Firms and the State

An Examination of Corporate Political Activity and the Business-Government Interface

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Bedrijven en de Staat

Een onderzoek naar de politieke activiteiten van bedrijven en het raakvlak tussen het bedrijfsleven en de overheid

Thesis

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CHAPTER 1.

GENERAL INTRODUCTION

1.1 Research Topic: Corporate Political Activity and the Business-Government Interface

Although the economic marketplace is commonly envisaged as *the* arena for competition, firms will often contend with considerable rivalry on its fringes. These so-called ‘nonmarket’ frontiers of the firm encompass the broad array of organizational interactions that are not mediated by private agreements or contracts (Baron, 1995). They are also where firms are likely to encounter most resistance to their economic objectives (Markman, Waldron & Panagopoulos, 2016).

Scholarly interest in how firms are influenced by, and attempt to influence, their nonmarket environment has largely developed along two parallel strands of research. The first, comprising the literature on strategic corporate social responsibility, focuses on corporate actions that aim to promote some social good while simultaneously enabling the organization to enhance its profits (Baron, 2001; McWilliams, Siegel, & Wright, 2006). The second strand, comprising the literature on Corporate Political Activity (CPA), focuses specifically on the business-government interface and examines the various ways in which firms try to shape public policy, with the aim of protecting and advancing their economic interests (Getz, 1997). This dissertation focuses on this second strand of research and investigates how firms -as represented by their managers and shareholders- perceive and attempt to manage their relationship with the state and its political representatives (henceforth, 'politicians').

Before delving into the various manifestations of CPA, it is important to first ask why firms would wish to expend resources into establishing and maintaining favorable relationships with the state. As the legitimate holder of legislative, executive, and judicial power, the state maintains the legal authority to develop, execute, and adjudicate over all matters of public policy. Politicians routinely draft, amend, decide upon, and implement legislation that has direct consequences for business. As such, politicians intent on favoring specific firms or industries may provide the latter with preferential access to state-controlled resources in the form of governmental subsidies, favorable taxation regimes, or lucrative public procurement contracts, for example (Bertrand, Kramarz, Schoar, & Thesmar, 2018; Goldman, Rocholl, & So, 2013). Politicians can additionally provide favored firms with protection by stalling regulations that harm their interests (Lux, Crook & Leap, 2012), or by displaying leniency when those firms engage in wrongdoing (Correia, 2014). They can also help firms guard market share by fending off competition from current rivals (Capron & Chatain, 2008) and by raising barriers to market access for foreign entrants and radical disruptors (McWilliams, Van Fleet, & Cory, 2002). Even without tangibly shaping the development of policy, politicians can offer favored firms a window on the 'inner workings of government' that puts them at an advantage relative to their uninformed counterparts (Lester, Hillman, Zardkoohi, & Jr, 2008).

There is ample evidence that firms and their managers are aware of the potential value to be accrued from political activity. Around the world, firms have been shown to engage in various forms of CPA, ranging from lobbying and campaign contributions, to the hiring of politicians as members of the board (Hillman & Hitt, 1999). In 2012 alone, 3,587 firms in the US spent a total of $1.84 billion on lobbying public officials, with 372 firms spending more than $1 million each (Drutman, 2015). It is important to note that these lobbying expenditures are distinct from the campaign contributions that firms also make to federal candidates through their Political Action Committees or PACs, and which amounted to an additional $170 million in 2012 (Center for Responsive Politics). That firms are prohibited from financing elected officials in other parts of the world, has not stifled the intensity of CPA there but has led instead to the rise of alternative strategies for attaining political influence. For example, the ‘revolving-door’ phenomenon, or the movement of individuals between positions in the public and private sectors, has been particularly prevalent in the EU. According to Transparency International, more than 30% of former Members of European Parliament and 50% of former EU Commissioners accepted employment in companies that had actively lobbied EU institutions before (Freund & Bendel, 2017).

The engagement of firms in political activity has not gone unnoticed, however. The notion of ‘money in politics’ is a topic that has and continues to generate significant societal interest, particularly around politically-sensitive periods such as elections or the formation of governments, when organized interest groups are eager to influence the ideological makeup of the incoming executive or legislature. Among academics, interest in the business-government interface has spanned a number of disciplines. Political scientists tend to view public policy outcomes as a function of interest group competition, which business -as a monolithic group- often dominates to the detriment of public interest and democratic process (Epstein, 1980; Salisbury, 1984). In industrial-organization economics, the primary focus has been on the inducements and challenges of collective political action given that policy outcomes are predominantly conceptualized at the industry-level (Esty & Caves, 1983; Olson, 1965; Stigler, 1971). Within the management literature, CPA is conventionally understood to be a strategic investment -or real option- that can supplement firms’ market capabilities (Baron, 1995; Oliver & Holzinger, 2008).

More concretely, scholarly work in the strategic management literature on CPA has tended to focus on three broad research areas. First, scholars have tried to unravel the factors that lead certain firms to engage in politics, as well as the extent to which they do so (Bonardi, Hillman, & Keim, 2005; Hillman, Keim, & Schuler, 2004; Lux, Crook, & Woehr, 2011). One of the primary insights from this line of inquiry is that because political engagement does not constitute a core competence for the majority of firms around the world, firms that are especially dependent on government- i.e. those operating in highly regulated industries, or those who have governmental agencies as major customers– have more to gain from maintaining favorable relations with the state, and are thus are more likely to engage in CPA (Hillman et al., 2004; Pfeffer & Salancik, 1978). In essence, this strand of research portrays CPA as a deliberate attempt by firms to strategically manage their *dependence* on government.

Recent research has suggested, however, that our understanding of the antecedents of CPA may benefit from further nuance. For example, recent meta-analyses have cast doubt on the effectiveness of CPA at influencing public policy in well-functioning democracies (Hadani, Bonardi, & Dahan, 2017), which begs the question why regulated firms would invest in CPA if their chances of success are modest at best? To quote Ansolabehere et al. (2003)'s response to economist Gordon's Tullock puzzle regarding why firms in the US do not invest more in campaign contributions: "the question is not why there is so little money in politics, but rather why organized interests [i.e. firms] give at all"? Such findings have prompted scholars to begin considering additional factors that might drive CPA, like the political ideology of the firm's top management (Chin, Hambrick, & Treviño, 2013), the inclination of the firm's controlling owners to appropriate wealth (Sun, Hu, & Hillman, 2016), and the firm's broader dependencies transcending the political domain (Hadani, Doh, & Schneider, 2016).

A second group of CPA studies has pursued the highly elusive but important question of whether engaging in politics ultimately affects firm performance, and if so, in what direction? Within this area, findings are markedly mixed. Studies have thus far documented positive (Cooper, Gulen, & Ovtchinnikov, 2010; Fisman, 2001; Goldman, Rocholl, & So, 2009; Hillman, 2005; Kim, 2008), negative (Aggarwal, Meschke, & Wang, 2012; Boubakri, Cosset, & Saffar, 2008; Fan, Wong, & Zhang, 2007; Siegel, 2007), and insignificant (Ansolabehere, Snyder, & Ueda, 2004; Faccio, 2006) effects of CPA on firm performance, irrespective of how performance is measured or operationalized. Although a host of arguments have been proposed to explain both the value-enhancing and value-destroying facets of CPA (e.g. Hadani & Schuler, 2013), it remains unclear what ultimately determines the net value that firms will accrue from engaging in politics given that the potential benefits and risks of CPA are likely to coexist at any point in time (Okmatovskiy, 2010). This ambiguity has prompted scholarly calls for further research into the *contingent* consequences of CPA, though much of this work remains of a conceptual nature (e.g. Lawton, Mcguire, & Rajwani, 2013; Sun, Mellahi, & Wright, 2012).

A final strand of research focuses on the institutional context in which CPA takes place (Doh, Lawton & Rajwani, 2012). Institutions, or the 'rules of the game' that condition human relations and govern political and economic interactions, are designed to reduce the uncertainty associated with exchange (North, 1991). Yet, institutions vary in their degree of completeness and impartiality towards the actors that they are supposed to govern (White III, Boddewyn & Galang, 2015). As such, institutions differentially determine the degree to which firms can readily rely on political action to create market value, but also the extent to which this value will be subsequently appropriated (Dorobantu, Kaul, & Zelner, 2017).

Although many studies within this stream have pointed to the various structural characteristics of the political environment that influence the antecedents, strategies, and outcomes of CPA (e.g. Bonardi et al., 2005; Bonardi, Holburn, & Vanden Bergh, 2006; Choi, Jia, & Lu, 2014; Holburn & Vanden Bergh, 2008; Kozhikode & Li, 2012), our understanding of the *international* variation of the business-government interface remains relatively limited however (Hillman & Keim, 1995). Specifically, because much of the extant literature has focused on single-country contexts, namely the US and China, there is a notable dearth of comparative studies on how specific political tactics are differentially employed *across* countries (e.g. Blumentritt, 2003; Hillman & Wan, 2005), and how these tactics differentially contribute to firm performance.[1] An understanding of CPA that is detached from the institutional context is in turn problematic because it can lead scholars to inadvertently infect findings and theoretical lessons learnt with country-specific biases (Cui, Hu, Li & Meyer, 2018), or to adopt a generic view of the business-government interface across all countries at similar levels of institutional development (Jackson & Deeg, 2008) or with similar types of political regimes (Marquis & Raynard, 2015).

In this dissertation, I aim to contribute to all three aforementioned strands of CPA research by tackling the following overarching research question: *How is the business-government interface differentially perceived and managed by firms and their stakeholders*

[1] The shortage of comparative work in CPA may be attributable in large part to institutional restrictions that prohibit certain forms of CPA (such as campaign financing) in some countries but not others, thus limiting the scope for cross-country studies. Lax disclosure requirements additionally present researchers with data availability challenges in certain parts of the world. Unlike the US, for example, corporate disclosure of lobbying expenditures is currently *voluntary* when lobbying EU institutions.

across institutional contexts? In addressing this question, I seek to contribute, first, to a more comprehensive understanding of the antecedents of CPA. I do so by arguing and showing that the appointment of politicians on the board, an exemplary political strategy in the literature, can also serve as a strategic corporate response to external threats that do not emanate directly from the firm's political environment. Second, I seek to forward a finer-grained, contingent view of CPA value. I do so by examining the conditions under which investors across 14 economically-developed countries expect firms to benefit from the appointment of politicians to the board, as well as the conditions that simultaneously cause them to be apprehensive of the risks associated with these political connections. In doing so, I demonstrate that the *net* value of this specific political strategy is contingent on attributes of the appointing firm as well as on the institutional context in which it takes place. Third, I advance a more nuanced understanding of the business-government interface in institutional environments wherein conventional forms of CPA may not be readily available for firms, as when an incumbent government is expected to depart imminently but the identity of the new regime is not yet known. Specifically, my final contribution lies in forwarding new insights on 'interim governments'-- that is, when an authoritarian status quo has clearly been rejected, but a democratic 'new normal' is yet to be established. While most of the extant literature on the business-government interface addresses conventional forms of government— i.e. democracies and autocracies-- we know very little of how this interface evolves when the 'rules of the game' are temporarily suspended in the immediate aftermath of a revolution or coup.

Having provided a glimpse of how this dissertation fits within the broader body of research on CPA and the business-government interface,[2] I now shift to the theoretical underpinnings of my research. In the next section, I briefly review the main theoretical perspectives used in the CPA literature, before highlighting how the three studies that make up this dissertation contribute to the advancement of theory in the field.

[2] Throughout this introductory chapter I refer to 'Corporate Political Activity' (CPA) and the 'business-government interface' interchangeably to account for the broad nature of the research agenda underlying this dissertation. There are of course differences between both terms. Whereas the business-government interface refers to the generic interactions and interdependencies between the private and public sectors (Hillman & Keim, 1995), CPA refers to the strategic manner in which firms deliberately attempt to manage these interactions (Getz, 1997). In essence however, both concepts are premised on the perception of the state as a primary stakeholder of the firm-- that is, a critical provider of firm resources that also stands to be affected by firm behavior.

1.2 Theoretical Background

1.2.1 Corporate Political Activity

Corporate Political Activity (CPA) is formally defined as "any deliberate firm action intended to influence governmental policy or process" (Getz, 1997 p. 32). CPA is *strategic,* in that it is planned, enacted, and evaluated on the basis of "maximizing economic returns from the political environment" (Oliver & Holzinger, 2008, p. 496). CPA is also highly *versatile*; it takes different forms, targets different centers of political power, and strives for diverse outcomes that are loosely related to public policy (Hillman & Hitt, 1999). At times, firms may engage in CPA in response to the emergence of a policy issue that jeopardizes the viability of firm operations. At other times, firms proactively engage in CPA with the aim of establishing a continued exchange relationship with policymakers that serves as real option, to be resorted to at times of need. Firms may engage in CPA individually, often with the express aim of attaining firm-specific benefits that they would not be required to share among industry peers. Other times, when confronted with highly salient and polarizing issues, firms will pool their political efforts through an overarching industry or trade association to share costs and to reduce the reputational liability associated with taking an unpopular position. CPA strategies themselves may vary based on the resources that firms are willing to trade in return for favorable public policy. When policymakers lack informational resources to adopt a clear policy stance, firms may engage in active lobbying in an attempt to position the firm's position as the desirable choice. On the other hand, when policymakers are in particular need of financial resources to fund their election campaigns or their post-politics careers, firms may make campaign contributions[3] or invite these politicians to serve as directors on their boards. Finally, firms may avoid direct interactions with politicians altogether, targeting instead their voting constituents in order to sway public opinion towards industry- or firm-friendly policy.

[3] Corporations and unions in the United States are generally prohibited from directly financing federal candidates. Nevertheless, firms can contribute to politicians and political parties indirectly through independent expenditure-only political committees (also known as SuperPACs), and/or via their managers and shareholders through Political Action Committees (PACs). At state-level, direct corporate contributions to candidates/parties are permissible in many states.

Within the management literature, scholars have conventionally relied on a subset of theories to probe the motivation of firms to engage in CPA, their choice of political strategies and tactics, as well as their ability to effectively implement CPA and reap its benefits (Table 1.1). The primary theoretical lens underlying the bulk of this research is resource dependence theory (RDT) (Hillman et al., 2004; Mellahi, Frynas, Sun, & Siegel, 2016). RDT is premised on the notion that firms' reliance on external resources creates important sources of uncertainty that, if left unmanaged, can endanger firm performance and survival (Pfeffer & Salancik, 1978). According to this view, it is imperative that firms actively manage their dependence on external parties in order to enhance their autonomy, to buffer against environmental fluctuations, and to reduce the transaction costs associated with external exchange (Davis & Cobb, 2010).

In general, firms can remedy their external dependencies in two ways. First, they may attempt to align the interests of key resource providers with the firm's own interests through absorption and co-optation. Alternatively, they may opt to reduce or eliminate this dependence altogether by internalizing the activities of the resource-controlling organization, or by diversifying the set of resource providers on whom the firm depends (Drees & Heugens, 2013). For example, a car manufacturer wary of its dependence on a sole supplier for its brakes may attempt to reduce the risks of this dependence by acquiring the brake supplier, by providing the supplier with an ownership stake in the firm, by manufacturing the brakes in-house, or by contracting with several brake suppliers simultaneously.

The core premise of RDT as applied to CPA research is that firms are dependent on the state for resources such as public policy and political legitimacy (Hillman, Withers & Collins, 2009). Because the state is neither absorbable nor easily replaceable, an RDT-based understanding of CPA posits that political engagement constitutes an effective mechanism through which firms build stronger connections with the state to buffer against resource volatility (i.e. mitigate the risk of unfavorable regulatory developments) and to advance firm interest (i.e. promote the development of firm-friendly policy). For similar reasons, RDT posits that greater dependence on government further incentivizes firms to engage in politics (Hillman, 2005). As insightful as a resource dependence theoretic understanding of CPA is however, some scholars have critiqued it for its relative inability

Table 1.1 Main Theoretical Lenses in the Management Literature on Corporate Political Activity (CPA) and the Business-Government Interface

Theoretical Lens	Example papers	Core assumptions	Key predictions
Political market theory	(Bonardi, Hillman & Keim, 2005; Bonardi, Holburn & Vanden Bergh, 2006)	The public policy process is a marketplace wherein demanders of policy (interest groups) engage in exchange-like relationships with suppliers of policy (politicians)	Firms compete with each other, as well as other interest groups for the resources that rival policymakers are willing to provide. Political markets differ in their attractiveness based on the nature of competition among both demanders and suppliers of policy
Institutional theory	(Marquis & Raynard, 2015; Marquis & Qian, 2014; Oliver, 1991)	Firm performance and survival hinge on whether key institutional actors view the firm as legitimate or not	Firms engage in CPA to attain and secure legitimacy from policymakers, and may be penalized if they do not adhere to prevailing institutional pressures and norms
Resource dependence theory (RDT)	(Hillman, 2005; Hillman, Withers & Collins, 2009; Hillman, Zardkoohi & Bierman, 1999; Pfeffer & Salancik, 1978)	Firm performance and survival hinges on the firm's ability to maintain access to critical resources from outside parties and to buffer against environmental uncertainty	CPA is a means through which firms manage their dependence on government with a view to securing and/or stabilizing the flow of state-controlled resources. Firms facing greater governmental dependence are more likely to engage in CPA
Resource-based view (RBV)	(Bonardi, 2011; Capron & Chatain, 2008; Dahan, 2005; McWilliams, Van Fleet, & Cory, 2002; Oliver & Holzinger, 2008)	Firms' strategic and performance differentials are attributable to their asymmetric possession of unique and valuable resource bundles and competencies	Firms are more likely to engage in CPA if they possess internal capabilities -such as prior political knowledge- that allow them to compete politically. At the same time, CPA itself may also lead to the protection of the firms' existing resource base from loss or competitive erosion

Behavioral theory of the firm	(Hadani & Schuler, 2013; Drutman, 2015)	Managers face cognitive limitations and biases that hinder them from scanning, screening, and acting upon external information	The complexity and uncertainty of CPA leads to causal ambiguity between CPA efforts and policy outcomes. This hinders the kind of effective performance feedback loops that managers conventionally rely on to adjust their strategies accordingly, leading them to engage in significant 'guesswork' or to increasingly rely on the advice of outside experts
Agency theory	(Hadani & Schuler, 2013; Hadani, 2012)	Managers have distinct objectives from their principals (shareholders)	Managers may engage in CPA for self-serving purposes and ideologically-driven reasons rather than to maximize shareholder interest
Social network and class unity theory	(Doh, Lawton & Rajwani, 2012; Mizruchi, 1992)	CPA is regarded as a means of building mostly-social and personal relationships with 'policy elites'	Firms, through their owners and managers, that are more central to social networks are more likely to engage in CPA
Transaction cost economics (TCE)	(Henisz & Williamson, 1999; Jia, 2018; Sawant, 2012)	Firms opt for organizational arrangements that most efficiently reduce transaction costs	Depending on uncertainty, transaction frequency, and asset specificity, firms may engage in CPA individually or as part of a coalition, and develop political capabilities in-house or outsource them to more specialized parties.

to account for the costs associated with CPA (Hadani & Schuler, 2013; Sun et al., 2016), or to convincingly explain why dependence on government does not guarantee the effectiveness of subsequent CPA efforts (Oliver & Holzinger, 2008). Other scholars have emphasized the need to complement RDT with insights from other theories in order to arrive at a more comprehensive understanding of CPA (Hillman et al., 2009).

It is in this spirit that I have set out to propose through this dissertation a more nuanced and finer grained conceptualization of CPA, beginning with the question of why firms actually engage in CPA, and ending with an examination of its consequences as perceived by the firm's most important stakeholders: its (actual and potential) shareholders. To do so, I infuse the RDT-based understanding of CPA with research from other streams of literature. In the next section, I provide a brief overview of these streams and discuss how they relate to my overall research agenda.

1.2.2 The Corporate Governance Role of Boards of Directors

Among the plethora of strategies that firms can embrace to participate in politics, many firms around the world choose to appoint current or former politicians -including regulators, elected officials, senior civil servants- on their board of directors. In most developed and developing countries, firms face minimal restrictions on such appointments, making them a particularly useful political strategy to examine in a comparative setting (Faccio, 2006). In this dissertation, I focus exclusively on politician appointments as an exemplary CPA strategy that firms employ to establish a strong relationship with policymakers and to remedy their political dependencies (Hillman, 2005). However, because politicians serve as *directors* on the firm's board, their appointment also has implications on the governance of the firm. An examination of the corporate governance literature is thus warranted.

Within the corporate governance literature, directors on the board are assumed to perform two distinct functions. First, directors monitor management on behalf of shareholders to ensure that the interests of the latter are being served (Fama & Jensen, 1983). Second, directors act as providers of valuable firm resources, which range from the provision of strategic counsel and advice to management, to the brokering of ties with important outside constituencies (Pfeffer & Salancik, 1978). A sizeable body of corporate governance research has investigated the conditions under which directors are able and willing to perform either or both functions simultaneously (Hillman & Dalziel, 2003). Director-centric research, for example, has identified directors' human and social capital, identity, and moral and ideological compass as underlying causes of their differential capacity and intrinsic motivation to fulfill their duties (Gupta & Wowak, 2017; Hambrick, Misangyi, Park, 2015; Johnson, Schnatterly & Hill, 2013). Other research has established the firm's dependencies as a strong predictor of which function(s) directors will focus on following their appointment (Zahra & Pearce, 1989).

In the context of politician-directors specifically, incorporating insights from the corporate governance literature can complement our resource dependence theoretic understanding of CPA in two ways. First, there are insights highlighting the need to broaden the RDT-based conceptualization of politician-directors as providers of exclusively *political* resources. Certo (2003) and others, for example, argue that the appointment of resource-rich or prestigious directors signals organizational legitimacy and quality to third parties, such as providers of capital (Houston, Jiang, Lin, & Ma, 2014). In other research, politician-directors have been identified as 'stakeholder directors'—that is, individuals with strong ties to societal stakeholders (Hillman, Cannella & Paetzold, 2000; Hillman, Keim & Luce, 2001; Kassinis & Vafeas, 2002), suggesting that their appointment by the firm may at times be aimed at community-based, rather than governmental-based, pressures (Chesky, 2016). Second, because RDT emphasizes the resource-provisionary role of directors, other theoretical lenses such as agency theory may be more suitable for examining the 'darker' side of these appointments (Sun, Hu & Hillman, 2016). Thus, in this dissertation, I incorporate both perspectives to argue that politician appointments may (a) constitute *generic* dependence-management strategies aimed at securing relational capital from a broad set of stakeholders, and (b) generate non-negligible costs that may at times outweigh the potential benefits they produce.

1.2.3 A Behavioral Perspective on Investor Reactions

Establishing a causal relationship between political strategies and firm-relevant outcomes constitutes one of the major challenges in CPA research (Hillman et al., 2004). Defining the success of CPA based exclusively on the passage of firm-friendly policy outcomes is problematic because policymaking is inherently complex, and is affected by the actions of competing and allied interest groups (Macher & Mayo, 2012). Similarly, capturing CPA value through conventional accounting-based indicators of firm performance may be confounded by the lag between CPA implementation and reported firm performance. Sometimes this lag is too long to enable clear causal inferences. At other times, it may be too short to meaningfully account for the longer-term impacts of political engagement (Lux et al., 2011).

