

# **STICKING TO THE RULES OR SHAPING THEM - CORPORATIONS BETWEEN MARKET- AND NON-MARKET-ORIENTATION**

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## **Abstract**

Oliver Williamson (2000) distinguishes between different levels of institutions. What these levels have in common is that they serve the purpose of furthering cooperation and avoiding problems related to market failure. Institutions at the level of the environment of firms, e.g. the protection of intellectual property rights or the protection of the natural environment, often deal with repeated cases of market failure or inefficiencies caused by external effects. They have a strong effect on firms.

Firms basically have two behavioural options concerning their institutional environment: They can stick to the existing rules, in other words accept the institutional environment as given, and try to compete successfully within the “rules of the game” (North 1990, 3). Market-orientation would be the name of the game in this case. Or they can try to shape the institutional environment in their own favour in order to achieve a competitive advantage through favourable “rules of the game”. Corporate political activity or non-market-orientation would be the label for this type of behaviour.

Douglas North (1990) claims that the behaviour towards institutions and the desire to change or not to change them depends on an individual cost-benefit calculation. In order to understand institutional change and the direction of change, it would therefore be helpful to understand the drivers of cost and benefit of change for the economic actors.

In this paper we aim at shedding some light onto this matter. We combine a new institutionalism with research results from path dependence theory and the resource based view. By doing so, we are able to better understand the drivers or rather the motivation of economic actors

and their efforts towards shaping the institutional environment. Our empirical research confirms that a lock-in into a public-affairs orientation (non-market strategy) seems to be a good explanation of the firms' activities to shape their institutional environment. The influence of corporations focussing on CPA might well result in an institutional environment that does not aim to solve the problem of (repeated) market failure but rather shapes the environment in the firms' interests. A potentially troublesome insight from our work might be that especially firms showing a weak performance on the market with respect to customer satisfaction will engage in CPA resulting in an institutional environment that might favour the weaker players on the market. Furthermore it seems that a non-market strategy focus of firms might actually reduce their market performance even further.

## **1. Introduction**

Corporate political activity (CPA) is as old as business. Pablo Spiller and Sanny Liao (2006) argue that the participation of interest groups in public policy making is unavoidable. Although this influence is accompanied by some noteworthy suspicion from both, policy makers and the public, it is generally assumed, that "lobbying" of firms and interest groups works in the favor of those who lobby.

Although this insight is not being questioned, in this paper we would like to point out, that an overly concentration on CPA might also be problematic for firms since they might get locked into a strategy of government orientation (non-market strategy) that could prevent them from being customer oriented (market strategy) in the long run. Even though this might not be a problem, when competitive pressure is low, firms might face economic problems when competitive pressure increases. A strategic lock-in with respect to government orientation makes shifting between market and non-market orientation a difficult task. By showing this path-

dependent development, we hope to contribute to both, a better understanding of CPA and its effects on the strategic (in)flexibility and performance of firms, and a better understanding of the role of corporations in shaping the institutional environment. Self-reinforcing mechanisms in connection with non-market orientation are shown as a core mechanism that influences the cost benefit calculation of economic actors (North 1990) with respect to activities directed at changing the institutional environment.

In the following second section we give a brief overview over the main concepts and ideas of the CPA literature. In the third section we develop a theoretical framework for the generation of our hypotheses concerning a potential strategic inertia through CPA. Path-dependence theory and the resource-based view are used to add to our understanding of institutional change. We then present an empirical test of our hypotheses and a discussion of the results. In the last section we present conclusions, including managerial implications and some thoughts about further research.

## **2. Corporate Political Activity – A Brief Introduction**

CPA is defined as corporate attempts to shape government policy favourable to the firm (Baysinger, 1984). The main reasons for CPA are the firm's desire to change the rules of competition and to improve its market position. Since CPA seems to promise economic success, it has received increasing attention in recent years. David Baron (1995) is among those, who emphasize the importance of non-market influences on the firm's strategic development and performance. Baron (1995) proposes an integrated strategy of market and non-market components. Brian Shaffer (1995) discusses the consequences of public policies for the competitive environment of the firm and provides an explanation for political behaviour. Whereas the public usually refers to CPA as "lobbying", researchers are focusing on different types of CPA strategies and their potential impact on firm performance (Boddewyn/Brewer, 1994; Hillman, 2003; Hillman/Hitt, 1999; Meznar/Nigh, 1995). Although equipped with different

perspectives, most work in this field converges in the common estimation that the engagement in CPA results in positive effects for firm performance (Hillman et al., 2004). Several empirical studies have demonstrated the positive impact of CPA on firm performance, although isolating the effect of CPA on performance is rather difficult (Hillman/Hitt, 1999; Marsh, 1998; Shaffer/Hillman, 2000; Shaffer et al., 2000). Others have shown that the benefits of different CPA strategies depend very much on the circumstances under which these strategies are chosen (Spiller/Liao, 2006).

Up to now, only a few studies have been directed towards the potential negative implications of CPA. For instance, Bonardi (2004) dealt with CPA strategies of former monopolies which had a negative influence on their international growth performance. Frynas and Mellahi (2003) analyzed firm specific political risks of transnational corporations. Siegel (2007) found in his study of South Korean enterprises that elite sociopolitical network ties to the regime in power can quickly change between liability and asset for firms which depend on political activities e.g. in cross-border strategic alliances. It is the purpose of this paper to further our understanding of the potential shortfalls of CPA. We argue that – although there might be positive effects of CPA for the firm– there are also cases where an overly concentration on CPA has negative effects on firm's flexibility and performance. We claim that there is a trade-off between CPA, representing a non-market strategy and customer satisfaction representing a potential performance indicator of market strategy. We argue that firms might get locked into a non-market strategy path through CPA that could prevent them from being customer oriented in the long run. At the same time this argument explains corporate activities towards shaping the institutional environment and their role as proponent or opponent of institutional change or rather, agents of institutional change.

