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Does Corporate Political Activity Make Firms Less Risk Taking?

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Abstract

Institutional theorists tend to view firm's corporate political activity (CPA) efforts as the pursuit of legitimacy which makes it more embedded in the institutional structure and subject to less uncertainty. If, as such asserts, firm behavior is shaped by taken-for-granted institutional prescriptions, how firms envision and enact risk-taking activities to the contexts in which they are embedded? This concept article aims to integrate legitimacy based view and behavioral agency model for a more comprehensive framework on risk-taking decisions of CPA-active firms. That is, both the ability as well as motivation are important to firms' risk taking decision. The article contributes to the CPA literature and strategy research. It is not only bridging non-market strategy with market-favored outcomes, but also integrating institutional logic and the behavioral perspective for a more complete and predictive view of firms' risk taking behavior than either theory alone.

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1 Introduction

The literature on corporate political activity (CPA) has a long history in the fields

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of political science, sociology and management. As an important component of a firm's non-market strategy, corporate political activity (CPA) is broadly defined as a firm's efforts to influence or manage political entities through campaign contributions, lobbying, executive testimony before legislators and regulators, operating a government relations office, and contributing to industry and trade political action committees (Hillman & Hitt, 1999; Lux, Crook, & Woehr, 2011).

Institutionalists tend to view CPA efforts as an attempt to gain legitimacy making the focal firms become more embedded within the institutional structure (Hillman, A. J., & Wan, W. P., 2005), but why and how do CPA-active firms, as embedded agents, intend to risk taking? What's more, the unite of analysis in previous studies has been factors in macro, leaving some microscopic factors touched. Departure from these gaps, this article aims to integrate legitimacy based view and behavioral agency model for a more comprehensive framework on risk-taking decisions of CPA-active firms, and to illustrate both the ability as well as motivation are important to firms' risk taking decision.

The article contributes to the CPA literature and strategy research. It is not only bridging non-market strategy with market-favored outcomes, but also integrating institutional logic and the behavioral perspective for a more complete and predictive view of firms' risk taking behavior than either theory alone. In addition, it also contributes to institutional theory by expanding the understanding of behaviors constrained in an institution by making propositions to answer the question of why and how the CPA-active firms, as embedded agents, have motivation to take risk.

2 Theoretical Background And Proposition Development

In this article, we combine legitimacy based view with behavioral agency model to answer the question why and how do CPA-active firms, as embedded agents, intend to risk taking? We argue that the legitimacy-driven CPA on a firm's risk-taking behavior not only depends on firms' aspiration level but also differs depending on decision maker's perceives and risk bearing (see framework).

Table 1: Definitions of key terms used

Terms	Definition
Corporate political activity	Firm's activities that attempts to shape government policy in ways favorable to this firm.
Legitimacy	A generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions.
Social class origin	A person's perceived place in an economic hierarchy in the childhood.
Instant endowment	Immediately including either just received or fully anticipated wealth into one's calculations of personal wealth
Problem framing	Framing a choice situation as a potential loss or a potential gain relative to some reference point, such as current wealth or aspirations for wealth
Risk bearing	Perceived risk to agent wealth that can result from employment risk or other threats to agent wealth
Overconfidence	The failure to know the limits of one's knowledge
Institutional expectation	Especially mean government and social expectation.
Risk taking	Bold actions taken in the face of uncertainty

2.1 Legitimacy based view

Scholars argue that legitimacy[2] is an important resource for acquiring other resources (Suchman, 1995; Zimmerman & Zeitz, 2002). With such legitimacy firms can easily gain access to rare and valuable resources, such as gaining lower effective taxes (Adhikari, Derashid, & Zhang, 2006), obtaining financing (Claessens, Feijen, & Laeven, 2008), or securing government bailouts (Faccio, Masulis, & McConnell, 2006), or to reduce the uncertainty of task environments, including reducing transaction costs (Hillman & Hitt, 1999) and enacting favorable laws (Richter, Samphantharak, & Timmons, 2009).Thus, legitimacy benefit firms are neither motivated to change nor are aware of or open to alternatives (DiMaggio & Powell, 1983). Therefore, CPA-active firms should have

[2] Suchman (1995) defined legitimacy as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions."

less incentive to engage in risk taking activities, and such awareness converges to isomorphism around increasingly taken-for-granted templates.