In two of the studies in this dissertation, I evaluate the impact of CPA, as well as state behavior, from the perspective of firms' actual and potential shareholders (i.e. investors). I do so through an event study methodology, which assumes that new information in the form of unanticipated corporate announcements or exogenous shocks in the firm's political environment has economic consequences for firms, and that these consequences are swiftly incorporated by investors into the firm's share price. The advantages of an event study approach are two-fold. First, as providers of capital and bearers of residual risk, investors have vested interest in firms and are significantly affected by developments that affect their performance (Fama & Jensen, 1983). Put simply, investor reactions are a suitable proxy for firm value because what is good for the firm's bottom line is also good for investors. Second, investor reactions can be measured at any time, making them particularly well suited for gauging the net, expected consequences of salient events. Within the CPA literature, event studies have thus been used to measure the firm-specific consequences of having directors run for political office (Hillman, Zardkoohi, & Bierman, 1999), of engaging in 'covert' forms of CPA (Werner, 2017), of hosting visits for high-ranking government officials (Schuler, Shi, Hoskisson, & Chen, 2017), and of backing winning presidential candidates (Knight, 2006).

Underlying event studies are important assumptions regarding the manner in which investors interpret and react to specific events. While the latter has predominantly been the focus of finance scholars (e.g. Malkiel & Fama, 1970), management and sociology scholars have been more interested in the cognitive processes underlying investor interpretations of new information (Oler, Harrison, & Allen, 2008; Zajac & Westphal, 2004). A promising perspective that I rely on in this dissertation is the 'behavioral perspective of investor reactions' (Schijven & Hitt, 2012). According to this view, investors face information asymmetries that prevent them from ascertaining the private incentives of actors whose decisions can ultimately affect their investments. As such, investors will subsequently seek signals -i.e. crude, but publicly available pieces of information- that help them mitigate these informational asymmetries. I apply this behavioral perspective in two ways. First, I show that because investors cannot trust management's valuation of the added value of CPA *ex ante* (e.g. Aggarwal et al., 2012; Hadani 2012; Hadani et al., 2017), they will resort to supplementary information pertaining to the firm and its institutional context to derive an independent judgement of this value. I similarly extend this framework to the level of the national government to show that signals can also help investors remedy information asymmetries vis-à-vis the incumbent regime in situations where the credibility of the latter is questionable. Second, in line with signaling theory (Spence, 1974), I show that management themselves can also utilize signals to remedy the informational asymmetries between them and important stakeholders, with the aim of eliciting positive stakeholder evaluations of the firm. Specifically, I show that certain forms of CPA may be used by management to signal their awareness of the community's grievances against the firm, and that they are actively working on remedying these concerns.

1.2.4 Political Uncertainty

There has been considerable interest among management scholars in the consequences of political uncertainty on firms (García-Canal & Guillén, 2008; Henisz & Delios, 2001, 2004; Holburn & Zelner, 2010, Kobrin, 1979), as well as how firms and their stakeholders will subsequently respond to such uncertainty (Oetzel & Getz, 2012). Firms face political uncertainty because their interests are not always aligned with those of the state, implying an ever-present risk of unfavorable regulations being introduced and existing ones amended. Policymaking, moreover, is an inherently complex and opaque process such that third parties are not always able to fully anticipate specific policy developments (Hadani et al., 2017; Hart, 2004). In the context of less developed countries with weak legal institutions, political uncertainty additionally manifests itself in the form of low policy credibility since unconstrained regimes can readily and unilaterally rescind their earlier commitments to the detriment of firms with existing investments (Delios & Henisz, 2003). Firms operating in such countries additionally contend with the real possibility of predatory state behavior, such as expropriation and forced divestment (Kobrin, 1980).

The notion of political uncertainty is closely related to the study of CPA because the asymmetric power of the state over business is ultimately what drives firms to actively seek to manage their dependence on government. In that regard, relational forms of CPA have been shown to provide firms with insider information and influence over the development of public policy, thus enabling them to partly mitigate the political uncertainty that they face (Wellman, 2017). There are circumstances, however, where CPA is a less feasible or less attractive option for firms. For instance, because developing formal and informal ties with policymakers is costly and time-consuming, firms may hesitate to adopt relational CPA when the regime is unlikely to remain in power for long (e.g. Blanes i Vidal, Draca, & Fons-Rosen, 2012). Because relational CPA is associated with corruption in emerging economies (Lawton et al., 2013), firms domiciled or operating there could also refrain from CPA to guard their reputational capital from negative stakeholder evaluations (Darendeli & Hill, 2016), or to avoid political retribution if a new regime were to abruptly displace the current one (Leuz & Oberholzer-Gee, 2006; Siegel, 2007). Under these conditions, it is not clear what firms can do to mitigate political uncertainty, and particularly, how else they can tap into valuable political knowledge that is privately held by select members of the ruling regime.

In this dissertation, I study the underexplored context of *interim* governments in emerging economies; a context wherein firms and their stakeholders face asymmetric information regarding the interim government's actual intention to follow through with a process of democratic transition in the aftermath of authoritarian regime overthrow. Because the potential derailing of democratization amplifies the political uncertainty that firms face, I look into how investors attempt to infer the regime's private political objectives in the absence of conventional forms of CPA.

1.3 Dissertation Overview

To address the overarching research question of this dissertation, I conducted three empirical studies broadly related to how the business-government interface is differentially perceived by firms and their stakeholders in two substantially different institutional contexts: across 14 OECD Members States at relatively high levels of political and economic development, and in the interim period in Egypt that succeeded the overthrow of its authoritarian Head of

State, Hosni Mubarak. Below, I provide an overview of each study in terms of its (a) central topic, (b) outcome, (c) theoretical lens of relevance, (d) research method, (e) unit of analysis, (f) sample, and (g) data source(s) used. I conclude with a table that summarizes the research gaps in the literature that are addressed by each study and the main contributions made.

1.3.1 Study One: "Politcian Appointments as Strategic Responses to Community-Based Legitimacy Threats"

The first study of this dissertation moves beyond the generic understanding of CPA in the literature wherein firms engage in politics only in response to threats stemming directly from their political environment. Instead, the study advances a complementary understanding of the antecedents of CPA by drawing on politicians' roles as 'community leaders' to position their appointment to the firm as a way to defuse the discontent from secondary stakeholders who lack institutionalized access to firm decision-making. Using a unique, hand-compiled dataset of all director appointments in the largest 1,063 firms in 14 developed economies from 2001 to 2010, the study finds that firms are likely to appoint politicians to the board when faced with community-based legitimacy threats, but not in response to shareholder-, customer-, or employee-based threats. Politcian appointments as strategic responses to community-based legitimacy threats are even more likely when the government is a major customer of the firm. Overall, the results of this study contribute to the resource dependence-theoretic understanding of corporate political activities specifically, and to the organizational legitimacy literature more generally.

Table 1.2. Theoretical and Methodological Underpinnings of Study One

Topic	CPA as a strategic response to community-based discontent
Outcome	Appointment of politicians to the board
Theoretical lenses	Resource dependence theory
	Stakeholder theory
	Varieties of Capitalism
Method	Panel data analysis (Mixed-effects Poisson regression)
Unit of analysis	Firm

Sample	4,439 firm-year observations for 1,063 firms across 14 OECD Member States (2001-2010)
Data sources	Author-compiled dataset on the political background of board members, derived from a variety of sources including BoardEx, annual reports, and governmental websites; Asset4; Datastream

1.3.2 Study Two: "Board of Thrones? Unraveling Investor Reactions to Politician Appointments"

In the second study, I shift my empirical focus to the consequences of CPA as measured by investor reactions to the appointment of politicians onto corporate boards. In response to the mixed findings in the literature regarding the value that firms accrue from establishing ties with politicians, this study adopts a multi-level, contingency approach that incorporates both resource dependence and agency theory to forward a more comprehensive and finer-grained understanding of politician appointment value. Specifically, the study argues and shows that investors perceive politician appointments as *both* value-enhancing and value-destroying, but that under certain conditions the potential dependence-management benefits of politician appointments are expected to outweigh their agency costs, and vice versa. Using event study methodology on the appointment of 349 politicians to the boards of 1,063 firms across 14 OECD countries from 2002 to 2010, the main findings of this study are that: (a) investors react positively to the appointment of politicians to financially-dependent but not politically-dependent firms, (b) the degree of corruption in the country in which the appointment takes place amplifies both the dependence management-based benefits and the agency costs that politician appointments are expected to generate, (c) investors are largely indifferent to politician-specific attributes such as ideology, incumbency, nationality and jurisdictional level, when assessing the resource-provisionary capacity of appointed politicians and the agency risks that they pose.

Table 1.3 Theoretical and Methodological Underpinnings of Study Two

Topic	Perceived consequences of CPA
Outcome	Investor reactions to the appointment of politicians to the board
Theoretical lenses	Resource dependence theory Agency theory Behavioral perspective on investor reactions
Method	Event study with cumulative abnormal returns as dependent variable of multivariate regression
Unit of analysis	Politician-appointment events
Sample	349 politician appointment events among 1,063 firms in 14 OECD Member States (2002-2010)
Data sources	Author-compiled dataset on the political background of board members, derived from a variety of sources including BoardEx, annual reports, and governmental websites; Lexis-Nexis; Datastream

1.3.3 Study Three: "Towards a Democratic New Normal? Investor Reactions to Interim-Government Dominance During Spells of Political Violence"

Departing from the developed economy context of the previous two studies, the final study of this dissertation zooms in on the interim period in Egypt during the highly turbulent Arab Spring. Interim periods are a cornerstone of political transitions: they succeed the collapse of an authoritarian regime but precede the establishment of an alternative democratic political order. Although interim governments have frequently featured in developing countries since the Second World War, the existing literatures on business-government relations and political uncertainty have thus far largely overlooked them, focusing instead on more conventional forms of government such as democracies and autocracies. During interim periods, firms and their investors face a significant information asymmetry vis-à-vis the national government since they cannot ascertain the regime's private commitment to democratization. Though investors will seek to remedy their information asymmetry, conventional forms of relational CPA are unlikely to be considered an attractive option in this context given the supposedly temporary tenure of interim regimes. Drawing on the behavioral perspective of investor reactions, this study argues and shows that investors will resort instead to the degree of force used by the interim government against non-governmental actors during spells of political violence as an informational signal by which they can infer the government's private political objectives. The study finds that higher governmental use of force against civilians in the interim period increases the political uncertainty that investors face but that firm-level attributes -namely, the firm's foreign footprint and ownership concentration- can mitigate the adverse impact of this uncertainty. Altogether, the results of this study contribute to a better understanding of how investors perceive and respond to the political uncertainty that the behavior of specific forms of government can produce.

Table 1.4 Theoretical and Methodological Underpinnings of Study Three

Topic	Political uncertainty under interim governments
Outcome	Investor reactions to spells of political violence
Theoretical lenses	Political uncertainty
	Behavioral perspective on investor reactions
Method	Event study with cumulative abnormal returns as dependent variable of multivariate regression
Unit of analysis	Spells of political violence
Sample	94 spells of political violence in post-Mubarak Egypt (2011-2015); 6,908 firm-spell observations
Data sources	Newspaper articles, Datastream

An important caveat regarding the following three chapters, is that each study was envisioned and written independently for the purpose of journal publication. As such, these studies may best be understood as stand-alone research articles that individually contribute to the overarching theme of this dissertation, as explicated below.

Table 1.5 Research Gaps Addressed in Dissertation and Intended Contributions

Study	Gaps in Prior Studies	Main Contributions of Study
1. CPA as a strategic response to community-based discontent (Chapter 2)	- Antecedents of CPA that transcend the firm's political environment - The managerial implications of politicians as 'stakeholder-directors'	- Advancing the strategic function of politician appointments as responses to legitimacy threats that emanate from the broader public - Highlighting the differential impact of the state on firms, based on its role as regulator vs. major customer
2. Investor reactions to politician appointments (Chapter 3)	- The perceived value of politician appointments, beyond political dependence-management - The perceived consequences of political overembeddedness - The moderating effect of the institutional environment on the perceived benefits and costs of politician appointments	- Documenting the prevalence of politician appointments in the world's most developed economies - Forwarding a multilevel, contingency-based approach to CPA value that incorporates RDT and agency theory, as well as the institutional context of the firm
3. Political uncertainty under interim governments (Chapter 4)	- The perceived business consequences of operating under interim governments - State behavior during violent conflict as a driver of political uncertainty	- Identifying a new source of political uncertainty for investors: uncertainty stemming from an interim government's perceived unwillingness to fulfil its democratic mandate - Demonstrating that violence has informational value: investors do not assess the consequences of violent conflict based solely on severity, but also by the regime's show of force - Uncovering firm-level attributes that determine organizational vulnerability to the adverse effects of political uncertainty

1.4 Declaration of Contribution

In this section, I (henceforth, 'the author') declare my contributions to the chapters of this dissertation and gratefully acknowledge the contribution of my supervisory team (promoter: Prof Dr. Hans van Oosterhout; daily supervisor: Dr. Marc van Essen) and co-authors, where relevant. **Chapter 1**, the introductory chapter of this dissertation, was completed entirely by the author, with feedback from his promoter. The majority of the work outlined in **Chapters 2, 3 and 4** was completed by the author—namely, the identification of the research gap and the underlying research question, literature review, data collection and analysis, and the writing of the manuscript. The author's promoter and daily supervisor provided theoretical and methodological guidance for all three chapters, and the author's promoter contributed to the writing of **Chapter 3** and **Chapter 4**. The author would finally like to acknowledge the contribution of Prof. Dr. Arjen Slangen to the framing and writing of **Chapter 4**.

Presently, **Chapter 2** is being prepared for submission to a top management journal. The author is the first author, the promoter second, and the daily supervisor third. **Chapter 3** is currently under review at a top management journal. The author is the first author, the promoter second, and the daily supervisor third. **Chapter 4** is currently under review at a top management journal. The author is the first author, Dr. Slangen second, the daily supervisor third, and the promoter fourth.

CHAPTER 2.

POLITICIAN APPOINTMENTS AS STRATEGIC RESPONSES TO COMMUNITY-BASED LEGITIMACY THREATS [4]

ABSTRACT

Prior research has largely interpreted the appointment of politicians on corporate boards as a way for firms to manage dependencies that emanate directly from the political environment. In this paper, we develop a complementary understanding that draws on politicians' roles as community leaders to position their appointment as a strategic response to organizational legitimacy threats emanating from the public at large. Furthermore, we shed light on the contingencies that make these appointments more likely by examining potential differences in the perceived power and legitimacy of community constituencies across different contexts. Using a unique, hand-compiled dataset of all director appointments in the largest 1,063 firms in 14 developed economies from 2001 to 2010, we find that firms appoint politician-directors in response to community-based legitimacy threats but not in response to shareholder-, customer-, or employee-based threats. Moreover, such appointments are more likely when the government is a major customer of the firm. Our findings contribute to the resource dependence-theoretic understanding of corporate political activities specifically, but also to the organizational legitimacy literature more generally.

[4] This study is conducted in collaboration with Hans van Oosterhout and Marc van Essen.

2.1 INTRODUCTION

The appointment of elected officials and high-ranking bureaucrats as directors on corporate boards (henceforth, 'politician appointments') is pervasive and well documented (Faccio, 2006). Resource dependence theorists have long recognized that politician appointments can help firms remedy their dependence on government by aligning their political and regulatory environments with their strategic objectives (Hillman, 2005; Hillman, Withers & Collins, 2009). Anecdotal evidence suggests however that politician-directors can play an even broader role, one that transcends their direct access to, and influence over, public policy. In March 2009, for example, amidst growing public dissent over its alleged role in helping wealthy clients evade taxes, Switzerland's largest bank, UBS, announced the replacement of its current chairman with former Swiss finance minister Kaspar Villiger. In a press statement, UBS described the appointment as "a clear signal [that] will prove valuable at a time when the bank is working to renew its commitment to *all* stakeholders to seek to maintain high standards of credibility, reliability and sustainable performance" (Business Wire, 2009, emphasis added). More recently, Airbnb announced its hiring of former US Attorney General Eric Holder to help the firm "craft a world-class anti-discrimination policy" (Chesky, 2016). Identifying discrimination as "the greatest challenge we face as a company", the move was interpreted in the media as an attempt to visibly address public concerns with racism on the home-sharing platform (Benner, 2016).

The examples above demonstrate the extent to which firms are apprehensive of violating the expectations of secondary stakeholders, such as members of the public (Gomulya & Boeker, 2014; Rhee & Haunschild, 2006; Zavyalova et al., 2012). Stakeholders are important, in large part, because they confer legitimacy to the firm and enable it to operate under the guise of normative conformity without fear of being socially, culturally or legally chastised (Campbell, 2007; Suchman, 1995). But the examples also suggest that firms, with a view to securing such legitimacy, may strategically respond to stakeholder expectancy violations by appointing politicians to their boards.

In responding to legitimacy threats, prior studies have shown managers to search for appropriate remedies that adequately secure organizational legitimacy whilst incurring the least structural costs to the firm (Ashforth & Gibbs, 1990; Ingram, Yue & Rao, 2010;

McDonnell & King, 2013). The extant literature however provides a less clear account of the influence of the firm's specific stakeholders on the choice of the strategic responses that managers will employ. For instance, institutional theorists commonly equate legitimacy to "an umbrella evaluation" (Suchman, 1995: 574), which is insufficiently nuanced to provide guidance on how managers respond to stakeholder-*specific* threats. As such, some studies have overlooked differences across stakeholder groups altogether, advocating generic legitimation responses with wide appeal to multiple audiences (Elsbach & Sutton, 1992; Sinha, Daellenback & Bednarek, 2015; Sutton & Callahan, 1987).

In alternative accounts, the decision-making underlying managerial responses to legitimacy threats is portrayed as a more measured process. Because stakeholders occupy different 'thought worlds' (Dougherty, 1992) they may be expected to react differently to the same strategic response. Meznar, Nigh and Kwok (1994), for example, find that corporate withdrawal from South Africa under apartheid may have appeased social activists, though at the expense of plummeting stock prices. Conversely, Lamin and Zaheer (2012) show that managerial scapegoating in response to labor controversies satisfies financial stakeholders, but fails to placate more socially oriented audiences.

Building on this stakeholder-specific perspective of firm strategic responses to outside demands, this study argues that managers regard politician appointments as suitable responses to legitimacy threats, but only when those threats emanate from secondary stakeholders (henceforth, 'community constituencies'). Community constituencies are predominantly diverse and fragmented, encompassing such entities as non-governmental organizations, watchdogs, as well as ordinary citizens. Importantly, and in contrast to primary stakeholders such as shareholders, employees, and customers, community constituencies lack the formal means to articulate, aggregate and coordinate their policy positions vis-à-vis the firm (Crane & Ruebottom, 2011; Freeman, 1984). This often means that they struggle to relay their grievances to the firm (Walker, Martin & McCarthy, 2008) while managers simultaneously lack the knowledge and incentives to appropriately address their concerns. In the absence of established channels to influence corporate decision-making, dissenting community constituencies usually have no choice but to resort to extra-institutional tactics such as protests and boycotts, often at the public embarrassment of management (King & Pearce, 2010).

We suggest that politician appointments can be interpreted as a deliberate attempt by managers to extend community constituencies with board representation, a channel of influence that is conventionally reserved for primary stakeholders. Because politicians are uniquely positioned to act as intermediaries between the firm and the broader public (Hillman, Cannella Jr. & Paetzold, 2000), we expect managers to resort to politician appointments when they wish to thwart the legitimacy threat that community constituencies pose to the firm and the managerial mandate to run it. Insofar that politician appointments are strategic responses to outside pressures, we also expect them to be conditioned by particular attributes of the stakeholder environment (Mitchell, Agle & Wood, 1997). Specifically, managers should be more likely to appoint politician-directors when community constituencies are better able to leverage the influence of primary stakeholders (i.e. when they are more powerful), and when the political-economic environment is less tolerant of deviations from community-based interests (i.e. when they are more legitimate).

To test our conjectures, we hand-compile a unique dataset of all 26,334 board members of the largest 1,063 firms in 14 OECD countries for the period 2001-2010. We research the professional backgrounds of each director to identify those with high-level political experience at supranational, national and regional levels. Using a multilevel, mixed effects Poisson-regression we model the impact of stakeholder-specific legitimacy threats on the subsequent number of appointed politician-directors for each firm. In line with our argumentation, we find that while financial, customer and employee-based legitimacy threats do not predict managers' subsequent appointment of politician-directors, legitimacy threats pertaining to the community are associated with a unitary increase in the number of politician-directors that firms subsequently appoint. Additionally, we find a stronger association between community threats and politician appointments in industries that depend on sales to government, but not in heavily regulated industries or economies in which strategic, non-market forms of coordination between participants prevail.

The contributions of this study are three-fold. First, we provide a much-needed extension of the resource dependence-theoretic understanding of corporate political activity to encompass its potential legitimating effects on non-political stakeholders (e.g. Houston et al., 2014; Schuler et al., 2017). After controlling for conventional predictors of politician appointments, our findings suggest that far from being a specific tactic through which firms manage their direct governmental dependencies, such appointments may also be a way for managers to 'coopt' external stakeholders by enlisting the services of a credible intermediary (Pfeffer, 1972). This distinction is important not only because it suggests that appointed directors can provide greater associational value to the firm beyond the core resource dependencies that they are primarily equipped to manage, but also because it validates the inherently intertwined nature of firms' social and political environments in the broader context of nonmarket strategy (Hadani, Doh & Schneider, 2016; McDonnell & Werner, 2016). Second, we build on recent scholarship recognizing the importance of treating legitimacy not as a 'monolithic' concept but as a deconstructable, stakeholder-specific organizational phenomenon (Lamin & Zaheer, 2012). The resolve to secure their community-based mandates does incentivize managers to attend to secondary stakeholder concerns (cf. Hillman & Keim, 2001), but they will do so in ways that differ fundamentally from primary stakeholders who have institutionalized mechanisms in place to better articulate and more directly remedy their grievances with the firm (Vasi & King, 2012). As such, we take steps in better understanding why, when and how managers respond to specific legitimacy threats. Third, we add to a growing body of literature at the nexus of organization theory and social movement theory that examines 'public politics', or the interaction between secondary stakeholders and the state (Reid & Toffel, 2009; Soule, 2009). That managerial responses to community-based threats are motivated more by the credible risk of public procurement cutbacks rather than the risk of regulation highlights the precise mechanism through which the state influences firms and thus the conditions under which activists can best leverage it as a fulcrum to exert organizational influence (Hiatt, Grandy & Lee, 2015).

2.2 THEORETICAL BACKGROUND AND HYPOTHESES

Institutional and resource dependence theorists conceptualize legitimacy as a productive resource that organizations strive to sustain in order to survive and flourish (Drees & Heugens, 2013). Commonly defined 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" (Suchman, 1995: 574), legitimacy provides assurances to exchange partners that firms comply with social expectations and norms (Deephouse & Carter, 2005), thereby securing access to a stable and continuous flow of resources (Baum & Oliver, 1991; Certo, 2003; Olsen, Sofka & Grimpe, 2016; Pfeffer & Salanick, 1978). Notwithstanding its importance to the firm however, scholars have also cautioned against embracing a singular, overly generalized conceptualization of legitimacy that overlooks the possibility that different stakeholder groups may have very different ideas of what constitutes 'desirable', 'proper' or 'appropriate' firm behavior (Ruef & Scott, 1998). At the same time, because managers do not perceive all stakeholders as equally relevant for securing the firm's legitimacy and by extension their mandate to run the firm (Deephouse & Suchman, 2008), they are unlikely to engage in equal efforts to placate the expectations of all the firm's stakeholders (Jensen, 2010).

