheds light on the causality, which in this case seems to be not a major concern.

3.6 DISCUSSION

Resource dependence theory has been used as a useful perspective on research on inter-organizational relations, as well as firms' political strategies. However, RDT has been mostly used to investigate the rationale for dependency management tactics such as building linkages with external entities that firms are dependent on, rather than to investigate the risks of partners' misappropriation of firm resources (Katila et al., 2008). In other words, RDT has been silent on the likelihood of the politicians to extract rents from the firm, when firms build political linkages. This paper takes one step back and questions the aftermath of such dependency management tactics, through looking at potential costs of political linkages once they are built, and mechanisms that may mitigate or exacerbate those costs.

The main argument is that the potential reach of firm influence, and whether the firm is going to be able to manage its dependencies through its political linkages is going to be influenced by whether the linkage encourages the reciprocity of the politician while limiting ex-post dependency of the firm on the politician. This paper focuses on three different types of political linkages firms build, and differentiates between those linkages in terms of those characteristics, i.e. whether a linkage creates incentives for the politician to reciprocate, while limiting ex-post dependencies between a firm and a politician. In other words, the paper looks into different types of linkages in terms of the benefits the politician may bring along, and whether those linkages allow the firm to terminate the relationship or switch partners with minimum costs in case of non-reciprocity by the politician. Different types of political linkages will pose a firm to different levels of political rent extraction; hence will impact the firm's financial performance differently. Linkages that create a lock-in situation and decrease incentives for the politician's reciprocity since they reduce the uncertainty about continuity of future exchanges, will decrease the benefits to be drawn from the exchange and increase the rent extraction by the politician from the firm, and thus will impact financial performance negatively. Linkages that create incentives for the politician to reciprocate since they preserve the uncertainty regarding future exchanges, and that limit the ex-post dependency of the firm on the politician, on the other hand, will increase the likelihood for the firm of obtaining benefits and decrease the rent extraction of the politician from the firm, and hence will impact firm performance positively.

The findings of the empirical analysis support these predictions and are quite intriguing since they imply that the potential value of political linkages at the firm level is to be revisited. Firms' political linkages have already been associated with macro-level negative consequences for the economy, such as entry barriers for new firms, limited competition in the market and poor long-term performance of the economy (Caprio, Faccio, & McConnell, 2008; Morck, Wolfenzon, & Bernard, 2005). Especially when political linkages work "hand in hand" with corruption, this ''produces bottle necks, heightens uncertainty, and raises costs'' for cross-border business transactions (Habib & Zurawicki, 2002). For example in countries where the threat of corruption is higher, firms hold a lower fraction of their assets in liquid form, i.e. firms tend to protect themselves from political rent extraction through structuring their asset holdings. To the extent that this deployment of assets is less efficient than would occur in the absence of the threat of such rent extraction, economic growth may be reduced through this corporate sheltering of assets (Caprio et al., 2008). The results of this study show that at the firm level, too, there might be negative consequences of having political linkages. The results confirm the intuition that political linkages constitute a specific case where there is a high risk for the firm to be exposed to rent extraction by the politician. There is indeed a need to consider the potential risks arising from dependency management tactics such as building linkages with politicians, and understand better how the characteristics of different types of linkages may mitigate or worsen those risks.

The paper complements very recent studies that have questioned the value drawn from firms' political actions (Aggarwal et al., 2012; Coates, 2010; Hadani & Schuler, 2013; Igan et al., 2011). Most recent studies relate the negative impact of political linkages on financial performance to agency theory, and suggest that managers divert firm resources to satisfy their personal political taste (Aggarwal et al., 2012; Hadani & Schuler, 2013; Igan et al., 2011). The empirical context of this study allows us to lessen concerns about possible alternative interpretation of the results from agency problems perspective. As stated before, the UK Companies Act is quite specific since it requires the managers of publicly listed companies to get consent of shareholders before providing financial contributions to politicians. Because of this legislation in the UK to obtain shareholder consent, at least political spending in the form of sponsorships and gifts constitute a case where concerns for agency problems are weakened, since executives are not allowed to spend firm money on politicians without getting approval of the shareholders. However, it should not be disregarded that the markets still may perceive political linkages such as board directorships or sponsorships as agency problem signals. In other words, such linkages may still be perceived as a signal of agency problems within the firm, and therefore the costs they bring along may far exceed the literal value of the payments made to the politicians. When firms' financial resources are compared with the amounts they contribute to politicians, it would be plausible to assume that such linkages' literal costs (such as the sponsorship amount or the board member politician's salary) should normally show no significant impact on the firms' financials[38]. However, if the market perceives these linkages as signals of agency problem within the firm, then the loss the firms face will exceed the literal value of the cost of those linkages to the firm. Yermack's (2006) analysis for the impact of CEOs' personal use of corporate aircraft on firms' performance provides a good example for this case. When such

[38] This assumption would be less likely to hold for small firms. However both prior work and the data used in this paper show that firms that provide sponsorships to politicians are very large firms with extensive financial resources.

expenditures of CEOs are disclosed, firms might face lower average returns from the market that cannot be explained only based on the costs arising from such CEO "luxuries". Moreover, opportunity costs related to political linkages may be important. Such political investments through linkages actually have opportunity costs for the firm because of reduced alternative investments in technology, research and development as well as human resources (Bhuyan, 2000). These alternative investments may actually provide the firm with less imitable firm-specific advantages, as opposed to political linkages, which might be replicable by other firms (Dahan, 2005).

3.6.1 Avenues for future research and managerial implications

One avenue for future research would be to compare the impact of board directorship of politicians, gift giving to politicians, and sponsorship provision to politicians, which are direct linkages to politicians, to the impact of having alternative sources of political resources, such as political consultancies. Such a comparison would yield important implications for both theory and practice.

It would also be interesting to look at the impact of different types of political linkages on more direct outcomes for the firm, other than financial performance. Firms establish linkages with politicians to ensure more "favorable" conditions for the firm. Future work could look into whether firms actually obtain from the linked politicians benefits that may be transferred to financial ones, such as privileged access to financing, contracts from the government or subsidies. In a similar vein, one could look into the actual rents extracted from the firm by the politician, even though such rent extraction would be much harder to spot and measure.

3.6.2 Managerial Implications

Political linkages have been shown to have important consequences for firm strategy and performance (Baron, 2001b; Johnson & Mitton, 2003). Linkages may help reduce the uncertainty regarding the regulatory environment, but they also pose the firm to other sorts of risks and costs, such as excessive rent extraction by politicians. To manage the costs arising from politicians' rent extraction while trying to manage dependencies on politicians, firms need to be careful about which types of linkages they build with politicians; and by choosing ex-ante what type of linkage to build with politicians, avoid the risk of excessive political rent extraction, thus negative financial returns from their linkages.

Table 3-2: Per year and per industry distribution of firms in the sample

Major sector	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
Banks	5	5	5	7	11	15	10	11	12	81
Chemicals, rubber, plastics, non-metallic products	33	35	38	50	54	54	52	53	51	420
Construction	25	27	28	30	33	36	28	24	30	261
Education, Health	5	5	12	13	10	16	20	15	10	106
Food, beverages, tobacco	19	23	26	29	31	33	31	28	29	249
Gas, Water, Electricity	11	12	14	16	18	21	19	21	17	149
Hotels & restaurants	18	20	23	25	25	26	25	20	20	202
Insurance companies	1	2	2	1	3	4	2	2	0	17
Machinery, equipment, furniture, recycling	82	90	107	112	123	129	119	106	106	974
Metals & metal products	25	27	28	28	31	42	34	34	45	294
Other services	154	198	253	310	347	356	316	315	313	2,562
Post & telecommunications	1	1	1	1	1	1	1	1	1	9
Primary sector	29	32	37	43	43	44	47	42	44	361
Publishing, printing	33	40	50	52	59	64	58	57	53	466
Textiles, wearing apparel, leather	13	14	21	21	18	18	15	17	16	153
Transport	19	20	22	22	25	26	25	24	22	205
Wholesale & retail trade	57	69	76	74	79	87	79	74	75	670
Wood, cork, paper	7	7	9	10	11	9	10	10	10	83
Total	**537**	**627**	**752**	**844**	**922**	**981**	**891**	**854**	**854**	**7,262**

Table 3-3: Descriptive statistics

	Variables	n	Mean	S.D.	Min	Max
1	ROAusing Net Income	7262	4.153	12.312	-94.18	89.94
2	directorships	7262	0.016	0.160	0	4
3	gifts	7262	0.022	0.352	0	15
4	sponsorships	7262	0.003	0.116	0	9
5	dummy linkage to CON when in power	7262	0.002	0.049	0	1
6	dummy linkage to LAB when in power	7262	0.015	0.122	0	1
7	remunerated employment linkages	7262	0.021	0.306	0	10
8	overseas visits funding linkages	7262	0.039	0.592	0	18
9	miscellaneous linkages	7262	0.001	0.053	0	3
10	shareholder politician linkages	7262	0.031	0.260	0	5
11	portfolio political linkages	7262	0.036	0.428	0	13
12	repetitive political linkages	7262	0.076	0.608	0	17
13	average tenure of politicians	7262	0.690	3.446	0	40
14	dependence asymmetry	7262	0.021	0.120	0	1
15	size	7262	1.40E+06	9.30E+06	76	3.10E+08
16	leverage	7262	0.545	0.267	0	5.87
17	firm slack	7262	14.565	13.918	0	98.96

Table 3-4: Correlations table for sampled firms

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1	1.00																
2	0.01	1.00															
3	0.01	0.03*	1.00														
4	-0.01	0.00	0.02	1.00													
5	0.01	0.06*	0.11*	0.26*	1.00												
6	0.01	0.17*	0.38*	0.10*	0.08*	1.00											
7	-0.01	0.04	0.19*	0.04*	0.19*	0.35*	1.00										
8	0.01	0.00	0.32*	0.01	0.05*	0.50*	0.04*	1.00									
9	0.00	0.01	0.03*	0.00	0.10*	0.20*	0.05*	0.00	1.00								
10	0.05*	0.05*	0.03*	0.01	0.07*	0.21*	0.02	0.24*	0.07*	1.00							
11	-0.01	0.27*	0.54*	0.06*	0.20*	0.44*	0.54*	0.50*	0.07*	0.14	1.00						
12	0.02*	0.24*	0.52*	0.03*	0.13*	0.52*	0.35*	0.66*	0.08*	0.47*	0.68*	1.00					
13	0.04*	0.53*	0.26*	0.04*	0.07*	0.50*	0.32*	0.21*	0.10*	0.38*	0.36*	0.48*	1.00				
14	0.04*	0.38*	0.26*	0.21*	0.16*	0.54*	0.22*	0.22*	0.09*	0.14*	0.22*	0.34*	0.70*	1.00			
15	0.03*	0.01	0.10*	0.01	0.10*	0.35*	0.07*	0.50*	0.07*	0.47*	0.17*	0.48*	0.25*	0.14*	1.00		
16	0.03*	0.03*	0.06*	0.00	0.00	0.07*	0.05*	0.03*	0.01	0.06*	0.06*	0.07*	0.11*	0.09*	0.05*	1.00	
17	0.07*	-0.02	0.00	0.05*	0.03*	0.00	0.00	0.01	-0.01	0.01	0.00	0.01	0.01	0.02	-0.02	-0.21	1.00

Significance level * $p<0.05$

1: ROA using Net Income, 2:directorships, 3: gifts, 4: sponsorships, 5: dummy linkage to CON when in power, 6: dummy linkage to LAB when in power, 7: remunerated employment linkages, 8: overseas visits funding linkages, 9: miscellaneous linkages, 10:shareholder politician linkages, 11: portfolio political linkages, 12: repetitive political linkages, 13: average tenure of politicians, 14: dependence asymmetry, 15: size, 16: leverage, 17:firm slack

Table 3-5: Impact of political linkages on firm's financial performance

DV: ROA (using Net Income)	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)
l.directorships		-1.562**			-1.281**
		(0.421)			(0.439)
l.gifts			1.051*		0.760*
			(0.374)		(0.345)
l.sponsorships				-2.187***	-2.134***
				(0.403)	(0.430)
l.dummy linkage to CON when in power	-0.315 (3.034)	-0.242 (3.165)	-0.451 (2.997)	0.765 (2.688)	0.701 (2.845)
l.dummy linkage to LAB when in power	0.492 (3.201)	0.729 (3.143)	0.325 (3.081)	0.550 (3.280)	0.623 (3.162)
l.remunerated employment	-0.582	-0.862	-0.430	-0.688	-0.804
	(0.721)	(0.828)	(0.775)	(0.675)	(0.821)
l.overseas visits funding	-0.082	-0.198	0.054	-0.138	-0.134
	(0.335)	(0.395)	(0.326)	(0.342)	(0.394)
l.miscallenous	-0.704	-0.855	-0.547	-1.008	-1.012
	(1.532)	(1.506)	(1.524)	(1.671)	(1.651)
l.shareholder politician linkages	-1.813+ (0.999)	-1.821* (0.846)	-1.524 (1.012)	-1.851+ (0.997)	-1.648+ (0.885)
l.portfolio political linkages	-0.279 (0.204)	-0.093 (0.243)	-0.625* (0.219)	-0.180 (0.172)	-0.281 (0.240)
l.repetitive political linkages	0.106 (0.209)	0.161 (0.238)	-0.033 (0.188)	0.097 (0.204)	0.042 (0.221)
l.average tenure of politicians	-0.099 (0.077)	-0.075 (0.069)	-0.095 (0.079)	-0.118 (0.078)	-0.095 (0.071)
l.dependence asymmetry	3.452*	3.284*	3.041+	4.382**	3.925*
	(1.561)	(1.541)	(1.443)	(1.497)	(1.358)
size	0.000	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
leverage	8.933***	8.938***	8.935***	8.956***	8.961***
	(0.768)	(0.761)	(0.769)	(0.761)	(0.756)
firm slack	0.045*	0.044*	0.045*	0.046*	0.046*
	(0.017)	(0.017)	(0.017)	(0.017)	(0.017)
year dummies	Y	Y	Y	Y	Y
fixed effects	Y	Y		Y	Y
Observations	7,262	7,262	7,262	7,262	7,262
R-squared	0.048	0.048	0.048	0.048	0.049
Number of firms	1,316	1,316	1,316	1,316	1,316
F stats	.	.	.	.	.
p value	.	.	.	.	.

Robust standard errors in parentheses
*** p<0.001, ** p<0.01, * p<0.05, + p<0.10

Annex 3-1: Variable descriptions for Table 3-5

directorships: Count of all directorship linkages that a firm has during a given year.

gifts: Count of all gift linkages that a firm has during a given year.

sponsorships: Count of all sponsorship linkages that a firm has during a given year.

dummy for linkage to CONS when in power: Dummy for connection to Conservative Party when in power *(*=1 when the firm has at least one linkage within a given year to the Conservative party, when the party is in power; =0 otherwise)

dummy for linkage to LAB when in power: Dummy for connection to Labor Party when in power *(*=1 when the firm has at least one linkage within a given year to the Labor party, when the party is in power, =0 otherwise);

remunerated employment: Count of all remunerated employment linkages that a firm has during a given year.

overseas visits funding: Count of all overseas visits funding linkages that a firm has during a given year.

miscellaneous: Count of all miscellaneous linkages that a firm has during a given year.

shareholder politician linkages*:* Count of all linkages with politicians that the politician is also a shareholder of the firm, during a given year.

portfolio political linkages*:* Count of all linkages with politicians that the firm has multiple types of linkages with the same politician, during a given year.

repetitive political linkages*:* Count of all linkages with politicians that endures from the year before with the same politician, during a given year.

average tenure of politicians*:* Average tenure (in years) of all politicians that a firm is linked with, during a given year.

dependence asymmetry: Ratio of the count of firm's linkages to politicians during a given year to the count of the connected MPs' all linkages during a given year

size: Turnover of the firm.

leverage: Total Debt/Total Assets of the firm.

firm slack: Cash flow/Operating Revenue of the firm.

4 CHAPTER 4: COMMUNITY ENGAGEMENT AS A COMPLEMENT TO FIRMS' POLITICAL LINKAGES

4.1 ABSTRACT

This paper investigates the impact of joint use of corporate political linkages and corporate community engagement on firms' financial performance. It looks into how community engagement makes the firm more attractive as an exchange partner for the politician, since firms with community support can increase the value package offered by the firm within the exchange; and how community engagement also decreases for the firm the relative value of the relationship with the politician, and thus the power of the politician within the exchange. Both mechanisms help the firm to obtain more favorable outcomes from the exchange relationship with the politician, since they change the power-dependence conditions in the exchange. The proposed relations are tested using a unique longitudinal dataset covering the period from 2002 to 2011, for UK companies. The results show that community engagement acts as a complement to firms' political linkages, and improve the financial returns for firms from their political linkages.

Keywords: corporate political linkages, corporate community engagement, complementarity between non-market strategies

4.2 INTRODUCTION

This paper investigates the joint impact of corporate political linkages and corporate community engagement on firms' financial performance. Establishing linkages with politicians and engaging in the community constitute two different actions by the firm, targeting two different dimensions of the firm's non-market environment. The term "non-market" as used in this paper, and as widely accepted, follows Baron's (1995: p.48) definition: "(the) set of forces [that] are manifested outside of markets but often work in conjunction with them [and] consists of the social, political, and legal arrangements that structure interactions among companies and their public".