Just to give a brief example: The biggest German telecommunications company, Deutsche Telekom, showed that a firm can be very well organized and successful in its non-market strategies by ever increasing engagement into CPA and influencing political decisions on

telecommunication regulation in Berlin and Brussels. But, at the same time their market strategy was not successful in raising the level of customer satisfaction. In addition, during the last years hundreds of thousands of customers have quit contracts and turned away to competitors. However, for a long time, it seemed hard for the Deutsche Telekom to change from non-market-orientation to market-orientation. Why was the management concentrating on managing the institutional environment and on non-market strategy instead of market-strategy? Which impact does this focus have on the firm's performance and on the institutions governing this industry?

### **3. Theoretical Framework**

In this section we will use both, path-dependence theory and the resource-based view in order to explain the cost-benefit calculation of firms towards their CPA concerning the institutional environment. In recent publications such as Dahan (2005a; 2005b) and McWilliams et al. (2002), the resource-based view offered a useful perspective on issues related to CPA such as political resources. For our study a resource-based perspective seems especially promising, because increasing investments of resources in non-market strategies are to be seen as one of the core arguments for a potentially inefficient strategic path development. Since political resources are scarce, immobile and highly specific, they cannot easily be employed at the market strategy side of the company. Hence, these tangible and intangible corporate resources cannot be shifted into market strategies such as raising the customer satisfaction level of the company.

#### **3.1 Political Resources**

Corporate resources are defined as "(...) any means of development controlled by a firm" (Dahan, 2005a, p. 10). Earlier works have already mentioned the need for mobilising specific resources in order to influence public decisions successfully (Baron, 1995, p. 60; Boddewyn,

1993). Political resources therefore meet the definition of corporate resources. They are a means of development of the firm, by generating a favorable political-legal environment. In addition, the resources need not necessarily be owned by the firm as long as it controls them. A typology of political resources can be found in Dahan (Dahan, 2005b, p. 47), where he differentiates among *expertise*, *financial resources*, *relational resources*, *organizational resources*, *reputation among other non-market actors*, *public reputation*, *support of stakeholders*, and *recreational skills*. Table 3.1 provides an overview of the various resource components.

**Table 3.1: Typology of Political Resources**

<i>Political Resource</i>	<i>Components</i>
Expertise	Expertise in technical, managerial, social, ecological, legal, and political fields.
Financial resource	Campaign contributions (directly) and funding investments in other resources (indirectly) for political action.
Relational resource	Sitting on a public committee (formal relationship) or personal contacts (informal relationship).
Organizational resource	Government relations department, legal unit, etc. (internal) or hired consultancy office, trade association, etc. (external).
Reputation among non-market actors	Reputation of the firm's leaders or advocates (individual reputation) and the reputation of the firm itself (institutional reputation).
Public reputation	Short-term perception of the politically active organization by public opinion and the media.
Support of stakeholders	Legitimacy and political weight through: Coalition building (short term), strategic alliances (short to mid term), business association membership (long term), number, unity and variety of the supporting stakeholders (formal to informal).
Recreational skill	All kinds of recreational services supplied to public decision makers and journalists in order to gain the opportunity for a more informal, personal and perhaps favorable contact. Includes diverse services like: wining and dining, free trips, as well as social events.

*Source:* According to Dahan (2005a, p. 14; 2005b, p. 47)

However, in order to use the resource-based view in combination with any path-dependence argument, it would be necessary to measure investments in CPA related resources. So far indirect indicators such as spending on political action committees have been used in research to measure the level of CPA on a firm level. A conceptualization and operationalization of CPA as a theoretical construct has not yet been established in the literature (for initial research on this topic see Siedentopp, 2007a; Siedentopp, 2008a). Therefore, one key challenge of this paper is to operationalize the CPA construct on the basis of Dahan's (2005b) typology in order to evaluate path-dependence through CPA. The second main challenge is to prove the existence of path-dependence mechanisms that in the end lead into a strategic lock-in, explaining the role of firms as agents of institutional change or persistence. Path-dependence theory is applied for this second challenge and its logic will now briefly be described.