Research has shown that discontent from primary stakeholder groups, such as shareholders, customers, suppliers and employees, constitutes the most consequential threat to the firm because a withdrawal of support from those stakeholders will have grave repercussions for the firm and its leadership (Arthaud-Day et al., 2006; Mitchell, Agle & Wood, 1997; Hancock et al., 2011; Sullivan, Haunschild & Page, 2007). Acknowledging their importance, firms have developed a number of institutionalized mechanisms of access and influence over decision-making to ensure that the interests of primary stakeholders are adequately protected, and their participation retained. These arrangements also help managers to promptly identify and remedy stakeholder concerns before they escalate into more consequential legitimacy challenges. For example, shareholders hold voting rights that they can exercise to directly secure their interests in the firm (Bebchuk, 2005; Mallin & Melis, 2012), but also to convey to management their dissatisfaction with how the firm is run (Hillman et al., 2011; Sauerwald, van Oosterhout & van Essen, 2015). Tying executive compensation, directly and indirectly, to customer and employee satisfaction binds managers' personal wealth to the value that they create for these groups (Luo, Wieske & Homburg, 2012). Integrating suppliers in the product-development process shares risks and rewards across the supply chain, and also helps managers identify quality and lead-time problems early on in the planning and designing phase (Paulraj & Chen, 2007).

In contrast, secondary stakeholders comprise a diverse array of community-based constituencies with a broad concern for the general societal impact of the firm's activities.

Community constituencies include civil, religious, and nongovernmental organizations, activists, watchdogs, and advocacy groups, as well as members of the broader public (Bowen, Newenham-Kahindi & Herremans, 2010; Eesley & Lenox, 2006; Henriques & Sadorsky, 1999). For those stakeholders, firms need to comply with broadly defined codes of conduct in order to secure a so-called societal 'license to operate' (Chiu & Sharfman, 2011). This societal license is inherently ambiguous as it is socially constructed to incorporate the legitimacy of the firm in the eyes of a diverse set of stakeholders. Nonetheless, it is essentially contingent on the display of corporate citizenship, sound ethical practices, and social responsibility (Henisz, Dorobantu & Nartey, 2014; Melé & Armengou, 2016). At its most basic level, a license to operate requires corporate compliance with applicable laws and regulations, but also adherence to the implicit norms and values that have garnered a level of cultural acceptance within society (Gunningham, Kagan & Thornton, 2004).

Although they stand to be affected by firm acts or omissions, community members maintain no voluntary exchange relationships within the firm, and are therefore typically unable to *directly* affect firm actions and outcomes (Clarkson, 1995; Frooman, 1999). Because this renders them less consequential to organizational flourishing and survival, they are often left with no direct access to management, which in turn lacks the incentives, structures, and capabilities to incorporate their expectations in decision-making (Hillman & Keim, 2001). Yet, community members have also been shown to be capable of effectively mobilizing against the firm in face of what they perceive are grave violations of responsible corporate conduct (Markman, Waldron & Panagopoulos, 2016). Far from being ceremonial acts of defiance, these mobilizations often embrace extra-institutional tactics, such as protests, petitions, and letter-writing campaigns, that aim to actively recruit primary stakeholders to their cause (King, 2011; McDonnell & Werner, 2016; Proffitt & Spicer, 2006; Rehbein, Logsdon & Buren, 2013). Boycotts for instance -the quintessential tactic of stakeholder groups lacking institutionalized channels of influence- attempt to drive current and future customers away from the firm's products thus harming its bottom line in the process (King, 2008). Thus, while managers may not be normally incentivized to dedicate much attention to their secondary stakeholders, a sufficiently-aggrieved community can pose a serious threat to their own mandates to govern the firm (King & Soule, 2007; McDonnell & King, 2013; McDonnell, King & Soule, 2015).

2.2.1 Politician appointments as strategic responses to community threats

When external constituencies, such as members of the community, possess the capacity to exert either direct or indirect influence on the firm, resource dependence theory (RDT) posits that the firm will actively seek to mitigate the threat that these constituencies pose (Pfeffer & Salanick, 1978). One way of doing so is by 'coopting' them and incorporating them within the firm's decision-making structure (Selznick, 1949). Cooptation serves two purposes: it provides external constituencies with a vested interest in the organization's flourishing, thus reducing their hostility against the firm and its management (Davis & Cobb, 2010). Cooptation, moreover, provides external constituencies with an institutionalized channel of influence, thus enhancing their access to and communication with management (Stearns & Mizruchi, 1993).

Our opening example suggests that, in line with the cooptation function predicted by RDT, appointing politicians to the board may constitute a deliberate attempt by management to neutralize the threats posed by the community when the firm falls short of meeting their expectations. Specifically, following a decline in the firm's community-based legitimacy, we posit that managers will appoint politician-directors as a way to visibly reaffirm their commitment to community interests and to mitigate the threats that their grievances against the firm can produce. More concretely, we expect politician appointments to the board to help bridge the relationship between the firm and an aggrieved community in three ways.

First, because boards are archetypal primary stakeholder-serving structures (Fama & Jensen, 1983), opening them up to secondary stakeholders "acknowledges the importance of their relationship with the firm" (Mitchell, Agle & Wood, 1997: p876; Pffefer, 1972), and extends these stakeholders with a previously restricted institutionalized channel of influence through which they can secure their interests. Politician-directors, specifically, are well positioned to act as representatives of community interests relative to other directors because they are endowed with a clear societal mandate that requires them to act as stewards of the public at large. While individual politician-directors may differ in the extent to which they are intrinsically motivated to protect the interests of all community members, public service ingrains in them “other-regarding” values (Frankforter, Berman & Jones, 2000; Hernandez, 2012) or a general concern for the welfare of the broader collective, without which they would be unable to remain in office for long. For that reason, management scholars have referred to politicians as ‘community influentials’ (Hillman, Cannella & Paetzold, 2000), ‘community leaders’(Golden & Zajac, 2001), and ‘stakeholder-directors’ when they join firms (Kassinis & Vafeas, 2002; Kock, Santaló & Diestre, 2012).

Second, the presence of a politician within the firm’s leadership can help managers to overcome the complexity that accompanies secondary stakeholder relationship management (Cennamo, Berrone & Gomez-Mejia, 2009). Relative to primary stakeholders, community constituencies encompass more diverse and fragmented interest groups (Crane & Ruebottom, 2011; Fassin, 2009), often with no well-defined agenda for change to be readily acted upon nor pragmatic requests to serve as starting points for further negotiations with the firm (Vasi & King, 2012). Because managers are usually ill-equipped to handle this type of ambiguity, they are likely to resort to routine decision-making frameworks such as cost-benefit analyses that misrepresent the nature of stakeholders’ demands (Hall & Vredenburg, 2005). In contrast, politician-directors are well-positioned to deal with stakeholder ambiguity because an integral part of public policymaking necessitates regular interaction with diverse societal groups, and the gathering, prioritizing and synthesizing of contradictory viewpoints. Their appointment to the board may thus help firms to better articulate, aggregate, and remedy community-based concerns.

Third, managers may wish to piggyback on politician-directors’ credibility as societal representatives to convince community members that subsequent initiatives aimed at addressing their concerns are genuine and trust-worthy. This is important because research shows that corporate social initiatives usually fail when stakeholders perceive them as being driven by economic self-interest rather than pro-social motives (Cuypers et al., 2015). Similar to the legitimation effect that firms seek when partnering with well-established NGOs and prominent associations on social initiatives (Hiatt et al., 2015; McDonnell, 2015), firms may appoint politician-directors to enhance the credibility of their commitments to the community.

Altogether, we posit that politcian appointments can symbolically and substantively bridge the relationship between the firm and its community-based constituencies. As such, managers may resort to such appointments to strategically thwart legitimacy threats that emanate from the community. Therefore:

> **Hypothesis 1:** *Community legitimacy threats are positively associated with subsequent politician appointments*

2.2.2 The moderating effect of stakeholder dynamism

A core premise of the stakeholder salience model (Mitchell et al., 1997; Henriques & Sadorsky, 1999) is that stakeholders are harder for managers to ignore when they are 'salient'- that is, when they pose a more credible and consequential threat against the firm and its leadership. Under such conditions, the need to mitigate their concerns becomes particularly pressing, and managers are thus even more likely to consider appointing politician-directors in response. We highlight two conditions that may influence the extent to which community-based discontent will be perceived by mangers as particularly threatening: when the firm is highly dependent on the government, and when the firm is domiciled in a coordinated market economy.

Governmental dependence. Research on social activism has documented the strategic leverage of power by community constituencies to effectuate corporate change. In many cases this entails community constituencies appealing to, and recruiting, primary stakeholders to their cause to leverage the influence of the latter over the firm (King, 2008; Lipsky, 1968). Because the state retains significant power over the 'opportunity sets' faced by firms (Hillman, Zardkoohi & Bierman, 1999), community constituencies have been shown to consider the government a key conduit of influence over the firm. Through what scholars define as 'public politics', community constituencies can exploit the contentiousness of the policy-making process to threaten negligent firms with the risk of punitive governmental action (Reid & Toffel, 2009).

Although the government has broad authority to intervene on behalf of the public at large, the threat of governmental intervention is generally more credible, and community-based discontent therefore more consequential, for firms that are highly dependent on the government (Hillman & Hitt, 1999; Hillman, Keim & Schuler, 2004; Lux, Crook & Woehr, 2011; Sharma & Henriques, 2005). Dependence on government creates targeted channels of state intervention that can be readily resorted to in response to community-based legitimacy threats (Marquis & Qian, 2014; Reid & Toffel, 2009). For example, firms in regulated industries operate under the supervision of regulatory agencies specialized in formulating, implementing and overseeing administrative rules that comprehensively govern a wide array of the firm's activities, from how it can produce its products to the specific rate at which it can charge end consumers (Hadani & Schuler, 2013; Bonardi, Holburn & Vanden Bergh, 2006). It is easier for the government to impose new restrictions and constraints in response to community discontent when the offending firm operates within a statutory regime that is specifically designed to seamlessly formulate and implement new policy when needed (Holburn & Vanden Bergh, 2008).

In a similar vein, the government can readily exercise influence over the firm when it is a major customer-- that is, as a primary stakeholder of the firm (Amore & Bennedsen, 2013; Goldman et al., 2013). As customer, the government may respond to community discontent by withholding business transactions from stigmatized firms (McDonnell & Werner, 2016), and by debarring them from public procurement contracts in extreme cases. As was the case for energy giant BP in the aftermath of its Gulf of Mexico oil spill, firms that violate their social license to operate may swiftly find themselves excluded from an important source of revenue as a result (Salant & Miller, 2014). Therefore:

> **Hypothesis 2a:** *Regulation moderates the relationship between community legitimacy threats and politician appointments, such that firms in regulated industries will appoint more politician-directors to the board in response to community legitimacy threats*

> **Hypothesis 2b:** *Public procurement moderates the relationship between community legitimacy threats and politician appointments, such that firms in industries that are more reliant on public procurement will appoint more politician-directors to the board in response to community legitimacy threats*

Market Coordination. The second contingency that we expect to affect the likelihood of politcian appointments as a strategic response to community-based threats pertains to the political-economic environment of the firm. A large body of research has explored how prevailing social structures and institutionalized norms influence various facets of corporate decision-making (e.g. Peng, Sun, Pinkham & Chen, 2009; Whitley, 1999), including the extent to which managers distribute their attention among competing stakeholder groups (Aguilera & Jackson, 2003; Campbell, 2007; Jackson & Apostolakou, 2010). Even as shareholder primacy prevails as the dominant corporate governance logic around the world, managers can still find themselves under substantial pressure to attach (similar) importance to other stakeholders (Aguilera, Ganapathi, Rupp & Williams, 2007; Maignan, 2001; Maignan & Ralston; 2002). Such pressures depend, in part, on how countries differentially bestow legitimacy to stakeholders and their causes.

In general, we expect an institutional environment that is less sympathetic of managerial negligence towards community-based grievances to prevail in coordinated market economies (CMEs), such as Germany and Japan, but less so in liberal market economies (LMEs) such as the United States and United Kingdom. First, CMEs are characterized by the proactive role of the state in the economy (Hall & Soskice, 2001), which means that the government is better positioned to compel firms to incorporate the interests of broader society in corporate decision-making (Fiss & Zajac, 2004). Second, firms in CMEs are heavily reliant on credit financing, effectively substituting the dominant role of shareholders in LMEs with that of banks and mutually interlocking owners in CMEs. For the latter type of financiers, emphasis is on the long-term preservation of power and influence within the firm. The maintenance of favorable ties with a wide set of societal actors is widely seen as a prerequisite for this (Matten & Moon, 2008). Third, CMEs and LMEs exhibit different predispositions towards normative standards-- that is, they hold varying degrees of 'collective social consciousness' (Ioannou & Serafeim, 2012). Consider the recent confrontation between Apple and the European Commission in which the Commission ruled that the firm must return €13 billion in undue tax benefits to the Irish government since these benefits constitute illegal state aid. Whereas to many American observers, including members of Congress, the EU's decision to retrospectively change the rules of the game represented a flagrant transgression on the firm's financial mandate, many Europeans took issue instead with the fact that a huge corporation could get away with paying so little taxes for so long, particularly at a time when wages were stagnating and public services being slashed (Lovejoy, 2016). In one narrative, Apple was acting with financial diligence; in another, it was acting irresponsibly towards its community.

To the extent that a societal consensus is established on the normative status of community constituencies as legitimate claimants of the firm and becomes deeply embedded in the business culture, managers will struggle to circumvent the incorporation of the welfare of those groups into their decision-making (Matten & Moon, 2008). It also follows that managers will be more driven to rectify community legitimacy threats when they do occur. This leads to the final hypothesis:

> **Hypothesis 3:** *The extent of market coordination within the economy moderates the relationship between community legitimacy threats and politician appointments, such that firms in more coordinated market economies will appoint more politician-directors to the board in response to community legitimacy threats*

2.3 METHODS

2.3.1 Data and Sample

We restricted our sample to countries at similar levels of institutional development because business-government relations have been shown to vary across conventional indicators of economic and political development (Rajwani & Liedong, 2015). Our study includes the following 14 OECD member states: Australia, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United Sates. In addition, prior research demonstrates that larger firms are significantly more likely to engage in political activities (Hillman et al., 2004), including the appointment of politicians as directors on the board (Faccio, 2006). We thus focus on the largest 50 firms by market capitalization, compiled for every country and every year between 2001 and 2010. Using company annual reports and *BoardEx,* a proprietary database for board composition, we compiled annual lists of each firm's board members. We removed firms that were active for less than two consecutive years since we could not trace changes in their board composition over time. In total, our panel dataset consists of 1,063 firms and 9,516 firm-year observations. Within this sample, we identified a total of 26,334 unique directors, of which 12,876 were newly appointed within the focal period 2002-2010.

2.3.2 Dependent Variable

Politician appointments. Our first hypothesis predicts the appointment of politician-directors in response to community legitimacy threats. For the outcome variable, we compute a firm-year count of newly appointed politicians to the board. In coding directors' political experience however, we note the ambiguity in the literature regarding the very definition of a 'politician'. For example, whereas some research has conservatively confined politicians to the upper echelons of policymaking (e.g. Boubakri, Cosset & Saffar, 2012), other studies have cast an exceptionally wide net to encompass individuals with political experience at all levels of public service, including members of presidential election campaigns and junior staff members of political parties (e.g. Agrawal & Knoeber, 2001; Goldman et al., 2013).

We adopt a middle ground view and use as a starting point the precedent set forth by Faccio (2006) in her seminal study on politically connected boards. We classify as politicians Heads of State, ministers, and national legislators (Parliament, Senate and their national equivalents). We further expand this classification by including politicians with similar roles at national and federal level, (e.g. deputy ministers, secretaries of state), at supranational levels of government (e.g. European commissioners and members of European Parliament), and subnational levels (e.g. regional and provincial ministers and commissioners, parliamentarians, governors and mayors). We also include the country's most senior bureaucrats -namely, ministry secretary-generals, chiefs of staff, principal private secretaries and ambassadors- because they commonly command high societal visibility, and also possess direct access to the regulatory agenda (Etzion & Davis, 2008; Putnam, 1973). Finally, we make use of the cross-country nature of our sample and include both former and current politicians. U.S.-centric studies have predominantly focused on the appointment of former politicians to the board in light of formal prohibitions against incumbent politicians from holding firm directorships. In many countries, however, no such restrictions exist meaning that firms are permitted to appoint incumbents to their boards (Gagliarducci et al., 2010).

We relied on a number of sources to collect background information on directors. BoardEx had extensive coverage of our sample countries, allowing us to check the entire employment history of directors for overlaps with our coding scheme. Because occupations and titles were not standardized and thus subject to input errors, we manually checked the profile of each of the 26,334 directors. For missing and incomplete profiles, we consulted a number of sources for additional information. These included annual reports, country-specific databases (e.g. Who's Who), and business-oriented bibliographies available online (e.g. Bloomberg BusinessWeek and Reuters People). In our sample, the minimum number of *politician appointments* in one firm-year is 0 (94% of all firm-year observations) and the maximum is 5.

2.3.3 Independent Variables

Community legitimacy threat. To derive our key variable of interest, we first sought a measure of community-based legitimacy. Thomson Reuters' Asset4, a global panel dataset on Environmental, Social and Governance (ESG) performance, is a relatively novel but increasingly popular data source within corporate social performance research, in large part because its international coverage provides a solid basis for comparative cross-country research (e.g. Cheng, Ioannou & Serafeim, 2014; Hawn & Ioannou, 2016; Ioannou and Serafeim, 2012). To derive performance scores, trained analysts at Thomson Reuters compile and code primary documentation relating to ESG data, on the condition that this data is verifiable and publicly available. Sources include annual and sustainability reports, stock exchange filings, NGO websites, and media articles. A total of 700 individual data points are first aggregated into 18 components, and then into four pillar scores corresponding to the firm's *environmental*, *social*, *corporate governance* and *economic performance*. Every firm receives a z-score, allowing researchers to benchmark a firm's performance against the entire universe of firms on an annual basis[5]. Z-scores range from 0 to 100, with higher values signifying better performance on the respective component or pillar.

We could not use the aggregated social pillar score as a direct measure of community legitimacy for two reasons. First, of the seven components that make up the social pillar, five are closely associated with a specific primary stakeholder-- employees[6] ('Employment

[5] To ensure maximum comparability, Asset4 handles peer-to-peer comparisons differently per pillar. For example, whereas environmental data points are benchmarked by industry, corporate governance data is benchmarked by region. The end result, according to Asset4, is data that is granular but also robust over time.
[6] The heavy skewness of the social pillar score towards employees has in fact prompted several scholars to use the aggregated social pillar score as a measure of the firm's relations with labor groups exclusively (e.g. Lee & Kim, 2016).

Quality', 'Health and Safety', 'Training and Development', 'Diversity and Opportunity', and 'Human Rights'). Second, it is not too clear if the four Asset4 pillars were designed with distinct stakeholder groups in mind. The three components most clearly associated with customer groups, for example, are dispersed across the *environmental* ('Product Innovation'), *social* ('Product Responsibility'), and economic *pillars* ('Client Loyalty').

We opted instead for the "Society/Community" score, a singular component within the social pillar, as a finer-grained measure of community legitimacy. Asset4 defines the community component as follows: "*[A] company's management commitment and effectiveness towards maintaining the company's reputation within the general community (local, national and global). It reflects a company's capacity to maintain its license to operate by being a good citizen (donations of cash, goods or staff time, etc.), protecting public health (avoidance of industrial accidents, etc.) and respecting business ethics (avoiding bribery and corruption, etc.)*". We note that this definition corresponds with the conventional conceptualization of community legitimacy in the literature as organizational compliance with explicit and implicit codes of conduct related to ethical business practices (Gunningham et al., 2004). It also embraces the diverse nature of secondary stakeholders and their expectations. For example, underlying the social/community score are 123 individual data points capturing different manifestations of responsible conduct that are relevant to a broad array of secondary stakeholders, such as the firm's endorsement of universal codes of conduct like the UN Global Compact and the Global Sullivan Principles; initiatives aimed at enhancing the firm's relationship with indigenous populations; a public commitment by the firm to fair competition; and clear policies against bribery and tax fraud.

Operationalizing community legitimacy using the Asset4 community score enables us to track changes in the firm's relationship with community constituencies over time. Drawing from our theoretical framework, we interpret a decline in the year-on-year community score as an indication of the firm's failure to maintain its prior commitment towards community members regarding what they perceive to be responsible behavior. Whereas slight declines in the community score may generally be insufficient to warrant managerial concern, more sizeable declines constitute a direct threat to the managerial mandate because they imply gross violations in the firm's commitment to the community. Under such circumstances, we would expect managers to feel pressured into acting to protect their mandates from an aggrieved community. To account for such differential severity in community-based threats, our *community legitimacy threat* measure represents the absolute percentage decline in the community score between year t_{-1} and year t, with higher values reflecting a more substantive decline in the firm's year-on-year community legitimacy. Moreover, because our theoretical arguments are specifically geared towards the strategic value of politician appointments in the case of firms facing legitimacy declines, we recode all cases in which the year-on-year community score either increased or remained constant as '0'. A selection of cases with the most sizeable declines in their scores can be found in Appendix 2.1, alongside a description of the circumstances that contributed to those declines.

Governmental dependence. To test Hypothesis 2a, the moderating role of *Regulation*, we assigned firms a dummy variable equal to '1' if they belong to a regulated industry based on their Fama-French industry classification. Because nations vary widely in the extent to which their industries are regulated, we followed other studies and adopted a narrowly defined subset of industries most prone to being heavily regulated across all countries, namely aircraft, banking, telecommunication, defense, petroleum and natural gas, pharmaceutical products, and utilities (Hillman, 2005; Pittman, 1977).

For Hypothesis 2b, we captured another form of governmental dependence, *Public procurement,* through the ratio of sales to the public sector (namely public administration, education, health and waste sectors) over total sales for the industry in which the firm (Amore & Bennedsenm 2013; Cingano & Pinotti, 2013). Industry sales data were obtained using the 2005 OECD input-output matrices, which measure the volume of trade between producers and customers (including government) across various sectors of the national economy. We derived our measures on a country-by-country basis in order to cash out differences in public demand patterns. Higher public procurement ratios indicate a larger portion of the industry's revenues are derived from sales to government, thus, greater dependence on the state.

Coordinated Market Economy. Based on Hall and Soskice's typology of coordinated market economies (CME) and liberal market economies (LME), Hall and Gingerich (2009) develop a 'coordination index' that captures the extent to which actors depend on non-market strategic cooperation and long-term relationships to coordinate their economic activities. Using factor analysis, they derive two dimensions responsible for much of the variation between capitalist systems: corporate governance (shareholder rights, stock market size, and free-float) and labor relations (wage coordination and labor turnover). We use this index to test Hypothesis 4 and standardize it such that countries prototypical of LMEs are closer to '0' whereas values closer to '1' represent CMEs (Saurwald, van Oosterhout & van Essen, 2015).