The relationship between the firm and its non-market environment has received considerable attention, primarily in economics, political science and more recently in management literature. Firms do not operate in a vacuum; among many other things, they are constrained by regulatory and political environments, as well as social forces. Therefore firms may adopt so called non-market strategies, to influence the institutional players that determine public policy –such as legislatures, regulatory agencies and courts (Holburn & Vanden Bergh, 2002); as well as the society, to change the political, legal and social forces that surround them and to create a more "favorable" environment for the firm (Pfeffer & Salancik, 1978).

Prior literature focuses primarily on a single dimension of the non-market environment, such as the political dimension of the non-market environment or the social dimension; and antecedents and consequences of firm strategies targeting actors in the political or social environment. For instance, political initiatives by firms have been investigated as early as the 40s through the lens of old institutional theory (Selznick, 1949).

More recent work focuses on performance effects of firms' political activities (Bonardi, Holburn, & Vanden Bergh, 2006; Hillman et al., 1999), as well as the attractiveness of political markets (Bonardi et al., 2005; Shaffer & Hillman, 2000). On the other hand, there is a broad literature on the impact of firm strategies towards the social dimension of the non-market environment, usually labeled under the corporate social responsibility (CSR) literature (see Margolis and Walsh (2003) for a comprehensive review).

Many studies on firms' non-market strategies rely on rather a dyadic assumption about the nature of the non-market strategy process. For instance, regarding the public policy process, there is an implicit assumption that public policy is determined primarily by the legislature in isolation from other policy institutions, and interest groups (Holburn & Vanden Bergh, 2002). As a result of this assumption, when analyzing the "effectiveness" of non-market actions by firms, scholars mainly investigate firm strategies towards a single component of the non-market environment, such as strategies towards politicians. Even though there is some theoretical work suggesting that firms should target different non-market actors simultaneously, and diversify their non-market strategies (Baron, 2001a, 2003, 2011; Lord, 2000), empirical investigation of the joint use of non-market strategies targeting different dimensions, and the impact of such simultaneous use of non-market actions on financial performance of the firm has not been conducted.[39] However, investigation of the interactions between firm strategies targeting different dimensions of the firm's non-market environment could prove to be a fruitful avenue for research:

Firms may deploy non-market strategies in a portfolio-like approach, i.e. firms may simultaneously adopt strategies targeting actors within different components (social, legal,

[39] One exception is Richter (2011), who in his working paper looks at the substitution complementarity relationship between CSR and political activities within the US context, and how these two activities impact firms' market performance.

political) of the non-market environment. The types and targets of non-market activities in the firm's portfolio may change; this portfolio of activities may expand or contract (i.e. firms may include new initiatives, or exit from some), while the degree of engagement in those activities may stay constant or change too. The issue for the firm is to pick up the right portfolio of strategies so that one can complement the other, and this way the firm secures improved chances to successfully manage its non-market environment. In this regard, I argue that the use of corporate political linkages and corporate community engagement together may wield interesting results for the firm. The public battle between Novartis and the Indian Government is a good example of the portfolio-like approach firms might have towards their non-market environments: Novartis was denied a patent on its Glivec, a popular cancer drug. While lobbying intensely to push the government to be granted a patent, Novartis at the same time has been challenging the government through litigation, has also mobilized public support for the product through media channels and more importantly, through its "corporate citizenship" programs, giving away the drug to needy patients at dramatically reduced prices (Bach, 2010). In other words, in order to secure its market position, Novartis deployed strategies to address all dimensions of its non-market environment at the same time: the political, regulatory and social environment. [40]

While in the example of Novartis, the firm uses its "corporate citizenship" programs, to mobilize public support, and benefits from it as a "weapon" in its battle against the government; community engagement might also be used in a complementary fashion to firms' political activities. Community and political engagement jointly may be used to increase rivals' costs; to draw some newcomers out of the industry; and to raise entry barriers. Through a comprehensive analysis of legislation on child labor lobbied by British

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[40] Novartis eventually lost the landmark patent case against the Indian Government, in spring of 2013, which lasted since 2006.

big mill owners in the 19th century, Marvel (1977) shows that the adoption of the legislation on child labor resulted in the exit of small mills from the business and enhancement of the competitive position of big mills, since only big mills were able to afford the costs arising from the new "socially responsible business" legislation that targeted to improve the welfare of the community.

Starting from the above mentioned gap in the literature and anecdotal evidence, in this paper, I look into how two non-market strategies targeted at two different dimensions of the firm's non-market environment, namely how corporate political linkages and corporate community engagement, impact the financial returns for the firm, both individually and jointly. The research question this paper addresses is the following:

Does corporate community engagement act as complementary to political linkages, i.e. does corporate community engagement improve the returns from firm's political linkages?

The paper exploits a panel dataset of 1667 firm-year observations, which covers hand-collected corporate political linkage information; corporate community engagement information provided by an extra-financial rating company, Asset4; and financial information, for 281 publicly listed firms in the UK from 2002 to 2011[41]. I find robust evidence that community engagement has no direct and significant impact on firms' financial performance, whereas the joint impact of community engagement and corporate political linkages is positively and significantly related to firms' financial performance. In other words, community engagement moderates the outcomes of firms' political linkages, either through diminishing the negative impact of political linkages that have a negative

[41] The firms in the sample are determined by the availability of Asset4 data for the UK companies. This limitation is discussed in the data and methods section.

impact on firms' financial performance; or enhancing the positive impact of political linkages that have a positive impact on firms' financial performance. This points at the importance for the firm of picking up the right portfolio of non-market strategies to achieve superior financial returns, and also hints at the existence of a complementary relationship between corporate political linkages and corporate community engagement.

Organization of the paper is as follows: The first section elaborates on the value of corporate community engagement and its financial implications. The second section reviews very briefly benefits and costs of corporate political linkages, and how they impact firms' financial performance, which have already been discussed in detail in Chapter 3 of this dissertation. Following this, the third section looks into the interaction between these two non-market strategies, and the joint impact of these strategies on firms' financial performance. Data, method and results are presented in the fourth section, followed by the last section, which is the discussion.

4.3 CORPORATE COMMUNITY ENGAGEMENT

Firms' non-market environment consists of different dimensions. The society that a firm operates in constitutes a source of dependency for the firm, which the firm needs to manage. Society provides the firm with the necessary resources to operate, and also punishes the firm in case firm actions are not deemed as "appropriate" (Dowling & Pfeffer, 1975). One way to create "goodwill" among the society is to actively participate in the improvement of the social welfare of the community the firm operates in, i.e. to engage in the community.

I define community engagement as the commitment of firm resources either financially or human resources-wise into addressing a social problem that may or may not have been aroused by the firm itself, and into improving the welfare of the community. Community engagement can take many forms including philanthropic contributions to community and social programs aiming at improving the welfare of the community. This sort of engagement has been existent since decades dating back to the factories and social programs of Victorian businessmen (Ashley, 2009). Firms have been making regular or ad-hoc donations to the community since a long time, and are still continuing to do so either directly or through decoupled foundations. Actually between 1950s and the 2000s, companies' philanthropic contributions more than quadrupled in real terms (Caplow, Hicks, & Wattenberg, 2001).

In order to prove the relevance for the firm of addressing the community's needs, many studies attempt to demonstrate the existence of a financial reward from "good" stakeholder management, which includes firm engagement in community; however fail to provide consistent evidence. The debate on whether firms' investments in improving the welfare of the community have a positive financial impact or not has been going on since decades, and has its roots in the discussion on "the purpose of the firm" (Berle, 1931, 1932; Dodd, 1932). Historically, fulfillment of contractual obligations to shareholders has been seen as a priority goal for the firm; and the so-called shareholder value maximization view (Friedman, 1970; Jensen, 2001; Sundaram & Inkpen, 2004) has turned into a dominant paradigm in management, at times being referred to as being "hegemonic" (Mason & O'Mahony, 2007). This view has been criticized, foremost by the stakeholder view (Donaldson & Preston, 1995; Freeman, 1984), which draws the attention to address the needs of stakeholder groups, which provide the firm with resources. However, most of prior work trying to establish a link between community engagement and financial performance has suffered from both theoretical issues and methodological difficulties.

On a theoretical level, the overriding challenge has been to define and capture what community engagement consists of; and on an empirical level, to link community engagement to the benefits, whether these are financial or non-financial. Many studies do not concentrate on benefits likely to be drawn by engagement of the firm in the community, but rather focus on a general "social performance" assessment of the firm, which takes into account many firm actions such as towards employees, suppliers[42]. However, aggregating the different corporate "social performance" dimensions do not theoretically make sense and creates problems in the evaluation of financial consequences of firm actions. Firms' socially responsible actions towards suppliers or employees should not be considered as identical to firms' engagement in the community, specifically since the former may be imposed by regulation, while the latter clearly could be considered as relatively benevolent and strategic. The aggregation of all "social" actions by firms poses a particular difficulty in soliciting out the causal link between such actions by firms and their impact on firm performance.

Hence, in this paper, I specifically focus on a single dimension of corporate "social" engagement, which is the *community engagement*, i.e. firm activities targeting to improve the welfare of the community, such as donations for and involvement of the firm in education, health, the underprivileged, among others. In other words, community engagement consists of firm actions that conventionally might be considered as the "responsibility" of the state. Community engagement is a form of "giving" by the firm to the society where the returns may take various forms, which I will discuss below:

First of all, firms that build good relationships with the community secure more willingness on the community's side for providing the needed resources (Backhaus et al.,

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[42] See Orlitzky and colleagues (2003) for a comprehensive account of such studies seeking for a link between financial and social performance.

2002; Dutton, Dukerich, & Harquail, 1994; Frooman, 1999). Moreover, firms that engage in community gain in return assets like legitimacy (Heugens et al., 2002; Selsky & Parker, 2005); and reputational capital (Fombrun et al., 2000); increased employee commitment (Turban & Greening, 1997); trust (Frank, 1996; Zucker, 1986), and acquiescence among regulatory institutions and legislative bodies (Jensen, 2002; Jensen & Murphy, 1990). Through community engagement, a firm can reduce the risk of losing resources it already controls (Barnett & Salomon, 2006; Brammer & Millington, 2004a, b; Godfrey, 2005). Corporate philanthropy- one form of community engagement- may provide the firm with insurance-like protection in case of negative events. To be more specific, the support of the community created through firm's engagement in the community acts as an insurance against loss, by mitigating negative stakeholder assessments and related sanctions when firm actions requiring legal punishments take place (Godfrey et al., 2009).

Therefore, a firm's community engagement helps the firm manage the uncertainties regarding the social environment, through increased support of the community. This increased support acts as a facilitator in the provision of resources to the firm by the community, as well as an insurance against the loss of wealth in case of negative events. Hence I expect community engagement to have a positive impact on firms' financial performance.

Hypothesis 1: Corporate community engagement is positively related to firms' financial performance.

4.4 CORPORATE POLITICAL LINKAGES

Firms establish linkages with external parties that create uncertainty and dependence, such as politicians, to manage the firm's dependencies and if possible, to obtain firm-specific benefits (Hillman, 2005). In Chapter 3, I have investigated in detail the consequences of firms' political linkages, in terms of firms' financial performance. I have differentiated between different types of linkages firms build with politicians, and have shown that there might be negative consequences for the firm of having political linkages. Different types of linkages bring along different incentives for the politician to provide benefits to the firm and different levels of rent extraction by the politician from the firm. I have specifically investigated three types of political linkages, which allow for exchanges between the firm and the politician: Board directorship of a politician, gift giving to a politician, and sponsorship provision to a politician. The argument put forward was about how different types of political linkages vary in the creation of incentives through the uncertainty of future exchanges they inherit, and in the degrees of ex-post dependence they bring along. The findings of the analysis in Chapter 3 has shown us that while linkages such as gift giving to politicians have a positive impact on firms' financial performance, linkages such as board directorship of politicians or political sponsorships have a negative impact on firms' financial performance. One question that arises from these findings regarding the consequences of firms' political linkages is whether firms can improve their power-dependence position within the firm-politician dyad through means other than political activities. What makes a firm more "valuable" as an exchange partner for the politician so that the politician will be more likely to provide benefits to the firm and be less likely to extract rents that may harm firms' financial performance, no matter what type of linkage the politician has with the firm?

In the next section, I will discuss how firms' community engagement may act as a complementary strategy to firms' political linkages by changing the power dependence relations between firms and politicians. Both the political environment, and the social environment of the firm create dependencies that the firm has to manage. I argue that although widely adopted, political linkages on their own may not constitute effective means to obtain favors from politicians that will help manage the political environment, and might actually harm firms' financial performance[43]. Community engagement, on the other hand, may be jointly used with political linkages to improve the returns from those linkages.

4.5 COMMUNITY ENGAGEMENT AS A POWER-BALANCING FACTOR IN FIRM-POLITICIAN LINKAGES

By definition, an exchange relationship in which the parties' powers are not equal is defined as unbalanced (Emerson, 1962; Emerson, 1972). The initial version of the exchange theory puts forward power-balancing operations, which include "factors that alter features of the dyadic exchange relation or the structure in which it is embedded" (Cook et al., 2006). Such factors have received little empirical investigation though (Cook et al., 2006).

According to exchange theory, reducing asymmetry of dependence (thus power) in an exchange relationship is possible through different actions. One option for an actor is actually to reduce its own dependence on the partner, by increasing available alternatives and/or by decreasing the value of the relationship with the partner. One other option for the actor is to increase the partner's dependency by increasing its value to the partner, or by reducing the partner's alternatives (Emerson, 1972). The crucial point here is that while

[43] Not all types of linkages have a negative impact on firms' financial performance. However, as shown in Chapter 3, certain types such as board directorships or political sponsorships do.

reducing relative dependence will reduce asymmetry, it also lowers the mutual dependence between the parties, and may harm the relation (Emerson, 1972). Therefore the best option for an actor in an exchange may be considered as to increase its value to the partner so that the relationship stays cohesive and the asymmetry in power becomes less threatening. This sort of "increased value" is not always achieved through increasing material resources of the actor, but may also be achieved through the use of symbolic resources, such as prestige, legitimacy (Cropanzano & Mitchell, 2005; Homans, 1958). Such symbolic resources may actually increase the commitment of the more powerful exchange partner to the relationship. Increased commitment reduces the incentives to search for alternative exchange partners, hence serves to reduce the dependence asymmetry within the exchange (Rice, 2002).

I argue that corporate community engagement acts as a complement to firms' political linkages, since it changes in a positive direction (for the firm) the power dependence asymmetry between the firm and the politician. In other words, community engagement has an impact on the power dynamics that determine the outcomes of exchanges between firms and politicians. There are two main mechanisms that are at work: First, community engagement makes the firm more attractive as a partner for the politician, since firms with community support can provide the politician with valuable resources that we will discuss later on. In other words, community engagement increases the value of the firm within the exchange relationship with the politician. Second, community engagement also increases the access of the firm to alternative sources to obtain political benefits, thus decreases the value of the relationship with the politician, and the power of the politician within the exchange. Both mechanisms help the firm to obtain more favorable outcomes from the exchange relationship with the politician, since they change the power-dependence conditions in a positive direction for the firm[44].

In the next section, I will elaborate on how community engagement actually moderates the relationship between political linkages and firms' financial performance through the above-mentioned mechanisms. I will look into all three types of political linkages investigated in detail in Chapter 3 (i.e. board, gift and sponsorship linkages) and hypothesize about the moderation impact of community engagement on the relationship between these three types of political linkages and firms' financial performance.

4.5.1 Community engagement and board directorship linkages

In Chapter 3, I have discussed in detail the impact of board directorship of politicians on firms' financial performance. I have argued that board directorship of politicians do not per se incentivize the politicians to bring in benefits that may enhance firms' financial performance and may also incur additional costs for the firm, since these linkages bring about a low uncertainty regarding continuity of the exchange and high ex-post dependency of the firm on the politician. Community engagement may act to balance these conditions in the exchange with politician.

First of all, community engagement increases the firm's legitimacy among the public, and increased legitimacy in the eyes of the public makes the firm more attractive for the politician as an exchange partner. Politicians would be more motivated to enter exchanges with legitimate firms, since through their linkages with these firms, politicians may acquire

[44] Change in a "positive direction" does not imply that the power asymmetry becomes in favor of the firm in absolute terms. Rather, it means that if the initial conditions are such that the imbalance of power is in favor of the politician, the power asymmetry in the firm-politician dyad decreases; or if the initial conditions are such that the imbalance of power is zero or in favor of the firm, the power asymmetry increases in favor of the firm.

resources such as prestige (Homans, 1958). Not only board members bring prestige to the firm (Certo, Daily, & Dalton, 2001), but also a legitimate firm may bring prestige and approval to the politician that sits on its board. Second, through community engagement, firms may also offer to the politician with whom they have a board directorship linkage more "material" benefits such as information. In Chapter 3, I have argued that it would be plausible to assume that politicians might have high discount rates (Kroszner & Stratmann, 2005), and that in return for sparing time for the firm as a board director, the politician might be inclined to "compensate" for the opportunity cost of sparing his/her time to the firm instead of political causes, and to long for more rent extraction from the firm. Politicians are indeed known to reserve a considerable amount of their time and resources to address concerns and interests of their constituencies (Chin et al., 2000). They seek out information on concerns of their constituencies, as well as on the impact of potential policies on their constituencies. Particularly if a policy is likely to have a significant impact on politicians' electoral prospects or alter the distribution or intensity of public opinion among their electorate, politicians will value opinions of their constituencies (Lord, 2003). Firms that engage in the community have a second-order benefit from this engagement: they may have access to novel information to share with public policymakers (Werner, 2011). When firms engage in the community, they have access to private information regarding the concerns of the community as well as the public opinion for potential policies. This information may serve as leverage within the exchange between the firm and the politician, since the cost of sitting on the board of directors for the politician decreases.