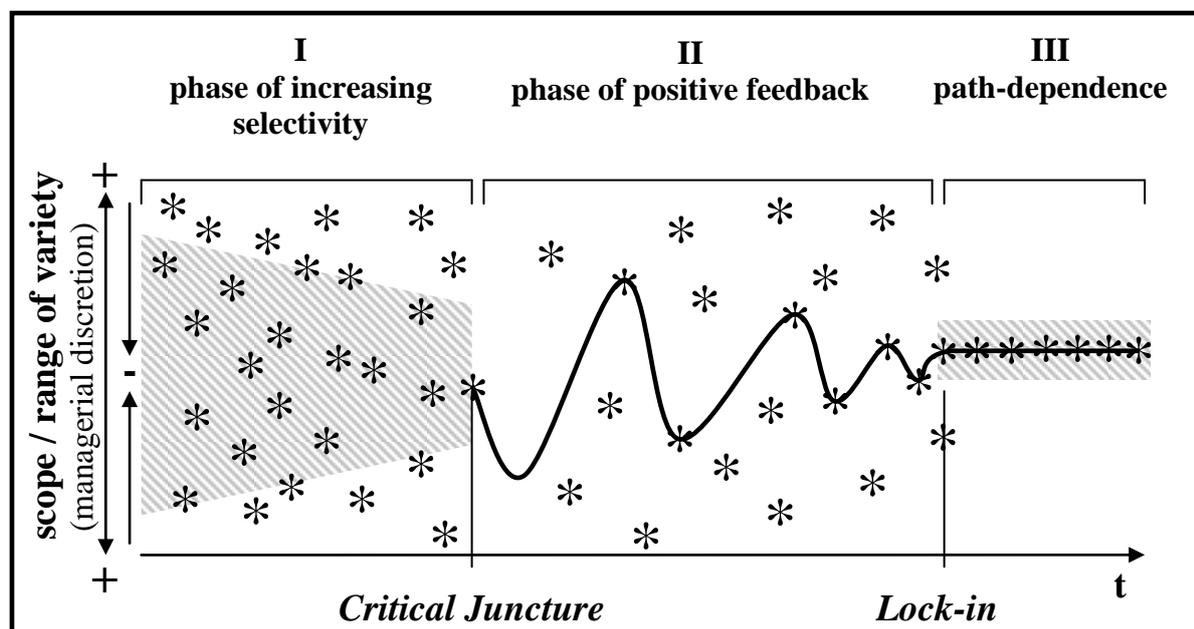
### **3.2 Path-dependence Theory**

The general claim of path-dependence theory is that a (strategic) process over time can, at a final stage, lead to a lock-in situation, where change will be very hard, costly or even impossible (Arthur, 1989; Arthur, 1994; David, 1985). Taking path-dependence theory as a rigorous perspective, it can be understood as an approach to explain emerging process-related phenomena, thereby focussing on self-reinforcing mechanisms and forming specific strategic practices (a combination of routines and resources) which eventually *can* lead to a lock-in situation (Sydow et al., 2005). In other words, path-dependence tries to explain how strategic scopes narrow down over time.

The most prominent example of path-dependence was described by Paul David (1985), when he explained why the QWERTY-keyboard succeeded over its alternative and, in his opinion, more efficient keyboard formations. Although his reasoning drew opposition from economists like Liebowitz/Margolis (1990), path-dependence theory has since then gained much support.

More recently, path-dependence examples can be found in Burgelman's (2002) case study of the Intel Corporation, in which he explained the development of a strategic inertia situation within a firm and in many other contributions (e.g. Black/Boal, 1994; Dougan/Bronson, 2003; Garud/Karnøe, 2001; Greener, 2002; Karim/Mitchell, 2000; Koch, 2006; Lamberg et al., 2004; Mahoney, 2000; Pierson, 2000; Siedentopp, 2008a; Siedentopp, 2008b; Wilts, 2006). Six types of self-reinforcing mechanisms are held responsible for a process of path-dependence: *economies of scale and scope* (main focus: cost), *direct and indirect network externalities* (utility), *learning* (skills/capabilities), *adaptive expectations and expectations of expectations* (standardisation), *coordination effects* (interaction), and *complementary effects* (connectivity) (Koch, 2006). Figure 3.1 illustrates how a path-dependent process can be divided into three stages.

**Figure 3.1: Model of a Path-Dependence Process**



Source: Sydow et al. (2005, p. 18)

First, we find a phase of increasing selectivity, wherein the firm's management makes certain decisions. A second phase is marked by positive feedbacks that make other behavioral options less and less attractive. It is the above mentioned self-reinforcing mechanisms that in the end

might lead to a final stage of path-dependence, where it is extremely difficult for the company's management to change the once chosen path. The transition from phase I into phase II is often characterised by a critical juncture or some kind of critical event.

Within the CPA literature, path-dependence reasoning has rarely been used explicitly. Despite the attention given to the role of inertia in organizational and industry evolution (e.g. Hannan/Freeman, 1984) and although Lamberg et al. (2004) and Skippari (2005) looked at CPA from a process perspective, researchers have paid little attention to how inertia in a CPA path-dependent process evolves. An exception is Wilts (2006) who writes about path-dependencies in corporate routines and actors' knowledgeability about CPA strategies. Generally, most studies used the notion of path-dependence in a rather metaphorical way. They do not really explain why firms rather invest resources in shaping the institutional environment instead of "playing" according to the rules of the market.

Adding ideas from the resource based view and path dependence theory to the theory of institutional change (North 1990), our study seeks to shed light on the cost-benefit calculation of economic actors towards shaping their institutional environment. Taking a closer look at the different political resources discussed by Dahan (2005b, p. 47) we are going to show that there are strong forces that keep firms on a CPA path in phase II of the model of a path-dependent process (see figure 3.1) and prevent them from other strategic orientations. This, however, will have a strong impact on the development of the institutional environment of the firms.

### **3.3 Hypotheses**

From our theoretical framework we derive two hypotheses:

*H. 1: A CPA strategy (non-market strategy) has a strong propensity to lead into a situation of path-dependence and lock-in.*

H. 2: A CPA strategy (non-market strategy) lock-in will reduce the firm's focus on market strategy, e.g. on customer satisfaction.