To date, research linking CPA and legitimacy has begun to emerge. The higher the degree to engaging in CPA, the higher the firm's legitimacy as a whole (Marquis & Qian, 2014). Marquis and Qian (2014) found that "by taking action in accordance with government policies, positions, and regulations … firms and their executives maintain their legitimacy in the eyes of the government." Bitektine argued that the judgments about firms' legitimacy that are rendered by government actors "can be a matter of life and death for an organization." (Bitektine, 2011) While Luo found evidence that MNEs can build legitimacy in the eyes of host governments through trustworthy behaviors, social capital, and investments of resources which are valuable and rare in the host economy (Luo, 2001).

Therefore, the CPA-legitimacy-resource relationship is printed in the memories of majority enterprise. For example, in China, when the government calls for firms to "go west", Texas Instruments (TI) has no hesitation to respond to such a call by establishing a major semiconductor plant in Chengdu. Such a policy-abiding action enhances TI's legitimacy in the eyes of the government and the public, ultimately reducing its political risk.

Legitimacy-driven CPA and risk taking

As an important lens for the adoption of particular organizational practices or strategies, *institutional theory* sheds light on the importance of legitimacy to the institutionalization (Kostova & Zaheer, 1999). Firms gain legitimacy, obtain more resources or protection, and then have less motivation to make changes, further become embedded in institutions (Meyer & Rowan, 1977). As an embedded actor, they are neither motivated to change nor are aware of or open to alternatives (DiMaggio & Powell, 1983). Therefore, CPA-active firms should have less incentive to engage in risk taking behavior, and such awareness converges to isomorphism around increasingly taken-for-granted templates. From this perspective, risk taking was given to exogenous "jolts" (Meyer, 1982), such as technological disruptions, competitive discontinuities, and regulatory change (Kraatz & Moore, 2002; Lounsbury, 2002). Further, engaging in risk taking may be sunk costs that have a longer payoff horizon and entail substantial risk and failed risk taking might damage firms' reputation. For these reasons, firms with higher levels of corporate political activity will have less risk taking behavior, since they have accessed to rare and valuable resources, and thus have no motivation to pursue risk taking (crowd-out effect).

Proposition 1*: Due to the crowd-out effect, a firm's efforts on corporate political activities make it less risk taking behavior.*

However, is that always truth? An analysis[3] by CNN Money has revealed how much companies are spending on lobbying in Washington. General Electric is by far the biggest spender on lobbying the US federal government, and spent around US$134 million since 2009. Coincidentally, another report[4] named GE as among the Top 10 most innovative companies in the world in 2015. This observation implies a counter-intuitive result to the analysis above， which tends to view CPA (eg, lobbying) efforts as an attempt to gain legitimacy making the focal firms become more embedded within the institutional structure and dulling them to be reluctant to risk taking when compared to less politically active firms. If, as such asserts, firm behavior is shaped by taken-for-granted institutional prescriptions, how can companies envision and enact risk taking activities to the contexts in which they are embedded?

From this perspective, we believe that there may be some mechanism influencing the relationship between legitimacy-driven CPA and risk taking. Actually, the Chi-square data of a meta-analysis made by Lux, Crook, & Woehr showed that it did be affected by other moderators (Lux et al., 2011). In the next two parts, we explore such moderate effect.

2.2 Aspiration level

The theory of aspiration levels is one of the most important view in strategic management (Cyert & March, 1963; Washburn & Bromiley, 2012). A firm's aspirations, or acceptable levels of accomplishment, refer to the smallest outcome that would be deemed satisfactory by the decision maker (Cyert & March, 1963; Greve, 2008). During the past decades, both theory and empirical work (Baum & Dahlin, 2007; Mezias, Chen, & Murphy, 2002) justify that aspiration level was determined by two factors, historical performance and comparative social performance (Bromiley, 2005; Joseph & Gaba, 2014; Shinkle, 2012).

However, in organizational settings it is well known government also play an important role in organizational development. Some researches (March, 2010)

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[3] Which Companies Are Spending The Most on Lobbying In Washington, D.C: Top 10 corporate spenders? http://ceoworld.biz/2014/10/30/companies-spending-lobbying-washington-d-c-top-10-corporate-spenders

[4] The World's Top 10 Most Innovative Companies of 2015 in Social Good. http://www.fastcompany.com/3041663/most-innovative-companies-2015/the-worlds-top-10-most-innovative-companies-of-2015-in-social

have pointed that organization definitely was effected by institutional expectation. Therefore, institutional expectation should be considered a third force to determine aspiration level.

Over decades, studies in aspiration level research have investigated how feedback on firm performance affects a variety of strategic decision (Chen & Miller, 2007; Iyer & Miller, 2008). Such research predicts that performance feedback will affect firm behavior such that performance below the aspiration level triggers problemistic search and increased risk taking, whereas performance above the aspiration level decreases risk taking (Lim & McCann, 2014).