Moreover, as a result of the increased value the firm may provide within the exchange (deriving from legitimacy and informational benefits), the firm has easier access to alternative exchange partners, which decreases for the firm the value of the relation with a specific politician, and decreases the likelihood of negative returns from the board directorship linkage.

In sum, community engagement first makes the value offering "package" by the firm more attractive for the politician, and thus increasing the firm's attractiveness for the politician as an exchange partner and the likelihood of the politician to reciprocate within the exchange with the firm; and second decreases the cost of the relation for the politician, and the likelihood of the politician to seek for excessive rents; and also increases access of the firm to alternative politicians, reducing for the firm the value of the relation with the politician. As a result, community engagement diminishes the likelihood of negative returns out of the board directorship linkage with the politician.

Hypothesis 2: Community engagement will weaken the negative relationship between board directorship linkages to politicians and firms' financial performance.

4.5.2 Community engagement and gift linkages

Gift giving to politicians is likely to increase firms' financial performance. As discussed in detail in Chapter 3, gift giving constitutes a specific case of political linkages where the incentives for the politician to reciprocate are high and the ex-post dependency of the firm on the politician is low, increasing the likelihood of obtaining positive returns from the linkage with the politician.

As discussed above, community engagement increases the firm's legitimacy among the public and makes the firm more attractive for the politician as an exchange partner. Whereas in the case of board directorships of politicians, this attractiveness of the firm may derive from the prestige it offers to the politician as well as informational benefits; in the case of gift giving to politicians, I argue that the attractiveness of a legitimate firm arises from lower risks of public reaction to the receipt of gifts by the politician. Gifts might be perceived as buying access to the politician (Mitchell, 1996), and may arouse public reaction to the politician since they might be considered as "bribes"; as opposed to other types of linkages which might be considered as more "acceptable" (such as sponsorships). Accepting gifts from firms that are known for their community services, on the other hand, would be less risky for the politician in terms of publicity and public reaction. Therefore community engagement will have a reinforcing role for the politician's desire to continue having exchanges with the firm, and thus will increase the likelihood of the politician to provide the firm with benefits that may improve the firm's financial performance.

On the other hand, this lower risk of public reaction will also impact the chances of the firm to find alternative politicians to link with. For firms, finding alternative exchange partners to give gifts to is already relatively easy (compared to finding alternative politicians to appoint to the board of directors for instance). Community engagement will exacerbate these opportunities; therefore will decrease even further the costs for the firm of switching exchange partners in case of no benefits obtained from the politician.

Therefore, I hypothesize that:

H3: Community engagement will strengthen the positive relationship between gift giving to politicians and firms' financial performance.

4.5.3 Community engagement and sponsorship linkages

Finally, as discussed in detail in Chapter 3, sponsorship linkages to politicians have a negative impact on firms' financial performance. Sponsorship provision brings about an exchange with the politician that has very low frequency and low chances of establishing an ongoing relationship, and creates asymmetric ex-post dependency of the firm on the politician, which is unfavorable for the firm.

Community engagement by the firm will increase the chances of establishing an ongoing relationship between the firm and the politician. As mentioned before, sponsorship alone is not likely to provide such an ongoing relationship between the parties. The less particularistic a benefit is, which is the case for political sponsorship, the more likely it is to be exchanged in a short-term fashion. For a benefit to increase the likelihood of an ongoing exchange, it has to be more particularistic to the politician (Cropanzano & Mitchell, 2005). Firms that are engaged in the community may have the means to create or change a public opinion, specifically towards an issue crucial to the politician's electoral success. In that case, the sponsorship providing firm increases its value offering to the politician since sponsorship combined with likelihood of creating support for the politician's electoral success becomes more "concrete" as a benefit and more valuable for the politician. This in turn increases the chances that the politician will be eager to have future exchanges with the firm and provide the firm with benefits to assure the continuity of exchanges. Therefore, while sponsorship alone may not provide the incentives for the politician to reciprocate, when complemented with community engagement, this incentivizes the politician to provide benefits to the firm.

On the other hand, the potential support of the firms that are engaged in the community for the politician's electoral success decreases the constraints on the firm regarding access to politicians that the firm did not initially support through sponsorships. Moreover, I have argued in Chapter 3 that the politician supported through the firm's sponsorship normally has an increased political power thus increased power on the firm once elected, and that the firm's ex-post dependence on that politician is likely to be higher than the politician's ex-post dependence on the firm, causing an asymmetry. However, for firms that are engaged in the community, and thus have power to change the public opinion, this asymmetry is likely to be less of a concern since the power of the firm over the constituencies of the politician is likely to re-balance the asymmetry, even though not entirely.

Hence, I argue that community engagement will diminish the negative impact of political sponsorship on firms' financial performance.

H4: Community engagement will weaken the negative relationship between sponsorship provision to politicians and firms' financial performance.

In this section, I have discussed how through community engagement, while the firm aims to secure resources from the society and to avoid sanctions; the firm also changes its power position vis-à-vis a politician, and improves its attractiveness as an exchange partner and enhances the likelihood of obtaining benefits from its linkages with the politician, and decreases the costs arising from ex-post dependency to the politician. In other words, community engagement provides a buffer against the politician's power; balances the asymmetry in dependencies between the parties and decreases the likelihood for the firm of negative returns from its linkages with the politician. Through community engagement, the firm actually "kills two birds with one stone", since it transfers some of its resources obtained through community engagement, to its exchanges with the politician, with no additional costs.

In the next section, I will test the above presented hypotheses.

4.6 DATA AND METHOD

This paper tests the predictions drawn above using a longitudinal dataset covering information on corporate political linkages and data on corporate non-financial ratings, as well as financial information, for the UK companies, for the period from 2002 to 2011.

4.6.1 Empirical setting and sample

The empirical setting is the United Kingdom. The UK is an interesting setting for investigating both corporate political linkages and corporate community engagement:

In the UK, the links between the politicians and companies have traditionally been strong. Compared to similar economies, the UK demonstrates higher rates of linkages between the two groups (Faccio, 2006), and a higher disclosure of those linkages (Djankov et al., 2009). As a result of the UK disclosure legislations, I was able to collect data that is very rich in content, and that would not have been as readily accessible through other means[45].

In terms of community engagement, on the other hand, the UK occupies « the [global] geographical center of gravity » (Vogel, 2006) with the highest levels of community engagement among large countries (Gjølberg, 2009).

I combine data from three sources. Financial information is gathered from Orbis (Bureau van Dijk) database, which covers extensive information on around 80 million companies in the world, using numerous sources of information such as Datamonitor, Lexis-Nexis, and Thomson Reuters among others. Political linkages data come from the public registers of the British Parliament. The registers are scanned for extracting company names that have linkages with the Members of the Parliament. The names of all the publicly listed

[45] In Chapter 1, which is the Introduction of this dissertation, I have discussed in detail the specificity of the UK legislation for disclosure of linkages between firms and politicians. Not to repeat myself, I will not go into the details of the legislation in this part.

firms[46] in the UK are matched with the company names in the parliament registers[47]. Any concerns regarding matching errors are eliminated using multiple matching rounds and a following manual check and coding of all political linkage information. Finally, community engagement data is extracted from the ASSET4 database, a subsidiary of Thomson Reuters. Details on the ASSET4 database are provided in the variables section that follows.

The final sample includes 1667 firm-year observations. Please see Table 4-1 for a distribution of the companies per year and per sector in the final sample used for regressions.

Insert Table 4-1 here

4.6.2 Measures

Corporate financial performance (DV)

The measure of financial performance used in this study is the Return on Assets (ROA). Most studies on the financial impact of corporate political actions use an accounting based measure of firm performance (see Lux et al. (2011) for a review of measures). Moreover, ROA is considered as a "standard" measure in the literature looking at the impact of social engagement on financial performance of a firm (Barnett & Salomon, 2012). Therefore I adopt the same measure, and use ROA as the dependent variable. Since financial information I use from Orbis database is for companies in a single country, the analysis would not suffer from any bias in terms of differences in accounting principles; therefore ROA might be considered as a valid performance measure.

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[46] Any firm that is publicly listed at least during one year from 2002 to 2011 is considered as publicly listed.

[47] See Appendix B for details of the process for identification of the linkages.

Independent variables (IVs):

Political linkages

As in Chapter 3, I use a total count of the type of linkage the firm has with MPs during a given year. Definitions of the linkages are provided below:[48]

Directorships: Remunerated directorships of the MPs in public and private companies including directorships which are individually unremunerated, but where remuneration is paid through another company in the same group.

Gifts: Any gift to the MP or the MP's spouse or partner, or any material benefit, of a value greater than one per cent of the current parliamentary salary from any company, organization or person within the UK which in any way relates to membership of the House or to a Member's political activity.

Sponsorships: (a) Any donation received by an MP's constituency party or association, or relevant grouping of associations which is linked either to candidacy at an election or to membership of the House; and (b) any other form of financial or material support as a Member of Parliament, amounting to more than £1,500 from a single source, whether as a single donation or as multiple donations of more than £500 during the course of a calendar year.

Community engagement

Community engagement is measured through ratings provided by ASSET4 database. ASSET4 is a subsidiary of Thomson Reuters, which provides extra-financial ratings of

[48] Definitions are taken from the official registers of the British Parliament: Code of Conduct for the Register of Interests of the MPs, British Parliament, May 2010, http://www.publications.parliament.uk/pa/cm200809/cmcode/735/735.pdf

companies worldwide since 2002. The database provides objective, comparable and auditable extra-financial information using environmental, social and corporate governance related information from publicly available sources (e.g. annual reports, NGO websites, CSR reports). The ratings consist of assessments of company performance based on over 250 key performance indicators. These ratings are then normalized to position the scored between 0 and 100%. The database provides an overall extra financial rating for each company, which can be decomposed in 4 category ratings, one of which is the “social category” rating that measures a company's capacity to generate trust and loyalty within its workforce, customers and society. The other category ratings correspond to the “environmental rating”, “governance rating”, and “economic rating”. In each category, there are sub-category ratings, which reflect different dimensions of the relevant category. For the social category, the sub-categories are as follows: *employment quality; health and safety; training and development; diversity; human rights; community* and finally *product responsibility*[49]. As a measure of corporate community engagement, I use the sub-category rating for “community”, which directly measures the performance of a company in terms of its community engagement.

ASSET4 data has its limitations. Although it is among the largest datasets available on extra-financial information, it does not cover all the publicly listed companies in the UK, however covers the full FTSE (250) and some other companies selected based on their size. Still, using the ASSET4 rating on community engagement is potentially superior to using an alternative measure such as charitable contributions data, since even though UK companies are required by the UK Companies Act 1985, Section 234 (3), to disclose contributions of over £200 to charities in the directors’ report, they are not required to disclose recipients, which makes it hard to evaluate whether the contribution targets the community’s welfare.

[49] Please see Figure 4-1 for the Asset4 data structure.

Moreover, it could be argued that charitable contributions provide sort of a limited view of "community engagement", compared to a rating based on a wider range of indicators, which is more consistent with the definition of community engagement adopted in this paper.

Political linkages*Community engagement

I interact the three political linkage variables, board directorships, gifts, and political sponsorships with community engagement. When these three predictor variables are used in an interaction term, one potential issue is increased multicollinearity. To avoid this, I have mean centered the variables before calculating the interaction term. Additional checks on multicollinearity and the variance inflation factors (VIF) have shown that multicollinearity was not an issue (see Table 4-4).

Controls

I include various controls in the models, in line with the previous chapter, i.e. Chapter 3. I use *size*, measured as operating revenue, as a control. Larger firms are more likely to engage in political activity, as well as in community issues, compared to small ones (Schuler, 1996). *Firm slack*, as measured by cash flow divided by operating revenue, on the other hand, is another control. Firm slack might also determine the propensity of the firm to engage in both activities, since availability of slack resources might give the firm more space for maneuver in these non-market areas. *Leverage*, another control variable, is measured by total debt divided by total assets. As discussed in Chapter 3, being linked to the governing party may impact the outcome of political linkages, as well as the outcome of the joint use of political linkages and community engagement. So I include two *dummies*, first one for being linked to the Conservative party when the party holds power, and second one for being linked to the Labor Party when it is in power. I also control for all other types of linkages the firm has with the MPs, such as *remunerated employment linkages, overseas visits funding* and *miscellaneous linkages*. On the other hand, to whom the firm is linked to will matter, therefore

I control for the *average tenure* of the linked MP. For controlling for the characteristics of the relation with the MPs, I include various controls, which account for *repetition* of the same type of linkage with the same MP; having multiple types (*portfolio*) of linkages with the same MP; having linkages with MPs that are also *shareholders*. I also control for the *dependence asymmetry* between the firm and the politician, by the ratio of the count of the firm's all linkages to politicians to the count of the linked MP's all linkages with firms. Additionally, I include in my main model a *dummy for regulated industries*, since Hadani and Coombes (2012) find evidence suggesting that industry-level factors increase firm propensity for engaging in both community engagement and also corporate political activity. For details of how each control variable is operationalized, please see Annex 4-1 at the end of this Chapter.

4.6.3 Analysis and results

I estimate the models including the above listed predictor and control variables with random effects estimator. One reason that I prefer random effects estimator for the analyses in this paper is that the community engagement data used in this paper is drawn from some larger population that could in principle have been selected for the analyses (Littell, Stroup, & Freund, 2002). To be more specific, assuming that the model is correctly specified, the fixed effects estimation would provide us with unbiased estimates of the β, but those estimates may be subject to high sample-to-sample variability. The random effects model, on the other hand, introduce some bias in the estimates of β, but can "greatly constrain the variance of those estimates- leading to estimates that are closer, on average, to the true value in any particular sample" (Clark & Linzer, 2013). Therefore from an empirical standpoint, the advantages and disadvantages of both fixed effects and random effects should be weighed considering which bias is more crucial for the purposes of an analysis. Given that our community engagement data comes from only a small sample of the population of firms in the UK, choosing random effects estimator could provide us with more "realistic" results about the interaction between firms' political linkages and community engagement in general, and the impact of this interaction on firms' financial returns.

Estimators are lagged for one year, and random effects estimation with robust standard errors, and sector clustering of firms is conducted.

Descriptive statistics and correlations among the variables are provided in Table 4-2 and Table 4-3.

Insert Table 4-2 & Table 4-3

about here

4.6.4 Hypotheses support

I first estimate the model with only the control variables. Firm-level control variables size and firm slack have a significant (+0.000, $p<0.001$ and +0.401, $p<0.001$ respectively) and positive impact on the DV, i.e. ROA. MP characteristic average tenure appears to have a negative and significant (-0126, $p<0.1$) coefficient. Decreasing dependence asymmetry (ratio approaching to 1), on the other hand, has a positive and significant coefficient (3.589, $p<0.1$). Finally, dummy for regulated industry is also significant at the 0.1 level with a negative coefficient (-2.781).

I then estimate the model with only political linkages (all three types that are among our independent variables). In line with the previous Chapter, board directorship has a negative and significant coefficient (-1.778, $p<0.01$); and sponsorship has a negative and significant coefficient (-3.951, $p<0.1$). Gift linkages have a coefficient consistent with prior results, however it is not significant (very slightly over $p<0.1$). This does not point to an issue in the prior results, since given that our sample is limited by Asset4 data, the sample size of this study is much smaller than our previous sample in Chapter 3. Loss of significance might well be due to this decrease in the sample size, specifically given that the p value for the coefficient of gift linkages is very close to being significant ($p<0.122$). In Model 3, I start testing the hypotheses. I first look into the impact of community engagement on firms' financial performance: Hypothesis 1 predicts a positive relation between community engagement and firms' financial performance. Even though the coefficient is positive, it is not significant; therefore Hypothesis 1 finds no support. In Model 4, I include in the model the political linkages and community engagement together. The coefficient of board directorship stays negative and significant (-1.777, $p<0.01$); and political sponsorship still has a negative and significant coefficient (-3.950, $p<0.1$). Model 5 tests Hypotheses 3 to 5, which relate to the interaction between political linkages and community engagement. Evidence from the regression shows a positive and significant (+0.820, $p<0.1$) coefficient for the interaction term of gift giving and community engagement, and a positive and significant coefficient (+8.761, $p<0.05$) for the interaction term for sponsorship and community engagement. The interaction term's coefficient for board directorships, on the other hand, has a positive yet insignificant coefficient. Please see Table 4-5 for reported results.

Insert Table 4-5 about here

At a first glance, the coefficients for the interaction terms seem to provide support for the hypotheses and proof for complementarity between these political linkages and community engagement, as predicted. In other words, the results indicate that "giving" to the community diminishes the negative impact arising from sponsorship linkages to politicians, whereas strengthening the positive impact of gift giving to politicians. The interpretation of gift giving to politicians when combined with community engagement is rather straightforward since a positive direct impact combined with a positive interaction impact can only be interpreted as a stronger positive final impact. The interpretation of the joint impact of sponsorship and community engagement, on the other hand is more complicated. Even though we can say that community engagement diminishes the negative impact of sponsorship on firms' financial performance, whether it would totally eliminate the negative consequences is a question mark. To correctly interpret the interaction effects, we need to plot the marginal impact of different political linkages in our regression on ROA, with differing degrees of community engagement. I therefore calculate and plot those marginal impacts, following Berry et al. (2012) and Brambor et al. (2006). Please see Figure 4-2, Figure 4-3 and Figure 4-4 for the respective marginal impacts of board directorships, gifts, and sponsorships on ROA with differing degrees of community engagement.