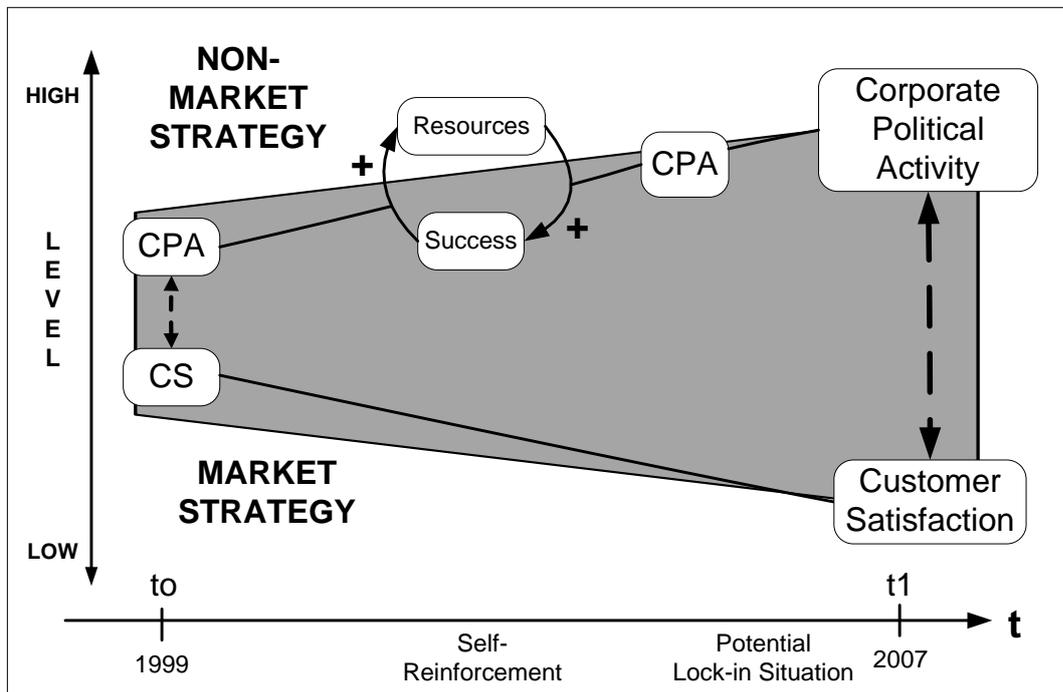
Ad H. 1) The reasons for a company to get involved in and stay on a CPA path (phase II) are manifold. Regulation plus issues such as taxes, labour, and environmental laws affect business. Therefore, management has to consider these political issues. Another reason why companies get involved in CPA is competition. If competing companies within a sector get involved into CPA and build up their own political interest networks (*relational resources*), it is almost impossible for a company to opt-out or refrain from CPA. Consequently, CPA units are being built into the organization (*organizational resources*). Once a company has decided to build up a CPA unit and has it running for some time (*expertise and financial resource allocation*), drawing out of CPA will yield sunk costs in terms of a loss of reputation and image on the political and stakeholder side (*public reputation and reputation among other non-market actors*). The laborious path of building a company's political reputation is quickly lost with a decision for draw back. One of the core arguments used in the theory of path-dependence seems applicable here. Many of the resources allocated for CPA have to be considered *specific* in the sense of Williamson (1975; 1985): Once deployed they are *sunk* and irretrievable. Building up a public affairs department does not only lead to sunk costs due to the fact that the resources cannot just be transferred to another use. It is also the *public reputation* and most important the *relational resources*, e.g. committee memberships and personal networks to political decision makers, that would be at stake in the case of closing down the department or terminating the relationship to administrative and government officials. *Learning* and building up political *expertise* can be seen as another strong source of self-reinforcement. North (1990, p. 103) as well as Denzau/North (1994) have emphasized the role of ideologies and mental models that may lead to institutional rigidity. Haase, Roedenbeck and Söllner (2007) claim that once a certain knowledge or ideology has been adopted, individuals tend to see the same problems and to use the same instruments to solve them. Accord-

dingly, individuals can only define or identify new problems on the basis of the mental models already available to them. If individuals build up knowledge in fields such as politics, public administration, social issues, environmental issues etc. it is much easier to extend this existing knowledge than to start learning in a completely new field. Consequently, if a CPA expertise worked perfectly well in the past, a firm will not see a need to change that process in the future. Even if a changing market environment would make a strategic shift necessary, the organizational culture of relying on CPA might prevent a firm from change.

Ad H. 2) Our second claim is that CPA as a non-market strategy works against a customer-focused market strategy. One argument in favor of this claim is very straight forward: From a resource-based point of view resources that are used for a non-market strategy cannot be used for a market-strategy. This does not only hold true for resources such as *relational resources* or numbers of employees in department A or B. It also applies to *expertise* as a resource. Expertise about the functioning of political systems and administrations are of limited help when it comes to understanding customer needs. Although one could argue that the number of employees in a public affairs department is relatively small as compared to the total number of employees working for a firm, we claim that if the firm's management is more focused on non-market strategy than on market strategy, this will have an impact on most of the structures and processes of that firm. Since we assume self-reinforcing mechanism regarding the CPA path, we also expect an increasingly negative impact of a raising CPA level on the firm's market strategy level, e.g. customer satisfaction. In the end this might lead into the last stage of the path-dependence model, a non-market strategy lock-in situation and the constant engagement of firms towards their institutional environment.

The *Resource Gap Model* in figure 3.2 visualizes the diversion of non-market and market strategy within a path-dependent process. The level of CPA on the non-market side and the level of customer satisfaction on the market side follow opposite directions. While CPA increases through self-reinforcing mechanisms, customer satisfaction decreases.

**Figure 3.2: Resource Gap Model**



Source: According to Siedentopp (2007a, p. 408)

## 4. Empirical Test and Discussion of the Results

### 4.1 Research Design and Data

In order to empirically evaluate the above hypotheses, it is necessary to answer two questions:

1. *Has the level of CPA increased while the level of customer satisfaction mutually decreased during the period of time analyzed? If yes:*
2. *Have self-reinforcing mechanisms played a role in the path-dependent development of CPA?*

To do so, the study follows the sequential explorative research design described by Cresswell (2003). First, in the explorative part, CPA was operationalised with the help of semi-structured interviews. The interviews, each lasting between 60 and 120 minutes, were conducted with over 40 German practitioners working within the field of Public Affairs (PA). A

broad selection of interviewees was chosen to receive an adequate picture and feeling of the whole PA field. Methodological emphasis, however, was placed on the quantitative part of the research design, which was conducted as a survey. The survey was sent out to 218 German companies and addressed to people working as heads of public or government affairs departments in German companies. The sample companies had to be selected by self research since no public register for public or government affairs activities exists for Germany. The selection criteria were that a company either had to have a separate public or government affairs unit or at least one person who was solely responsible for public and government affairs issues. The sample includes all DAX 100 companies, but also large-scale unlisted companies. The return rate of the survey was 47 per cent which makes this survey, to our knowledge, the most extensive one yet conducted in Germany focusing on the CPA of German companies. Some items within the survey asked for both current and past evaluation (turnover with public institutions, position to which to report CPA, number of employees working for PA issues, and PA budget), in order to collect data about the development of CPA over time.