The effect of firms' aspiration level

According to theory of aspiration level, when performance (including historical performance and comparative social performance) meet aspirations, lessons from earlier experiences are reinforced, and current efforts continue largely unchanged and gradually become routine action (Greve, 2008; Powell, Lovallo, & Fox, 2011). The focus of learning is on local search and minor adjustments of existing routines that promise small improvements by reducing variability in the quality or efficiency of task performance (Baum & Dahlin, 2007) . That is, when firm performance is in a sure-gain domain, firm may be reluctant to risk taking (Sitkin and Weingart 1995). This prediction has also been supported empirically (Greve, 2003). A sure-gain context resulting from superior performance creates an anticipation of future gains that engenders risk reduction, weaken the negative relationship of legitimacy-driven CPA and risk taking behavior.

On the contrary, when performance (including historical performance and comparative social performance) is not meet aspirations, organization will pursue problem search, such as more exploratory, nonlocal search and larger changes, to raise the organization's performance closer to aspirations (Baum & Dahlin, 2007; Park, 2007). That is, when firm performance is in a sure-loss domain, firm may invest in organizational change and risk taking activities because the resulting higher outcome variations may help turn around performance or improve the firm's position relative to its competitors. This baseline hypothesis has also been supported by studies (Argote & Greve, 2007; Baum, Rowley, Shipilov, & Chuang, 2005). Therefore, we conduct,

Proposition 2: *Prior performance will moderate the risk-taking effect of CPA, such that the sure-gain context (rising performance over time) makes CPA-active firms engage less in risk taking, while the sure-loss context (declining performance over time) makes CPA-active firms engage more in risk taking.*

Proposition 3: *Comparative social performance will moderate the risk-taking effect of CPA, such that sure-gain context (rising performance over time) makes CPA-active firms engage less in risk taking, while the sure-loss context (declining performance over time) makes CPA-active firms engage more in risk taking.*

As we just mentioned in the second part, organization was also effected by institutional expectation (March, 2010), and institutional expectation should be considered a third force to determine aspiration level. Some research argues that CPA-active firms can access rare and valuable resources such as financial capital, key supplies, product distribution, and personnel, meanwhile they are also expected to achieve various national goals, such as creating employment, developing laggard regions, developing national technological capabilities (Pinkse & Groot, 2015; Rajwani & Liedong, 2015). Therefore, we believe as firms engage in CPA, they are exposed to political expectations, increasing their awareness to fulfill some institutional expectation. Therefore, firms will be motivated to pursue risk taking. Thus:

Proposition 4*: Institutional expectation will positively moderate the risk-taking effect of CPA, such that the propensity of CPA-active firm to engage in risk taking is strengthen, because higher level CPA firms are more aware, open and motivated to fulfill institutional expectations.*

2.3 Behavioral agency model and the bias of key decision makers

Although legitimacy-driven CPA is considered an attempt to access rare and valuable resources, then have less incentive to engage in risk taking activities, it leaves behavioral issues unaddressed, such to what extent the key decision makers perceives their contexts and how well they prefer to bear the risk.

In order to understand how key decision makers might interact with legitimacy-driven CPA to influence firm risk taking, we draw on the behavioral agency theory (Wiseman & Gomez-Mejia, 1998). As an integration of prospect theory and agency theory, the behavioral agency model (BAM) is appropriate to understand the role of incentives. Just as Wiseman and Gomez-Mejia (1998) argued it "examine key elements of incentive alignment and monitoring control and how the decision and risk-bearing attributes associated with these elements influence executive choices of firm strategy involving risk" (p. 135).

Similar to prospect theory (Kahneman & Tversky, 1979), BAM assumes that agents are loss averse rather than risk averse and mainly focus on agents' risk preferences. According to BAM, decision makers' risk-taking behavior changes with gain or loss framing. They use past performance or executive aspirations as the reference points for framing choices as gains or loss. Decision makers exhibit risk-averse preferences in the face of positively framed prospects and exhibit risk-seeking preferences when faced with negatively framed prospects (Kahneman & Tversky, 1979; Wiseman & Gomez-Mejia, 1998).

As we just mentioned in the beginning, on the unite of analysis, previous studies mainly focus on the factors at the institutional (Tian, Hafsi, & Wu, 2009), industry (Grier, Munger, & Roberts, 1991), and firm level (Schuler, Rehbein, & Cramer, 2002), less attention to relative the micro level. Actually, lots of empirical studies have found key decision makers' characteristic did influence the firms' risk taking behavior (Kish-Gephart & Campbell, 2015; Lim & McCann, 2014). They believe key decision makers lead an overall direction for the firm, and affect the prospects of all the projects, that is, the firm as a whole (Goel & Thakor, 2008). Here, we draw on the behavioral agency model (Wiseman & Gomez-Mejia, 1998), which view firm decision maker as bounded rational agent toward risk taking depend on problem framing and perceived threats to agent wealth.