2.3.4 Control Variables

We surveyed the CPA literature for other determinants of appointing politicians to the boards and the engagement in political activity in general. At country-level we are cautious not to include too many controls given that our sample size is restricted to only 14 countries and because our sample countries, as a subset of OECD nations, are at similar levels of institutional development. We included *Corruption* however since Faccio (2006) finds it be to a strong predictor of the national incidence of corporate-political ties. Controlling for corruption is all the more important because it is expected to additionally influence the extent to which politician appointments are perceived as acceptable managerial responses to certain community-based grievances. For example, firms may struggle to convince their community constituencies that a track record of bribery can best be remedied by appointing a politician on the board when the national level of perceived corruption is high. We captured corruption using the annual Corruption Perception Index (CPI) provided by Transparency International and which ranges from 0 to 10. Scores are inversed so that higher values reflect greater corruption. In addition, we included a cultural predictor of politician appointments: *Power-distance* (Hofstede, 1983). Ioannou and Serafeim (2012: 843) note that in cultures with high power-distance, high-ranking actors are revered in large part because of their sense of obligation "to the expectations and needs of key stakeholders and society more broadly". We would expect such cultures to be more inclined towards the appointments of politician-directors with or without legitimacy threats.

At firm level, we controlled for both firm size and leverage. Our sample is already restricted to the largest firms in their respective markets, but we still account for size differentials given its overwhelming importance in CPA literature (Hillman et al., 2004). We used both an accounting (natural log of total assets in US dollars, *Total assets*) and market-based measure (market-to-book ratio, *Market value*). Because political connections help firms obtain preferential financing (Claessens et al., 2008; Faccio & Parsely, 2009; Khwaja & Mian, 2005), we also note that levered firms may stand to gain more from politician-directors compared to firms that are less reliant on external debt. We measured *Leverage* as the book value of debt (long and short term) over total capital.

We further considered possible agency theoretic determinants of appointing politician-directors. Thus, we controlled for *Board size*. Because agency theory contends that the primary function of directors is the monitoring of management on behalf of shareholders (Hillman & Dalziel, 2003), smaller boards are likely to prioritize directors with a stronger capacity to supervise. Second, we accounted for the possibility that director appointments constitute a mechanism through which majority shareholders reduce their agency costs by placing a direct representative on the board (Holderness & Sheehan, 1988). We thus controlled for *State ownership* since we expect the appointment of politician-directors to be more frequent in in state-owned firms (Musacchio, Lazzarini & Aguilera, 2015). Firms are assigned a dummy variable equal to '1' when their largest shareholder owns more than 20% of shares and is a governmental agency or sovereign wealth fund (Faccio & Lang, 2002). Finally, whereas inter-group relations theory posits that existing directors will prefer working with those who are quite similar to them (Fan, Wong & Zhang, 2007; Westphal & Zajac, 2013), one may also predict diminishing margins of returns of politician appointments when there are politicians already serving on the board. We thus accounted for the possibility that *Politicians on the board* can positively or negatively influence the likelihood of further politician appointments and coded as '1' firms that already have at least one politician on their board.

Finally, a core premise of our theoretical model is that politician appointments, as strategic responses to legitimacy declines, are only appropriate for underrepresented constituencies that lack the capacity to aggregate, articulate and coordinate their policy positions with the firm. Politician appointments are expected to be less effective when dealing with primary stakeholders' concerns because those stakeholders possess more direct channels through which they can relay their grievances, and through which firms can directly respond. To further investigate this conjecture, we included financial-, customer- and employee-based legitimacy threats as additional control variables. *Financial legitimacy* *threat* was captured through share price volatility (variation of a stock's annual high and low price from its mean price) since volatility is a widely used proxy for investor confidence in the management's ability to deliver expected returns (Beckman, Haunschild & Phillips, 2004).[7] For *Customer legitimacy threat* and *Employee legitimacy threat* we resorted to Asset4 and derived the average score of the components named earlier and which relate to each stakeholder constituency respectively. In the same way as community legitimacy threats, we calculated the percentage change in scores and converted them into absolute terms. For customer and employee threats we similarly retained the percentage declines and coded all else as '0'; for financial threats we retained the percentage *increase* because a year-on-year rise in share price volatility implies greater investor uncertainty.

2.3.5 Analytical Strategy

We selected a multilevel, mixed-effects Poisson regression with maximum likelihood estimation (*mepoisson* command in Stata 13) to incorporate key elements of our dataset. Poisson and negative binomial regressions will both accurately approximate count data and are well suited to our dependent variable. Poisson regressions are generally deemed more efficient, but they do necessitate that the dependent variable mean be equal to its variance (Madsen & Rodgers, 2015). A comparison of the sample mean (0.07) and variance (0.09) shows that the difference is not substantial, implying that our count data is unlikely to suffer from over-dispersion concerns and that a Poisson distribution is a realistic assumption (Walker, 2009). Consequently, all reported models are estimated using Poisson regressions.

In addition, because of the nested nature of the panel data structure, we clustered standard errors at two levels: firm and country. In the absence of clustering, unobserved characteristics at both levels of analysis will bias results if they are correlated with the error terms. Our empirical specification allows non-independent error correlations to exist *within* firms and countries, but retains the assumption of independence *across* groups respectively (Cameron, Gelbach & Miller, 2011). Finally, to avoid temporal endogeneity, we lagged time-variant control variables by one year and included year–fixed effects in all models. Because of additional data requirements, the final sample dropped to 711 firms and 4,439

[7] In unreported tests, we used alternative measures of market-based (Tobin-Q, Market capitalization) and accounting-based performance (Return on assets, Return on equity). Results remained substantively and statistically unchanged.

firm-years. All 14 countries are represented in the final sample, with the minimum and maximum number of firm-years being 97 for Norway and 528 for the United States, respectively.

2.4 RESULTS

Table 2.1 provides descriptive statistics and correlations for the variables used in the analysis. Variance inflation factor (VIF) tests negated multicollinearity concerns, with mean VIF (1.30) and maximum VIF (1.86) being well below threshold levels (Hair, Anderson, Tatham & Black, 1995). Table 2.2 displays the results of the multilevel mixed-effects Poisson regression models of politician appointments. Model 1 includes only control variables. In clear support of the resource dependence theoretic logic that is widely propagated by CPA research, heavily regulated industries appoint more politicians to their boards. Dependence on public procurement contracts however does not predict politician appointments, suggesting that firms' pursuit of political resources under normal conditions centers more on politician-directors' access to regulations rather than their influence over public spending. Also, in line with CPA, firm size is associated with more appointments, but only when captured through accounting rather than market-based measures (cf. Hillman, 2005). Politician appointments are strongly and positively associated with the presence of other politicians on the board but not, counter-intuitively, to state ownership. In a nod to behavioral agency theory, this finding may indicate that the politician-director nomination and appointment process is better understood as a function of existing directors' inclinations towards similar-minded individuals rather than a direct manifestation of the state's desire to monitor its interests. In contrast with Faccio (2006), perceived corruption did not predict the incidence of political connectedness through board appointments. On the other hand, the coefficient for power-distance was expectedly positive and significant, albeit marginally. Firms will generally appoint more politician-directors when they operate in countries where power-distance is relatively high and politicians are presumably afforded higher status.

Table 2.1 Descriptive Statistics and Correlations

	Variable	Mean	SD	1	2	3	4	5	6	7	8
1	Politician appointments	0.09	0.32								
2	Community legitimacy threat	0.13	0.20	0.020							
3	Regulation	0.32	0.47	0.093*	-0.062*						
4	Public procurement	0.12	0.10	-0.002	0.027	0.061*					
5	Coordinated market economy	0.53	0.34	0.033*	0.047*	-0.051*	-0.145*				
6	Corruption	2.16	1.06	0.074*	-0.033*	0.130*	-0.019	0.359*			
7	Power-distance	43.99	11.47	0.080*	-0.017	-0.015	-0.066*	0.323*	0.665*		
8	Total assets*	16.75	1.78	0.114*	-0.104*	0.326*	0.014	-0.129*	0.230*	0.105*	
9	Market value	2.73	8.47	0.066*	-0.008	-0.010	0.053*	-0.025*	-0.009	-0.01	-0.027*
10	Leverage	42.08	33.33	0.047*	-0.051*	0.190*	0.008	0.021	0.078*	0.005	0.274*
11	Politicians on the board	0.46	0.50	0.146*	-0.019	0.138*	-0.005	-0.075*	0.116*	0.101*	0.296*
12	Board size	12.91	5.01	0.124*	-0.034*	0.159*	0.015	0.231*	0.299*	0.166*	0.534*
13	State ownership	0.03	0.17	0.088*	-0.003	0.155*	-0.031*	0.098*	0.064*	0.048*	0.082*
14	Financial legitimacy threat	0.04	0.08	0.004	0.030*	-0.010	-0.042*	0.013	0.009	-0.005	0.083*
15	Customer legitimacy threat	0.08	0.13	0.011	0.256*	0.001	0.031*	-0.046*	-0.012	-0.033*	-0.045*
16	Employee legitimacy threat	0.05	0.09	-0.011	0.203*	-0.034*	0.025	-0.020	-0.022	-0.031*	-0.073*

	Variable	9	10	11	12	13	14	15
10	Leverage	0.008						
11	Politicians on the board	-0.014	0.126*					
12	Board size	-0.017	0.129*	0.267*				
13	State ownership	-0.006	0.035*	0.118*	0.019			
14	Financial legitimacy threat	-0.014	0.099*	0.009	0.022	-0.0130		
15	Customer legitimacy threat	-0.003	0.008	-0.007	-0.036*	-0.029*	-0.011	
16	Employee legitimacy threat	0.055*	0.000	-0.030*	-0.034*	-0.019	-0.030*	0.220*

Notes. N= 4,439 firm-years for 711 unique firms across 14 countries. Correlations marked with an * are significant at p<.05. * Variable is log transformed

Table 2.2 Results of Multilevel Mixed Effects Poisson Regression of Politician Appointments, 2002-2010

DV: Number of politician-director appointments	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Regulation	0.279 *	0.285 *	0.284 *	0.282 *	0.289 *	0.286 *
	(0.124)	(0.123)	(0.124)	(0.123)	(0.124)	(0.124)
Public procurement	0.173	0.129	-0.126	-0.231	0.122	-0.223
	(0.590)	(0.589)	(0.589)	(0.634)	(0.590)	(0.635)
CME	0.277	0.237	0.237	0.207	0.248	0.217
	(0.319)	(0.215)	(0.315)	(0.315)	(0.319)	(0.318)
Corruption	-0.040	-0.033	-0.033	-0.034	-0.034	-0.035
	(0.110)	(0.108)	(0.108)	(0.108)	(0.109)	(0.109)
Power-distance	0.018 †	0.018 †	0.018 †	0.018 *	0.018 †	0.018 *
	(0.010)	(0.009)	(0.009)	(0.010)	(0.009)	(0.009)
Total assets	0.098 *	0.101 *	0.101 *	0.098 *	0.0101 *	0.098 *
	(0.043)	(0.042)	(0.041)	(0.042)	(0.042)	(0.042)
Market value	0.001	0.001	0.001	0.001	0.001	0.001
	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)
Leverage	0.001	0.001	0.001	0.001	0.001	0.001
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Politicians on the board	0.515 ***	0.517 ***	0.518 ***	0.516 ***	0.513 ***	0.513 ***
	(0.134)	(0.134)	(0.134)	(0.135)	(0.134)	(0.135)
Board size	0.021	0.021	0.021	0.022	0.021	0.022
	(0.014)	(0.014)	(0.014)	(0.014)	(0.014)	(0.014)
State ownership	0.291	0.286	0.287	0.303	0.281	0.297
	(0.236)	(0.234)	(0.234)	(0.235)	(0.235)	(0.235)
Financial legitimacy threat	-0.079	-0.187	-0.181	-0.169	-0.201	-0.180
	(0.827)	(0.831)	(0.832)	(0.832)	(0.830)	(0.832)
Customer legitimacy threat	0.679 †	0.446	0.449	0.428	0.441	0.423
	(0.393)	(0.404)	(0.405)	(0.406)	(0.405)	(0.407)

Table 2.2 Results of Multilevel Mixed Effects Poisson Regression of Politician Appointments, 2002-2010

Employee legitimacy threat	-0.413	-0.663	-0.669	-0.671	-0.657	-0.661
	(0.634)	(0.643)	(0.644)	(0.644)	(0.642)	(0.644)
Community legitimacy threat		0.649 **	0.641 *	0.603 *	0.678 **	0.627 *
(H1)		(0.248)	(0.252)	(0.252)	(0.250)	(0.258)
Community legitimacy threat X			0.086			-0.048
Regulation (H2a)			(0.479)			(0.483)
Community legitimacy threat X				3.812 *		3.715 †
Public procurement (H2b)				(1.944)		(1.99)
Community legitimacy threat X					-0.576	-0.391
CME (H3)					(0.730)	(0.728)
Constant	-6.147 ***	-6.253 ***	-6.251 ***	-6.174 ***	-6.257 ***	-6.178 ***
	(0.752)	(0.748)	(0.748)	(0.748)	(0.751)	(0.750)
Observations (*n*)	4,349	4,349	4,349	4,349	4,349	4,349
Wald Chi-Square	88.51 ***	96.91 ***	97.22 ***	100.54 ***	85.34 ***	100.51 ***
Log likelihood	-1,276.87	-1,273.63	-1,277.70	-1,271.88	-1,273.33	-1,271.73
Akaike Information Criteria	2,601.74	2,597.27	2,599. 23	2,595.75	2,598.65	2,599.46

Notes. All models include year-fixed effects. Standard errors are clustered by firm and country, and reported in parentheses. Significance levels: † $p < 0.10$; * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$ (two-tailed tests). CME= Coordinated market economy.

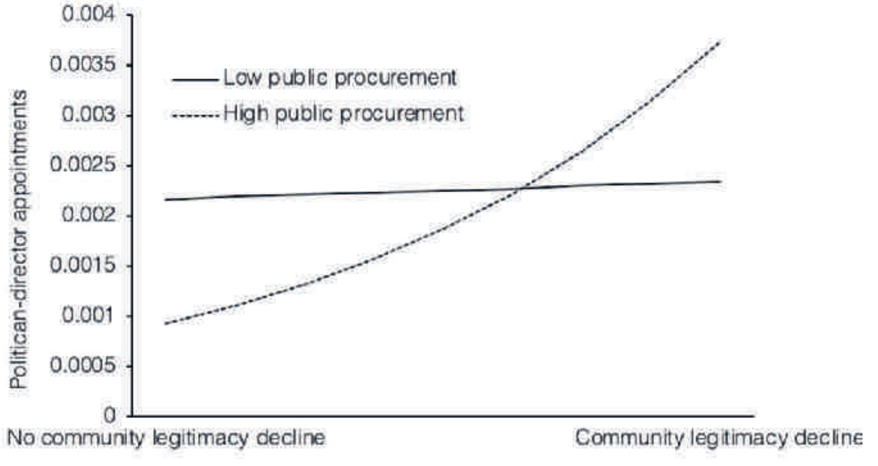
Finally, and in support of our theoretical framework, we do not find evidence that the legitimacy threats emanating from shareholders, customers or employees increase the number of subsequent politician appointments. The coefficient for customer legitimacy threats is positive and marginally significant, but loses significance in all other models.

Models 2-5 introduce the main independent variable and interaction effects. *Community legitimacy threat* in Model 2 is positive and significant (β= 0.65; p<0.01). This indicates that, in contrast to other legitimacy threats, firms are indeed likely to appoint politician-directors in response to community legitimacy threats specifically, and that the number of appointees is contingent on the perceived urgency of that threat as captured by the magnitude of the legitimacy decline. Since the legitimacy threat construct is a percentage-based measure, it translates into a large, close-to-unitary, effect size. Specifically, a 10% (0.1 unit) decline in the firm's year-to-year community legitimacy score increases the expected number of politician appointments by 9.1%. The effect is positive and statistically significant across all models and in the presence of interaction effects, thus providing support for Hypothesis 1.

Model 3 introduces the first governmental dependency, *Regulation*, to examine whether managers are more likely to address community legitimacy threats through politician appointments when there is an existing channel in place that allows the government to readily translate community concerns into binding policy. Contrary to our expectations, Hypothesis 2a does not receive support as the interaction between *Community legitimacy threat* and *Regulation* was negative and statistically insignificant. While regulated firms generally tend to appoint politicians to their boards, they are not more likely to do so following a decline in their community-based legitimacy. The coefficient of the interaction between *Community legitimacy threat* and *Public procurement* in Model 4 was positive and significant however (β=3.81; p<0.05), revealing an exact opposite effect to the one observed for regulation. While dependence on public procurement, in general, does not appear to incentivize managers to appoint politician-directors, once this dependence is coupled with a decline in community legitimacy, there is a subsequent increase in the number of politician appointments (Figure 2.1). Hypothesis 2b therefore receives support.

In Model 5, we examine the country-level prediction of a stronger relationship between community legitimacy decline and politician appointments in *CME*s. Hypothesis 3 is not supported: the interaction term is negatively signed and statistically insignificant. We discuss the implications of this finding in the next section and offer a potential justification. Finally, in Model 6, all independent and control variables are included. Results remain substantially unchanged, with the exception of the *Community legitimacy threat* and *Public procurement* interaction that is now marginally significant but still positively signed (β=3.72; p<0.10).

Figure 2.1 Interaction of community legitimacy threat and public procurement



2.4.1 Robustness Checks

The Akaike information criteria (AIC) of Models 2-6 are lower than the baseline Model 1 indicating that, despite having more parameters, these models offer a better fit. We conducted a number of sensitivity tests nonetheless to verify the robustness of our analysis. First, we reran our models using different specifications, starting with a negative binomial instead of a Poisson regression. Results remained substantively similar however. Additionally, because the number of observations at the second (country) level is limited, our standard error estimates may be susceptible to bias (Maas & Hox, 2005). We replicated our models as a panel regression with fixed rather than mixed effects and with robust standard errors, which offer the advantage of insulating coefficient estimations from unobserved differences across higher-level units. Despite a sizeable drop in the number of observations (n=1,700), our key findings did not change, further supporting their robustness across empirical specifications.

Second, although we take the magnitude of the legitimacy threat to be indicative of its urgency and hence a predictor of politician appointments, some scholars have conceptualized legitimacy as a dichotomous measure (e.g. Deephouse & Suchman, 2008). To check whether a drop in legitimacy, irrespective of the magnitude of decline, could similarly predict the likelihood of appointments vis-à-vis firms experiencing no decline at all, we recoded all legitimacy declines as '1'. The main effect retained its positive and significant association with the number of subsequent politician appointments. The effect size was substantially smaller (β=0.32; p<0.01) compared to Model 2 however, indicating that larger legitimacy declines provide management with added impetus to respond through politician appointments.

Third, to test whether legitimacy declines broadly predict the propensity of politician appointments, we coarsened the outcome variable from a count to a binary measure ('1' for the appointment of one or more politician-directors and '0' otherwise). To model the probability of a binary outcome, we used a logistic regression whilst retaining our multilevel and mixed-effect panel specification accordingly. Results remained the same (β=0.67; p<0.05), this time suggesting that while the magnitude of the legitimacy decline influences the *propensity* to use politician appointments as a strategic response, it does not necessarily affect the intensity of the response that managers opt for (i.e. the *number* of subsequent politician-directors they will appoint).

Fourth, we accounted for the possibility that legitimacy threats are not mutually exclusive and that a firm can experience both social and financial threats in a single year. In that case, the presence of more than one threat simultaneously could heighten manager's perceived necessity to respond. We interacted community and financial legitimacy threats but results were statistically insignificant. We take this as further support for the theory we have articulated in which firm responses to legitimacy threats are stakeholder-specific. Similar to Meznar et al. (1994), the appointment of politician-directors may adequately assuage secondary stakeholder concerns, but they are less effective remedies when the legitimacy threat in question involves stakeholder groups that play a more instrumental role in the firm.

2.5 DISCUSSION AND CONCLUSION

We set out to explore if managers are inclined to appoint politician-directors when the firm's legitimacy and consequently their own managerial mandate to run it is under threat. In doing so we explicated several assumptions about the nature of politician-directors and their role in the firm. First, managers acknowledge a link between appointed directors and the constituencies they wish to placate. Second, a single director can appeal to several audiences simultaneously, depending on the symbolic and substantive significance of their appointment. Third, 'cooptation' is perceived as effective insofar that it provides stakeholders with a superior channel of feedback within the firm. Our results are broadly supportive of this reasoning; we now elaborate on their significance to the extant literature.

Our first contribution though this study is to the CPA field, and specifically the resource dependence logic that has come to dominate it (Hillman et al., 2004, Hillman, Withers & Collins, 2009). That politician-directors are revered for their access to political resources, that much is clear: larger firms and firms operating in heavily regulated industries are highly exposed to the public policy process and thus inherently incentivized to maintain ties to the political apparatus by appointing politicians to their boards. However, and as corroborated in financial economic research, to assume that politician-directors only address the firm's governmental dependencies adopts an unnecessarily narrow interpretation of resource dependence theory (Houston et al., 2014).

Specifically, results demonstrating that firms are likely to respond to community legitimacy threats through politician appointments, and especially so when they rely on sales to government, has implications to two underlying concepts in resource dependence theory. First, it reinforces the often-neglected function of 'cooptation', as initially envisaged by Selznick (1949), as a way to thwart resistance from outside factions rather than just to secure existing relationships (Pfeffer, 1972). Seen in that light, politician-directors can potentially serve two simultaneous yet distinct functions: they buffer against political uncertainty in their role as politicians, but also dispel external resistance in their role as community leaders. Second, our findings lend credence to the notion that directors are resource-rich, i.e. capable of bestowing firms with multiple resources (Peng, 2004), and that their merit should thus not be assessed exclusively based on the specificity of the environmental linkages they provide. Empirical research shows that directors indeed rarely play a single role on the board: venture capitalists not only provide young firms with capital but also help in the formulation of strategy (Fried, Bruton & Hisrich, 1998); lawyers are not only knowledgeable of legal matters but also bring with them connections to policymakers owing to their repetitive dealings with government (Agrawal & Knoeber, 2001); women directors who promote gender diversity also bolster strategic decision-making by introducing divergent values to the board (Hillman et al., 2007). Similarly, managers do not seem to only associate politician-directors with political-based benefits such as favorable legislation, but social benefits as well in serving as an articulation, aggregation and coordination mechanism that intermediates the relationship between the firm and its community. As moreover indicative in the context of public procurement, the provision of both sets of benefits need not be mutually exclusive.

Findings additionally reveal that politician appointments are contingent on the specific type of legitimacy threat that managers are faced with. Whereas community-based threats motivate subsequent politician-director appointments, we do not observe a similar reaction to threats pertaining to shareholders, customers or employees. Our second contribution is thus to the organizational legitimacy literature as we heed calls to accentuate the importance of stakeholder-specificity in the context of how firms choose to strategically respond to external pressures (Lamin & Zaheer, 2012). Stakeholder theory has developed useful tools to help managers identify which stakeholder groups they need to 'attend to', but has stopped short of suggesting which legitimation tactics should be consequently selected for different conferrers of legitimacy. Similarly, focusing on a singular legitimacy threat is insightful when the aim is to explore the repertoire of tactics that corporations employ in response to social activism for example (Ingram, Yue & Rao, 2010; Hadani, Doh & Schneider, 2016; McDonnell & King, 2013; McDonnell, King & Soule, 2015) but less so for investigating how tactic choice may itself be a function of the specific threat facing the firm.