The period of time covered in our analysis is from 1999 to 2007. Although determining a critical juncture which triggers phase II of the model presented in figure 3.1 might not be an easy task in the case of CPA, a number of researchers and practitioners claim that the move of Germany's capital from Bonn to Berlin in 1999 has marked such a critical juncture and that thereafter business-government relations have emerged into a new phase. The historically strong role of business associations in Bonn started to decrease and especially large-scale enterprises took their role in presenting themselves in the political arena of Berlin (Speth, 2006; Streeck et al., 2006). Furthermore, the time span of our study marks a time of deregulation (e.g. infrastructure, telecommunication) and increased competition due to globalization and fading trade barriers. Therefore one could expect a shift from non-market (CPA) to market orientation (e.g. customer satisfaction) in many industries. If firms would not redirect their strategy and resources towards more customer and market orientation, this could be inter-

preted as an indicator for a path-dependent development of CPA. Self-reinforcing mechanisms might be at work.

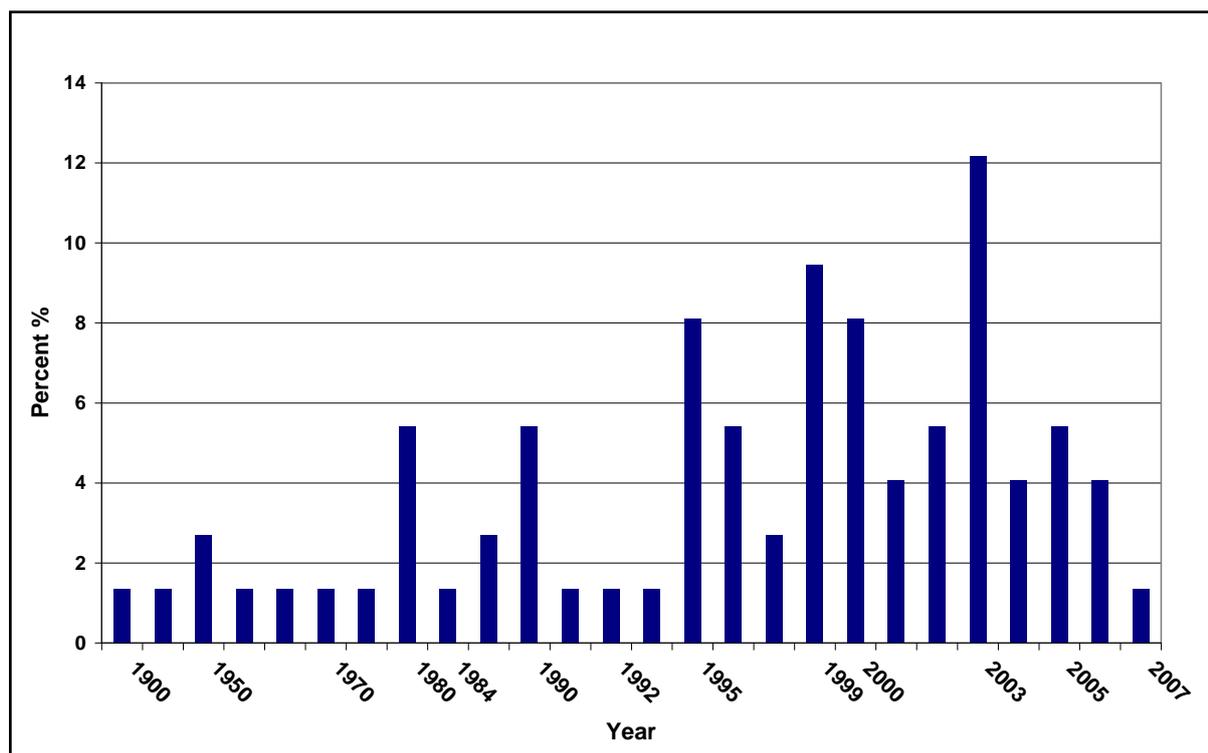
For measuring market-strategy we used the company specific data on the level of customer satisfaction that was provided by the *Servicebarometer AG, Munich* (2007). This index data is collected with standardized methods on a yearly basis. More than 20,000 customers are asked about their level of satisfaction with companies from most service and industry sectors. The question which creates an index for “global customer satisfaction” states as follows: “How satisfied are you with the service of this (mainly used) vendor?” The respondents were asked to reply on a five-point Likert scale from fully satisfied (1) to unsatisfied (5).

#### **4.2 Descriptive Statistics**

In order to answer the question if the level of CPA increased from 1999 to 2007 we will first present several descriptive statistics on the CPA development. Secondly, we show the correlation between the companies CPA level over time and their respective level of customer satisfaction.

An indirect measure on overall CPA level development of German companies is whether and when companies have founded their own PA unit(s). The statistics indicate that the situation changed in 1999 when Berlin became the new capital of Germany. A large number of companies (54 per cent) founded their representative office in 1999 or later (see Figure 4.1).

**Figure 4.1: Founding Year of Public Affairs Units (in %; N=74)**



Source: Siedentopp (2007b, p. 22)

Another indirect measure on overall CPA level development is presented in table 4.1. It shows the development of the number of employees working in PA units. For Germany, in 1999 the mean number was 10.6 employees which increased to 17.3 in 2007; or by 63 per cent. On EU level, the PA employee number almost doubled from 7.8 in 1999 to 14.8 in 2007.

**Table 4.1: Development of PA Employees: Responsibility for Germany vs. EU (N=87)**

	1999		2007	
	GER	EU	GER	EU
Mean	10.6	7.8	17.3	14.8
Median	3	1	6	4
Stand. Deviation	25.9	22.8	30.1	29.0
Max. Number	150	135	150	150
Total Employees	516	357	1256	957

Source: Siedentopp (2008a, p. 210)

In order to support hypothesis number one, it would be necessary (however not yet sufficient) to show an increase in the foundation of PA units after 1999 and the number of PA employees. Indeed we find a noteworthy increase for both criteria. To get a third indication of an increase in CPA level, the figures in table 4.2 show PA budget development since 1999 and future budget planning until 2010. The majority of companies (54 per cent) have increased their PA budget. This finding is supported by the fact that 16 per cent of the companies have increased their budget since 1999 by 100 to 400 per cent. For the future development of PA budgets, 58 per cent say that they do not further increase their budgets. However, over one-third of the companies have made plans to even further increase their budget, indicating an ongoing investment in CPA.

