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Politically Active Firms and Innovation Decisions: A Legitimacy Based View

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Abstract. Corporate political activities (CPA) of a firm have long been viewed as a means of gaining legitimacy which help the firm to access to unique and vital resources. Although researchers have thus far widely examined the antecedents and the outcomes of CPA, top management teams (TMT) are less attention by CPA scholarship, not to mention the behavioral side of managerial perception is also relevant to their tendency to invest accessible resources on innovation. This paper aims to explore the innovation effect of CPA-active firms in their legitimacy-building process as a strategic response to institutional expectation. We attempt to make inquiries into why do CPA-active firms which are embedded agents, choose to innovate themselves and develop propositions upon if managerial perception affects the ways they bear the risk of innovation. Building upon the institutional theory and prospect theory, this paper suggests that firms with higher levels of CPA generate better innovation performance through their unique acquire rare and valuable resources, and are more aware, open and motivated to satisfy the institutional expectations. Further, we also propose that top management team factors will moderate the relationship between CPA and innovation. In the face of a sure-loss context, the top management team increases the propensity of risk-taking, which enhances the innovation effect of CPA intensity. Meanwhile, when the top management team is faced with a sure-gain context, it reduces the managerial propensity for risk-taking, which negatively moderates the innovation effect of CPA intensity. The study contributes to the corporate political activities literature and strategy research by bridging non-market strategy and market-favored outcomes and integrating institutional perspective and the behavioral logic for a more complete view of firm innovativeness than either theory alone.

Keywords: Corporate Political Activity, Embedded, Innovation Decision, Institution

1. Introduction

As an important component of firms' non-market strategy, corporate political activities (CPA) are broadly defined as firms' efforts to manage or influence political entities through lobbying, campaign contributions, operating a government relations office, executive testimony before legislators and regulators, and contributing to trade and industry political action committees [1, 2].

According to an analysis which has revealed by CNN Money, how much companies are spending on lobbying in Washington, D.C., and presents rankings of the biggest lobbying spenders. General Electric is the biggest spender on lobbying the US federal government. According to statistics, GE spent around US$134 million since 2009. Coincidentally, another report accounts GE as among the Top 10 most innovative companies in the world in 2015. This observation means a counter-intuitive result to the institutional theory, which tends to view corporate political activity efforts as an attempt to acquire legitimacy making the firms become more embedded in the institutional structure and dulling them to the possibilities of innovation when compared to less politically active firms. If, as institutional theory asserts, firm behaviors are shaped by taken-for-granted institutional prescriptions, how can companies enact and envision innovation to the contexts where they are embedded?

Corporate political activity has recently caught the interest of a number of scholars from different fields, such as management [1, 3], political science [4], economics [5, 6], sociology [7], and finance [8]. Although CPA literature works toward the understanding of corporate political strategies and their implications for firms, many of them are empirical in nature and focus mainly on firm-level analyses.

On the theoretical front, there are a variety of theoretical angles into CPA behavior. For example, the *resource dependency theory* [9] views CPA as a way to reduce dependence on the environment and then create a more favorable environment [10]. The *strategic choice perspective* [11] prefers to consider CPA as an investment in political activities which may generate a better return than other investments in other activities [12]. The *resource-based view* [13] also opens a window to explain corporate political activities. Building on the resource-based view of the firm, organizational capabilities, including in the non-market environment, obviously in respect to relations with political authority have emerged as a primary explanatory framework of competitive advantage [14, 15]. Drawing on resourced base view, some research considers that the co-optation of politicians into corporate boards increase the resource base of firms [16], while some research demonstrates that political strategies aim at raising rivals' costs by blocking the use of substitute resource may create opportunities for the firm [17]. Meanwhile, principal-agent conflicts have long been the locus of the *agency theory* [18] so a recent study views the managerial pursuit of CPA as self-aggrandizement because of the non-compulsory disclosure requirement of corporate political spending [19].

Although researchers have thus far focused mainly on the antecedents and the outcomes of CPA [20, 21], top management teams (TMT) are noticeably less attention to corporate political activities scholarship. In a few qualitative papers of CPA, TMT attitudes toward political activity were recorded as one of the largest drivers of the CPA decision-making [22, 23]. Furthermore, behavioral agency literature has long considered the managerial perception of risk relevant to their tendency to invest accessible resources on innovation [24].