Figure 4-2 shows that with increasing levels of community engagement, there is a very slight decrease in the negative impact of board directorship linkages on ROA, however only for values of community engagement between 0 and approximately 0.25[50]. Figure 4-3, on the other hand, shows that there is an increase in the positive impact of gift giving to politicians with increasing levels of community engagement, once the community engagement score is higher than about 0.35. Finally Figure 4-4 shows that the negative impact of political sponsorship on ROA decreases sharply when firms combine it with community engagement, however only for firms that score really low, such as firms with community engagement scores between 0 and 0.1. For those firms, the increase in community engagement score decreases clearly the negative impact of political sponsorship.

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[50] The dashed lines give us a 90% confidence interval for the significance/interpretation of the marginal impact of board directorship linkages on ROA. For the areas where the zero line is in between the two dashed lines, we cannot reject the null hypothesis that the marginal impact would be equal to zero.

In sum, for those linkages that the prediction of the ROA is a negative value, i.e. for board directorships and sponsorships, even though community engagement diminishes the negative impact of those linkages on firms' financial performance, it is not sufficient to turn this relation into a positive one. Still, using the two non-market strategies jointly relates to less negative financial returns or more positive financial returns, depending on the initial impact of the linkage on firms' financial performance.

4.7 DISCUSSION

This paper explicitly takes into account the portfolio like nature of firms' non-market actions and looks into the impact of simultaneous deployment of political linkages and community engagement on firms' financial performance. The paper therefore takes a step to treat the external environment of the firm "as the multi-faceted concept it is", and does not consider the social and political environment of the firm as conceptually discrete (Henisz & Delios, 2002).

Firms need to and try to manage multiple fields of their non-market environment. To manage their political environment, one option for firms is to build linkages with politicians. However, as discussed both in Chapter 3 and in this paper, political linkages differ in the degree of incentives for reciprocity they create and the ex-post dependencies they bring about. Under certain circumstances, political linkages may constitute a "cost" for the firm, rather than an "investment" that will help manage the political environment. On the other hand, firms that engage in the community gain support from and protection by the community. Firms demonstrate "goodwill" to the community through engaging their resources in improving the welfare of the community. In return, they secure more willingness on the side of community to provide resources that the firm needs, and more "tolerance" from the community in case negative events come up. What is most interesting, however; and what is the main focus of this paper is that such firm actions in one non-market field, such as community engagement targeting the social environment, may serve as leverage in other non-market fields, such as the political environment. In other words, community engagement acts as a complement to firms' political linkages, since it changes in a positive direction (for the firm) the power dependence asymmetry between the firm and the politician. This paper discusses two main mechanisms through which community engagement complements firms' political linkages: First, firms that are engaged in the community become more attractive exchange partners for politicians, as a result of various benefits they may offer to the politician, such as legitimacy, information, public opinion support, which firms obtain via their engagement in the community. This is the mechanism through which the value package offered by the firm becomes more interesting for the politician. Second, community engagement alters the asymmetry of dependence between the parties in favor of the firm, since it increases the likelihood of the firm to find alternative sources to obtain benefits in the political arena. This is the mechanism through which the value package offered by the politician becomes less valuable for the firm. As a result, community engagement enhances the likelihood for the firm of obtaining benefits from its linkages with politicians, and decreases the costs arising from the firm's ex-post dependency on the politician.

The findings complement both literatures on the relationship between firms' social engagement and financial performance, and firms' political linkages and financial performance.

First, when we look into the findings, the non-significant impact of community engagement provides further support to the view that community engagement may not have any direct impact on financial performance, but rather works through mediating mechanisms. Recent studies have focused on such mechanisms as intangible assets of a firm (Surroca, Tribó, & Waddock, 2010) or customer satisfaction (Lev, Petrovits, & Radhakrishnan, 2010). The results may also be an indication of the fact that financial markets are myopic and highly shareholder oriented (Charkham, 1994; Sykes, 1994); and operate based on agency theory (Alchian & Demsetz, 1972; Fama & Jensen, 1983; Jensen & Meckling, 1976)**.** Financial markets may assume that such engagement in community's welfare issues bear the risk of increasing agency costs in the economic system and give managers the excuse to pursue their own interests at the expense of the firms' financial claimants (Jensen, 2001). Under such circumstances, financial awards for engagement become ambiguous at best, and are still far beyond being incorporated to everyday financial evaluations. On the other hand, as priory mentioned, the UK companies rank high in general in terms of their community engagement. Considering that this paper is based on data on a single country, and this single country has a highly institutionalized notion of community engagement, it may be the case that community engagement is already the "minimum" expected from firms, and will not directly impact financial performance of the firm.

Second, the findings indicate to complementarity between political linkages and community engagement. Community engagement acts as leverage in the exchange between the politician and the firm, and increases the likelihood of reciprocity of the politician within the exchange relationship; and also changes the power dynamics between the firm and the politician in favor of the firm; thus improving the financial returns from political linkages. Therefore the study contributes to very recent literature looking at possible association between social and political activities of firms. The results of this study are partially in line with Richter's (2011) work that finds an economic complementarity between "CSR" and corporate political activity through lobbying. The focus of this study is different from Richter's though, foremost in a theoretical sense, since this paper looks into the relationship between firms and politicians through a power dependence lens, whereas Richter's paper is based mostly on a CSR perspective. The two papers also differ in their focus of analysis: this paper investigates only direct linkages between firms and politicians (as opposed to lobbying); and only a specific dimension of corporate social responsibility, i.e. community engagement. On the other hand, taking a different perspective regarding the association of community engagement and political strategies, Werner (2011) reports that certain activities by firms such as charitable contributions to local communities may actually enhance political access. In this regard, this study also considers that community engagement can have a political function, however rather than considering it as a "gate" to the politician, it sees community engagement as a leverage that increases the likelihood of reciprocity from the politician and that changes the power dynamics between the firm and the politician.

4.7.1 Limitations and future work

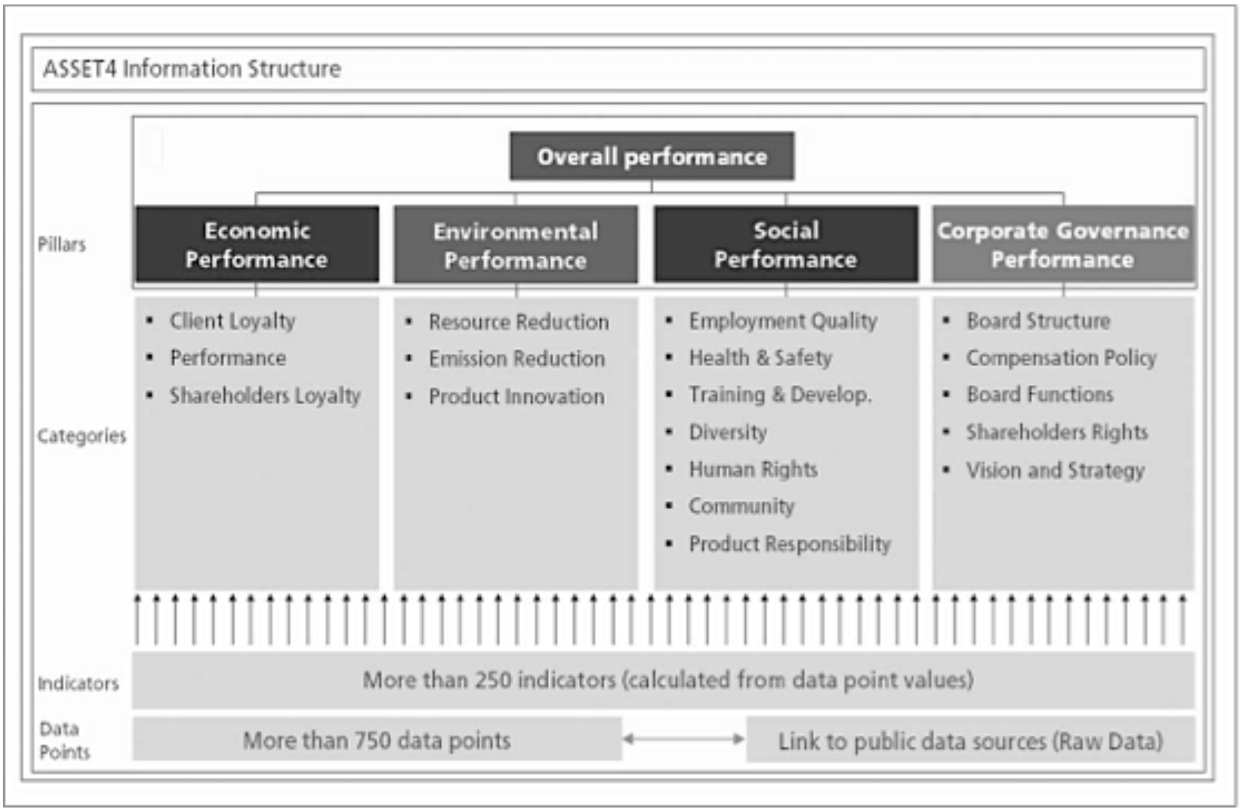
The biggest limitation of this study is empirical, and is that Asset4 data limit the number of observations in the final sample. Since Asset4 provides rankings for only a subset of companies in every country, I do not have data on community engagement scores for all the companies in the UK; in other words, I do not have data on community engagement for all companies for which I have political linkage data. The selectivity of the Asset4 data creates a bias. Asset4 has two selection criteria: country of the company, and total assets of the company. Asset4 data do not cover the same number of companies in every country, i.e. only a certain number of companies based on their total assets are included in the database for each of those countries. For the time being, a database that is more comprehensive in terms of the number of companies covered, is not available.

Moreover, this paper focuses on publicly listed firms. To analyze whether the impact of political linkages as well as community engagement, and the joint use of the two would be similar for privately held firms, could be investigated.

One avenue for further research would be to look into different types of political strategies targeted towards political actors other than the MPs, and investigate the outcomes of those strategies conditional on the degree of community engagement of the firm. Community engagement may provide the firm with chances to collaborate with other power beholders (apart from politicians) in the political arena, such as interest groups, NGOs. Firms highly engaged in the community may thus more likely to benefit from these other "entry points" to the political arena. To investigate whether they could obtain political benefits through these "alternative" power beholders would be interesting.

It could also be fruitful to look into how a firm should arrange a portfolio of non-market actions that would have a total positive impact on financial performance? Combining multiple political strategies and community engagement simultaneously may enhance firms' effectiveness by increasing the flexibility with which the firm adapts to changes in the political environment and rendering it more difficult for rivals to imitate them (Oliver & Holzinger, 2008).

Figure 4-1: ASSET4 Data Structure[51]



[51] Asset4 Assetmaster Professional Guidelines, October 2010

Table 4-1: Per year and per industry distribution of firms in the final sample

Major sector	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
Banks	0	0	1	2	1	0	1	2	1	8
Chemicals, rubber, plastics, non-metallic products	4	3	9	11	11	11	11	13	12	85
Construction	8	8	12	12	11	9	8	11	11	90
Education, Health	0	0	0	0	1	1	1	0	1	4
Food, beverages, tobacco	2	2	8	12	13	12	11	15	12	87
Gas, Water, Electricity	5	6	7	8	8	8	8	8	6	64
Hotels & restaurants	5	6	12	13	12	12	12	13	11	96
Machinery, equipment, furniture, recycling	10	11	23	26	27	27	27	28	23	202
Metals & metal products	2	2	11	11	12	14	15	16	13	96
Other services	19	19	46	56	62	59	64	73	66	464
Primary sector	1	1	11	12	12	10	10	9	11	77
Publishing, printing	4	5	11	13	13	13	13	14	12	98
Textiles, wearing apparel, leather	0	0	0	1	1	1	1	2	2	8
Transport	2	3	9	11	11	10	12	11	7	76
Wholesale & retail trade	7	8	21	25	26	25	24	29	24	189
Wood, cork, paper	0	0	1	3	3	4	4	4	4	23
Total	69	74	182	216	**224**	216	222	248	216	1,667

Table 4-2: Descriptive statistics

	Variable	Mean	S.D.	Min	Max
1	ROA (using Net Income)	7.391	8.906	-78.62	89.34
2	directorships	0.027	0.187	0	3
3	gifts	0.074	0.647	0	15
4	sponsorships	0.059	0.084	0	2
5	community engagement	0.614	0.275	0.03	0.97
6	directorships* community engagement	-0.004	0.047	-0.64	0.54
7	gifts* community engagement	0.007	0.173	-5.02	2.76
8	sponsorships* community engagement	0.0005	0.029	-0.85	0.33
9	remunerated employment	0.089	0.628	0	10
10	overseas visits funding	0.157	1.180	0	18
11	miscellaneous	0.007	0.109	0	3
12	dummy linkage to CON when in power	0.006	0.080	0	1
13	dummy linkage to LAB when in power	0.052	0.222	0	1
14	portfolio political linkages	0.113	0.801	0	13
15	repetitive political linkages	0.272	1.196	0	17
16	shareholder politician linkages	0.113	0.485	0	5
1d	dependence asymmetry	0.059	0.189	0	1
18	avg tenure of the politicians	2.164	5.837	0	40
19	size	5.40E+06	2.00E+07	8432.42	3.10E+08
20	leverage	0.633	0.214	0.06	2.32
21	firm slack	17.024	14.330	0.05	95.36
22	dummy for regulated industry	0.088	0.284	0	1

Table 4-3: Correlations table for sampled firms

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22
1	1.00																					
2	-0.02	1.00																				
3	0.00	0.02	1.00																			
4	0.01	-0.01	0.06*	1.00																		
5	-0.05*	-0.01	0.04	0.02	1.00																	
6	-0.05	-0.12*	0.01	0.00	0.00	1.00																
7	0.05*	0.01	0.02	0.07*	-0.02	0.04	1.00															
8	0.01	0.00	0.05*	-0.05*	-0.05	-0.01	0.06*	1.00														
9	-0.08*	0.07*	0.21*	0.10*	0.06*	-0.03	0.18*	0.09*	1.00													
10	-0.01	-0.01	0.36*	0.02	0.04	0.00	-0.04	-0.04	0.03	1.00												
11	-0.02	0.02	0.03	0.00	0.02	0.00	0.03	0.00	0.03	-0.01	1.00											
12	0.02	0.07*	0.15*	0.17*	0.02	-0.06*	0.17*	0.09*	0.18*	0.06*	0.06*	1.00										
13	-0.01	0.12*	0.39*	0.21*	0.12*	0.00	0.13*	0.11*	0.38*	0.52*	0.23*	0.11*	1.00									
14	-0.06*	0.11*	0.58*	0.08*	0.05	-0.04	0.14*	-0.01	0.59*	0.51*	0.07*	0.21*	0.45*	1.00								
15	0.00	0.12*	0.53*	0.10*	0.07*	-0.04	-0.01	-0.08*	0.35*	0.70*	0.08*	0.16*	0.54*	0.68*	1.00							
16	0.10*	-0.03	0.01	0.06*	0.11*	-0.01	0.01	-0.10*	0.00	0.26*	0.08*	0.09*	0.21*	0.08*	0.47*	1.00						
17	0.02	0.42*	0.26*	0.24*	0.10*	-0.09*	0.09*	0.10*	0.25*	0.24*	0.09*	0.12*	0.56*	0.22*	0.32*	0.10*	1.00					
18	0.00	0.43*	0.25*	0.10*	0.14*	-0.05	0.05*	0.03	0.35*	0.21*	0.10*	0.07*	0.51*	0.30*	0.45*	0.39*	0.74*	1.00				
19	-0.01	0.00	0.09*	0.00	0.11*	0.00	0.04	-0.02	0.06*	0.52*	0.06*	0.13*	0.37*	0.17*	0.53*	0.51*	0.12*	0.25*	1.00			
20	-0.10*	0.16*	0.08*	-0.01	0.04	-0.11*	0.01	0.06*	0.08*	0.04	0.00	0.00	0.10*	0.08*	0.09*	0.05*	0.20*	0.19*	-0.02	1.00		
21	0.39*	-0.03	-0.02	0.09*	-0.04	0.01	0.02	-0.06*	-0.01	0.00	-0.03	0.03	-0.02	-0.02	-0.02	0.00	0.03	-0.01	-0.06*	-0.24*	1.00	
22	-0.06*	-0.05	0.13*	0.10*	0.02	0.00	-0.03	0.00	-0.04	0.12*	0.06*	-0.03	0.11*	0.08*	0.07*	-0.06*	0.06*	-0.01	-0.01	0.15*	0.03	1.00

Significance level: * $p<0.05$

1: ROA using Net Income, 2:directorships, 3: gifts, 4: sponsorships, 5: community engagement, 6: directorships* community engagement, 7: gifts* community engagement, 8: sponsorships* community engagement, 9: remunerated employment linkages, 10: overseas visits funding linkages, 11: miscellaneous linkages, 12: dummy linkage to CON when in power, 13: dummy linkage to LAB when in power, 14: portfolio political linkages, 15: repetitive political linkages, 16: shareholder politician linkages, 17: dependence asymmetry, 18: average tenure of politicians, 19: size, 20: leverage, 21:firm slack, 22: dummy for regulated industry