**Table 4.2: Public Affairs Budget Development from 1999–2007 and 2008–10**

<i>PA Budget 1999–2007</i>	<i>No.</i>	<i>Sampling Rate in %</i>
Increase	47	54
Decrease	6	7
No change	34	39
<i>PA Budget 2008–10</i>		
Increase	31	35
Decrease	7	8
No change	51	58

*Source:* Siedentopp (2007b, p. 21)

Support for our hypothesis number two can be found when looking at the correlation between the level of CPA and customer satisfaction for the time period 1999 to 2007. In order to calculate this correlation, we first formed an additive index with the above mentioned ex post CPA items. Each item was coded with -1 (indicating an increase since 1999), 0 (no change), and +1 (a decrease since 1999). In total, we were able to correlate the CPA and customer satisfaction data for 21 companies. The result of the Spearman correlation coefficient was -0.418 with a 10 per cent level of significance (0.059; two-tailed test). As proposed by our hypothesis number two we interpret this result as follows: A raising level of CPA between 1999 and 2007 is

accompanied by a falling level of customer satisfaction within that period. Hence, a CPA strategy (non-market strategy) focus reduces the firm's focus on customer satisfaction (market strategy).

The following second empirical part explores in more detail, which self-reinforcing factors played a role in the observation of "path-dependence through CPA" and if a sufficient explanation for hypothesis number one can be provided.

### **4.3 Self-Reinforcement Indicators for the CPA Path**

For the operationalization of the CPA construct and its influence on the latent construct of "path-dependence through CPA" we will use the methodology of Partial Least Squares (PLS) and follow the suggestions of Chin (1998) and Lohmöller (1989). PLS is valued as a powerful method of analysis because of the minimal demands on measurement scales, sample size, and residual distributions (Wold, 1982). It can be used for theory confirmation, to suggest where relationships might or might not exist, and to suggest propositions for testing. Since the iterative algorithm performed in a PLS analysis generally consists of a series of ordinary least squares (OLS) analyzes, identification is not a problem for recursive models nor does it presume any distributional form for measured variables. PLS starts with the goal to help the researcher obtain determinate values of the latent variables for predictive purposes.

Since PLS makes no distributional assumption, traditional parameter-based techniques for significance testing/evaluation would not be appropriate. Instead, Wold (1980; 1982) argued that PLS should apply prediction-oriented measures that are also non-parametric. Therefore, the  $R^2$  for dependent LVs, the Stone-Geisser test  $Q^2$  (Geisser, 1975; Stone, 1974; Wold, 1982) for predictive relevance of the model, and the effect size  $f^2$ , to see whether the impact of a particular independent LV on a dependent LV has substantive impact, are applied. The interpretation of the  $R^2$  and the corresponding standardized path estimates is identical to that of traditional regression. The sample reuse technique  $Q^2$  has been argued as fitting the soft mod-

elling approach of PLS “like hand in glove” (Wold, 1982, p. 30).  $Q^2 > 0$  implies the model has predictive relevance, whereas  $Q^2 < 0$  represents a lack of predictive relevance.

On the left side of the PLS model we used 14 items (see Appendix II) to measure three dimensions to represent the latent construct of CPA: *Degree of Political Activity*; *Degree of CPA Organization*; *Strategic Importance of CPA* (Siedentopp, 2008a, p. 100 ff.). The dimensions were theoretically deducted from our theoretical framework. Since “path-dependence through CPA” itself is considered to be a latent construct, the aim was to find the adequate items that best represent and explain this construct. Five items, theoretically deducted beforehand and cross validated with the empirical results of the interview data, were chosen from the questionnaire. They are located at right side of the PLS model in figure 4.2. Table 4.3 states the wording of these items.

**Table 4.3: Items of the Latent Construct “Path-Dependence through CPA”**

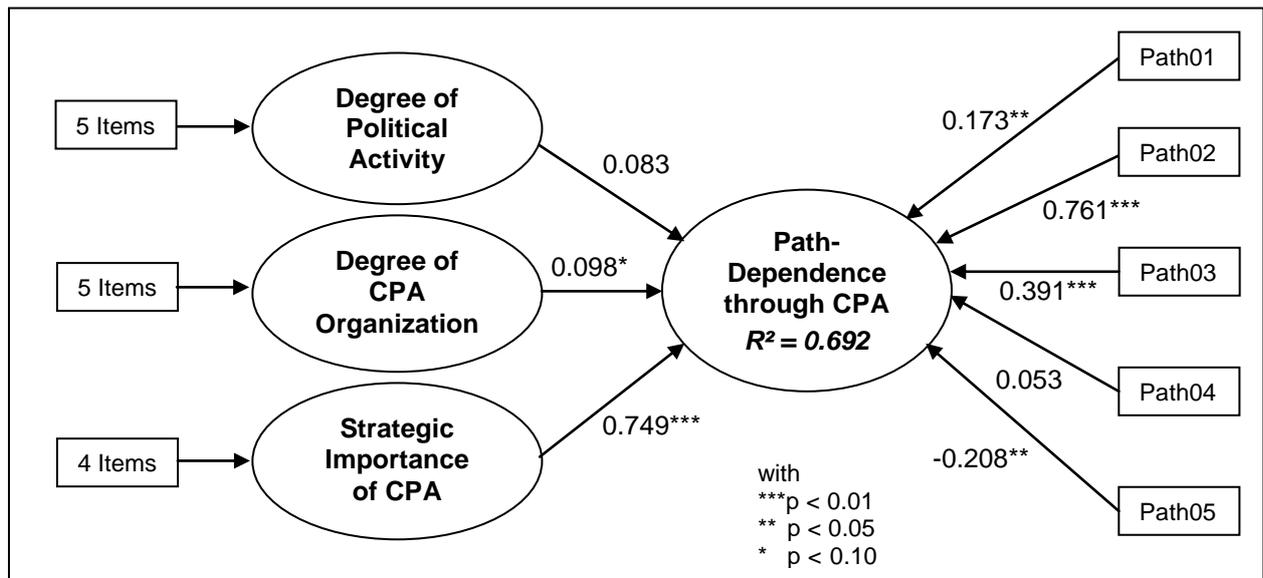
<i>Short</i>	<i>Item</i>	<i>Phase</i>
Path01	We use often a similar approach for our public affairs management.	Historicity
Path02	In the future, public affairs management will gain an increasing weight when it comes to strategic decisions for our company.	(Self-) Reinforcement
Path03	Frequently, in our core business we find mutual dependence between politics and our company.	Path-Dependence
Path04	The influence of political institutions constrains business decisions in our company.	Path-Dependence
Path05	Frequently, we find different objectives between politics and our company after applying corporate political activities.	Path-Dependence