2.3.1 Risk bearing

"Risk bearing represent perceived risk to agent wealth that can result from employment risk or other threats to agent wealth" (Wiseman & Gomez-Mejia, 1998). As Wiseman and Gomez-Mejia explained, under conditions of sure gain, decision makers perceive more risk to wealth since they now have something to lose. Conversely, when facing a sure-loss domain, decision makers perceive less risk to wealth, since the wealth is already lost. Therefore, decision makers act conservatively when they face sure-gain context, but more risk taking when facing sure-loss. Based on this argument, we predict that risk bearing moderate the link between CPA and risk taking.

Proposition 5*: Decision maker's risk bearing will positively moderate the risk-taking effect of CPA, such that positively framed problems increase risk bearing, then exhibits a negative effect on pursuing risk taking.*

2.3.2 Social class origins

Individuals' risk preferences are influenced by their motivation toward avoidance or opportunity, as well as by relevant situational factors (March & Shapira, 1987). Recent theoretical and empirical studies suggest that social class can have a profound influence on individuals' perspectives and strategic choice, especially highlight an executive's social class origins have a lasting and varying impact on somebody's preferences, affecting their tendency to take risks (Kish-Gephart &

Campbell, 2015).

Following previous research (Gray & Kish-Gephart, 2013), we distinguish three levels of social class—lower, middle, and upper. Key decision makers *from the upper social classes* have experienced the benefit of a substantial safety net which provides not only economic security, but also psychological security (Kish-Gephart & Campbell, 2015). They tend to perceive the world as safe, welcoming, and full of opportunity. In comparison with upper class, key decision maker who grow up *from middle social class* perceive their safety net is smaller and less secure (Gray & Kish-Gephart, 2013). They always have "fear of falling"(fall into the lower social classes) , so that those from the middle classes are motivated to maintain their current position and minimize the likelihood of status loss (Kish-Gephart & Campbell, 2015). Therefore, we expect that key decision maker from upper social class origins will engage in more strategic risk taking in comparison to those coming from middle class. While, executives *from lower social class origins* are familiar with uncertainty and lack of resources. In such environments, individuals in lower social class may be likely to develop greater sensitivity to potential social and environmental threat" (Kraus, Piff, Mendoza-Denton, Rheinschmidt, & Keltner, 2012). They may perceive "nothing to lose" and be more willing to take risks.

Proposition 6: *Decision maker's social class origins will moderate the risk-taking effect of CPA, such that the tendency of CPA-active firm to engage in risk taking is decrease when key decision makers coming from middle social class origins, and the tendency of CPA-active firm to pursue risk taking is increase when key decision makers from upper and lower social class origins.*

2.3.3 Managerial overconfidence

Besides risk bearing and social class origin, personal attributes and behavioral biases of key decision makers, such as overconfidence, also affect their risk taking decisions (Malmendier & Tate, 2005).

Overconfidence, which has been defined as the failure to know the limits of one's knowledge (Simon, Houghton, & Aquino, 2000), often exists when unfamiliar problems and limited information result in the tendency for decision makers to produce overly optimistic decisions (Robinson & Marino, 2015) , resulting in inaccurate perceptions of personal abilities (Moore & Healy, 2008). Some previous research indicates that individuals tend to lower their perceptions of risk and simplify the complex environment when they are overconfident (Russo & Schoemaker, 1992). Thus, they may invest in a project even though when they would not invest in the project if they were rational. This point support by previous research, which suggest that executives who are overconfident are more likely to undertake acquisitions, or other risk taking behavior (Malmendier & Tate, 2008). Therefore, we believe,

Proposition 7: *Decision maker's overconfidence will positively moderate the risk-taking effect of CPA, such that lower perceptions of risk makes CPA-active firms engage more in risk taking.*

2.3.4 Career background

Another potentially influential factor is key decision makers' experience, such as career background. Some scholar pointed out top executives often have experience in multiple functions, although they may have dominant experience in one (Hitt & Tyler, 1991). We consider the tendency of CPA-active firm to pursue risk taking also based on whether the executive is a broad generalist or a narrow functional specialist (Bunderson & Sutcliffe, 2002; Cannella, Park, & Lee, 2008).