To heed the recent calls for more inquiries into the economic or political consequences of CPA, this paper aims to explore the innovative effect of CPA-active firms in their legitimacy-building process as a strategic response to institutional expectation. Our work is to integrate institutional theory and prospect theory to answer the question: Why do CPA-active firms, as embedded agents within the current institutions, choose to innovate themselves? Although legitimacy-driven CPA is considered a means of accessing rare and valuable resources for innovation, it leaves behavioral issues unaddressed, such as to what extent top management teams perceive their contexts and to what extent they prefer to bear the risk of innovation. This study thus complements institutional logic with prospect theory for a more comprehensive view of CPA-active firms' innovation decisions when they are faced with situations that involve risk.

The study contributes to the corporate political activities literature and strategy studies by bridging non-market strategy within market strategy and integrating institutional perspective and the behavioral logic for a more predictive and complete view of firm innovativeness than either perspective alone. What's more, it also contributes to institutional theory by expanding our understanding of behavior constrained in an institution by making propositions into why the CPA-active firms, as embedded agents, chose to innovate themselves.

The rest of the paper is unfolded as follows. We begin with elaborating on why we view CPA-active firms' innovation-decision from the institutional perspective. Next, we integrate institutional theory and prospect theory to develop propositions into why firms engaging in CPA choose to innovate themselves. After that, we conclude with a discussion and suggestions for future research.

2. Theoretical orientation and propositions

As an important perspective for the adoption of particular organizational strategies or practices, *institutional theory* sheds light on the importance of legitimacy to institutionalization [25]. Firms gain legitimacy and then become embedded in institutions [26]. As an embedded firm, they are neither motivated to change or open to nor are aware of alternatives [27]. Therefore, CPA-active firms should have less incentive to operate in innovation, and such awareness combines to isomorphism around the increasingly taken-for-granted template. From this logic, innovation was exogenous "jolts" [28], such as technological disruptions, regulatory change, and competitive discontinuities [29, 30]. For this reason, innovation should originate from firms with lower levels of engagement in CPA firms, and then further change the intellectual environment of ideas [31].

However, institutional logic and structures are never frozen. In recent work, scholars have sought to identify the processes and locus of institutional change [32]. They found that even in highly mature domains, stability is transitory, raising the awareness to try to explore endogenous sources of deliberate innovation. Departing from this idea, we focus our attention on the rare and valuable resources obtained from legitimacy gained through CPA. The institutional theory focuses on the role of the environments in which firms operate on organizational activities, structures, and strategies, arguing that organizations primarily seek legitimacy [33]. With such legitimacy, they can easily gain acquire rare and valuable resources, for instance gaining lower effective taxes [34], obtaining financing [35], or securing government bailouts [5], or reducing transaction costs [1] and enacting favorable laws [36]. Therefore, we contend:

Proposition 1. Firms with higher levels of corporate political activities yield better innovation performance through their unique acquire rare and valuable resources.

Besides such rare and valuable resources obtained from legitimacy gained through CPA, another factor influencing CPA-innovation intensity is institutional expectation. Some study argues that a CPA-active firm can access rare and valuable resources such as key supplies, product distribution, personnel, and financial capital. What's more, they are also expected to achieve a variety of national goals, such as developing laggard regions, creating employment, building up national technological capabilities [37]. Therefore, we believe as firms engage in corporate political activities, they are made familiar with political expectations, raising their awareness to satisfy some institutional expectations. Therefore, the firm will be motivated to engage in innovation. Thus:

Proposition 2. Firm with higher levels of corporate political activity yields better innovation performance because they are more aware, open, and motivated to satisfy institutional expectations.

Although legitimacy-driven CPA is considered a try to acquire rare and valuable resources and fulfill institutional expectations for innovation, it leaves behavioral topics unaddressed, such as to what extent the top management team (TMT) comprehends their contexts and how well they are willing to bear the risk of innovation.

Prospect theory is an alternative view of explaining choices under the conditions of risk [38]. They divided the choice process into two phases: framing and valuation. In the framing phase, decision-makers construct a representation of contingencies, outcomes, and acts, which are related to the decision. In the second phase, the valuation phase, decision-makers judge the value of each prospect and choose accordingly. The certainty effect contributes to risk aversion in choices which are involved sure gains, and to risk seeking in choices which are involved sure losses. Therefore, we here consider two contexts: a sure-gain context and a sure-loss context faced by TMT.