Item “Path01” indicates the historic dimension of CPA within a company, reflecting phase I of a path-dependent process (see figure 3.1). Phase II is reflected by item “Path02”, in which CPA increases over time. It also shows the tendency to further increase CPA. All other items reflect phase III which indicates path-dependence. All items used a 7-point Likert scale, where 1 meant “do not agree at all” and 7 meant “totally agree”.

In order to validate the measurement model, the first test is for multicollinearity between the items of the LV. The PLS model was calculated with the SmartPLS 2.0 (M3) software package (Ringle et al., 2007). After looking at the variance inflation factor (VIF) values for all items including the items for the exogenous LV, multicollinearity can be excluded (all VIF < 10). Secondly, indicator relevance is tested by first looking at the values of path weights for each indicator and secondly running a t-test for significance. Figure 4.2 shows the results of the structural model of path-dependence through CPA and states the path weights and R<sup>2</sup> value. Only the path coefficient for the factor “Degree of Political Activity” is not significant. For theoretic reasons, we decided to leave the factor included in the model (Lohmöller, 1989). Also, we find that all path coefficients have the predicted sign. Hence, hypothesis one can be approved. Concerning the items of the endogenous LV, only the item “Path04” does not comply with Lohmöller’s critical value of 0.1 for the path coefficients (1989, p. 60 f.). The highest path weight can be found with item “Path02”, indicating the highest impact on the latent construct. The impact of CPA on future strategic business decisions is significantly high when it explains path-dependence through CPA. This result goes along with the high weight of the dimension “Strategic Importance of CPA” which has a significant weight of 0.749. In order to validate the structural model we first find the R<sup>2</sup> value to be exceptionally high with 0.692. This means that through this model we can explain 69.2 per cent of the whole variance of the latent construct “Path-dependence through CPA”. Further, we look at the effect size  $f^2$  of each factor and the Stone-Geisser criterion  $Q^2$  for predictive relevance of the model. The dimension “Degree of Political Activity” (0.02) and “Degree of CPA Organization” (0.02) have a small effect towards the LV. The dimension “Strategic Importance of CPA” has the highest and most substantial effect on the endogenous LV indicated by an effect size of 1.36. The  $Q^2$  value for the model is 0.158 indicating a reliable predictive relevance of the model. In other words, path-dependence through CPA can be predicted through the impact of all three dimensions. Summarizing the results of the PLS model, hypotheses one is approved by the PLS

model. However, to support our argument that a CPA strategy has a propensity to lead into a situation of path-dependence and lock-in, mechanisms of self-reinforcement must be identified.

**Figure 4.2: Structural Model of Path-dependence through CPA**



Since self-reinforcement can have many underlying mechanisms, we chose to examine interview statements which describe how CPA can follow a self-reinforcing process and lead to strategic inertia. We evaluated five core interviews to identify the relevant aspects. Table 4.4 lists the relevant interview statements. We distinguish between a phase of self-reinforcement and a phase of strategic inertia in order to provide a better understanding of how and why CPA can narrow a company’s strategic options down to a situation with inertial consequences for the overall strategy.

**Table 4.4: Indications of CPA Self-reinforcement Leading to Strategic Inertia**

<i>Phase</i>	<i>Statements</i>
<i>self-reinforce</i>	1. “(...) especially for those companies, which strongly rely on regulation, e.g. pharmaceutical industry, energy sector (...) the <i>interplay between politics and managerial action play an ever major role.</i> ” (Int. A)

- 
2. „We (PA) are *closely linked to the operational units* of our company. We are asked for support on the political side for certain issues, e.g. regulation or sales. And on the other hand we ask them if they need support on the political frontier.” (Int. D)
  3. “*Traditionally business-government relations are very important to us.*” (Int. D)
  4. “(...) We are *building up a false bottom*. Because, today the chances that you come a cropper with your business, in terms of image, are high; e.g. Coca-Cola.” (Int. B)
  5. “*Economy constantly has to work with politics*. E.g. issues like social reforms and labour market laws. (...) If the system is going through reforms, even more lobby work is done through the companies. (...) The whole *process is enforced through Europeanization and Globalisation.*” (Int. E)
  6. “Whole *industry sectors are largely dependent on tax reallocation*, e.g. agriculture, solar energy.” (Int. E)
  7. “The experience shows that companies of a certain size, *need to permanently talk to politicians at higher ranks*. (...) If critical issues arise, you can rely on build up trust and the political side has a basic understanding of your business.” (Int. C)
  8. A company “(...) can gain a *better competitive position* (...) not because it has made better managerial decisions, but *because it has influenced the surrounding conditions towards its own interests.*” (Int. E)
- 