Broad generalist experienced diverse functional experience, did operations in different country, all channel. They would like to take more risks because they have more leeway to fix it and have more experience and more confidence to do it (Kish-Gephart & Campbell, 2015). Further, they are likely to have more extensive personal networks and have good perception of where the knowledge is and how to tap into it (Cannella et al., 2008). In contrast, as tenure within a single functional area increases, an executive's perspective relatively are narrow and more closely reflects the dominant logic of the particular functional area (Geletkanycz & Black, 2001). Therefore,

Proposition 8: *Decision maker's career background will moderate the risk-taking effect of CPA, such that general management functional background makes CPA-active firms engage more in risk taking, while a special management functional background makes CPA-active firms engage less in risk taking.*

3 Discussion And Conclusion

Building upon legitimacy based view and behavioral agency model, this article proposes that firms with higher levels of CPA yield less risk taking behavior, since they have acquired unique access to rare and valuable resources through CPA and thus have no incentive to pursue risk taking. However, the relationship is not constant. We explore some moderators in the process, such as aspiration level and the effects of key decision makers. Specifically, performance will moderate the risk-taking effect of CPA, such that the sure-gain context (a return in excess of the reference) makes CPA-active firms engage less in risk taking, while the sure-loss context (a return below the reference) makes CPA-active firms engage more in risk taking. What's more, institutional expectation will positively moderate the risk-taking effect of CPA, such that the propensity of CPA-active firm to engage in risk taking is strengthen, because higher level CPA firms are more aware, open and motivated to fulfill institutional expectations.

Besides factors mentioned above, we notice key decision makers' characteristic did influence the tendency of CPA-active firm to pursue risk taking. In this article, we choose social class origins, overconfidence, risk bearing, and career background as representative. Specifically, decision maker's risk bearing will positively moderate the risk-taking effect of CPA, such that positively framed problems increase risk bearing, then exhibits a negative effect on pursuing risk taking. Decision maker's social class origins will moderate the risk-taking effect of CPA, such that the tendency of CPA-active firm to engage in risk taking is decrease when key decision makers coming from middle social class origins, and the tendency of CPA-active firm to pursue risk taking is increase when key decision makers from upper and lower social class origins. While decision maker's overconfidence will positively moderate the risk-taking effect of CPA, such that lower perceptions of risk makes CPA-active firms engage more in risk taking. What's more, decision maker's career background will moderate the risk-taking effect of CPA, such that general management functional background makes CPA-active firms engage more in risk taking, while a special management functional background makes CPA-active firms engage less in risk taking.

Our article contributes to the CPA and strategy research in several ways. First, our consideration of behavioral influences on CPA-active firms' risk taking behavior. Most early researchers have been built primarily on the assumption of risk-averse propensity. However, some governance studies departed from this traditional view, focusing on how behavioral concepts such as risk bearing, social class origins, overconfidence, as well as career background affect firms' strategic choices. We add to this growing body of literature by extending the BAM perspective to the realm of CPA-active firm's risk taking behavior.

Second, by fruitfully integrating legitimacy based view and behavioral agency model, this article offers explanations for why and how the CPA-active firms, as embedded agents, may engage in risk taking. It not only bridges non-market strategy with market-favored outcomes, but also integrates institutional logic and behavioral perspective for a more complete and predictive view of firm innovativeness than either theory alone.

Third, we contribute to the behavioral theory of the firm by extending the perspective of aspiration level. We believe CPA-active firms are exposed to political expectations so that increasing their awareness to fulfill some institutional expectation. Therefore, institutional expectation could be the third force to determine aspiration level.

However, much remains to be done. First, is there any difference between emerging economies and developed economies? In developed economies, CPA is largely about legal, firm-level engagement with institutionalized political actors and structures, while in weak or incompletely institutionalized environments in emerging economies, CPA can lead to the development of informal and potentially corrupt political engagement by firms (Lawton, McGuire, & Rajwani, 2013). Further research could extend on this.

Second, we integrate legitimacy based view and behavioral perspective for a more complete and predictive view of firms' risk taking than either theory alone. According to the myopic loss aversion perspective, as the evaluation period for decisions lengthens, risk aversion decreases (Thaler, Tversky, Kahneman, & Schwartz, 1997). That is, goal divergence and risk aversion co-occur when short-term goals dominate, whereas goal convergence and risk acceptance are more likely to co-occur when long-term goals are more highly valued (Chua, Chrisman, & Sharma, 1999). We believe that as the relative importance of long-term goals increases, the executives will tend to favor actions that increase socioemotional wealth in the long term, even if short-term wealth is put at risk.

Last but not least, we have proposed conceptual propositions on risk taking decisions of CPA-active firms. It is important to note that, in conjunction with these conceptual developments, empirical research should test the validity of the propositions raised by this paper.

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