Table 4-4: Variance Inflation Factors

Variable	VIF	1/VIF
ROA (using Net Income)	1.59	0.627247
directorships	2.12	0.471543
gifts	1.21	0.823315
sponsorships	5.47	0.182693
community engagement	1.04	0.96197
directorships* community engagement	1.14	0.880078
gifts* community engagement	1.1	0.908944
sponsorships* community engagement	2.83	0.352738
remunerated employment	3.87	0.258407
overseas visits funding	1.16	0.861237
miscellaneous	1.22	0.81786
dummy linkage to CON when in power	2.85	0.351307
dummy linkage to LAB when in power	4.24	0.235817
portfolio political linkages	5.49	0.182252
repetitive political linkages	2.44	0.409617
shareholder politician linkages	3.64	0.274706
dependence asymmetry	4.16	0.240322
avg tenure of the politicians	2.19	0.457304
size	8.69	0.115059
leverage	2.45	0.408157
firm slack	1.2	0.83238
Year dummies	(…)	(…)
Mean VIF	2.7	

Table 4-5: Impact of Political Linkages and Community Engagement on Firms' Financial performance

DV: ROA (using Net Income)	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)
l.directorships		-1.778**		-1.777**	-1.725**
		(0.597)		(0.600)	(0.648)
l.gifts		0.579		0.579	0.585
		(0.494)		(0.495)	(0.389)
l.sponsorships		-3.951+		-3.950+	-3.688*
		(2.398)		(2.398)	(1.503)
l.community engagement			0.012	-0.007	0.025
			(0.890)	(0.873)	(0.909)
l.directorships* l.com eng.					0.654
					(3.837)
l.gifts* l.com eng					0.820+
					(0.499)
l.sponsorships* l.com eng					8.761*
					(4.124)
l.remunerated employment	-1.217	-1.173	-1.217	-1.173	-1.279
	(0.862)	(0.799)	(0.863)	(0.801)	(0.934)
l.overseas visits funding	-0.349	-0.357	-0.349	-0.357	-0.330
	(0.407)	(0.364)	(0.410)	(0.366)	(0.389)
l.miscallenous	-1.221	-1.358	-1.219	-1.358	-1.241
	(1.391)	(1.219)	(1.421)	(1.250)	(1.252)
l.dummy linkage to CON	1.752	2.290	1.751	2.288	1.871
when in power	(2.661)	(2.573)	(2.615)	(2.535)	(2.590)
l.dummy linkage to LAB	2.113	2.250	2.113	2.250	1.947
when in power	(3.389)	(3.036)	(3.397)	(3.044)	(3.022)
l.portfolio political linkages	0.433	0.260	0.433	0.260	0.206
	(0.282)	(0.258)	(0.286)	(0.261)	(0.256)
l.repetitive political	-0.003	-0.005	-0.003	-0.006	0.075
linkages	(0.231)	(0.174)	(0.228)	(0.172)	(0.193)
l.shareholder politician	0.498	0.563	0.502	0.567	0.652
linkages	(0.620)	(0.679)	(0.620)	(0.679)	(0.675)
l. dependence asymmetry	3.589+	4.074*	3.588+	4.075*	3.813*
	(1.986)	(1.810)	(1.948)	(1.773)	(1.786)
l.avg tenure of the	-0.126+	-0.125+	-0.126+	-0.125+	-0.122+
politicians	(0.072)	(0.066)	(0.071)	(0.065)	(0.065)
size	0.000***	0.000***	0.000***	0.000***	0.000**
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
leverage	0.798	0.797	0.799	0.799	0.872
	(2.233)	(2.237)	(2.227)	(2.232)	(2.214)
firm slack	0.401***	0.404***	0.401***	0.403***	0.401***
	(0.087)	(0.089)	(0.087)	(0.089)	(0.089)
dummy for regulated	-2.781+	-2.858*	-2.781+	-2.857*	-2.796*
industry	(1.476)	(1.373)	(1.475)	(1.371)	(1.331)
Year dummies	Y	Y	Y	Y	Y
Observations	1,667	1,667	1,667	1,667	1,667
Number of firms	281	281	281	281	281
F stats	.	.	.	.	.
p value	.	.	.	.	.

Robust standard errors in parentheses *** p<0.001, ** p<0.01, * p<0.05, + p<0.10

Figure 4-2: Marginal Impact of Board Directorship of Politicians on ROA, with differing levels of Community Engagement

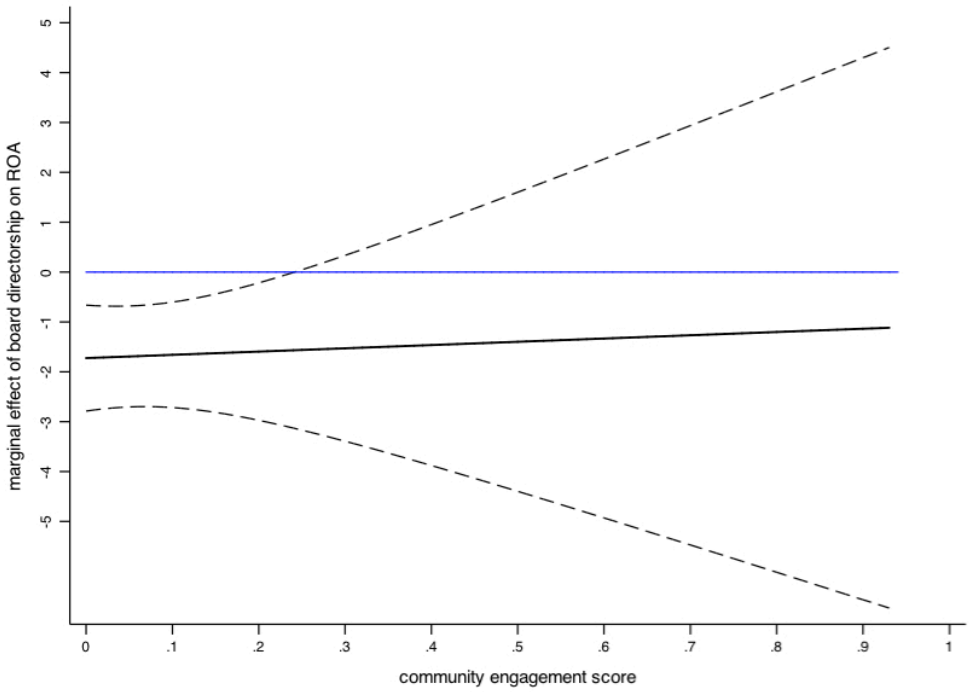


Figure 4-3: Marginal Impact of Gift Giving to Politicians on ROA, with differing levels of Community Engagement

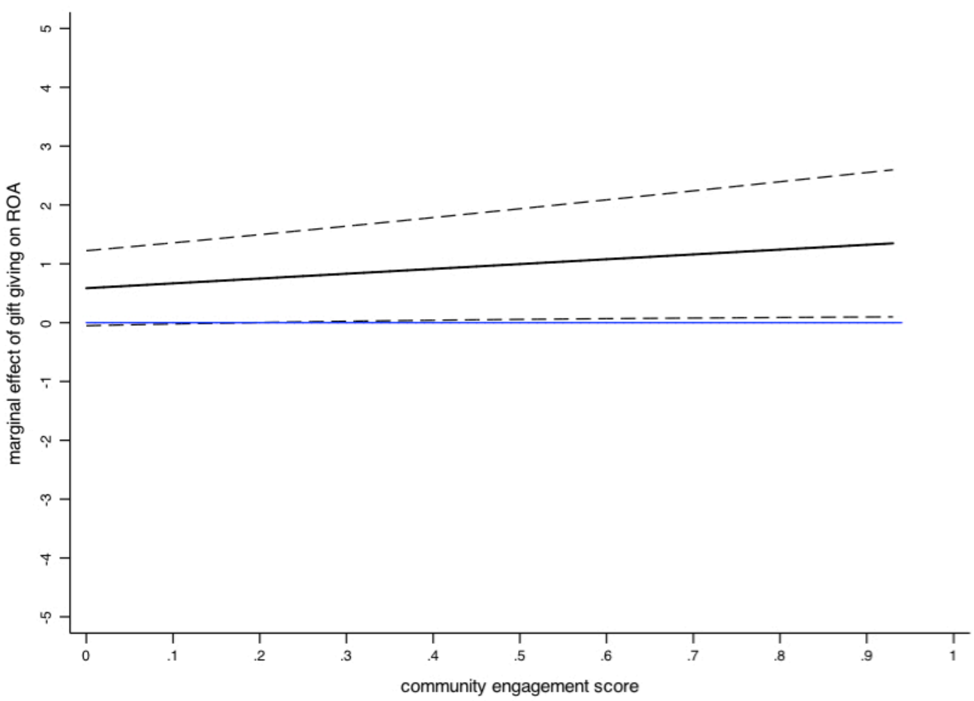
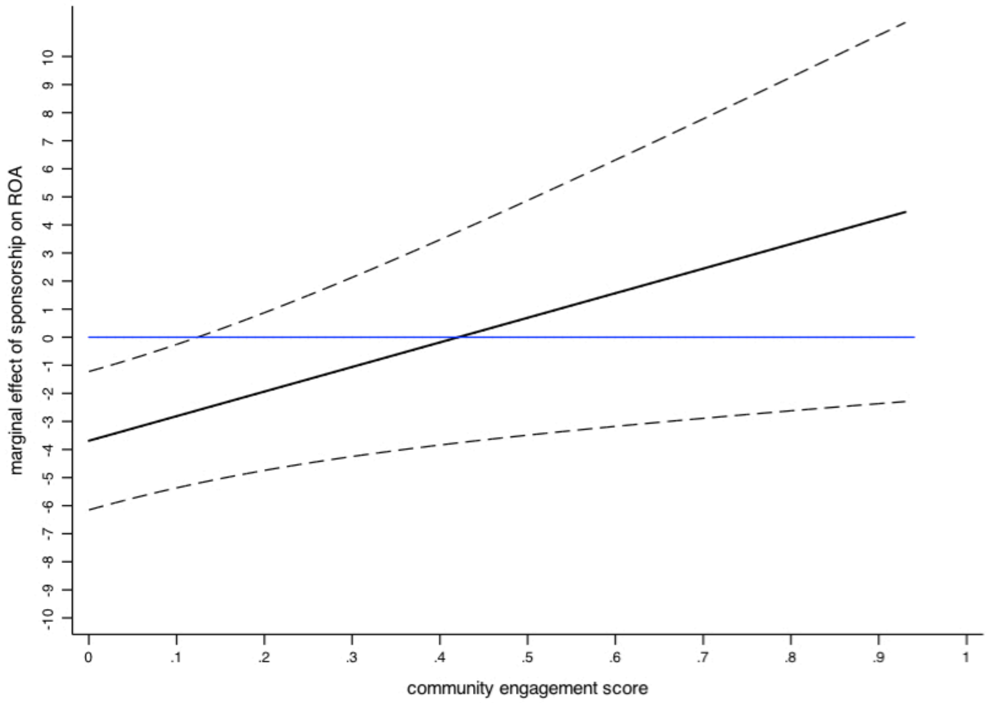


Figure 4-4: Marginal Impact of Sponsorships on ROA, with differing levels of Community Engagement



Annex 4-1: Variable descriptions for Table 4-5

directorships: Count of all directorship linkages that a firm has during a given year.

gifts: Count of all gift linkages that a firm has during a given year.

sponsorships: Count of all sponsorship linkages that a firm has during a given year.

community engagement: Score of a firm in terms of engagement in the community, ranges between 0 and 1, continuous.

directorships*community engagement: Interaction term between the count of directorship linkages and community engagement score.

gifts*community engagement: Interaction term between the count of gift linkages and community engagement score.

sponsorships* community engagement: Interaction term between the count of sponsorship linkages and community engagement score.

dummy for linkage to CONS when in power: Dummy for connection to Conservative Party when in power (=1 when the firm has at least one linkage within a given year to the Conservative party, when the party is in power; =0 otherwise)

dummy for linkage to LAB when in power: Dummy for connection to Labor Party when in power (=1 when the firm has at least one linkage within a given year to the Labor party, when the party is in power, =0 otherwise);

remunerated employment: Count of all remunerated employment linkages that a firm has during a given year.

overseas visits funding: Count of all overseas visits funding linkages that a firm has during a given year.

miscellaneous: Count of miscellaneous linkages that a firm has during a given year.

shareholder politician linkages: Count of all linkages with politicians that the politician is also a shareholder of the firm, during a given year.

portfolio political linkages: Count of all linkages with politicians that the firm has multiple types of linkages with the same politician, during a given year.

repetitive political linkages: Count of all linkages with politicians that endures from the year before with the same politician, during a given year.

average tenure of politicians: Average tenure (in years) of all politicians that a firm is linked with during a given year.

dependence asymmetry: Ratio of the count of firm's linkages to politicians during a given year to the count of the connected MPs' all linkages during a given year.

size: Turnover of the firm.

leverage: Total Debt/Total Assets of the firm.

firm slack: Cash flow/Operating revenue of the firm.

dummy for regulated industry: Dummy for whether the firm is in a regulated industry (=1 if the firm's industry is a regulated one and =0 if not; regulated industries: banking; utilities (gas, water, electricity); telecommunications; transport; insurance)

5 CHAPTER 5: CONCLUSION

This dissertation investigates the performance implications of firms' non-market strategies. In this dissertation, the term "non-market" is used as it pertains to the relationship between firms and two aspects of the firms' external environment: politicians and society. Non-market environment of a firm creates uncertainty and dependence for the firm. Designing and deploying strategies towards non-market players is crucial for the firm, and has implications on firms' survival and performance. To understand better how firms' non-market strategies impact firms' financial performance, this dissertation answers in three steps the main research question:

What impact do non-market strategies have on firms' financial performance?

To be able to answer this main research question, this dissertation addresses three separate research questions. First, a theoretical framework outlining the factors that lead to rent extraction from firms by politicians is provided. Then, the relationship between political linkages and financial performance of firms is explored, through distinguishing between different types of linkages that expose firms to different levels of rent extraction by politicians. Finally, simultaneous deployment of different non-market strategies and their complementary nature, and the eventual impact on firms' performance are investigated. Main results are summarized below.

5.1 MAIN RESULTS

Essay 1 looks into firm-politician linkages and outlines the conditions under which rent extraction by politicians from firms will occur. Taking a social exchange theory perspective, it looks into rent extraction by politicians as determined by a multitude of factors which all change the power dynamics between the firm and the politician. The framework distinguishes between factors that would act as sources of power for the parties in the exchange, and factors that would act as constraints on the use of power behold by the parties, specifically by the politician. The conceptual framework outlines the boundary conditions of dependency management actions by firms such as building linkages with politicians, and draws attention to the double blade nature of such linkages. Also, this framework provides a first step in explaining the interplay of multiple-level factors such as firm level, politician level, relationship level and political/social institutions level, and the impact of this interplay on rent extraction.

Essay 2 focuses on the micro-dynamics of the political linkages firms establish, and how the characteristics of different linkages expose the firm to differing levels of misappropriation of firm resources, i.e. rent extraction by politicians, and thus impact the value captured by the firm from those linkages. Three types of linkages, differing in their characteristics in terms of the uncertainty they inherit regarding future exchanges and ex-post dependencies they create are investigated: Board directorship of politicians, which locks the firm and the politician in an exchange and create asymmetric ex-post dependencies; gift giving to politicians, which limits firms' ex-post dependencies while preserving the uncertainty regarding continuation of exchanges; and sponsorship to politicians which create asymmetric ex-post dependencies, while bringing about very low frequency of exchanges, thus few chances of an ongoing exchange. Empirical analysis is based on a unique longitudinal dataset containing information on these three types of linkages (among others) between firms and politicians in the UK. The analysis provides robust evidence that board directorship of politicians, as well as sponsorship provision to politicians are negatively and significantly related to firms' financial performance, whereas gift giving to politicians is positively and significantly related to firms' financial performance. The results confirm the predictions that exchanges through linkages that create asymmetric ex-post dependency of the firm on the politician, and that decrease incentives for the politician to reciprocate will increase the rent extraction by the politician from the firm, while decreasing the likelihood for the firm of obtaining benefits from the politician; and thus will impact financial performance negatively. Exchanges through linkages that create incentives for the politician to reciprocate and that limit the ex-post dependency of the firm on the politician, on the other hand, will increase the likelihood of the firm to obtain benefits from the politician, while decreasing the rent extraction of the politician from the firm, and thus will impact firm performance positively.

Finally, Essay 3 investigates the financial performance implications of using a portfolio of non-market strategies, i.e. combining strategies targeted towards different dimensions of the non-market environment, such as towards politicians and society. It looks into how community engagement acts as a complement to firms' political linkages, since it changes the power dependence dynamics between the firm and the politician. Two mechanisms are put forward to explain how this complementarity functions: First mechanism is about the increase in the attractiveness of firms that are engaged in the community as exchange partners for politicians. In other words, it is about how the value of the firm for the politician as an exchange partner, thus its power in the relation increases. Second mechanism is about how community engagement alters the asymmetry of dependence between the parties in favor of the firm, since it increases the likelihood of the firm to find alternative sources to obtain benefits in the political arena. In other words, it is about how the value of the relation with the politician decreases for the firm. Using hand-collected data on political linkages of UK firms from 2002 to 2011, as well as community engagement data provided by an extra-financial rating company, Asset4, this essay systematically investigates the impact of such a portfolio approach to non-market strategies on firm's financial performance. In line with the predictions of the essay, findings indicate that firm actions in one non-market field, such as community engagement targeting the social environment, may serve as leverage in other non-market fields, such as the political environment, and improve the financial returns for the firm.

5.2 CONTRIBUTIONS TO STRATEGIC MANAGEMENT LITERATURE

This dissertation aims to contribute to strategic management literature both theoretically and empirically.