We posited that managers appoint politician-directors following community legitimacy threats because politicians are prototypical community representatives who can assure constituencies that their interests will no longer be 'marginalized' in corporate decision-making. Additionally, politician-directors can actively help the firm engage in constructive dialogue with diverse societal groups typically characterized as being highly fragmented, geographically dispersed, and representative of a myriad of causes with incoherent objectives. On similar grounds, we can deduce why the merits of politician appointments will fail to assuage the concerns of primary stakeholders. Employees, customers, suppliers and shareholders are conventionally guaranteed access to official channels of feedback and influence that provide direct and instrumental means of communicating their preferences with the firm, oftentimes through existing board representation but also dedicated organizational functions. These structures furthermore serve as articulation, aggregation and coordination mechanisms, effectively ensuring managers are capable of promptly and appropriately responding to grievances should they arise. As such, it is not clear how the appointment of politician-directors would add much value to primary shareholders beyond the existing corporate structures and mechanisms of influence they have access to. In that respect, we encourage future scholarly work to pay more attention to the heterogenous attributes of stakeholders, not only in terms of whether or not they will elicit managerial responses (Eesley & Lenox, 2006; Mitchell el al., 1997), but also what kind of responses.

Finally, our findings have relevance to the growing body of research at the intersection between social movement theory and organization theory, which examines the influence of social dissent on corporate decision-making. Much of this research has focused on the tactics that dissidents employ to confront the firm directly, such as boycotts and protests, and which the literature collectively defines as "private politics" (Baron, 2003). A smaller stream within this field has paid attention instead to "public politics" as more indirect forms of pressure that rely on the leveraging of the coercive power of the state to influence firms. Although there is general agreement that the state is theoretically responsive to constituent grievances, there has been much debate about the actual political influence that activists and movements yield relative to other interest groups such as powerful businesses lobbies (e.g. Burstein & Sausner, 2005; Piven 2006). Our contribution to this literature is to point scholars to another manifestation of state power, its role as a major customer, as a potentially more promising venue of inquiry compared to its role as regulator.

We postulate that greater managerial sensitivity to community threats under conditions of high public procurement rather than high regulation may be attributable to the complexity of the regulatory process. New legislation is often time-consuming to draft; is broad-spanning and designed for longevity; and is susceptible to multiple veto points (Bonardi, Hillman & Keim, 2005; Choi, Jia & Lu, 2014). In contrast, the threat of punitive action via public procurement channels is more viable and, consequently, more credible. Relative to regulations, procurement debarments target individual firms, are quick to implement, and are temporary since they are usually contingent on subsequent improvements in the firm's behavior.

One exception to our narrative however is the hypothesized country-level contingency. Contrary to expectations that powerful and more socially involved governments in CMEs amplify the political and social-based value of politician appointments, results did not support this conjecture. On one hand this may be attributable to our small sample size at the country-level, which may also explain why we did not observe the expected positive relationship between corruption and politician appointments (Faccio, 2006). A conceptual justification could also underlie this non-finding. The prevalent deliberations that take place in CMEs not only heighten the legitimacy of community constituencies, but may also substantially extend their influence over corporate decision-making relative to their counterparts in LMEs. Specifically, deliberative procedures bring firms and societal actors together in multilateral forums that help "develop a common diagnosis of the situation", "devis[e] an effective and coordinated response" and "facilitate agreement in subsequent exchanges" (Hall & Soskice, 2001: 11-12). In other words, deliberations both ensure that secondary stakeholders are not structurally insulated from the firm, and directly substitute the need for the articulation, aggregation and coordination mechanisms that the appointment of politician-directors would bring. For community constituencies in CMEs therefore, similar to primary stakeholders, there may be little value in the appointment of politician-directors given their existing access to institutionalized channels of influence over corporate decision-making.

Appendix 2.1 Examples of community legitimacy threats facing firms

Company name	Country	Year	% Y-o-Y decline in community legitimacy	Description of circumstances surrounding legitimacy threat
Thales SA	France	2005	95	The company is convicted of fraudulent practices in Cambodia, resulting in its temporary debarment from further World-Bank financed contracts.
American International Group Inc.	United States	2008	86	In one of the landmark bailouts of the financial crisis, the government acquires 80% of the firm's equity. Many view the firm's aggressive expansion in risky lending practices as a contributor to the worst recession the world has ever seen since the Great Depression.
ProSiebenSat1 Media AG	Germany	2007	80	Acquisition of firm by international owners sparks debate in Germany about the merit of allowing foreign takeovers of national broadcasters. The new owners expect sizeable layoffs and will refrain from long investments in the firm given their intention to resell it in a few years.
Tohoku Electric Power Company	Japan	2007	79	The electric utility company admits that it had manipulated data on reactor operations to cover up previous emergency reactor shutdowns.
Eldorado Gold Corp.	Canada	2006	79	Villagers near the firm's Kisladag goldmine in Turkey claim high levels of cyanide in their bloodstream. Errors and omissions are also allegedly found in the environmental impact assessment reports submitted by the firm to acquire its mining permits.
DNO International ASA	Norway	2005	76	The company sparks international outrage by signing an oil exploration deal with Kurdish separatists without the approval of the Iraqi central government; critics see the move as an infringement on Iraq's sovereignty.
Paladin Energy Ltd	Australia	2006	75	The company is given permission to begin mining in Kayerekela, Malawi's largest uranium mine, despite strong resistance from local organizations who call the project 'an ecological disaster in waiting'.
Adecco SA	Switzerland	2009	75	The firm is fined $43.8 million by French Authorities for engaging in anti-competitive practices.
Trelleborg AB	Sweden	2007	71	Two executives of the firm are convicted and imprisoned by the US Department of Justice for their role in the 'marine hose cartel', whose illicit activities included rigging bids and fixing prices.
Airbus Group	Netherlands	2009	66	An Airbus A330 aircraft, commonly considered among the world's safest passenger aircrafts, crashes between Rio de Janeiro and Paris, killing all 228 passengers and crew members. It is the deadliest crash in the history of both Airbus and Air France. Malfunctioning onboard equipment were partly to blame.
Glaxosmithkline PLC	United Kingdom	2004	66	The drug manufacturer is embroiled in a series of scandals involving allegations of fraud and conducing medical experiments on orphans infected with HIV.

CHAPTER 3.

BOARD OF THRONES? UNRAVELING INVESTOR REACTIONS TO POLITICIAN APPOINTMENTS [8]

ABSTRACT

Because prior research has documented inconsistent findings regarding the expected value to firms of appointing politicians to the board of directors, we develop a multi-level contingency approach to explain why investors in developed economies may perceive politician appointments as value-enhancing and value-destroying at the same time. Drawing on resource dependence theory and agency theory, we identify several conditions under which the expected dependence-management benefits of politician appointments are likely to outweigh their expected agency costs, and vice versa. Using event study methodology on the appointment of 349 politicians to the boards of 1,063 firms across 14 OECD countries from 2001 to 2010, we find that investors expect politicians to help their firms remedy a broader set of resource dependencies than those on government alone, and that higher levels of perceived corruption in a country increase both the dependence management-based benefits and the agency costs of politician appointments. Our findings not only contribute to the politician appointment literature specifically, but also to the development of resource dependence and agency theory in corporate political activity research more generally.

[8] This study is conducted in collaboration with Hans van Oosterhout and Marc van Essen.

3.1 INTRODUCTION

The appointment of current and former politicians as corporate directors (hereafter ‘politician appointments’) is one of the most prominent manifestations of the ties that firms establish with governmental stakeholders in order to create value (Agrawal & Knoeber, 2001; Chizema, Liu, Lu, & Gao, 2015; Lester, Hillman, Zardkoohi, & Cannella Jr, 2008). Research has documented the ubiquity of such appointments, which are not only prevalent in institutionally less developed parts of the world, but also in countries with more developed institutions in place, such as the United States and United Kingdom for example (Faccio, 2006). But while the prevalence of politician appointments has been widely documented and the motives underlying them theoretically scrutinized (Hillman et al., 2004), there is little agreement in the literature on whether investors perceive the establishment of such board-level ties to politics favorably or not (Hadani et al., 2017). To date, studies have shown the relationship between politicians on the board (hereafter ‘politician-directors’) and firm value to be positive (Boubakri, Cosset, & Saffar, 2012a; Goldman et al., 2009; Hillman, 2005), negative (Hadani & Schuler, 2013) as well as non-significant (Faccio, 2006).

In this study, we attribute the empirical ambiguity on the expected value of politician appointments to a theoretical tension between two alternative understandings of politician appointments specifically, and corporate political activity (CPA) more generally. Because a central tenet of resource dependence theory (RDT) is that reliable and stable access to key resources from the external environment is a prerequisite for firm survival (Pfeffer & Salancik, 1978), CPA scholars have predominantly invoked an RDT logic to theorize politician appointments as value-enhancing conduits to political resources or as buffers against political uncertainty (Selznick, 1949). Accordingly, investors expect politician-directors to provide firms with influence over policy outcomes, and with insider information about the policymaking process (Hillman, 2005).

Other scholars, in contrast, have pointed at the possible agency costs of politician appointments, suggesting that politician-directors are ill-positioned, or even unwilling, to serve as guardians of shareholder interests. Specifically, politician-directors have been argued to be poor monitors of management (Fan, Wong, & Zhang, 2007), collude with blockholders at the expense of minority shareholders (Sun et al., 2016) and to be prone to divert corporate resources towards political rather than shareholder-aligned objectives (Shleifer & Vishny, 1994). According to this view, investor reactions to a politician appointment should thus be negative in anticipation of the agency risks it propagates.

In the context of developed countries specifically, the ambiguity of politician appointment value may additionally be attributable to a limited understanding of how corporate political action may be differentially perceived across economies at similar levels of institutional development (Rajwani & Liedong, 2015). The few studies that have used cross-national research designs have resorted primarily to the logic of institutional underdevelopment to explain the differential prevalence and effectiveness of political connections around the world (Boubakri et al. 2012a; Faccio, 2006). Illuminating as this may be, it is unclear if this logic also applies to countries featuring more developed institutional remedies against the most blatant forms of cooptation. Yet within institutionally well developed economies, differences do exist in the extent to which their culture, values and norms, tolerate the trading of favors between public and private actors (Davis & Ruhe, 2003). Thus, even where institutions are well developed, there may be cross-national heterogeneity in the expected value of politician appointments to the board (e.g. Acemoglu et al., 2016; Amore & Bennedsen, 2013; Gray, Harymawan, & Nowland, 2016).

This study seeks to resolve such ambiguities in the CPA literature by advancing a finer-grained, multi-level, and multi-theoretical view of politician appointment value as perceived by investors. In applying RDT and agency theory in isolation, prior studies may have overlooked the relational nature of politician appointments (Hillman & Hitt, 1999). That is, because directorships involve an ongoing exchange between the firm and the appointee, the dependence-management benefits of politician appointments as well as the agency risks that they pose are *both* likely to materialize over the course of the appointment. This means that politician-appointments cannot be judged as generically value-adding or value-destroying, but that the interplay of certain contingencies will determine the *net* value that they may be expected to create or destroy.

Concretely, we argue that at the firm-level, investor reactions to politician appointments will be sensitive to the extent to which the resources provided by politicians are actually needed by the firm. Departing from the generic view of resource dependence that dominates the CPA literature (Hillman, 2005), we distinguish between firms' regulatory and financial dependencies and argue that investors will consider both in assessing politician appointment value. We argue, second, that investors are apprehensive of politician appointments if they associate them with severe agency risks, such as those resulting from the over-embeddedness of firms within political networks (Okhmatovskiy, 2010). Extending our framework to the country level, finally, we argue that under higher levels of perceived of corruption, relational political strategies are not only likely to confer larger benefits to resource-dependent firms due to higher levels of social acceptance of relationships between business and politics, but will also increase the agency risks that investors expect to materialize from more entrenched firm relationships with governmental stakeholders (Sun et al., 2012).

To test our theoretical framework, we study 12,867 new director appointments in 1,063 companies across 14 developed OECD economies over the period 2001 to 2010. After manually identifying all directors who serve or have served in a political role at various levels of government, we employ an event study methodology to capture investor reactions to the appointment announcements of 349 of these politician-directors. Using cumulative abnormal market returns (CARs) as the dependent variable in a multi-level regression model, our findings suggest that investors in developed countries are indeed sensitive of both the firm- and country-level contingencies that shape the costs and benefits of politician appointments. Specifically, we find that investor reactions to politician appointments are higher for financially more dependent firms and that higher perceived corruption increases positive reactions to politician appointments in heavily regulated firms as well as negative reactions to the appointment of politicians to already-connected boards.

Our findings seek to contribute to the CPA literature by developing a more nuanced understanding of politician appointments, which are an exemplary and highly prevalent political strategy, the benefits of which have been highly contested in the literature. By incorporating insights from two alternative theoretical lenses at two levels of analysis, our findings suggest that the present ambiguity can at least partly be reconciled by developing a contingency-based, multi-level approach to CPA (Sun et al. 2012). We not only show that a framework rooted in *both* RDT and agency theory can explain the heterogeneity in market reactions to politician appointments, but also that this framework will need to incorporate the institutional context in order to offer systematic predictions as to *why* investors react differently. Given the dearth of empirical cross-national studies in the field, our findings demonstrate the perils of overlooking important institutional contingencies that may explain differences in the perceived value of political connections around the world.

3.2 THEORETICAL BACKGROUND AND HYPOTHESES

3.2.1 A Resource Dependence Perspective on Politician Appointments

RDT has long conceptualized corporate boards as “vehicles for co-opting important external organizations” (Pfeffer & Salancik, 1978: 168). Cooptation, or providing outside parties a vested interest in the firm by offering them a seat on the board, establishes dedicated linkages to crucial resource providers in order to secure a stable flow of resources to the firm and buffer against the uncertainty that accompanies external dependence (Selznick, 1949). Central to the RDT logic is the need to secure a close board-environment match, such that each coopted director addresses a specific dependency of the firm (Hillman, Cannella, & Paetzold, 2000). Thus, firms in need of financial resources appoint bank representatives to their boards (Mizruchi & Stearns, 1988), while those operating in complex legal environments choose directors with law degrees (Agrawal & Knoeber, 2001). Within the CPA literature, therefore, appointing politicians to the board is understood as a cooptation tactic aimed specifically at managing the firm’s dependence on government (Hillman et al., 2009). Because neither the government or its agencies are wholly absorbable or readily substitutable, politician appointments serve as a more feasible strategy to transform government representatives into agents of the firm (Getz, 2002).

Research has established that firms appointing politicians can expect two types of benefits specific to the resource-provisionary capacity of public officials. First, by virtue of their access to policy formulation or enforcement, politicians can actively shape firms’ market environments by providing privileged access to state-controlled resources (Schuler et al., 2017). They can do so either by building support around specific policies that serve the interests of their firms, or by diluting or impeding regulatory encroachments that threaten the viability of firm operations (Hadani, Doh, & Schneider, 2018). Prior studies have documented numerous manifestations of such political influence, which include preferential access to governmental subsidies, favorable taxation, public procurement contracts, federal earmarks, and even official state representation on matters of international trade (Bertrand, Kramarz, Schoar, & Thesmar, 2018b; De Figueiredo & Silverman, 2006; Goldman, Rocholl, & So, 2013; Schuler, Schnietz, & Scott Baggett, 2002).

Preferential access to public policy making or enforcement can also help firms maintain their monopolistic status if used to undermine the competitive position of rivals (Capron & Chatain, 2008; McWilliams et al., 2002). Traditional automakers and hospitality establishments, for example, have been shown to leverage their political connections to mandate licensing fees against competitors (Frynas, Mellahi, & Pigman, 2006), as well as raise institutional barriers against radical disruptors and foreign entrants (Benner, 2017; Wilson, 2014). Politically-connected firms have even been found to use their political influence to advance stringent industry regulations if they know their smaller rivals cannot afford the higher costs of compliance (Delmas, Lim, & Nairn-Birch, 2016).

Second, because political processes are complex and opaque to outsiders (Hadani et al., 2017), politician-directors may supply firms with valuable, private knowledge of the 'inner workings of government', information on exploitable loopholes within the bureaucracy, and a real-time, insider's view into the policymaking process as it unravels (Ferris, Houston, & Javakhadze, 2016; Lester et al., 2008). Thus, even without being able to influence policy making and enforcement, preferential access to politics may still lead to a competitive advantage by allowing connected firms to assess the likelihood of, and prepare for, specific policy outcomes before their non-connected peers (Wellman, 2017).

In line with this specific dependence-management understanding of politician appointments, several studies have documented a positive relationship between politician appointments and firm value. In a sample of US-based firms, Hillman (2005) and Goldman et al. (2009) find that firms with former politicians on their boards are associated with superior market-based performance measures. In a cross-country study, Boubakri and colleagues (2012a) find that firms experience a significant gain in profitability of around 57% when a politician is appointed to the board, or when a director enters politics.

3.2.2 An Agency Theoretical Perspective on Politician Appointments

While RDT emphasizes the potential benefits of politician appointments, it cannot explain why such appointments have at times been found to *reduce* rather than create firm value.

Because such outcomes suggest there to be a cost to politician appointments, scholars have often resorted to agency theory to explain the risks that the establishment of political ties may impose upon the firm and its shareholders (Hadani, 2012). One view, for example, questions whether the set of skills that make politicians suitable for public office is congruent with the monitoring role of directors in publicly listed firms. Because their occupational background lies primarily in areas of public policy and societal welfare, politician-directors typically lack the commercial expertise to adequately monitor management and provide strategic counsel (Fan et al., 2007).

Others have argued that politician appointments may create agency costs because they entrench the interests of dominant insiders at the expense of outside shareholder interests. CEOs, for example, may seek politician appointments for ideological rather than economic reasons (Aggarwal et al., 2012), or because they eye a future career in politics and see appointments as an opportunity to curry favor with political insiders (Coates IV, 2012). Political connections can also insulate management or large blockholders from the threat of disciplinary action, thereby increasing the prevalence of misconduct and other forms of insider opportunism. Research has documented that relative to non-connected firms, executives of politically-connected firms are more likely to engage in insider trading (Bourveau, Coulomb, & Sangnier, 2016), evade or delay detection of fraudulent behaviors (Yu & Yu, 2011), and face lower penalties when they are prosecuted (Correia, 2014). In a similar vein, Sun et al. (2016) document that politically-connected blockholders may privately appropriate value because minority shareholders are left with minimal legal recourse against insider opportunism. As such, the establishment of political connections may not only encourage managerial entrenchment and self-dealing, but can also exacerbate so-called principal-principal agency costs through value-destroying forms of tunneling (Dharwadkar, George, & Brandes, 2000).

Finally, politician-directors themselves can also command compensation for their services to the firm such that the value that they create may be offset by the rents they extract. Bonardi and colleagues (2005), for example, argue that suppliers of policy (i.e. politicians) provide demanders of policy (i.e. firms) access to state-controlled resources in exchange for electoral support. Accordingly, politician-directors may be driven by partisan allegiances or societal obligations at the expense of shareholder value maximization. Thus politically-connected firms have been found to scale up hiring and postpone lay-offs during election years, adopt egalitarian rather than merit-based compensation structures, and raise spending on philanthropic initiatives (Bertrand, Bombardini, Fisman, & Trebbi, 2018a; Bertrand et al., 2018b; Bonardi & Urbiztondo, 2013; Chizema et al., 2015; Zhang, Marquis, & Qiao, 2016). At the extreme, economists have even portrayed politicians as ‘rent-seekers’ who use firms as vehicles for their personal enrichment (Shleifer & Vishny, 1994).

Consistent with agency theory, and in contrast to the RDT-based findings discussed above, Hadani and Schuler (2013) find that S&P 1500 firms with former public officials on their boards suffer from lower market valuations relative to their non-connected peers. They conclude that as such, corporate political activities constitute poor-quality investments with high moral hazard problems. Likewise, in a cross-country study, Faccio (2006) documents negative but statistically insignificant investor reactions following the announcement of 48 politician appointments to corporate boards, and attributes it primarily to politician-directors’ rent-seeking behaviors. In a follow-up study, she reports politically connected firms to have significantly lower accounting and market-based subsequent performance (Faccio, 2010).

In sum, there does not seem to exist comprehensive understanding of politician appointments in the literature, as rival theories make alternative predictions that are each corroborated by the empirical evidence. As a result, it remains unclear how investors will ultimately react to these appointments. To reconcile these conflicting views, we propose that investors are likely to understand the appointment of politicians to comprise a *relational* political strategy (Hillman & Hitt, 1999). That is, as a conduit of continued exchange, governed by norms and expectations of reciprocity, politcian appointments provide both firms and politcian-directors with mutual opportunities for extracting value over the course of the appointment. As a result, both the potential dependence-management benefits of appointments as well as their agency-based risks are likely to co-exist.

When estimating the value implications of appointments, we posit that investors will base their reactions on the *balance* of the expected benefits and costs of appointments (Rosenstein & Wyatt, 1990). Insofar as the benefits of policymaking access and political know-how are perceived to be sizeable enough to compensate for the agency-risks that they may pose, investor reactions to politcian appointments should be favorable. Conversely, investors will be wary of politician appointments when the risks of ineffective monitoring, managerial entrenchment, and rent-seeking are so severe as to outweigh expected benefits. In developing our hypotheses, we draw on RDT and agency theory to theoretically identify the causes of these costs and benefits as they materialize in the different national contexts in which politician appointments take place.

3.2.3 Perceived Benefits of Politician Appointments

While prior studies have acknowledged dependence on government as a strategic motivation for political activity (Lux et al., 2011; Pfeffer, 1972), research has not examined the degree in which investors incorporate this in their expectations of politician appointment value. Similar to other forms of external dependence, we argue that high dependence on government creates uncertainty regarding the sustained viability and ability of firms to create future value. In particular, firms operating in highly-regulated industries are exposed to considerable policy uncertainty since even small changes in regulation can affect a wide array of firm activities: from how they operate and produce their products, to the conditions they must comply with when offering services to consumers (Bonardi et al., 2006; Shaffer, Quasney, & Grimm, 2000). For such firms, the effective management of the political environment is critical for performance (Hillman et al., 2009).

Although in developed economies the implementation of regulation is typically assigned to dedicated agencies, Holburn and Vanden Bergh (2008) observe that politicians maintain *de facto* influence over these agencies through legislation, court procedures, and the authority to set their budgets. For regulated firms, appointing politicians to the board can therefore provide valuable opportunities to exercise direct and indirect influence over the way in which regulations are shaped, implemented, and ultimately enforced. Owing to their in-depth knowledge of the inner workings of government, politician-directors can additionally help these firms navigate administrative hurdles that burden economic activities with strict regulatory oversight (Ferris et al., 2016; Holburn & Vanden Bergh, 2014).

In contrast, government is not an important source of external risk for firms in less regulated industries. The absence of an established statutory regime makes it harder for the government to impose new restrictions and policy at will. At the same time, the diminished role of the state in less regulated industries implies that connected firms have fewer opportunities to undermine the competitive position of rivals through political markets, and have little use for an insider view of a policymaking process that is only of sporadic relevance to the firm. But while politician appointments in less regulated industries are therefore less likely to create firm benefits, they may still pose the aforementioned agency-based risks to shareholder value. We hence hypothesize:

> **Hypothesis 1.** *There will be a positive relationship between the firm's regulatory dependencies and investor reactions to politician appointments.*

In conceiving politician appointments as strategies aimed exclusively at the firm's political environment, CPA scholars have mostly ignored the possibility that politician-directors are also well-positioned to address firm dependencies other than dependence on government. Recent findings in financial economics for example have linked politically-connected firms to preferential access to bank financing, or the attainment of larger and cheaper loans (Claessens, Feijen, & Laeven, 2008; Leuz & Oberholzer-Gee, 2006). To date, however, the financial needs of the firm have not been incorporated in the CPA literature.