According to prospect theory, decision makers' risk-taking behavior changes along with gain or loss framing. They treat executive aspirations or past performance as the reference point for framing choices as loss or gain. Decision-makers show risk-averse preferences faced with positively framed prospects and show risk-seeking preferences when in front of negatively framed prospects [24, 38].

Loss-aversion is a well-known phenomenon and sheds light on the innovation decisions of firms that engage in corporate political activities. Although innovation is the application of better solutions meeting new requirements, existing market needs, or unarticulated needs [39], essentially, it is the behavior of risk-taking. Specifically, investments in innovation are sunk costs that have a longer payoff horizon and entail significant risk [40], and failed innovation may damage a firm's reputation.

Unlike the rational expectation view of decision-making which operates from the assumption that sunk costs are independent of choices of future investment, behavioral models suggest that past and current performance may influence risk-taking through its effect on the reference point used in framing problems [24, 41]. This perspective is captured in our third proposition:

Proposition 3. The possibility of a sure-loss context faced by the top management team, in the face of the firm's rising performance over time, increases the managerial propensity of risk-taking which positively moderates the innovation effect of CPA intensity.

Besides past and current performance, the mechanism of supervision may also influence the managerial propensity for risk-taking. Although some models ignore direct supervision [42], there are patterns that have included it [24, 43]. Supervision would like to involve communicating and setting performance standards to the agent, and within the constraints set by the market and industry practice for executives, these standards are significantly related to TMT's preference. Conversely, being short of vigilant supervision or weak board supervision, standards, like performance targets, should be lower. Therefore, the vigilance of monitoring should relate to the difficulty of reaching performance targets, and to the executive's reference point for sure-gain context, thus, negatively moderating the innovation effect of CPA intensity.

Proposition 4. The possibility of a sure-gain context faced by the top management team, as a result of less demanding and weak board supervision, reduces the managerial propensity of risk-taking which negatively moderates the innovation effect of CPA intensity.

3. Conclusion

Building upon the institutional theory and prospect theory, this paper suggests that firms with higher levels of CPA generate better innovation performance through their unique acquire rare and valuable resources, and are more aware, open and motivated to satisfy the institutional expectations. Further, we also propose that top management team factors will moderate the relationship between CPA and innovation. In the face of a sure-loss context, the top management team increases the propensity of risk-taking, which enhances the innovation effect of CPA intensity. Meanwhile, when the top management team is faced with a sure-gain context, it reduces the managerial propensity for risk-taking, which negatively moderates the innovation effect of CPA intensity.

Our research contributes to the corporate political activity and strategy study in several ways. By fruitfully integrating institutional theory and prospect theory, this study presents explanations for how and why the firms that engage in CPA, as embedded agents, may innovate themselves. It not only bridges non-market strategy with market strategy but also integrates institutional perspective and behavioral logic for a more predictive and complete view of firm innovativeness than either logic alone.

4. Discussion

However, much remains to be done. The first one is: is there any difference between emerging economies and developed economies? In developed economies, corporate political activity is largely about legal, firm-level engagement with institutionalized political agents and structures, while in incompletely or weak institutionalized environments in emerging economies corporate political activities may lead to the development of informal and potentially corrupt political engagement [44]. Further study could extend on this.

Second, we integrate the institutional theory and behavioral logic for a more predictive and complete view of firm innovativeness than either perspective alone. According to the myopic loss aversion lens, as the evaluation period for decisions lengthens risk aversion decreases [45, 46]. What implications might this have as time horizons lengthen? Specifically, risk aversion co-occur and goal divergence when short-term goals dominate, while goal convergence and risk acceptance are more likely to co-occur when a long-term goal is more highly valued [47]. As the relative significance of long-term goals increases, the top management team will tend to favor actions that increase socioemotional wealth in the long term, even though short-term wealth is put at risk.

Last but not least, we have presented conceptual propositions on the innovation decisions of a firm that engages in corporate political activity. It is important that, in conjunction with these conceptual developments, the empirical study should test the validity of the propositions raised by this research.

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