5.2.1 Contributions to resource dependence theory

One of the contributions of resource dependence theory to management literature has been to discern and describe the strategies employed by organizations to change and to adapt to the environment (Scott, 1992). RDT has been used as a useful perspective on research on inter-organizational relations, especially on a dyadic level. However, one of the "challenges" for RDT is that its prescriptions are intertwined with its theoretical predictions (Casciaro & Piskorski, 2005). The theory has focused primarily on the "cooperative" side of relationship formation, and has ignored the possibility that both parties can be manipulated (Davis & Cobb, 2010). In other words, RDT has been mostly used to investigate the rationale for establishing linkages rather than on the risk of partners' potential misappropriation of the firm's resources (Katila et al., 2008). In other words, it does not really address the question of "what happens next?" once the linkage is in place. By explicitly taking into account the costs that might arise from a dependency management tactic, i.e. building linkages with politicians; and by investigating the dynamics as well as the consequences of such dependency management tactics, this dissertation aims to contribute to defining boundary conditions for the theory. Moreover, through the theoretical framing, this dissertation aims to contribute to a refined definition of the sources of power and dependence, which is called for (Davis & Cobb, 2010), specifically in the context of firm-politician relations.

RDT has also been unclear about how multiple dependencies are to be managed. Although the theory takes into account the problems arising from competing demands, and states that a firm survives only to the extent it creates and maintains the coalition of support necessary for operation, the theory sees these multiple demands rather as a "problem" and does not suggest ways to overcome such problems. Through looking into firm strategies targeting multiple fields of the non-market environment, this dissertation also shows how firm strategy in one non-market field may be used as leverage in another non-market field, having financial performance consequences in the "market" environment. This provides further support to the view that inter-dependence can be multi-lateral and socially constructed, not just fixed and dyadic (Ozcan & Eisenhardt, 2009), and that multiple demands may not always create a problem.

5.2.2 Contributions to literature on firms' political strategies

Strategy research has paid little attention to firm differences in being exposed to and responding to threats and opportunities stemming from the political environment (Henisz & Zelner, 2003a).

First, this dissertation aims to contribute to the literature on political strategies of firms through investigating the characteristics and consequences of exchanges between firms and politicians, since "relatively little is known about such exchanges (Cropanzano &

Mitchell, 2005). The dissertation shifts the focus of exchanges to firm-politician level, and provides a granular analysis of the interaction between the firm and the politician, taking into account both parties' attributes and how these attributes will interact with each other within the dynamics of the relationship as well as the context.

Second, this dissertation contributes to the literature on firms' political strategies by taking into account the downsides of firms' political linkages, in addition to the potential value to be drawn from them. The findings on negative returns from political linkages (as shown in the cases of board directorship of politicians as well as sponsorships provided to politicians) complement very recent studies that have questioned the value drawn from firms' political linkages (Aggarwal et al., 2012; Coates, 2010; Hadani & Schuler, 2013; Igan et al., 2011). Complementing this literature, this dissertation provides a more granular analysis of the types of linkages with politicians that firms establish, and shows that different types of linkages have differing impacts on firms' financial performance.

Finally, the dissertation theorizes about the potential moderator factors that will impact the value drawn from political linkages, and provides evidence that firms' political strategies may be complemented with other non-market strategies targeting non-market players other than political actors. Therefore, it treats the external environment of the firm "as the multi-faceted concept it is", and draws attention to not consider the social and political environment of the firm as conceptually discrete (Henisz & Delios, 2002), when analyzing performance implications of firms' non-market strategies.

5.2.3 Contributions to literature on CSR

The impact of firm strategies towards the social dimension of the non-market environment, usually labeled under the corporate social responsibility (CSR) strategies, has been much investigated. Despite a huge literature trying to prove a win-win situation for both the firm and the society, the relationship between CSR strategies and financial performance has remained a question mark (Margolis & Walsh, 2003).

This dissertation looks into a single aspect of such social responsibility strategies, which is community engagement, and shows how firms' engagement in the community may act as leverage in firms' relations with the political actors. Therefore it contributes to CSR literature by showing how such strategies may actually improve financial performance through not direct, but indirect ways. Traditionally, the role of the state in improving social welfare has been emphasized, and even though the role of business in having multiplier effects on development has been admitted, social welfare has been seen as a "result" rather than "purpose" of business actions (Jensen, 2001; Reich, 2007). This dissertation, without challenging this view and without trying to prove a win-win situation from such strategies as community engagement, shows how community engagement may actually act as a source of power for the firm and improves the financial returns from firms' political engagement by increasing the likelihood of obtaining benefits and changing the power dynamics between the firm and the politician, thus mitigating the costs arising from such political engagement.

5.2.4 Managerial implications

Non-market actors have the power to change the business landscape and the competitive positions of firms. Therefore, firms design and deploy strategies towards those players in the non-market environment, and such strategies may have important consequences in their market environment. Firms could ex-ante consider the different factors which will determine the risks and costs arising from such non-market strategies, and very carefully choose strategies that will increase the likelihood of successful management of the uncertainties arising from their non-market environment.

This dissertation has practical implications for managers. It outlines the conditions under which firms will be able to achieve positive returns from their political linkages. It questions the value of appointing politicians to the board of directors of the firm, as well as the value of political sponsorship provided by firms to politicians. It shows, on the other hand, linkages built through gift giving may be advantageous for firms as opposed to other types of linkages, in terms of improving firms' financial performance. Finally, the dissertation draws attention to the complementary nature of community engagement to firm strategies in the political arena. By carefully selecting ex-ante the types of linkages to build with politicians, as well as by forming a portfolio of non-market strategies that is hard to imitate by competitors, firms can achieve a competitive advantage in their market environments (Oliver & Holzinger, 2008).

5.2.5 Public policy implications

Political strategies of firms have been of interest primarily to economists and political scientists. When firms seek benefits through their political strategies, one concern is the re-distribution of existing wealth to those specific firms and the dispersion of the costs to the public and taxpayers arising from the provision of those benefits to firms. Another concern is that at the extreme case, such benefit seeking behavior by firms may result in the so-called "regulatory capture". Regulatory capture occurs when regulatory institutions act in line with the interests of a special group, or individual firm, instead of acting in public interest (Stigler, 1971). From this public policy perspective, firms might be seen as "leviathans" that engage in political activities and whose political agendas are likely to hurt the general welfare of the public. Actually, the tendency to consider governments and regulatory bodies as "unwitting victims rather than willing participants in a relationship that is mutually beneficial to politicians and firms alike" (Desai & Olofsgård, 2008) might bias the analysis of the consequences of such political strategies by firms. I do not argue that firms' political strategies, including the linkages they build with politicians are not likely to harm public welfare. However, when designing public policies to decrease the likelihood of such adverse effects, actors on both sides of the relationship should be taken into account.

Prohibiting exchanges between firms and politicians would be practically impossible, and may result in an increase in informal and disguised relations between the two parties. Instead, increasing the requirements for disclosure of firm-politician relations might be a better option, since it allows for overseeing these linkages without pushing them under the table. To adopt mechanisms that would disincentivize such exchanges between firms and politicians carries the risk of eliminating the possible win-win cases for the firm and the public, since firms' political pursuits may not always be at the expense of the public welfare. For instance, firms might demand from politicians better infrastructure, or stability in the financial markets, which clearly is beneficial for the public too.

5.3 LIMITATIONS AND AVENUES FOR FURTHER RESEARCH

On top of those limitations mentioned within the essays, there are further limitations to this dissertation that should be acknowledged, most of which also provide avenues for further research.

First of all, in terms of non-market strategies targeting the political environment, this dissertation focuses only on direct linkages between firms and politicians, and does not take into consideration group-level political strategies targeting the political environment of the firm, such as through business associations, industry associations or lobbying groups. In real life, relations between firms and their political environment are multi-layered. Olson's (1965) seminal work in political science delineates two levels of participation for public arena: individual level and collective level. In case of firm political action, this would correspond to firm level and collective level strategies. In many countries political actions at the firm level is observed more and considered more influential than political actions at the collective level, i.e. firm level contributions or lobbying are observed more than collective level political actions and are deemed as more influential (Baumgartner & Leech, 2001; Coen, 2007; John & Schwarzer, 2006). Still, even though beyond the purpose of this dissertation, a more fine-grained approach taking into account these multiple levels would have improved the analysis regarding the consequences of firms' non-market strategies targeting the political environment. Collective actions pool firms' resources and may decrease the costs arising from the allocation of firm resources to political strategies (Hillman & Hitt, 1999). We may actually observe that firms use collective strategies as substitutes for their individual political strategies (Hansen, Mitchell, & Drope, 2004) or that such collective strategies may act as complements to individual (firm) level strategies (Holburn & Vanden Bergh, 2013).

Second, a main assumption of this dissertation is that firms establish political linkages to manage uncertainty arising from the political environment, thus to manage their dependencies on political actors. However, there might be other reasons why firms build political linkages, such as "celebrity" CEOs who use political resources to satisfy their "taste" for politics (Ansolabehere et al., 2003). The mere existence of the slang "Potomac fever" suggests that some managers are prone to pursue their personal political ambitions rather than targets of the firm for which they work (Hart, 2008). Therefore, even though the empirical setting used in this dissertation lessens concerns about it, the findings of this dissertation may also be indicating to potential agency problems within the firm and costs arising from the firm executives' personal motivations in building political linkages (Hadani & Schuler, 2013). Taking into account this possibility, further analyses using standard variables such as ownership structure, board size and structure, CEO compensation can be used to proxy and control for agency problems. Even though potential agency issues do not rule out the costs arising from rent extraction by politicians, they might be complementary to rent-seeking behavior of politicians in explaining the negative financial returns from political linkages.

Third, this dissertation tests the arguments related to the impact of non-market strategies on firm performance in a single-country context. The underlying institutional environment may have important consequences in terms of the value to be drawn from strategies towards the political environment, as well the social environment. Some argue that the institutional environment rather than political linkages per se may determine whether political strategies by firms are going to be effective or not (Gehlbach et al., 2010). In countries where institutions are weak, politicians may have more discretion over resource allocations and enforcement of regulations, thus the power they have might actually be more (Zhou & Peng, 2012). In turn, this may result in more rent extraction by the politician. On the other hand, in such institutional environments where markets and market-supporting institutions are weak, firms engage more actively in political strategies (Henisz, 2000; Henisz & Zelner, 2003b), since such institutional voids may also provide the firm with more benefits, although the risks may be too much for small firms whereas not that "excessive" for big ones. Moreover, the degree of the strength of the institutional environment may impact the value drawn from individual level vs. collective level political strategies of firms, in the sense that slightly underdeveloped institutional environments might actually push for greater marginal returns of collective political strategies, relative to individual level political strategies; whereas a highly underdeveloped institutional environment may actually generate greater chances of pursuing political benefits by individual firms (Jia, 2013). In a similar fashion, the effectiveness of using community engagement strategies may depend on how a country's socio-political institutions legitimize and interpret the firm's activities as being altruistic or self-serving (Gardberg & Fombrun, 2006). The single country analysis in this dissertation, however, does not allow for testing for the impact of socio-political institutions on the findings. It could yield interesting results to test the proposed relations in this dissertation across different institutional contexts.

Finally, there are further limitations to this dissertation relating to the data and methods used. An empirical limitation pertains to the missing data in the Orbis (BvD) financials database. While information provided by Orbis on large companies is extensive, it is not complete. Unfortunately Orbis does not provide financial information on the full list of companies in the UK. It covers financial information quite extensively on average for the first 2000 publicly listed firms, whereas for the rest of publicly listed firms (more than one third of the whole population), it has much less extensive data. On the other hand, it still provides one of the best available coverage of financials data for the European countries, including the UK. For future work, to avoid the loss of observations due to missing data in Orbis, one possibility would be to complete the data on a certain number of firms in the UK, such as the biggest 1000 firms, even though this would create other selection bias. The missing data in Orbis also avoided me to take into account the private firms in the analyses, although a comparison of public vs. private firms in terms of outcomes of their political linkages could be interesting.

Another limitation regarding the methods used in the empirical analyses is that fixed effects estimation or the random effects estimation used in the essays do not fully address causality issues. Even though I conduct some preliminary tests on potential reverse causality issues, these still do not eliminate the reverse causality concerns. An instrumental variables approach could yield more convincing results in terms of causality of the relationship between linkages and firms' financial performance. Finding a good instrument is not easy, however any fluctuation that would impact the propensity of politicians to establish linkages, which would not have an effect on firms' financial performance would provide a valid instrument for our purposes. Normally, a change in MPs' salaries, a taxation break for remunerated employment of MPs, and similar shocks could be instruments to be used. Future work could test the predicted relations using an instrumental variable approach.

Moreover, in the empirical analyses, since treating all politicians alike can bias the results (Lester et al., 2008), politicians' affiliations with the party in power, as well as their tenure in the parliament are taken into account. However, as theorized in the conceptual framework, politicians differ in their political as well as business capital, and this will have implications in terms the rents they can extract from firms. Further research could empirically integrate in the analyses information regarding the business capital politicians have, which would also allow for a more direct testing of the conceptual framework provided in the dissertation.

5.3.1 Further Research Avenues

To conclude, I will mention some other research avenues that could be worth taking, other than those opportunities arising from the limitations of this dissertation, already listed above.

One interesting avenue for future research lies in looking into the process of how firms may actually establish different types of political linkages to achieve their goals. For instance to look into whether firms with a specific type of linkage (such as gift giving) are more likely to establish another type of linkage, such as board directorship linkages in the future could yield interesting results. A firm's successful engagement in one type of linkage may actually help establishing other types of linkage with politicians (Schuler et al., 2002). On the other hand, while investigating this process of linkage establishment, one could further look into whether the propensity of being exploited actually influences the decision to enter into an exchange with politicians (Davis & Cobb, 2010).

Another potentially fruitful avenue for further research would be to look into outcomes of political linkages for the firm other than financial performance. Market entry, internationalization, mergers and acquisitions, among others, are possible alternative outcomes that could be analyzed, and that could yield interesting insights into the relationships between firms and politicians.

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7 APPENDICES

7.1 Appendix A: Definition of the different types of interests registered by the MPs[52].

- ***Board directorships*****:** Remunerated directorships of the MPs in public and private companies including directorships which are individually unremunerated, but where remuneration is paid through another company in the same group.
- ***Remunerated employment:*** Employment, office, trade, profession or vocation (apart from membership of the House or ministerial office) of the MP which is remunerated or in which the MP has any financial interest.
- ***Sponsorships*****:** (a) Any donation received by an MP's constituency party or association, or relevant grouping of associations which is linked either to candidacy at an election or to membership of the House; and (b) any other form of financial or material support as a Member of Parliament, amounting to more than £1,500 from a single source, whether as a single donation or as multiple donations of more than £500 during the course of a calendar year.
- ***Gifts and benefits:*** Any gift to the MP or the MP's spouse or partner, or any material benefit, of a value greater than one per cent of the current parliamentary salary from any company, organization or person within the UK which in any way relates to membership of the House or to a Member's political activity.

[52] Code of Conduct for the Register of Interests of the MPs, British Parliament, May 2010, http://www.publications.parliament.uk/pa/cm200809/cmcode/735/735.pdf

- ***Overseas visits:*** With certain specified exceptions, overseas visits made by the MP or the MP's spouse or partner relating to or in any way arising out of membership of the House where the cost of the visit exceeds one per cent of the current parliamentary salary and was not wholly borne by the Member or by United Kingdom public funds.
- ***Overseas gifts and benefits:*** Any gift to the MP or to the MP's spouse or partner, or any material advantage, of a value greater than one per cent of the current parliamentary salary from or on behalf of any company, organization or person overseas which in any way relates to membership of the House.
- ***Shareholdings:*** Interests in shareholdings held by the MP, either personally, or with or on behalf of the MP's spouse or partner or dependent children, in any public or private company or other body which are: (a) greater than 15 per cent of the issued share capital of the company or body; or (b) 15 per cent or less of the issued share capital, but greater in value than the current parliamentary salary.
- ***Miscellaneous***: Any relevant interest, not falling within one of the above categories, which nevertheless falls within the definition of the main purpose of the Register which is "to provide information of any financial interest or other material benefit which a Member receives which might reasonably be thought by others to influence his or her actions, speeches, or votes in Parliament, or actions taken in his or her capacity as a Member of Parliament," or which the Member considers might be thought by others to influence his or her actions in a similar manner, even though the Member receives no financial benefit.

7.2 Appendix B: Details of the process of identification of the linkages between firms and politicians

The parliament registers are scanned for extracting company names that have linkages with the Members of the Parliament (MPs). Names (and previous names) of all the publicly listed and formerly publicly listed firms in the UK were matched with the company names in the parliament registers. The first step of this matching is automated, and the code used for this first step allowed for extremely conservative matching[53]. To put it more specifically, at a first step, only partial matching of the company names with the registers was done: i.e. when looking for "Conversus Capital" in the registers, the code based the search on only first three letters of the company name, i.e. "con". The search thus has turned out any word in the registers that started with the three characters "con", such as "constituency", "Conservative", "contribution". Although this character restraint was not the most efficient matching method, it proved to be the safest to avoid matching errors. Full name matching turned out to be too risky since many MPs do not use the full names of the companies when declaring their relationships with the company for the registers. For company names that had less than three characters, such as BP, the code automatically relaxed the restraint and searched for any word in the registers starting with "bp"[54]. Any concerns regarding matching errors are eliminated using multiple matching rounds with different restraint criteria and many rounds of manual checks of consistency of the identified text.