In developed economies, there are two reasons why creditors may be expected to extend preferential treatment to politically-connected firms. First, if connected firms enjoy superior access to state-controlled resources, creditors will perceive them as less risky than their non-connected counterparts (Boubakri, Guedhami, Mishra, & Saffar, 2012b). Prior research has indeed shown politically-connected firms to have lower rates of failure (D'Aveni, 1990), as well as a higher likelihood of being bailed out by the government in times of distress (Faccio, Masulis, & Mcconnell, 2006). As such, lower perceived risk subsidizes the firm's cost of capital. Relatedly, creditors may favor politically-connected firms because they themselves seek to leverage the firm's connections in order to advance their own interests. Thus a bank may offer preferential borrowing to a politically-connected firm, for example, expecting in return that the firm uses its political connections to assist the bank in securing a favorable regulatory environment (Houston et al., 2014).

Second, because politicians in developed economies are competitively vetted through elections, their appointment to the firm could be interpreted by stakeholders, including banks, as a signal for firm quality and reputation (Oehmichen, Braun, Wolff, & Yoshikawa, 2017). In light of the inherent information asymmetries between lenders and borrowers, politician appointments can thereby allow firms to capitalize on the observable status of the politician to maintain or enhance their own standing with outside parties (Certo, 2003). Schuler and colleagues (2017) show that hosting a visit from high-ranking government officials generates positive stock price reactions for the hosting firm, in part because of the status signals that these visits produce. We expect a politician appointment to constitute an even stronger signal of endorsement given that it establishes a more enduring connection with the firm.

Investors are unlikely to expect all firms to benefit equally from better access to external financing however. For highly indebted or financially distressed firms, appointments can reduce borrowing costs or facilitate credit lifelines that would not be available in the absence of political affiliation (Carretta, Farina, Gon, & Parisi, 2012; Duchin & Sosyura, 2012). Conversely, firms less reliant on debt financing or those with sufficient liquidity to meet their short-term financial obligations, face less urgency in managing their financial dependencies. Holding agency risks constant, the relative value effects of politician appointments should thus be more positive under higher financial dependence. We therefore predict:

> **Hypothesis 2.** *There will be a positive relationship between the firm's financial dependencies and investor reactions to politician appointments.*

3.2.4 Perceived Costs of Politician Appointments

Contrary to RDT, an agency-theoretic perspective on politician appointments would expect politician-directors to be poor monitors, increase the entrenchment of dominant insiders at the expense of outside minority investors, and to promote the pursuit of socio-political goals that conflict with shareholder value maximization. While investors may be willing to absorb such costs as a price worth paying relative to the dependence-management benefits resulting from politician appointments, we consider one condition that may tip the balance the other way: when the appointing firm already has (a) politician(s) serving on its board.

From a dependence-management perspective, if a firm is already politically-connected, establishing new connections is likely to bring diminishing returns due to the overlap in the type of resources that politicians may provide the firm access to (Pollock, Chen, Jackson, & Hambrick, 2010). Whereas the appointment of a politician to a politically-unconnected firm extends the benefits theorized above, investors are unlikely to expect the same amount of benefits from the appointment of a second or even third politician.

At the same time, agency theory would suggest that the appointment of additional politicians will increase the risks of agency costs materializing from such appointments. Since politician-directors cannot be expected to perform their supervisory duties with the same level of competence as outside directors with business experience or professional backgrounds (Fan et al., 2007), the appointment of even more politicians is likely to foreshadow a deterioration in the monitoring capacity of the board (Hambrick, Misangyi, & Park, 2015).

Establishing additional ties with politics may even lead to "political overembeddedness", a term Okhmatovskiy (2010) has coined to describe the cognitive and structural lock-in that can get hold over overly connected firms. Cognitive lock-in occurs when the multiplicity of ties to politics provide easy access to political resources that managers may get used to at the expense of the market competitiveness of the firm (Sun, Mellahi, & Thun, 2010). As such, political overembeddedness may lead managers to see their political ties as substitutes for value-enhancing investments in technological and marketing innovation, for example (Wan, 2005), and lock them into a state of complacency. When these ties fail to deliver or become obsolete due to a major change in government, the firm is left dangerously unprepared for dealing with market-based competitive threats (Sun et al., 2010).

Appointing politicians to an already-connected firm also runs the risk of structurally locking firms into an exchange relationship with politics that becomes increasingly difficult to exit. Corporate governance research has documented the risks of a 'dominant coalition' materializing, defined as a sizeable faction of like-minded directors on the board that has "unequalled, collective, and synergized influence" (Pearce II, 1995: 1075) due to the shared identity of its members. Members of a dominant coalition are prone to entrench themselves by favoring the appointment of similar directors (Fan et al., 2007; Westphal & Zajac, 1995), and have been found to exert disproportionate influence over corporate strategy and actions (Zhang & Greve, in press). With politician-directors specifically, we expect their overrepresentation to increase the agency costs of politician appointments beyond the point at which they start to dominate the perceived benefits that they may have. We therefore hypothesize:

> **Hypothesis 3.** *There will be a negative relationship between the presence of existing politicians on the board and investor reactions to politician appointments.*

3.2.5 Contextualizing the Benefits and Costs of Politician Appointments

So far, our theorizing has assumed that the perceived costs and benefits of appointments depend on firm-level attributes only, while it is likely that these costs and benefits, as well as the balance between them, will vary between countries. In well-developed countries, formal institutions, such as an effective separation of powers between the legislative, executive, and judiciary functions of government, and a free press for example, are firmly established. These will not only constrain public officials in abusing their powers for private gain, but in maintaining an arm's length relationship between business and politics, may also serve to limit the effectiveness of corporate political strategies more generally (Rajwani & Liedong, 2015).

Next to formal institutions however, countries also feature informal institutions, which manifest themselves as social norms, customs, practices, or values. Informal institutions differ widely between institutionally and economically well-developed countries, and are likely to exhibit a differential tolerance of firm-specific relationships between the public and private spheres (Hooker, 2009). While formal institutions may curb the most blatant forms of bribery, informal institutions may be differentially conducive to other forms of political favoritism.

In postwar Italy, for example, a culture of political patronage has led to a unique form of pork-barrel politics in which politicians supply clienteles with individualized benefits under the implicit expectation that these constituencies will 'repay the favor' during election times (Golden, 2003). In France, the shared educational experience of the elite, who often attend the same limited set of schools known as "Grandes Ecoles", forms the basis of socially-sanctioned relations between future political and business leaders (Bertrand et al., 2018b). The differential social permissiveness towards patronage, even among the economically and institutionally most developed countries, is reflected in widely diverging national perceptions of corruption. While OECD Member States such as New Zealand and

Denmark ranked among the world's least corrupt nations according to Transparency International's 2017 Corruption Perceptions Index, another OECD member, Italy, trailed the likes of Rwanda and Namibia.

Because higher perceived corruption captures a social order conducive to the formation of reciprocal exchange relations between business and politics, we expect resource-dependent firms in more corrupt environments to have more to gain from pursuing relational political strategies. Under higher perceived corruption, politician-directors are more inclined to help their firms due to the expectation that favors are likely to be reciprocated in the future. At the same time, politicians may be allowed greater discretion over the distribution of state-controlled resources if society is generally more tolerant of the exchange of favors, including between politicians themselves. As such, politician-directors of regulated firms are expected to face fewer obstacles in helping their firms preserve the regulatory status quo, or in introducing unmerited changes to existing policy if needed (García-Canal & Guillén, 2008).

In a similar vein, we expect politician-directors to be better able to remedy firms' financial dependencies in higher-corruption environments. Since higher levels of perceived corruption provide politician-directors with greater influence over policy and access to inside political knowledge, politically-connected firms are likely to be associated with a lower risk of failure relative to their counterparts in low-corruption environments, thus subsidizing their cost of capital further (Boubakri et al., 2012b). Rodriguez et al. (2005) additionally note that when institutional norms are pervasive and broadly diffused, not only is acquiescing to these pressures expected, but it can even legitimize the firm in the eyes of local suppliers and creditors. That is, "because corruption is socially valid where it is pervasive, compliance with the practices of a corrupt environment is likely to yield external legitimacy" (Ibid: 390). Finally, through politicians' influence over the lending activities of government-owned banks, connected firms in corrupt environments have access to an additional means of external financing that is independent of the actual risk hazard that they pose for creditors (Dinç, 2005; Khwaja & Mian, 2005). In Italy, for example, Infante and Piazza (2014) found that firms with politicians on the board attain lower interest rates from banks that also have politicians on their board, suggesting that bank-lending is particularly amenable to relational exchange between business and politics. As a result, we hypothesize:

Hypothesis 4a. *The positive effect of firm regulatory dependence on investor reactions to politician appointments will be stronger in countries with higher levels of perceived corruption.*

Hypothesis 4b. *The positive effect of firm financial dependence on investor reactions to politician appointments will be stronger in countries with higher levels of perceived corruption.*

In the same way that higher levels of perceived corruption will enhance opportunities for gain, we also anticipate corruption to aggravate the agency costs resulting from political overembeddedness. First, in environments perceived to be more corrupt, managers of politically-overembedded firms may be even more prone to take political protection for granted. Armed with the belief that their stronger connections with government will insulate them from failure, managers may be more inclined to take unwarranted risks with regard to their investment choices for example (Boubakri et al., 2013). In a similar vein, powerful insiders such as managers and blockholders may be more likely to engage in self-dealing when they are more deeply embedded in a network of powerful relations that they can depend on for political favors, such as immunity from disciplinary action (Sun et al., 2016). Second, an environment in which the trading of favors is sanctioned or even encouraged, amplifies the adverse influence of a self-interested dominant coalition over firm decision-making. For example, the presence of multiple politician-directors on the board could facilitate even more politician appointments if such directorships are treated as rewards or tokens of exchange. Third, due to the greater social norms of reciprocity and the higher opportunity costs of being unconnected in more corrupt environments, appointing politicians to already connected boards can make political connections particularly hard to exit even if they become unbalanced, or are no longer advantageous over time (e.g. Gargiulo & Benassi, 2000; Uzzi, 1997).

In contrast, firms in less-corrupt environments are better able to shield against such adverse outcomes because of lower discretion for politicians, as well as lower expectations of reciprocity. While this may generally limit the effectiveness of relational political strategies in these environments, it also mitigates against lock-in by enabling firms to more readily loosen their political connections when it is economically expedient. Therefore:

Hypothesis 5. *The negative effect of existing political connectedness (i.e. the presence of politicians on the board) on investor reactions to new politician appointments will be stronger in countries with higher levels of perceived corruption.*

3.3 METHODS

3.3.1 Data and Sample

To investigate investor perceptions of politician appointments across different countries, we required information on firms' board composition, the timing of director appointments, and the detailed occupational background for each appointed director. We thus required a sample of countries whose disclosure requirements are sufficiently high to ensure data quality and availability.[9] Our analysis focuses on 14 of the largest OECD Member States, namely Australia, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States. Even as these countries collectively embody the world's most developed economies, they still differ in terms of their national levels of perceived corruption, our country-level variable of interest (Treisman, 2000).

A dominant view in the CPA literature is that the resource endowments of larger firms makes them more likely to engage in political activity compared to smaller firms (Hillman et al., 2004; Lux et al., 2011). To ensure we pick up on a sufficient number of politician appointments events, we thus focused our analysis further on the largest 50 firms by market capitalization in each market respectively, over the period 2001 to 2010. For each firm we tracked its board composition over the focal period using company annual reports and *BoardEx*, a proprietary database providing detailed information on the employment history of corporate directors around the world (Shi, Hoskisson, & Zhang, 2017). We excluded firms that traded for less than two consecutive years on the stock market since we were unable to track changes in their board composition. Our sample comprised 1,063 firms

[9] Additionally, a proper application of the event study methodology necessitates the presence of well-functioning stock markets so that a semi-strong form of the efficient markets hypothesis holds—that is, the assumption that a corporate event entailing newly publicly-disclosed information is swiftly incorporated by investors into the stock price (McWilliams & Siegel, 1997). While perfect market efficiency is rarely tenable in practice, research has shown that is more likely to hold in developed economies due to their higher liquidity, more stringent restrictions on insider trading, and an abundance of experienced traders (Antoniou, Ergul & Holmes, 1997; Bhattacharya et al., 2000).

and 9,516 firm-year observations (Table 3.1). In total, 12,876 directors were appointed during the focal period.

We manually researched the occupational backgrounds of all appointed directors in order to identify all politicians in our sample. Prior U.S.-based studies have examined the appointment of only former politicians to the board given formal prohibitions against public officials from holding firm directorships while serving in office. Yet in many places around the world, including the majority of countries making up our sample, no such restrictions exist (Faccio, 2006; Gagliarducci, Nannicini, & Naticchioni, 2010). We thus account for the possibility that firms may choose to appoint either incumbent and former politicians, and code for all individuals who are or were active in politics.

We note that the literature is replete with different operationalizations for such individuals however. Faccio (2006) for example conservatively restricts politician-directors to current Members of Parliament, Ministers, and Heads of State. Goldman et al. (2009) use a typology covering 24 different functions, including agency deputy-directors and presidential election campaign staff. Aggrawal and Knoeber (2001) include all individuals who were ever employed by a governmental body or political party.

For this study, we sought a typology that is sufficiently comprehensive to incorporate most functions associated with high degrees of political influence, yet parsimonious enough to be applicable to different political systems. We thus created three categories of politician-directors. First, we coded for 'national politicians' which we define based on Faccio (2006) as the national Heads of State, Ministers, and Members of Parliament and Senate. We broadened our definition to include the functional equivalents of national executives and legislators at the supranational level, such as European Commissioners and Members of European Parliament, as well as politicians with similar responsibilities at the national-level such as Junior Ministers, Minister-delegates, Deputy Ministers and Secretaries of State. The second category, 'local politicians', was assigned to executives and legislators at state, regional and provincial-levels. We expect local-level political connections to be of value to firms since local officials oftentimes possess ultimate influence over many areas of policymaking and enforcement of direct interest to business, including licensing, taxation, infrastructure and healthcare (Werner, 2017). Examples of local politicians are State Commissioners and Ministers, Members of Regional Parliament, Governors, Provincial Councilors, and Mayors at the municipal level. Finally, we coded for 'senior civil servants', who although not elected, are high-ranking members of the political hierarchy with indirect access to policy and with considerable knowledge of the bureaucracy (Etzion & Davis, 2008). Examples of senior bureaucrats include the Secretary-Generals and Chiefs of Staff of ministries, as well as Ambassadors.

Our first source of information for coding was the *BoardEx* database. When the employment profile of the director was incomplete or did not go back sufficiently in time, we resorted to additional sources to triangulate the data. For example, we checked the director profile section on publicly available databases such as *Bloomberg Businessweek, Wall Street Journal, Reuters People,* and *Who's Who*. Additionally, we searched annual reports for bibliographical information on the director, when available. Once we established that a director is or was a politician, we verified this from the websites of the political bodies, as well as other organizations and foundations that the director is/was affiliated with.

Table 3.1 provides a summary of the coding procedure. Of all newly appointed directors, 674 (5.2%) were politician-directors. Of those, 51 percent were national politicians, 18 percent were local politicians, and 31 percent were senior civil servants. Figure 3.1 shows the distribution of politician appointments across our sample countries. Strikingly, the proportion of firms we identified as having hired at least one politician-director over the focal period is five times higher than Faccio's (2006) cross-country study for a subsample of the same countries (35% vs. 7% respectively). We attribute this discrepancy to several methodological deviations: our study examines *all* directors on the board rather than only the CEO and Chairman, and we include both current and former politicians. Given that much research on political connections relies on the Faccio (2006) dataset, we believe that politician appointments are likely to be more prevalent than has been documented to date.

3.3.2 Event Study: Cumulative Abnormal Returns as the dependent variable

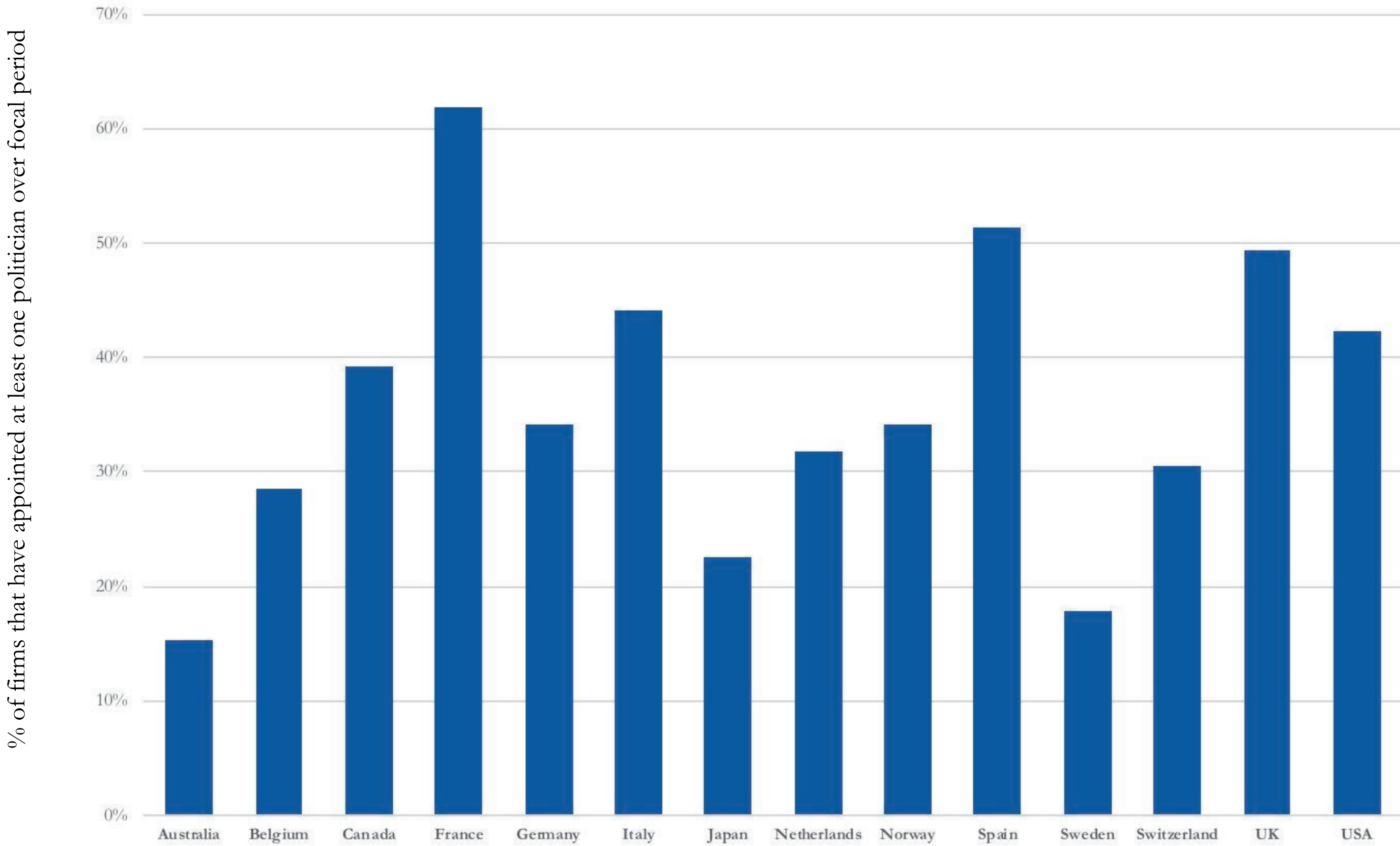
In an event study, unanticipated corporate announcements such as the appointment of outside directors to the board (Rosenstein & Wyatt, 1990; Shivdasani & Yermack, 1999), trigger changes in the price of the firm's securities in a magnitude and direction that reflect investors' estimate of the economic value to be derived from that event. Given the

Table 3.1 Country Distribution of Sampled Firms, Appointed Politicians and Cumulative Abnormal Returns

Countries	Firms	Firm-year observations	Newly appointed directors	National politicians	Subnational politicians	Senior civil servants	Any politician	Event Study Sample	CARs
Australia	78	732	640	4 (0.63)	0 (0.00)	12 (1.88)	16 (2.50)	11	-0.78%
Belgium	70	637	567	11 (1.94)	14 (2.47)	16 (2.82)	41 (7.23)	20	-0.10%
Canada	79	702	667	13 (1.95)	13 (1.95)	17 (2.55)	43 (6.45)	20	-0.19%
France	69	641	1,107	40 (3.61)	9 (0.81)	63 (5.69)	112 (10.12)	50	-0.47%
Germany	76	657	1,692	34 (2.01)	25 (1.48)	6 (0.35)	65 (3.84)	36	0.55%
Italy	78	645	991	39 (3.94)	15 (1.51)	7 (0.71)	61 (6.16)	29	1.14%
Japan	84	792	1,649	1 (0.06)	0 (0.00)	29 (1.76)	30 (1.82)	9	0.99%
Netherlands	66	590	657	22 (3.35)	2 (0.30)	6 (0.91)	30 (4.57)	17	0.07%
Norway	76	611	812	29 (3.57)	2 (0.25)	7 (0.86)	38 (4.68)	17	3.03%
Spain	72	596	831	62 (7.46)	15 (1.81)	8 (0.96)	85 (10.23)	56	-0.14%
Sweden	90	807	955	15 (1.57)	3 (0.31)	2 (0.21)	20 (2.09)	10	0.58%
Switzerland	72	659	591	16 (2.71)	13 (2.20)	4 (0.68)	33 (5.58)	10	0.13%
UK	75	709	960	31 (3.23)	2 (0.21)	22 (2.29)	55 (5.73)	37	0.66%
USA	78	738	757	27 (3.57)	9 (1.19)	9 (1.19)	45 (5.94)	27	-0.35%
Total	1,063	9,516	12,876	344 (2.67)	122 (0.95)	208 (1.62)	674 (5.23)	349	0.26%

Note: Firms refers to the number of unique firms ranked among the 50 largest by market capitalization in their respective market over the focal period 2001-2010. *Newly appointed directors* are the number of directors who were appointed to corporate boards during the focal period. *National politicians* is the number of newly appointed directors who were/are Cabinet Ministers, Members of Parliament, Heads of State, Members of European Parliament, European Commissioners, Junior Ministers, Minister-delegates, Deputy Minsters and Secretaries of State. *Subnational politicians* is the number of newly appointed directors who were/are State Ministers/Commissioners, Members of State/Regional/Provincial Parliament, Governors and Mayors. *Senior civil servants* is the number of newly appointed directors who were/are Secretary-Generals of Ministries, Ambassadors, Chiefs of Staff, and Private Secretaries. Figures in parenthesis are percentages of total newly appointed directors. *Event study sample* is the number of observations following the removal of confounding events within a seven-day event window. *Cumulative Abnormal Returns* (CARs) are calculated through the market-model approach over a three-day event window covering the day of the event, the day before, and day after. An event represents the earliest announcement date for the appointment or nomination of a politician to the board.

Figure 3.1 Distribution of Politician Appointments by Country, 2001—2010



complexity of gauging the outcomes of firms' political activities (Dahan, Hadani, & Schuler, 2013), event studies are frequently used within the CPA literature because of their ability to provide a clear and immediate link between the adoption of firms' political strategies, and the expected financial benefits that flow to the participating firm (e.g. Cooper, Gulen, & Ovtchinnikov, 2010; Hillman, et al. 1999; Schuler et al., 2017; Werner, 2017). While the ultimate value that politician-directors bring to the firm can deviate from initial investor expectations, stock price changes surrounding appointments may be viewed as an 'opinion survey' among market participants on the performance implications of appointees (Oler, Harrison & Allen, 2008).