**Strategic Inertia**

9. “(...) if you want to do good marketing in the future, you have to convince the customer: Look, I have something with a value which exceeds the product itself. (...) Yes, this is something good or I am part of it. (...) Therefore empty public affairs and PR campaigns are a farce. (...) than you really have a problem for years (...). *If you only miscalculated once, than you will struggle for years*; e.g. BP.” (Int. B)
  10. “(...) media perception of your action play an ever major role and in certain situations you only stick with decisions, because one agrees that it is not possible to present a total shift in strategy publicly. This would mean a major image, trust, and also a capital market loss. Internally one would possibly say: *Actually, we would decide differently, but this can not be communicated, so we stick with the old decision.*” (Int. A)
  11. “Yes, *we do face strategic rigidities and low customer orientation through our tight corporate political activities*. (...) If we would get less dependent on politics, we would enjoy greater strategic flexibility and higher market orientation.” (Int. D)
  12. “A *company can quickly be buggered, simply because they are closely monitored on what they do*. Therefore it has less freedom to act.” (Int. E)
  13. “Those companies have a problem, which think that they can easily take business decisions; while de facto the rules of the game (...) are constantly changing. *The degree of freedom which you think you have is not as big as you might think.*” (Int. E)
- 

The statements highlight important strategic aspects of CPA for a company’s overall business strategy. They show that CPA is closely linked to other operational business units and mark its mutual dependence. Since CPA often serves as a preventive function towards potential negative future events for the company, it is often used for building a “reputation buffer”. The

other major goal which increases the strategic value of CPA is its role of influencing political decisions in favor of the company, hoping to gain competitive advantage against others. As a consequence, CPA is in a constant process of interaction with political actors and other stakeholders. The inertial consequences which arise are multilayer. Short winded PA and public relations campaigns can easily fall back on the company and impose long lasting negative reputation among all stakeholders including politicians. Strategic flexibility decreases dramatically, once a certain strategy has been communicated among the stakeholders. Consequently, a company has to stick with old decisions, since a logic change would impose a loss of trust and reputation. Overall, the degree of freedom to act and react decreases once political issues and actors need to be considered for managerial decisions on the market side. Firms that opted for a non-market strategy have a tendency to remain active players concerning their institutional environment.

## **5. Conclusion and Implications**

One of the main contributions of this piece of work is related to the challenge of understanding institutional change. North (1990 and 1997) has emphasized the role of individual cost-benefit calculations. In this paper we point out some mechanisms that motivate a particular group of economic actors – corporations - to focus on shaping their institutional environment. Through the *historic evolution* of a firm, especially within former monopolistic markets such as infrastructure industries, and through *self-reinforcing* mechanisms, firms are tempted to follow a non-market strategy concentrating on the institutional environment. Doing so they risk losing their market focus. They rather shape the rules of the market instead of playing the game according to them. Thus, they fall back in competition if regulatory changes, such as the liberalisation within the European Union and other markets, take place.

At a firm's micro-level, the empirical results show, that strategic factors of CPA have the highest effect on the construct "Path-dependence through CPA". In other words, strategic

decisions once made in favor or against CPA will have a significant influence on the future flexibility of the firm, whereas organizational and activity factors play a minor role. A look at the high weight of item “Path03” (mutual dependence between politics and company) of the latent construct indicates that the executive management board might have to engage in reducing existing mutual dependency between politics and their company.

As far as understanding institutional change at the level of the firm’s institutional environment is concerned, our contribution might help to better understand the drivers and the motivation of economic actors and their efforts towards shaping the institutional environment. The influence of powerful corporations focussing on CPA might well shape the environment in the firms’ interests. An especially troublesome result of or work might be, that especially firms showing a weak performance on the market with respect to customer satisfaction will engage in CPA resulting in an institutional environment that might favour the weaker players on the market.

In terms of future research implications we call on focusing on the way, corporations are authorised to participate in the process of rule-shaping. The mechanism presented in this paper indicate that further research in the role of firms being agents of institutional change might be necessary. One of the main goals of this research should be to critically analyse the process through which firms influence rule-shaping and to develop recommendations to restrict CPA that might result in inefficient institutions at the level of the environment.

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## Appendix I

- Interview A: General Manager, Public Affairs Consultancy, 14 December 2006  
Interview B: General Manager, Public Private Partnership Consultancy, 23 November 2006  
Interview C: Vice President Government Affairs, Company, 29 November 2006  
Interview D: Head of Associations and Academic Relations, Company, 16 November 2006  
Interview E: Academic Director, Scientific Institute, 15 November 2006

## Appendix II

Items to measure the “Degree of Public Affairs”

<i>Dimension</i>	<i>Item</i>
<b><i>Degree of Political Activity</i></b>	1. “Please estimate how often on average informal talks with political actors are part of your task within your public affairs activities.”
	2. “We analyze the law and regulation plans relevant to our company.”
	3. “We have comprehensive knowledge about the positions of key actors which can influence political decision processes relevant to our business.”
	4. “We influence the arrangement of the legal guidelines.”
	5. “We analyze political and societal changes which influence our business.”
<b><i>Degree of CPA Organization</i></b>	6. “We have installed an independent organizational unit in our company to represent our interests in the field of public affairs.”
	7. “In order to be successful in our public affairs activities an own representative office in the capital is not needed.” (reversed coded item)
	8. “How many directly (e.g. in representative office) responsible employees for Germany work in your company in the field of public affairs?”
	9. “In the case of a political issue which is highly relevant for our success, our management board invests personal effort at the political level.”
	10. “Please estimate how often on average cooperation with public affairs agencies is part of your task within your public affairs activities.”
<b><i>Strategic Importance of CPA</i></b>	11. “Today, public affairs management is the central aspect of the successful implementation of the overall business strategy.”
	12. “The management board in our company has an understanding about political processes.”
	13. “The majority of our approaches in the field of public affairs are future oriented.”
	14. “The majority of our approaches in the field of public affairs are directed towards crisis management.”