After this primary round of scanning the registers, all the identified text in the registers was used to match the company names that appeared in them with the name of the politician

[53] Matlab program was used to write and run the code.

[54] Similarly, with company names starting with "the", the code allowed for passing on the next word in the company name, so that the actual company name would be searched in the text.

who declared the company's name, i.e. to identify the linkage between a specific firm and a specific politician. To avoid misidentifying any firm-politician linkage, further measures were taken: When a company changes its name and if in the registers the MP referred to the company with its previous name (which was true at the time of the declaration or just because the MP knew the company with its old name), there arises a risk of mismatch if the previous name of the company is now being used by another company. That would mean identifying a wrong linkage. Actually since the code searches for a match in the text for both the current name of the company and all the previous names at the same, and since we had information on all the name changes dates of the companies, further rounds of checks on this were conducted; and where there is any doubt, the information about the company's name was re-checked and re-coded.

7.3 Appendix C: Details of board directorship linkages between firms and politicians

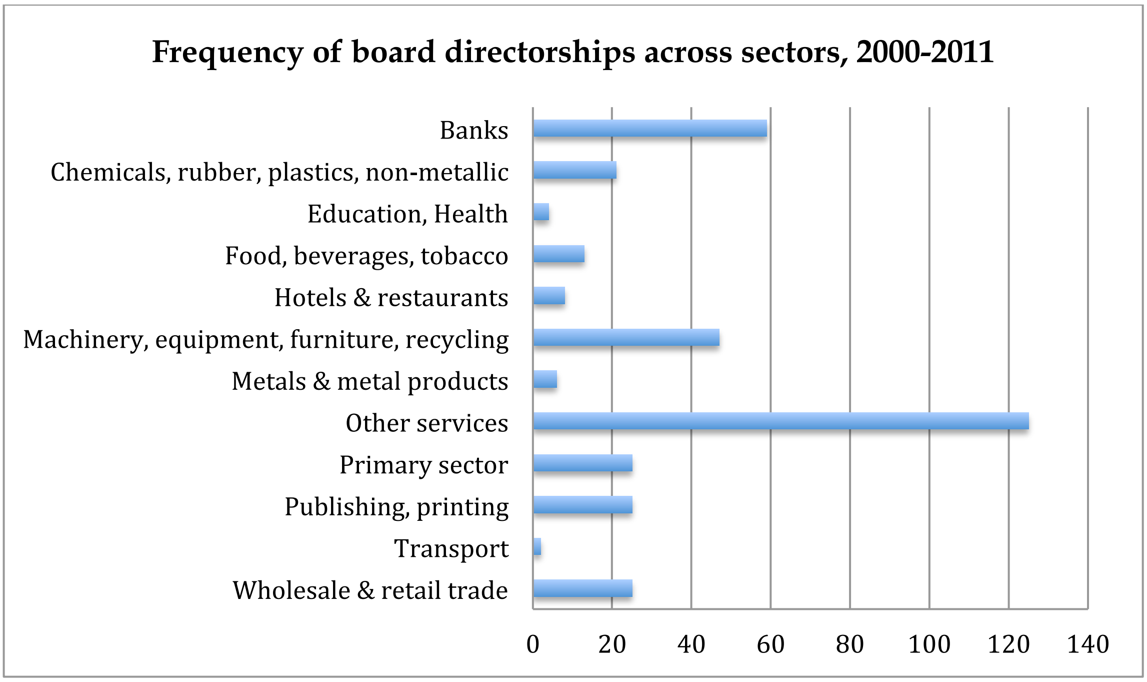
I identify **363 board directorship** linkages that take place between 2000 and 2011, among 68 different companies and 40 different MPs. The data point to the fact that some MPs sit on the board of directors of more than one company, whereas the opposite case, i.e. companies having more than one MP on their board of directors, is very rare.

- The MPs who have the highest number of directorship linkages are: Ian Taylor of the Conservative Party (with 47 directorships), Tony Baldry of the Conservative Party (with 31 directorships), and Francis Maude of the Conservative Party (with 20 directorships).

- Among all the firms, Nextfifteen Communications have the most intense board directorship linkages throughout the years, with 17 board linkages in total, followed by Petards Groups and Topps Tiles both having 13 board linkages. Parkmead Group and Idox PLC rank as the third with 12 board directorship linkages each, during the 12 years of time window.

For the distribution of these directorship linkages sector-wise, please refer to Figure 7-1 below.

Figure 7-1: Frequency of board directorship linkages across sectors, 2000-2011.



7.4 Appendix D: Details of gifts and benefits linkages between firms and politicians

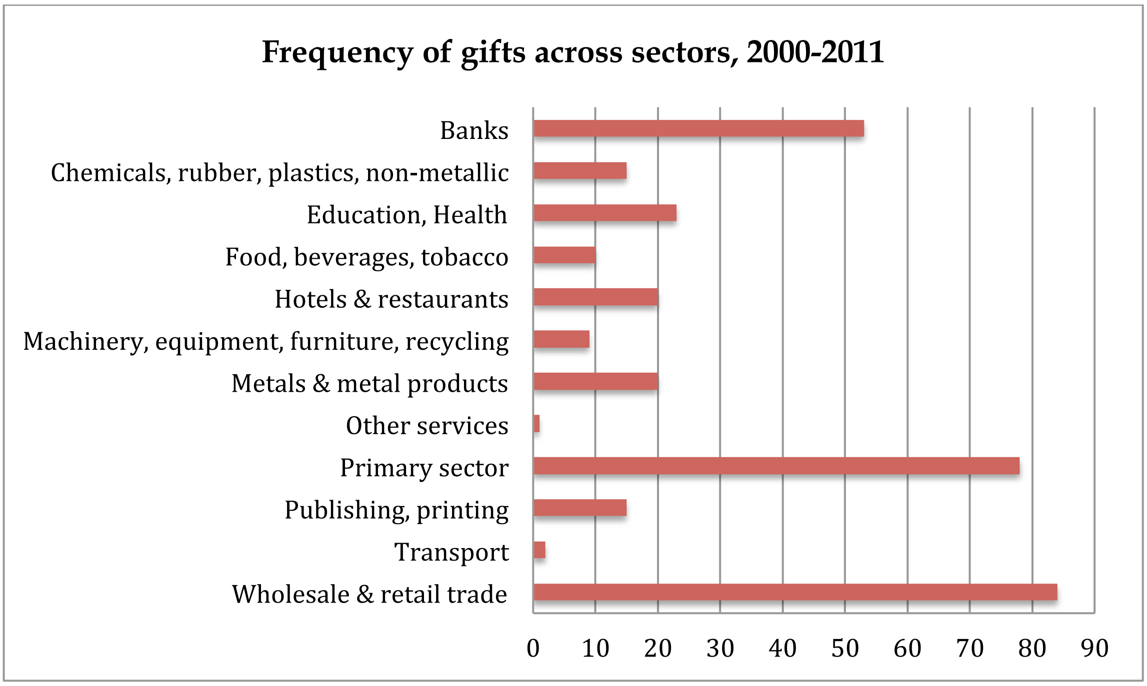
Throughout the 12 years, there are **336 cases of gifts and benefits** provided to politicians. These cases occur between 50 companies and 122 MPs. The data point to the fact that companies give gifts to multiple politicians, and consequently MPs receive gifts from multiple companies.

- Jack Straw of the Labour Party and Gerald Howarth of the Conservative Party rank top in terms of the number of gifts and benefits they received, each with 11 gifts. Menzies Campbell of the Liberal Democrats and Ian Taylor of the Conservative Party, and Jeremy Hunt of the Conservative Party each have received 8 gifts and benefits, while Quentin Davies of the Labour Party ranks after them with 7 gifts and benefits received.

- Among the companies, British Airways ranks as the top gift giver (with 81 gifts and benefits provided) since the company provides many free flights or class updates in its flights to the MPs. Top "gift givers" continue with Provident Financial Plc with 21 gifts and British Sky Broadcasting with 20, Ladbrokes with 18 and BAE Systems with 17 gifts and benefits provided to MPs.

For the distribution of these gifts linkages sector-wise, please refer to Figure 7-2 below.

Figure 7-2: Frequency of gifts and benefits linkages across sectors, 2000-2011.



7.5 Appendix E: Details of sponsorship linkages between firms and politicians

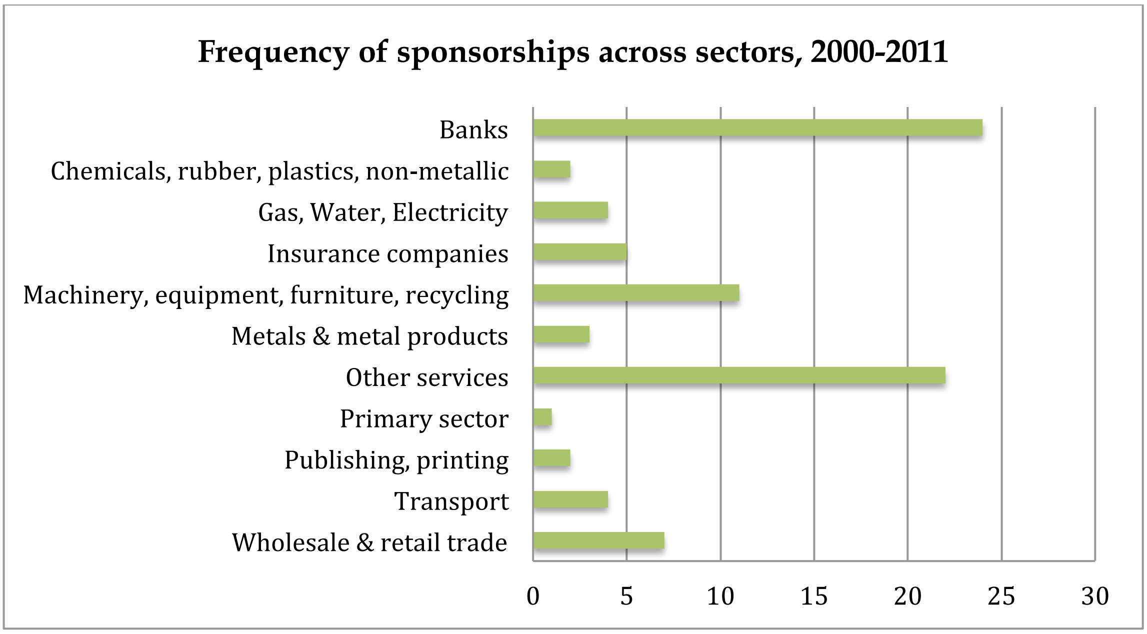
There are **95 sponsorship cases** that take place during the whole time window, between 43 MPs and 31 companies. The data point out interestingly to the fact that whereas some companies have multiple sponsorships, in almost all cases politicians receive sponsorships from a single company, i.e. companies may provide multiple sponsorships to the same MP, however not to multiple MPs.

- Edward Timpson has received the most number of sponsorships, with 10 sponsorships throughout the years. He is followed by Tony Baldry of the Conservative Party, with 5 sponsorships; and then by David Mundell of the Conservative Party, Hazel Blears of the Labour Party, Nick Herbert of the Conservative Party and Roger Casale of the Labour Party, and Oliver Letwin of the Conservative Party with 4 sponsorships each.

- Caledonia Investments rank first in the list of companies who have provided sponsorship to MPs, with 15 sponsorships provided from 2000 to 2011. The company is followed by BT Group PLC and Timpson Services Limited with 10 sponsorship linkages each; and Transense Technologies and Canary Wharf Group PLC with 5 sponsorships each.

For the distribution of these sponsorship linkages sector-wise, please refer to Figure 7-3 below.

Figure 7-3: Frequency of sponsorship linkages across sectors, 2000-2011.



8 SUMMARY OF THE DISSERTATION IN FRENCH

STRATÉGIES HORS MARCHÉ ET PERFORMANCE DES ENTREPRISES

Trois essais sur les liens politiques des entreprises et leur impact sur la performance financière

Cette thèse examine les implications des stratégies hors marché des entreprises en termes de performance. S'appuyant sur la théorie de la dépendance envers les ressources et la théorie de l'échange, elle met en lumière la double nature des stratégies hors marché des entreprises, ainsi que l'importance pour l'entreprise de constituer un portefeuille de stratégies adapté. La thèse s'articule autour de trois essais étroitement liés. Chaque essai aborde un aspect non-traité dans la littérature et vient nourrir la réflexion engagée sur la principale problématique de la thèse :

Quel impact les stratégies hors marché ont-elles sur la performance financière des entreprises ?

L'essai 1 fournit un cadre conceptuel sur les facteurs à caractère contingent qui conditionnent l'extraction de rentes par les politiques auprès des entreprises. Ce n'est que depuis peu que l'interaction entre les entreprises et les politiques a commencé à retenir l'attention des universitaires (Faccio, 2006; Gehlbach, Sonin, & Zhuravskaya, 2010; Hillman, 2005). Les entreprises n'ont pas toutes la même capacité à bien gérer leur environnement politique, ni la même inclination à accepter d'être soumises à l'extraction de rentes par les politiques. L'extraction de rentes par les politiques est inhérente aux relations entre l'entreprise et le politique, puisque ces relations sont fondées sur des échanges entre les parties, et les échanges par définition donnent lieu à un transfert de ressources d'une partie à une autre. Si elle n'est pas bien calculée, cette extraction de rentes par le politique peut entraîner une détérioration de la performance de l'entreprise. C'est pourquoi il est crucial pour nous de comprendre les facteurs qui peuvent conduire à une extraction de rentes par les politiques pour pouvoir évaluer si les stratégies politiques, comme l'établissement de liens avec les politiques, seront « efficaces » sans toutefois nuire à la performance financière de l'entreprise.

Dans ce cadre conceptuel, j'examine d'abord les caractéristiques des partenaires de l'échange, c.-à-d. les caractéristiques des entreprises et des politiques, qui déterminent les ressources que les partenaires de l'échange peuvent potentiellement apporter dans l'échange et donc la dépendance potentielle des partenaires de l'échange envers les uns et les autres et le pouvoir que chaque partie détiendra sur les uns et les autres.

J'examine ensuite les caractéristiques de l'échange, c.-à-d. la dynamique de la relation, qui détermine si le pouvoir détenu par les parties sera utilisé. Je prends également en considération les caractéristiques de l'environnement politique qui peuvent changer les règles du jeu entre les parties, en dispersant le pouvoir au sein de l'arène politique, et modifier la dynamique pouvoir-dépendance entre les partenaires de l'échange et donc avoir une incidence sur l'extraction de rentes par les politiques. Dans ce cadre conceptuel, je fais la distinction entre les facteurs qui agiraient comme des sources de pouvoir pour les parties de l'échange et les facteurs qui agiraient comme des contraintes sur l'utilisation du pouvoir détenu par les parties, et plus spécifiquement par le politique. Ce cadre constitue, en outre, une première étape dans l'explication de l'interaction des facteurs qui entrent en jeu à plusieurs niveaux (l'entreprise, le politique, la relation et les institutions politico-sociales, par exemple) et de son impact sur l'extraction de rentes.

L'essai 2 cherche à déterminer si les entreprises tirent des avantages financiers de leurs liens politiques. Les experts en management s'intéressent de plus en plus aux conséquences de ces liens politiques au niveau de l'entreprise. Un courant de la littérature met en exergue la valeur positive que les entreprises peuvent tirer de leurs liens politiques. Plusieurs études ont démontré que l'établissement de liens avec les politiques a un impact positif sur la performance financière des entreprises (Faccio, 2006; Gehlbach et al., 2010; Hillman, 2005). Ces liens facilitent l'accès des entreprises aux ressources essentielles, comme le crédit (Johnson & Mitton, 2003), l'accès aux renflouements financiers lorsque les entreprises sont en détresse financière (Faccio, Masulis, & McConnell, 2006) et les marchés publics (Goldman, Rocholl, & Jongil, 2009). D'un autre côté, une littérature émergente remet en question la valeur des liens politiques et met en évidence leur incidence négative sur la performance financière des entreprises. Hadani et Schuler (2013) montrent que les investissements politiques des entreprises sous forme de contributions financières au profit des politiques et la nomination d'anciens politiques aux conseils d'administrations ont une incidence négative sur la performance des entreprises sur le marché. Ces liens peuvent devenir un handicap pour les entreprises en cas de changement de régime ou si le pouvoir change de mains (Siegel, 2007), si une figure politique importante en lien avec l'entreprise rencontre des problèmes de santé (Fisman, 2001) ou si l'entreprise se retrouve enfermée dans ses réseaux politiques et ne parvient pas à s'adapter à un contexte commercial qui change rapidement (Sun, Mellahi, & Thun, 2010). Il convient donc de se poser la question suivante : *Les entreprises tirent-elles des avantages financiers de leurs liens politiques, et si oui, à travers quels types de liens ?*

Selon la théorie de la dépendance envers les ressources (RDT – Resource Dependence Theory) (Pfeffer and Salancik, 1978), les entreprises établissent des liens avec les politiques afin de mieux gérer leur dépendance envers l'environnement politique. Par exemple, en établissant des liens, les entreprises espèrent avoir accès aux marchés publics et aux informations privées, ou pouvoir jouer un rôle actif dans la formulation d'une réglementation qui leur est favorable. La RDT a souvent été utilisée pour justifier l'établissement de liens avec des parties externes dans le cadre d'une stratégie de gestion de la dépendance. Cependant, les risques liés à cette stratégie, comme le risque de détournement des ressources de l'entreprise par le partenaire associé ne sont en général pas pris en compte (Katila, Rosenberger, & Eisenhardt, 2008). Autrement dit, la littérature se focalise sur les conditions ex-ante d'établissement de liens avec les politiques, en tenant pour acquis que les entreprises pourront tirer des avantages des échanges mis en place. Or, les liens établis avec les politiques peuvent avoir un effet contre-productif dans la mesure où les politiques qui détiennent le pouvoir d'accorder des avantages à l'entreprise ont également le pouvoir de se procurer des avantages à leur seul profit. Lorsque l'on évalue l'impact des liens politiques sur la performance financière des entreprises, les risques potentiels inhérents à ces liens, ainsi que les avantages financiers privés obtenus par les politiques et donc les coûts imposés aux entreprises doivent être pris en compte. Il existe différents types de liens entre les entreprises et les politiques qui peuvent générer différents avantages et coûts pour les entreprises.