Using *Lexis-Nexis*, we were able to locate the earliest news reference for the appointment or nomination to the board of 599 of the 674 politician-directors we identified. To ensure that market reactions were not confounded with other firm-specific events, we excluded observations in which mergers, acquisitions, earnings and dividends announcements, estimate updates, major litigation, labor unrest, major board reshuffling, and company restructurings coincided with the appointment announcement or fell within the three days preceding and/or succeeding it (McWilliams & Siegel, 1997). Because event studies further necessitate a period of 'normal' trading activity prior to the event to estimate abnormal returns (Paruchuri & Misangyi, 2015), we also excluded appointments that took place within the first year of the firm's listing on the stock market, or when we could not extract the historic stock price data for the firm using *Datastream*. In total, we were left with 349 'uncontaminated' events.

We followed standard event study methodology to see if these appointment events resulted in stock price movements that are significantly different to what we would expect in their absence. Our price expectations were guided by the correlation between a benchmark index and the firm's past stock price over a fixed pre-event estimation period. We selected an estimation period that covers 255 trading days lying between 285 and 30 days prior to the event (Hillman et al., 1999). The benchmark indices we used were either the all-share stock index or its broadest equivalent for each country respectively.[10]

[10] The following benchmark indices were used: ASX All Ordinaries (Australia), Brussels All Share (Belgium), S&P/TSX Composite (Canada), CAC All Tradable (France), CDAX General Performance (Germany), FTSE Italia All Share (Italy), Topix (Japan), AEX All Share (The Netherlands), MSCI Norway (Norway), Madrid General (Spain), OMX Stockholm (Sweden), Swiss Market (Switzerland), FTSE All Share (United Kingdom),

For our event window, we opted for a period covering the day of the event, the day before and the day after [-1/+1]. Research has indicated that shorter event windows are preferable over longer ones since they decrease the likelihood that confounding effects are uncontrolled for (Brown & Warner, 1985). Shivdasani and Yermack (1999) additionally find that market reactions to outside director appointments tend to be short-lived and are largely limited to the first day after the announcement. The three-day window is particularly suitable for our study since it accounts for potential leakages just prior to the announcement, as well as the possibility that director appointments might be announced after trading hours.

We employed a standard market model to calculate abnormal returns over the three-day window. To test for the firm- and country-level contingencies that we have hypothesized to condition investor perceptions of politician appointments, we subsequently employed a multivariate regression in which CARs serve as the dependent variable.[11]

3.3.3 Independent Variables

Regulatory dependence. To test Hypothesis 1, we employ a widely used proxy for the firm's dependency on the government: firm membership in a regulated industry. Because industry regulation implies heightened levels of governmental oversight, prior studies have embraced it as a measure of firms' exposure to political uncertainty (Hillman et al., 2004). Following Coates (2012) and Werner (2017), we adopted a narrowly-defined subset of 13 industries that are most likely to be universally regulated. Specifically, we code firms as regulated if their primary two-digit primary SIC code corresponds to any of the following Fama-French industry groups: beer and liquor (04), tobacco products (05), pharmaceutical products (13), aircraft (24), defense (26), precious metals (27), oil and gas (30), utilities (31), telecommunication (32), transportation (40), banks (44), insurance (45), and real estate (47).

NASDAQ Composite & NYSE Composite (United States). Results are unchanged if we use each country's MSCI country index as its respective benchmark index.

[11] We calculate abnormal returns, $AR_{i,t}$, using the following standard market model: $AR_{i,t}=R_{i,t}-\left(\hat{a}_i+\hat{b}_i \cdot R_{m,t}\right)$, where '^' are the coefficients from the OLS regression $R_{i,t}=a_i+b_i \cdot R_{m,t}+e_{i,t}$, $R_{i,t}$ denotes the return of stock i in period t; $R_{m,t}$ the return of the benchmark index in period t; a_i the intercept and b_i the slope coefficient (stock-i-specific and time-independent parameters); and $e_{i,t}$ the random disturbance estimate of the market model for stock i in period t. Cumulative abnormal return, $CAR_{i,t}$, was calculated by summing abnormal returns over the three-day window. For the multivariate regression, we use the following model: $CAR_{i,j} = \alpha + \beta_1 Z_{i,j} + \beta_2 X_{i,j} + e_{i,j}$, where $CAR_{i,j}$ represents the cumulative abnormal returns calculated earlier, $Z_{i,j}$ is the vector of control variables, $X_{i,j}$ is the vector of hypothesized variables, and $e_{i,j}$ is the residual term.

Financial dependence. To test Hypothesis 2, we operationalize financial dependence through firm leverage (Pfeffer, 1972). Indebted firms are more dependent on ready access to external financing compared to less levered firms as the latter face lower refinancing demands (Mizruchi & Stearns, 1991). We calculate leverage as the ratio of total debt to total capital.

Existing political connectedness. To test Hypothesis 3, which examines whether the presence of politicians on the board conditions the effect of new appointments, we create a dummy variable, *Politicians on the board.* The variable takes a value of 1 if the firm has at least one politician already serving on its board at the end of the last fiscal year prior to the appointment, using the same coding protocol as before.

Perceived corruption. In line with prior studies, we test Hypotheses 4 and 5 using the Corruption Perception Index (CPI) provided by Transparency International (Davis & Ruhe, 2003). The CPI is an annual composite index that scores countries based on how corrupt their public sector is perceived by business actors and country experts. We reverse the scale, which ranges from 0 to 10, such that higher scores reflect higher levels of *Perceived corruption*.

3.3.4 Control Variables

We control for several country-, firm- and director-level attributes that might also affect firms' returns around the time of the appointment. At the country-level we account for *Shareholder protection* since the appropriation of firm wealth will depend in part on the degree of legal protections afforded to minority shareholders. We use the Shareholder Rights Index developed by Guillén and Capron (2015), and which varies by country and year. Because the resource-provisionary capacity of politician-directors can depend in part on whether or not they are connected to the political party in power, we also include *Election year*, a dummy variable equal to one if legislative or executive elections were held in the country during the year in which the appointment took place, and which is suggestive of possible political turnover. We also code for *Leftist regime*, a dummy variable equal to one if the appointment takes place when a leftist government is in power because investors might expect fewer benefits from relational political strategies if the ideology of the ruling regime is less sympathetic to business interests. Finally, we include a *Global Financial Crisis* dummy for appointments that took place in 2008, 2009 and 2010 as public sentiment towards business-government ties dipped around the crisis (Lessig, 2011). We collected these variables from the World Bank's Database of Political Institutions at the year of appointment.

At the firm-level, visibility, resource endowments and clout, have been argued to bolster the effectiveness of CPA (Hillman et al., 2004; Schuler, Rehbein, & Cramer, 2002). A contrasting proposition is that larger and more established firms have different means at their disposal to manage external dependence, such that the perceived value of a single strategy is diluted (Peng & Luo, 2000). We thus include *Firm size,* measured as the natural log of total assets, as well as *Firm age,* measured in years since incorporation, to account for the possibility that more established firms may face a competitive (dis)advantage when engaging in the political process. We also include *Board size*, a count variable, because the effect of an additional director's appointment on the firm, both positive and negative, may be greater in smaller boards (Hillman et al., 2009). *State ownership,* a dummy variable if the state is the largest ultimate owner with at least 10% ownership (Faccio & Lang, 2007), is included to account for the possibility that politician appointments may be imposed by the state as major shareholder rather than represent a proactive choice by management to engage in politics. Finally, we include *Financial sector,* a dummy variable to mark firms operating in the banking, insurance and real estate sectors as these could be assessed differently by the market compared to non-financial ones. Firm-level variables, collected from the most recently reported annual figures prior to the appointment, were obtained from *Datastream and FactSet*.

Although our theorization focuses exclusively on firm and country-level contingencies, we acknowledge that lumping all appointed politicians into a single category of directors risks overlooking important individual differences in their perceived capacity to remedy the firm's dependencies, as well as the agency risks that they pose. To account for politician-level heterogeneity, we include the following controls: *Local politician,* a dummy variable equal to one if the appointed director's most recent political role was at the subnational level; *Civil servant*, a dummy variable equal to one if the appointed director was most recently a senior civil servant; *Political tenure*, calculated as the total number of years spent across all political roles prior to being appointed to the board; and *Duration since* *office,* measured in years elapsed between the last political role served and the year of appointment to the firm, with incumbent politicians coded as 0.[12] We additionally control for attributes that are associated with higher human and social capital for outside directors in general (Johnson, Schnatterly, & Hill, 2013). Thus, we include *Foreign director,* if the nationality of the politician-director is different to the country in which the firm is domiciled; *Director age* at year of appointment, *Director gender*, if the director is male; *Director education,* if the politician-director's highest educational qualification is a doctorate; *Directorships held*, the number of directorships they hold or have held in other publicly listed firms at the time of appointment and which may be suggestive of business acumen; and *Executive directorship*, if the politician-director was appointed as an executive, rather than a supervisory, director. Director-level attributes, measured at the time of appointment, were obtained using *BoardEx* and cross-checked with the data sources mentioned earlier. Due to missing data, four observations were dropped from our final sample. The multivariate analysis therefore comprises a total of 345 politician appointment events.

3.3.5 Analytical Strategy

Because we predict cross-level interaction effects, our dataset has a nested structure that includes both country- and firm-level observations. To account for the resulting non-independence of our observations (Brauer & Wiersema, 2012a), and to be able to model our cross-level interaction effects, we need to estimate slopes and intersects for the different countries in our sample. We therefore estimated our models using a mixed-effects regression that clusters standard errors at the firm and country-levels in order to calculate robust standard errors (Cameron, Gelbach, & Miller, 2011). To mitigate the impact of same-day event-clustering on the independence of observations (Faccio, 2006), we add a dummy variable, *Appointment clustering*, to mark events involving the appointment of more than one politician simultaneously. Finally, to facilitate the interpretation of interaction terms, we mean-centered all continuous variables (Dawson, 2014).

[12] In unreported tests, we replace this variable with political incumbency -a binary indicator that codes directors as either former or current politicians- and obtain the same results.

3.4 RESULTS

Table 3.1 reports the results of the event study. The average CARs generated by politician appointments are positive (0.26%) but statistically insignificant (p= 0.20), similar to Faccio (2006). Combined with the sizeable heterogeneity in cross-country CARs, we interpret this as evidence that the relationship between politician appointment and the value that investors expect from it requires further 'unpacking' to identify the contingencies that condition this relationship. Table 3.2 provides descriptive statistics for our variables of interest. We check for multicollinearity in our models by conducting a variance inflation factor (VIF) test after running an OLS regression with the full range of variables (Model 6 in Table 3.3). The maximum value obtained was 4.69 and the mean VIF was 1.65. Both values are well under the suggested threshold of 10, indicating that multicollinearity is not likely to be a concern (Meyers, 2006).

Table 3.3 provides the results of the multi-level regressions with CARs as the dependent variable. Model 1 includes only control variables; Model 2 tests the three hypotheses on the firm-specific contingencies that may shape investor perceptions; Models 3 to 5 test the moderation effect of perceived corruption; and Model 6 serves as the full or unrestricted model. Hypothesis 1 predicts a positive relationship between the firm's regulatory dependencies and investor reactions to politician appointments. Surprisingly, Hypothesis 1 does not receive support. In Model 2, the coefficient for *Regulatory dependence* is statistically insignificant and negatively signed. In contrast, the coefficient for *Financial dependence* is positive and significant (β= 0.0002, p<0.01), providing support for Hypothesis 2. In terms of practical significance, an increase in firm leverage from one standard deviation below to one standard deviation above the mean, generates higher CARs of about 1.17%. With an average market capitalization of our sample firms of $22.7 billion, this translates into a sizeable average gain of $266 million for each appointing firm. Hypothesis 3, which predicts that new politician appointments to already connected boards will be associated negatively with investor reactions, finds no statistical support. The coefficient for *Politicians on the board* is negative but statistically insignificant. In sum, we find only partial support for our firm-level hypotheses, with financial dependence being the only significant predictor of positive appointment returns.

Table 3.2 Descriptive Statistics and Correlations

#	Covariates	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11
1	CAR	0.003	0.038											
2	Regulatory dependence	0.600	0.491	-0.085										
3	Financial dependence	51.890	29.205	0.141*	0.089									
4	Politicians on the board	0.678	0.468	-0.109*	0.109*	0.049								
5	Perceived corruption	2.461	1.116	0.007	0.084	0.132*	0.1243*							
6	Shareholder protection	6.048	1.173	-0.043	0.016	-0.173*	0.069	0.146*						
7	Election year	0.469	0.000	0.068	0.061	-0.012	-0.053	0.017	-0.012					
8	Leftist regime	0.449	0.498	0.094	-0.060	-0.001	-0.101	-0.109*	-0.151*	-0.016				
9	Global financial crisis	0.339	0.474	-0.077	0.085	0.010	-0.096	0.1278*	0.1173*	-0.065	0.055			
10	Firm size	16.892	2.004	-0.214*	0.421*	0.216*	0.205*	0.098	0.297*	0.017	-0.111*	0.112*		
11	Firm age	58.299	51.357	-0.050	-0.050	-0.035	-0.008	-0.029	-0.187*	0.068	-0.061	-0.035	0.103	
12	Board size	14.522	5.548	-0.095	0.264*	0.052	0.311*	0.183*	0.104	-0.021	-0.083	-0.081	0.496*	14.522
13	State ownership	0.229	0.421	-0.040	0.206*	-0.030	0.2424*	0.178*	0.054	-0.083	-0.104	0.018	0.081	0.229
14	Financial sector	0.229	0.421	-0.019	0.445*	0.327*	0.006	0.055	-0.032	-0.024	-0.035	-0.041	0.576*	0.229
15	Local politician	0.125	0.331	0.100	0.075	0.012	0.072	0.046	-0.050	0.020	-0.006	-0.048	0.003	0.125
16	Civil servant	0.258	0.438	-0.131*	-0.019	-0.132*	0.080	-0.044	0.252*	-0.055	-0.106*	0.039	0.038	0.258
17	Political tenure	7.451	0.000	-0.007	-0.053	0.096	-0.026	-0.065	-0.118*	0.102	0.098	-0.015	0.022	7.451
18	Duration since office	6.246	7.526	-0.011	-0.111*	0.009	0.009	0.183*	-0.055	-0.134*	0.029	-0.043	-0.128*	6.246
19	Foreign director	0.407	0.000	-0.056	0.055	-0.031	-0.013	-0.127*	-0.012	0.086	-0.077	-0.021	0.099	0.407
20	Director age	57.980	7.749	0.095	-0.006	0.083	-0.055	0.198*	0.078	0.127*	-0.024	-0.020	-0.001	57.980
21	Director gender	0.858	0.350	0.009	-0.078	0.031	0.004	0.155*	-0.060	0.052	-0.100	-0.042	-0.002	0.858
22	Director education	0.235	0.424	0.029	-0.022	0.066	-0.028	0.016	-0.119*	-0.004	-0.005	-0.007	0.010	0.235
23	Directorships held	3.830	0.000	0.079	-0.108*	0.096	-0.037	-0.016	0.164*	0.042	-0.035	0.043	-0.005	3.830
24	Executive directorship	0.052	0.223	0.043	-0.021	-0.075	0.078	-0.032	0.094	-0.051	-0.107*	-0.003	0.000	0.052
25	Appointment clustering	0.099	0.298	-0.106*	-0.068	-0.041	0.040	0.093	-0.042	0.041	-0.005	-0.031	-0.047	0.099

Table 3.2 Descriptive Statistics and Correlations (*continued)*

#	Covariates	12	13	14	15	16	17	18	19	20	21	22	23	24
13	State ownership	0.276*												
14	Financial sector	0.269*	-0.051											
15	Local politician	0.251*	0.129*	0.024										
16	Civil servant	-0.056	0.073	-0.069	-0.223*									
17	Political tenure	0.035	-0.063	0.085	0.057	-0.315*								
18	Duration since office	-0.092	-0.043	-0.132*	-0.164*	0.218*	-0.292*							
19	Foreign director	0.007	-0.110*	0.094	-0.129*	0.007	0.075	-0.009						
20	Director age	-0.096	-0.144*	-0.014	-0.170*	-0.034	0.244*	0.215*	0.096					
21	Director gender	0.044	0.064	0.004	0.053	0.012	0.059	0.131*	0.025	0.184*				
22	Director education	-0.047	-0.107*	-0.009	-0.085	-0.077	0.078	0.077	0.170*	0.178*	-0.029			
23	Directorships held	-0.107*	-0.188*	-0.100	-0.103	-0.029	-0.090	0.240*	0.129*	0.256*	0.101	0.065		
24	Executive directorship	-0.024	0.089	-0.035	-0.049	0.070	-0.030	0.018	0.008	-0.101	0.021	-0.069	0.003	
25	Appointment clustering	-0.072	0.2600*	-0.088	-0.066	0.050	-0.046	0.002	0.070	0.057	0.079	-0.068	-0.016	-0.034

Note: n= 345. CAR= cumulative abnormal returns over a three-day event window [-1, 0, +1]. Firm size (firm assets in USD millions) is log transformed. Correlations marked with an * are significant at $p < .05$

Table 3.3 Results of Multilevel Mixed Effects Regression Models Using CAR as the Dependent Variable

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Main variables						
Regulatory dependence (H1)		-0.0042	-0.0034	-0.0046	-0.0037	-0.0031
		(0.0048)	(0.0047)	(0.0048)	(0.0047)	(0.0047)
Financial dependence (H2)		0.0002**	0.0002**	0.0002***	0.0002**	0.0002**
		(0.0001)	(0.0001)	(0.0001)	(0.0001)	(0.0001)
Politicians on the board (H3)		-0.0043	-0.0049	-0.0047	-0.0057	-0.0065
		(0.0044)	(0.0043)	(0.0044)	(0.0044)	(0.0043)
Regulatory dependence X Corruption (H4a)			0.0089*			0.0085*
			(0.0035)			(0.0036)
Financial dependence X Corruption (H4b)				0.0002*		0.0001
				(0.0001)		(0.0001)
Politicians on the board X Corruption (H5)					-0.0091*	-0.0096**
					(0.0036)	(0.0036)
Country-level controls						
Perceived corruption	0.0006	-0.0002	-0.0059*	-0.0008	0.0055+	0.0001
	(0.0020)	(0.0020)	(0.0029)	(0.0020)	(0.0030)	(0.0035)
Shareholder protection	0.0012	0.0025	0.0026	0.0022	0.0023	0.0020
	(0.0020)	(0.0021)	(0.0020)	(0.0020)	(0.0020)	(0.0020)
Election year	0.0056	0.0060	0.0056	0.0061	0.0050	0.0046
	(0.0042)	(0.0041)	(0.0041)	(0.0041)	(0.0041)	(0.0041)
Leftist regime	0.0074+	0.0074+	0.0074+	0.0079*	0.0066+	0.0069+
	(0.0040)	(0.0039)	(0.0039)	(0.0039)	(0.0039)	(0.0038)
Global financial crisis	-0.0038	-0.0038	-0.0036	-0.0044	-0.0037	-0.0040
	(0.0042)	(0.0042)	(0.0041)	(0.0042)	(0.0041)	(0.0041)

Firm-level controls						
Firm size	-0.0061***	-0.0062***	-0.0059***	-0.0057***	-0.0065***	-0.0058***
	(0.0015)	(0.0015)	(0.0015)	(0.0015)	(0.0015)	(0.0015)
Firm age	-0.0000	-0.0000	-0.0000	-0.0000	-0.0000	-0.0000
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Board size	-0.0001	0.0001	0.0001	0.0001	0.0001	0.0001
	(0.0005)	(0.0004)	(0.0004)	(0.0004)	(0.0004)	(0.0004)
State ownership	0.0045	0.0059	0.0064	0.0071	0.0071	0.0084
	(0.0054)	(0.0054)	(0.0053)	(0.0054)	(0.0053)	(0.0053)
Financial sector	0.0156**	0.0125+	0.0118+	0.0115+	0.0137*	0.0125*
	(0.0061)	(0.0064)	(0.0063)	(0.0064)	(0.0063)	(0.0062)
Politician-level controls						
Local politician	0.0095	0.0101	0.0102+	0.0093	0.0089	0.0083
	(0.0063)	(0.0062)	(0.0061)	(0.0062)	(0.0062)	(0.0061)
Civil servant	-0.0085+	-0.0077	-0.0081+	-0.0080+	-0.0075	-0.0080+
	(0.0050)	(0.0049)	(0.0049)	(0.0049)	(0.0049)	(0.0048)
Political tenure	-0.0005+	-0.0006*	-0.0007*	-0.0006*	-0.0006+	-0.0006*
	(0.0003)	(0.0003)	(0.0003)	(0.0003)	(0.0003)	(0.0003)
Duration since office	-0.0004	-0.0004	-0.0003	-0.0004	-0.0003	-0.0003
	(0.0003)	(0.0003)	(0.0003)	(0.0003)	(0.0003)	(0.0003)
Foreign director	-0.0023	-0.0010	-0.0016	-0.0018	-0.0022	-0.0034
	(0.0049)	(0.0049)	(0.0048)	(0.0048)	(0.0048)	(0.0048)
Director age	0.0007*	0.0007*	0.0007*	0.0006*	0.0007*	0.0006*
	(0.0003)	(0.0003)	(0.0003)	(0.0003)	(0.0003)	(0.0003)
Director gender	-0.0003	-0.0006	0.0000	0.0007	-0.0004	0.0010
	(0.0057)	(0.0056)	(0.0056)	(0.0056)	(0.0056)	(0.0055)
Director education	0.0028	0.0024	0.0025	0.0014	0.0018	0.0012
	(0.0047)	(0.0046)	(0.0046)	(0.0046)	(0.0046)	(0.0045)
Directorships held	0.0008	0.0004	0.0006	0.0005	0.0005	0.0007
	(0.0006)	(0.0006)	(0.0005)	(0.0005)	(0.0005)	(0.0005)
Executive directorship	0.0140	0.0152+	0.0148+	0.0146+	0.0136	0.0128
	(0.0087)	(0.0086)	(0.0085)	(0.0085)	(0.0085)	(0.0084)

Appointment clustering	-0.0156*	-0.0152*	-0.0158*	-0.0152*	-0.0154*	-0.0161*
	(0.0070)	(0.0069)	(0.0068)	(0.0068)	(0.0068)	(0.0067)
Constant	-0.0034	0.0019	0.0011	0.0010	0.0037	0.0024
	(0.0067)	(0.0078)	(0.0077)	(0.0077)	(0.0077)	(0.0076)
Observations	345	345	345	345	345	345
Event window length (days)	3	3	3	3	3	3
AIC	-1286.47	-1292.16	-1296.49	-1295.78	-1296.46	-1302.725
BIC	-1190.38	-1184.54	-1185.03	-1184.320	-1185.00	-1183.575
Log-likelihood	668.24	674.08	677.25	676.89	677.23	682.36
Degrees of freedom	21	24	25	25	25	27
Wald chi-square	56.68	70.56	78.45	77.36	78.26	91.14
Prob. > chi-square	0.000	0.000	0.000	0.000	0.000	0.000

Note. Robust standard errors are reported in parentheses and clustered at country and firm-levels. + $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

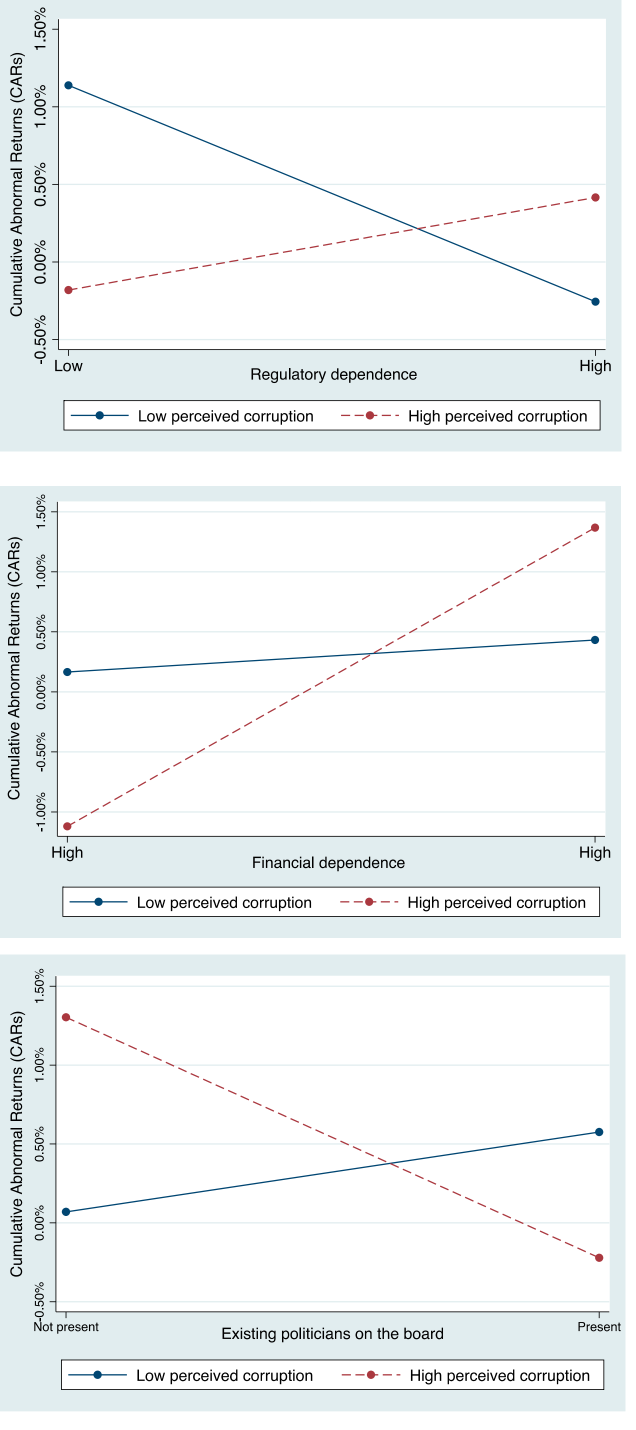
Shifting analysis to the cross-level interaction effects, we do find finer-grained support for our hypotheses. Hypothesis 4 predicts that perceived corruption positively moderates the relationship between the firm's resource dependencies and investor reactions to appointments. In contrast to the non-significant main effects of both regulatory dependence and of corruption, we find a positive and statistically significant interaction term in Model 3 (β= 0.0089, p<0.05) and in the full model (Model 6). Hypothesis 4a is therefore supported. Similarly, the interaction term of financial dependence and corruption is positive and statistically significant in Model 4 (β= 0.0002, p<0.05), although the statistical significance dissipates in the full model. Hypothesis 4b is therefore only marginally supported. Finally, Hypothesis 5, which predicted a negative moderation effect of corruption on the relationship between existing politicians on the board and market returns, is supported. In Model 5, the interaction term is negative and statistically significant (β= -0.0091, p<0.05), and remains so in the full model.