Dans cet essai, je soutiens que la relation entre les liens politiques des entreprises et leur performance financière dépend du type de lien politique et de sa propension à augmenter ou réduire la dépendance *ex post* de l'entreprise vis-à-vis du politique, tout en diminuant ou en augmentant l'incertitude liée aux futurs échanges. Les liens qui augmentent la dépendance *ex post* de l'entreprise vis-à-vis du politique en verrouillant la relation établie, c.-à-d. en rendant difficile pour l'entreprise de mettre un terme à la relation ou d'établir des relations avec d'autres partenaires, tout en réduisant l'incertitude liée aux futurs échanges, augmentent la probabilité d'impacts financiers négatifs pour l'entreprise. D'un autre côté, les liens qui ne créent aucune dépendance *ex post*, en offrant la possibilité de rompre immédiatement la relation et de changer de partenaires d'échange en cas de besoin, tout en préservant l'incertitude liée à la continuité de l'échange entre les parties, augmentent la probabilité de retours positifs pour l'entreprise. C'est pourquoi le niveau de dépendance *ex post* et le niveau d'incertitude liée aux futurs échanges rendus possibles par le lien établi déterminent si les liens établis avec les politiques auront une incidence positive ou négative sur la performance financière des entreprises.

À l'aide de données longitudinales uniques (2002-2011), focalisées sur le Royaume-Uni, cet essai distingue trois types de liens avec les politiques, à savoir les membres du parlement (MP) : la nomination de politiques aux conseils d'administration, le don de cadeaux et l'apport de soutiens financiers aux politiques. L'analyse de 7262 observations sur un panel de 9 ans montre que la participation des politiques aux conseils d'administration et l'apport de soutiens financiers aux politiques ont une incidence négative significative sur la performance financière des entreprises, tandis que le don de cadeaux aux politiques a une incidence positive sur leur performance financière. Les résultats confirment les prédictions de l'essai et mettent en évidence la dynamique coût-bénéfice différente créée par les différents types de liens établis avec les politiques.

L'essai 3 analyse l'impact de l'intégration des stratégies hors marché ciblant deux dimensions différentes de l'environnement hors marché, à savoir les politiques et la société, sur les avantages financiers conférés à une entreprise. Si l'impact de l'environnement politique et de l'environnement social des entreprises sur leur performance financière a fait l'objet d'études, l'intégration des différentes stratégies portant sur les différentes dimensions de l'environnement hors marché est rarement abordée dans la littérature sur le management

(Doh & Lucea, 2013). Certains travaux théoriques préconisent que les entreprises ciblent simultanément différents acteurs « hors marché » et diversifient leurs stratégies hors marché (Baron, 2001, 2003, 2011; Lord, 2000). Cependant, l'utilisation conjointe de différentes stratégies hors marché et les implications de ce déploiement simultané de stratégies portant sur la performance financière d'une entreprise n'ont pas encore fait l'objet d'études systématiques. En outre, ces dernières décennies, nous avons observé des changements dans le monde des affaires, ainsi qu'une augmentation de la co-dépendance entre les entreprises, les politiques et la société et un « rééquilibrage du pouvoir » entre ces différents acteurs (Doh & Lucea, 2013) qui rendent encore plus pertinente l'analyse de l'interaction entre les stratégies hors marché ciblant différents acteurs hors marché. C'est pourquoi, le troisième essai traite de la question suivante : *Quel impact l'intégration des stratégies hors marché ciblant différents secteurs hors marché a-t-elle sur la performance financière des entreprises ?*

Dans cet essai, je prends explicitement en compte le fait que les actions hors marché, par nature, s'apparentent à un portefeuille, et j'analyse l'impact du déploiement simultané de liens politiques et de l'implication sociale des entreprises sur leur performance financière. J'examine comment les actions ciblant l'environnement social de l'entreprise peuvent servir de levier complémentaire dans les autres secteurs hors marché, tel que l'environnement politique de l'entreprise. Deux mécanismes sont mis en avant pour expliquer le fonctionnement de cette complémentarité. Tout d'abord, je soutiens que l'implication sociale des entreprises peut réellement augmenter la probabilité d'une réciprocité avec le politique en augmentant la valeur de l'offre globale proposée par l'entreprise dans le cadre de l'échange. Les entreprises socialement impliquées deviennent des partenaires d'échange plus attractifs pour les politiques en raison des divers avantages qu'elles peuvent offrir au politique, tels que la légitimité, des informations et le soutien de l'opinion public obtenu grâce à leur implication sociale. Ensuite, l'implication sociale des entreprises modifie l'asymétrie de la dépendance entre les parties en faveur de l'entreprise puisqu'elle augmente la probabilité que l'entreprise trouve d'autres sources pour obtenir des avantages dans l'arène politique. Il s'agit du mécanisme par lequel la valeur de l'offre globale du politique diminue pour l'entreprise. Ces deux mécanismes aident l'entreprise à obtenir de la relation d'échange avec le politique les résultats les plus favorables, puisqu'ils modifient les conditions de la relation pouvoir-dépendance en faveur de l'entreprise.

Cet essai exploite un ensemble de données unique composé de 1667 observations, incluant des informations sur les liens politiques des entreprises collectées manuellement et des informations sur l'implication sociale des entreprises fournies par une entreprise de notation extra-financière, Asset4, pour les entreprises cotées en Bourse au Royaume-Uni entre 2002 et 2011. Comme prévu, les résultats indiquent que les actions de l'entreprise dans un secteur hors marché, par exemple les actions ciblant l'environnement social, servent de levier dans d'autres secteurs hors marché, tel que l'environnement politique. Autrement dit, l'implication sociale modère les effets des liens politiques des entreprises, soit en diminuant l'impact négatif des liens politiques qui ont une incidence négative sur la performance financière des entreprises, soit en renforçant l'impact positif des liens politiques qui ont une incidence positive sur la performance financière des entreprises. Les résultats mettent également en lumière l'importance pour l'entreprise de constituer un portefeuille de stratégies hors marché adapté pour obtenir les meilleurs avantages financiers.

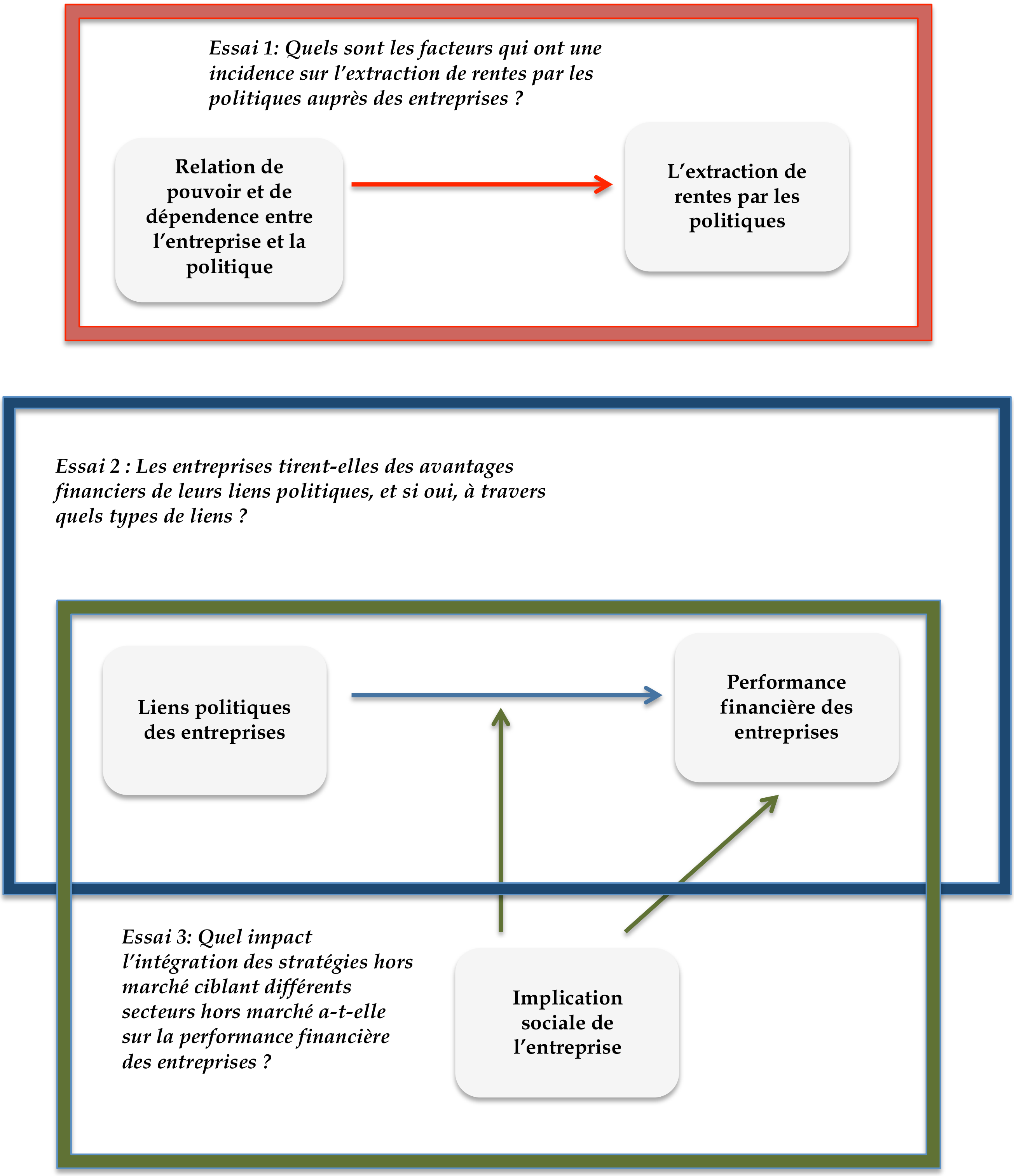
À travers ces trois essais, cette thèse a pour objectif d'étoffer la littérature existante sur le management stratégique, tant sur le plan théorique que sur le plan empirique.

Dans un premier temps, la RDT s'est principalement intéressée à l'aspect « coopératif » de la formation de la relation, en ignorant la possibilité que les deux parties puissant être manipulées (Davis & Cobb, 2010). Autrement dit, la RDT était surtout utilisée pour analyser les raisons d'établir des liens sans tenir compte du risque que les partenaires détournent les ressources de l'entreprise (Katila et al., 2008). La théorie n'aborde pas vraiment la question de « l'après » - que se passe-t-il ensuite, une fois que le lien est en place ? – et ne mentionne pas la probabilité que les politiques demandent une rente aux entreprises, lorsqu'elles établissent des liens politiques. Cette thèse prend du recul pour examiner les conséquences pour les entreprises de cette stratégie de gestion de la dépendance, en analysant les coûts potentiels des liens politiques une fois qu'ils ont été établis et les mécanismes qui peuvent réduire ou augmenter ces coûts. De plus, l'objectif de cette thèse sur le plan théorique est de contribuer à affiner la définition des sources de pouvoir et de dépendance ; ce qui est nécessaire en particulier dans le contexte des relations entreprises-politiques. Enfin, cette thèse émet des hypothèses sur les facteurs modérateurs qui sont susceptibles d'avoir une incidence sur la valeur créée par ces liens politiques, et apporte la preuve que les stratégies politiques des entreprises peuvent être complétées par d'autres stratégies hors marché ciblant les acteurs hors marché, autres que les acteurs politiques. Elle traite donc de l'environnement externe de l'entreprise « en tant que concept à multiples facettes » et souligne l'importance de ne pas considérer l'environnement social et et l'environnement politique de l'entreprise comme paramètres indépendants (Henisz & Delios, 2002) dans l'analyse des implications des stratégies hors marché des entreprises en termes de performance.

Concernant les stratégies politiques des entreprises, cette thèse montre que les coûts inhérents à l'établissement de relations directes d'échange avec les politiques sont sous-estimés. La thèse s'intéresse avant tout à la micro-dynamique des liens politiques établis par les entreprises, et explique en quoi les caractéristiques de ces différents liens exposent l'entreprise à des risques plus ou moins élevés de détournement de ses ressources via l'extraction de rentes par les politiques et donc ont un impact sur la valeur captée par l'entreprise à travers ces liens. Les résultats des analyses empiriques mettent en exergue la nécessité de réévaluer la valeur potentielle des liens politiques au niveau de l'entreprise. Les conséquences négatives des liens politiques des entreprises sur l'économie globale ont déjà été identifiées, telles que les barrières à l'entrée de nouvelles entreprises, la limitation de la concurrence sur le marché et la performance médiocre de l'économie à long terme (Caprio, Faccio, & McConnell, 2008; Morck, Wolfenzon, & Bernard, 2005). Les résultats des essais empiriques montrent que les liens politiques peuvent avoir des conséquences négatives au niveau de l'entreprise également. Les conclusions sur les conséquences négatives des liens politiques viennent étayer de très récentes études qui remettent en question la valeur créée par les liens politiques des entreprises (Aggarwal, Meschke, & Wang, 2012; Coates, 2010; Hadani & Schuler, 2013; Igan, Mishra, & Tressel, 2011). Les conclusions évoquent également la possible association entre les activités politiques et sociales des entreprises (Richter, 2011; Werner, 2011).

Pour conclure, cette thèse a également des implications concrètes pour les dirigeants d'entreprises. Elle décrit les conditions dans lesquelles les entreprises pourront tirer des avantages financiers de leurs liens politiques. En sélectionnant au préalable et avec prudence les types de liens à établir avec les politiques, et en constituant un portefeuille de stratégies hors marché difficilement imitable par des concurrents, les entreprises peuvent se procurer un avantage concurrentiel sur leurs marchés (Oliver & Holzinger, 2008).

Structure de la thèse:



~ABSTRACT~

NON-MARKET STRATEGIES AND FIRM PERFORMANCE

Three Essays on Firms' Political Linkages and Their Impact on Financial Performance

Abstract: This dissertation looks into performance implications of firms' non-market strategies. It draws attention to the double-blade nature of firms' non-market strategies, as well as the importance for the firm of forming a right portfolio of such strategies. Using insights from social exchange theory and resource dependence theory, it first outlines the conditions under which firms will be subject to rent extraction by politicians. It then looks into the impact of political linkages on firms' financial performance, differentiating between different types of political linkages; which expose a firm to different levels of uncertainty regarding the continuity of exchange with the politician, and different levels of ex-post dependency on the politician. Finally it investigates how community engagement might act as a complement to firms' political linkages, and how such complementarity may help to achieve improved financial returns from those political linkages. The predictions of the essays are empirically tested using a unique longitudinal dataset covering various types of linkages between all politicians and all publicly listed companies in the UK, for the period from 2002 to 2011. Taking a critical stand on the value to be drawn from firms' non-market strategies, this dissertation contributes to strategic management literature, particularly the literature on firms' non-market strategies and their implications on financial performance.

Keywords: *political linkages, rent extraction, social exchange theory, resource dependence theory, non-market strategies, financial performance*

STRATÉGIES HORS-MARCHÉ ET PERFORMANCE D'ENTREPRISE
Trois essais sur l'impact des Liens Politiques sur la Performance Financière des entreprises

Résumé: Cette thèse explore les implications des stratégies hors marché des entreprises en termes de performance. Elle attire notamment l'attention sur la nature paradoxale des stratégies hors-marché ainsi que sur l'importance pour les entreprises de former des portefeuilles spécifiques de ce type de stratégie. En utilisant une approche fondée de la théorie de l'échange social et sur la théorie de la dépendance aux ressources, cette thèse tout d'abord analyse les conditions pour lesquelles les entreprises sont soumises à une extraction de "rente" de la part des politiciens. Elle explore ensuite l'impact de ces liens politiques sur la performance financière des entreprises. Elle distingue notamment différents types de liens politiques qui exposent les entreprises à différents niveaux d'incertitude quant à la continuité de leur échange avec les politiciens, et à différents niveaux de dépendance à leurs ressources à postériori. Enfin, cette thèse examine comment l'engagement communautaire des entreprises pourrait agir comme une stratégie complémentaire aux liens politiques, et comment cette complémentarité peut permettre d'obtenir de meilleurs retours financiers de ces liens politiques. Les hypothèses de cette thèse sont empiriquement testées sur des données longitudinales uniques couvrant différents types de liens entre l'ensemble des politiciens britanniques et toutes les sociétés cotées en bourse au Royaume-Unis, sur une période allant de 2002 à 2011. En prenant une position critique sur la valeur que les entreprises peuvent tirer des stratégies hors-marché, cette thèse contribue à la littérature en management stratégique, en particulier à celle portant sur les stratégies hors-marché des entreprises et leurs implications en termes de performance financière.

Mot clés : *liens politiques, extraction de rente, théorie de l'échange social, théorie de la dépendance aux ressources, stratégies hors-marché, performance financière*