Figure 3.2 graphically demonstrates the critical impact of the national context on investor reactions to politician appointment through interaction plots. Perceived corruption can be clearly seen to strengthen the *positive* relationship between firm regulatory dependence (and to a lesser extent, financial dependence) and market returns, while simultaneously strengthening the *negative* relationship between existing political connectedness and returns. Interestingly, and perhaps counter-intuitively, we note that the appointment of politicians to heavily regulated firms in low-corruption countries appears to trigger negative investor reactions, while additional appointments to connected boards triggers positive reactions. We speculate on the reasoning behind these findings in the discussion section.

3.4.1 Robustness Checks

We conduct a host of robustness checks to test the strength of our findings. Although prior research has emphasized the benefits of using shorter windows, we test whether our results are stable over the use of different event windows, calculating CARs over 4 [-1,+2], 5 [-1,+3] and 7-day [-1,+5] event windows respectively. With the exception of the interaction between financial dependence and corruption, which loses significance in some models, our results are stable across alternative operationalizations of the dependent variable. Second,

Figure 3.2 Interaction Plots



we reran our regressions without firms operating in the *Financial Sector.* Our results remain substantively identical to the full sample. In fact, we now find that Hypothesis 4b is fully supported in the unrestricted model. Third, we re-estimated our models using an alternative operationalization for firm financial dependence. Instead of leverage, we used the Altman Z-score, a widely used measure indicating firm financial distress and a higher risk of credit default in the short to medium-term (Miller & Reuer, 1996). Hypothesis 2 continues to receive support, while Hypothesis 4b is again fully supported, suggesting that the politician appointments are especially valuable under more salient periods of financial dependence. Fourth, we examined whether the *degree* of existing political connectedness rather than the mere presence of a politician on the board has a bearing on our results. We reran our regressions, replacing the *Politicians on the Board* dummy with a count measure of the number of politicians serving on the board. Our results remain similar, although the statistical significance for the interaction effect of political connectedness with corruption is slightly lower. Overall, our findings seem sufficiently robust, and sometimes become even stronger in the robustness tests we performed.

As a final check, we reran our main analysis using a Heckman selection model that controls for selection-into-treatment. It could be argued that the heterogeneity in investor reactions that we observe may partly be driven by the expectation that some firms are more likely to choose to appoint politicians than others. To account for this possibility, we ran a Probit model on the entire sample of 1,063 firms and 9,516 firm-year observations, to predict the likelihood that a firm will appoint a politician to its board at a given firm-year. The first-stage of the selection model includes lagged measures of our four hypothesized variables (regulatory dependence, financial dependence, politicians on the board, perceived corruption), three additional antecedents of politician appointments derived from the CPA literature (board size, firm size, and state ownership), and a 'selection instrument' (Certo, Busenbark, Woo, & Semadeni, 2016). For the selection instrument we created a binary variable, *Capital HQ,* to mark whether or not the firm is headquartered in the political capital of the country in which it is domiciled. Kynazeva and colleagues (2013) show that, holding demand-side characteristics constant, the ability of firms to find and recruit qualified outside directors is affected by the availability of prospective directors nearby. In a similar vein, we posit and find that the firm's proximity to the epicenter of policymaking -i.e. the national capital- is a positive and significant (p<0.001) predictor of politician appointments. At the same time, we expect the location of the firm within its national borders to have little bearing on investor reactions to appointments, thus meeting the exclusion criterion. After obtaining the predicted probabilities from the first stage, we calculated the selection parameter -inverse Mills ratio (IMR)- and included it into our second-stage model. Results remain similar to our main analysis. In any case, the fact that IMR, which is indicative of the correlation between the error terms in the first and second-stage regressions was statistically insignificant, makes us confident that our main results are not biased by treatment selection (Werner, 2017).

3.5 DISCUSSION AND CONCLUSION

Against the backdrop of the field's emerging understanding of the performance consequences of corporate political strategies, Lee Preston concluded an early review of the CPA literature predicting that: "the significant studies will be those that specify more clearly the *conditions* under which [firm] political activity of different types and levels produces (or fails to produce) different kinds of effects [emphasis added]" (Preston, 1986: 269). More than thirty years later, the need to develop a contingency approach to better understand the value of corporate political strategies has been reiterated (Hillman et al., 2004; Lawton et al., 2013; Sun et al., 2012) but remains empirically unsearched to date.

In this study, we have developed this much-coveted contingency approach with respect to the appointment of politicians to firm boards, which is the globally most prevalent relational political strategy that firms engage in to address their dependencies on government. Our findings demonstrate that investors do not perceive politician appointments as consistently value-adding or value-destroying, in part, because relational political strategies bring dependence-management benefits as well as agency-based risks to firms. Drawing upon both RDT and agency theory, we further hypothesized that appointments should elicit positive investor reactions when firms face significant dependencies, and negative reactions when the firm is already politically connected. Although we only find support for our financial dependence hypothesis across our sample countries, we also find that the degree of perceived corruption, even among 14 well-developed OECD countries, amplifies both the expected costs and benefits of these appointments, suggesting that investor perceptions of politician appointments are highly sensitive to the different national contexts in which they take place. As such, our findings contribute to the literature in several ways.

3.5.1 Contributions to Resource Dependence Theory and the CPA Literature

First, that the expected value of politician appointments is *jointly* conditioned by factors at the firm and country-levels of analysis contributes to both the CPA and the inter-disciplinary literature on political connectedness (Faccio, 2006; Hillman et al., 2004), which to date have predominantly relied on single-country and/or single-level research designs. In developing and empirically testing a multi-theoretical and multi-level contingency framework to explain the expected costs and benefits of politician appointments, as well as their variation across countries, our study illustrates how future CPA research may more systematically and comprehensively predict the performance consequences of political strategies. Our results refute the premise that political connections may *generally* create or destroy firm value (e.g. Goldman et al. 2009), which in any case would be difficult to reconcile with prior research on other relational strategies showing that investors account for both the firm's dependencies and its institutional context when inferring the net value to be gained from partnerships and strategic alliances (Gubb et al., 2010; Yang, Zheng, & Zaheer, 2015).

Second, and more concretely, our study adds to RDT as it is applied in CPA research. The notion that firms engage in politics to manage their governmental dependencies specifically has become an axiom in the CPA literature (Hillman, 2005; Hillman et al., 2009). But while scholars continue to apply this political-dependence logic to the study of CPA antecedents (Lux et al., 2011), others have criticized the oft made assumption that what explains CPA also drives its success (Dahan, 2005; Oliver & Holzinger, 2008). Our results support this more critical view as investors in our sample countries do not consistently consider politician-directors to be effective remedies for firms' regulatory dependencies. Specifically, our findings echo doubts, raised by some scholars, regarding the actual ability of politician-directors to single-handedly steer public policy within developed legislative environments (Ansolabehere, Figueiredo, & Snyder, 2002). Hart (2004), for example, argues that the complexity of the political marketplace makes it exceptionally difficult for individual politicians to anticipate policy outcomes in democratic systems. In a recent meta-analysis of US-based studies, Hadani et al. (2016) refer to the structural uncertainty of the public policymaking process and its openness to competing interest groups, as a possible explanation for the lack of association between CPA and policy outcomes desired by firms.

By identifying the role of the institutional environment in unraveling the benefits of politician appointments, our findings add nuance to this debate. In environments where the exchange of favors between public and private actors are more widely accepted, investor reactions to appointments by regulated firms are positive in anticipation of the access to and influence over policy that will ensue. In contrast, investor reactions are tempered in environments where the unmerited channeling of state-controlled resources towards private interests is less acceptable.

In fact, we observe that investors in less corrupt countries are actually prone to react *negatively* to the appointment of politicians to regulated firms (Figure 3.2). This is a surprising finding that appears to run counter to the resource-dependence logic underpinning the CPA literature. We speculate, however, that since politician appointments involve a highly visible form of political relationship, investors in less corrupt environments may worry that the adoption of such relational political strategies by firms that are clearly politically-dependent will invite public scrutiny, unwanted media attention, and perhaps even the risk of reputational damage (Kingsley, Vanden Bergh, & Bonardi, 2012). Werner (2017: 2428), for example, notes that where business-government ties are subject to public scrutiny, societal constraints “may lead managers, investors, and policymakers to prefer that firms engage covertly”. Under such circumstances, more discrete political strategies like lobbying, which rely exclusively on behind-the-scenes maneuvering, may be understood to be more effective than director appointments. Akey’s (2015) observation that firms employing former politicians invest less in lobbying further suggests that more or less visible political strategies are likely to be seen by investors as substitutes rather than compliments.

Third, our study sheds light on other associational benefits that politician appointments may bring to firms even when powerful formal and informal restrictions on the exchange of political favors are in place. Positive market reactions to politician appointments by financially-dependent firms across our sample countries suggest that investors expect the value of politician-directors to go beyond directly remedying the firm's political dependencies. The implication of this is twofold. First, while much of the extant research on RDT has referred interchangeably to the political and associational value of affiliations with government officials (e.g. Hillman, 2005; Schuler et al., 2017; Zheng et al., 2015), our study suggests that these may actually involve different mechanisms in the context of developed economies. Second, the idea that director value need not be restricted to the specific dependencies that their appointments are primarily designed to remedy resonates with prior research on the consequences of dependence-management strategies more broadly. In a meta-analysis on inter-organizational dependence management strategies, Drees and Heugens (2013) conclude that joint ventures, mergers, and acquisitions are only weakly associated with their coveted objective of realizing organizational autonomy, yet they bolster organizational legitimacy nonetheless. In a similar vein, our findings can be interpreted as evidence that politician appointments should perhaps not be understood as corporate *political* strategies in the narrow sense of the word, but as more generic dependence-management strategies that can help firms secure legitimacy from a broader set of stakeholders, including suppliers of finance.

In that regard, it would be interesting to examine whether politician appointments are also effective in assuaging other stakeholders with whom politician-directors may be able to secure relational benefits, such as the public at large. Management scholars have already referred to politician-directors as "stakeholder directors" (Kock, Santaló, & Diestre, 2012; Sauerwald, Van Oosterhout, & Van Essen, 2016), "community representatives" (Hillman, Keim, & Luce, 2001), and "community influentials" (Hillman et al., 2000). We suggest future research to further examine the scope of relational benefits that politician appointments could secure across a broad variety of secondary stakeholders.

3.5.2 Contributions to the Corporate Governance Literature

Our study also has implications for the corporate governance literature, and agency theory-guided corporate governance research more specifically. Prior research has suggested that the presence of subgroups of directors on the board with highly similar backgrounds may lead to the rise of a dominant coalition whose influence on firm strategy and decision-making is sizeable (Greve & Zhang, 2017; Zhang & Greve, in press). In the case of politician-directors, specifically, we predicted that appointing politicians to already-connected firms would greatly enhance opportunities for managerial entrenchment, self-dealing by insiders, and the pursuit of socio-political objectives at the expense of shareholder value maximization.

The results of our study, however, seem to identify a boundary condition applying to this prediction, as it was empirically supported only in firms located in environments with higher levels of perceived corruption. In contrast, politician appointments to already-connected boards in environments perceived to be less corrupt elicited *positive* investor reactions (Figure 3.2), suggesting that the diminished marginal returns of additional connections will still outweigh their agency-based risks in such contexts. In environments that are perceived to be less corrupt, lower expectations of reciprocity may allow for easier termination of political ties when they are no longer deemed valuable, and firms are therefore less likely to be held captive by their political connections.

3.5.3 Limitations and Future Research

Our results should be interpreted in light of a few limitations. First, the limited number of countries in our sample does not allow us to examine other country-level contingencies than those hypothesized or controlled for. Because of data quality requirements, we restricted our sample to countries in which information on board composition and the background of directors was publicly available and verifiable. We nevertheless urge future research to extend our sample as more high-quality data becomes available from other countries. Moreover, and contingent on the availability of this data, researchers may particularly benefit from expanding the scope of analysis to countries exhibiting even higher levels of perceived corruption. As our findings show, corruption, even among the world's most industrialized economies, critically moderates the expected costs and benefits of relational political strategies. It would be interesting to see whether more extreme differences in corruption would amplify the costs and benefits of establishing political ties even further.

Second, in spite of controlling for a considerable number of individual politician-director variables, our analyses hardly register any significant effects of these variables on investor reactions to politician appointments. One reason may be that once firms decide to appoint a politician, investors expect them to select the most suitable type of appointee to meet the firm's resource requirements. It could also be that politician attributes are highly contingent on the institutional context in which they are embedded (Hillman & Keim, 1995). For example, whether local-level politicians can exert sizeable influence over business-relevant policy may largely depend on the extent to which political authority is decentralized in the country of interest (Choi et al., 2014). As further scrutiny of these findings goes beyond the scope of this study, we urge future research to further investigate them.

3.5.4 Conclusion

In response to the mixed evidence on the value of appointing politicians to corporate boards, this study has drawn on both RDT and agency theory to develop and test a multi-level contingency model to unravel the costs and benefits of this highly prevalent relational political strategy at both the firm- and country-levels. By showing that politician appointments are associated with dependence-management benefits as well as agency costs, and that the perceived level of corruption in a country amplifies both, this study has established an understanding of the expected performance consequences of political appointments that is more comprehensive and finer-grained than prior research was able to generate.

CHAPTER 4.

TOWARDS A DEMOCRATIC NEW NORMAL? INVESTOR REACTIONS TO INTERIM-GOVERNMENT DOMINANCE DURING SPELLS OF POLITICAL VIOLENCE[13]

ABSTRACT

Although interim governments have a unique mandate and have been in power in many countries, their impact on firms has been underexplored. In developing countries, such governments are typically installed after the fall of an authoritarian regime and mandated with the task of establishing a democratic new normal. As investors usually cannot access private information on an interim government's commitment to that task, we argue that they will infer that commitment from informational signals. Specifically, we argue that investors interpret higher interim-government dominance during spells of political violence - that is, the greater use of force by an interim government against civilians - as a signal of lower regime commitment to democratization, and that they associate such lower commitment with higher political uncertainty. We further hypothesize moderating effects of several firm-specific attributes that investors will likely use as signals for a firm's vulnerability to political uncertainty. We find support for most of our hypotheses in an event study of 94 spells of political violence that occurred under the two Egyptian interim regimes during the Arab Spring, and discuss the implications of our findings for business and management research on political uncertainty and violent conflict.

[13] This study is conducted in collaboration with Arjen Slangen, Marc van Essen and Hans van Oosterhout.

4.1 INTRODUCTION

The impact of national governments on firms is well established in the business and management literature. Prior research has documented that governmental acts such as the introduction or the removal of regulations (Delmas, Russo, & Montes-Sancho, 2007; Shaffer, 1995), the use or discouragement of corrupt practices (Galang, 2012; Sartor & Beamish, 2018; Spencer & Gomez, 2011), and the violation or protection of human rights (Blanton & Blanton, 2006), significantly influence firms' strategies and performance. A common feature of these and other studies of government influences on firms is that they have focused predominantly on conventional types of government, notably established democracies and established autocracies (Alvarez, Cheibub, Limongi, & Przeworski, 1996). Yet, over the past 70 years more than 40 countries have at some point had a different type of government—that is, an 'interim' one (Guttieri & Piombo, 2007).

Interim governments are especially common in developing countries, where they are typically installed after the fall of an authoritarian regime and mandated with the sole task of preparing and holding free elections that are meant to mark the beginning of a democratic 'new normal' for the country and its populace (Seely, 2009). But while such governments typically claim to be committed to their mandate of democratization, they have not always been or remained committed to that objective (Shain & Linz, 1995). In several countries, such as Algeria, Brazil, Chile, Cuba, Ethiopia, Egypt, Iran, Yemen, and Zaire, interim governments have fallen short of their promise to transfer power to a democratically-elected government by the end of their pre-specified term, deciding instead to prolong their rule either temporarily or indefinitely, and often through the use of considerable force.

Because an interim regime's commitment to democratization at a given point in time is generally only known to a limited number of senior government officials, interim periods pose a significant information asymmetry between such officials and the stakeholders of locally-active firms. That is, although interim periods are supposed to represent critical political junctures that lead to democracy, stakeholders cannot ascertain *ex ante* whether an interim period will indeed usher in a new and better era of democratic government, or if interim authorities will instead illegitimately perpetuate their rule, effectively replacing one authoritarian regime with another. To be able to decide on the best course of action, stakeholders will likely attempt to reduce this information asymmetry, but the exact ways in which they do so have so far remained unclear.

In this study, we aim to start shedding light on these ways by exploring how investors react to certain informational events that enable them to better infer an interim regime's commitment to democratization. We focus on investor reactions because investors are a critical stakeholder for firms, especially in developing countries (Bilson, Brailsford, & Hooper, 2002; Busse & Hefeker, 2007). Drawing on the behavioral perspective on investor decision-making (Schijven & Hitt, 2012; Shiller, 2003) and political science research on governments' strategic use of violence (Davenport, 2007; Stanton, 2016), we argue that investors attempt to reduce the information asymmetry they face with respect to an interim government's commitment to democratization by gauging the latter's show of force, or 'dominance', during spells of domestic political violence. Specifically, we argue that investors interpret higher interim-government dominance during a given spell of violence as a signal of lower governmental willingness to establish a democratic new normal, and that they associate this lower willingness with higher political uncertainty. We therefore hypothesize that spells of violence characterized by higher interim-government dominance will be received more negatively by the local stock market. Furthermore, we argue that investors rely on firm-specific attributes as signals for a particular firm's vulnerability to the political uncertainty resulting from higher interim-government dominance. Specifically, we contend that investors consider this vulnerability to be lower among firms with a larger foreign footprint, a more concentrated ownership structure, and smaller strategic growth potential. For such firms we therefore hypothesize the relationship between an interim government's dominance during a spell of violence and investor reactions to that spell to be less negative. Measuring interim-government dominance during a given spell of violence by the share of non-governmental casualties to total casualties, we find support for most of our hypotheses in an event study of 94 spells of violence that occurred under the two Egyptian interim regimes during the Arab Spring.

Overall, our study makes three contributions to the literature. First, to the best of our knowledge, we are the first to empirically examine the challenges of doing business under interim governments, and as manifested in the political uncertainty that the use of violence by such governments can produce. Whereas prior business and management studies of political uncertainty have largely focused on the uncertainty stemming from a lack of political constraints on governmental actions (e.g. Hendriks, Slangen, & Heugens, 2018; Henisz, 2000a), our study points to an interim regime's perceived lack of commitment to democracy as a unique source of political uncertainty that is specific to countries undergoing political transitions. Second, in developing our theoretical framework, we take the novel approach of combining a behavioral perspective on investor decision-making, which asserts that investors use signals to reduce information asymmetries, with political science research on domestic conflict, which asserts that governmental decisions on the use of force against civilians are typically deliberate and reflective of officials' political intentions. Our study demonstrates the complementarity of these two perspectives in explaining the important but poorly-understood phenomenon of how investors react to interim governments' use of force during spells of political violence (cf. Buckley, Doh, & Benischke, 2017). Third, our study enriches business and management research on political violence, which has so far mainly explored how firms are affected by the occurrence, severity, and spatial magnitude of such violence (Dai, Eden, & Beamish, 2013, 2017; Hiatt & Sine, 2014; Witte, Burger, Ianchovichina, & Pennings, 2017). We add to that research by highlighting how the behavior of what is perhaps *the* key party in political violence -the national government- also influences the firm-specific consequences of conflict.

4.2 THEORETICAL BACKGROUND AND HYPOTHESES

4.2.1 Background on Interim Governments

When countries experience a coup, revolution, or foreign invasion that causes an authoritarian regime to fall, an interim government is typically installed to manage the process of democratization (O'Donnell & Schmitter, 1986). Several characteristics distinguish interim governments from their conventional counterparts. First, whereas conventional governments are entitled and expected to pursue a variety of policy goals, interim governments typically only have the mandate to organize and hold free elections, which are meant to mark the beginning of a democratic new normal (Seely, 2009). Second, interim governments are usually expected to have a shorter tenure than conventional governments. In the words of Shain and Linz, an interim government "bespeaks a choice, or at least the appearance of a choice, not to translate its *de facto* control to a *de jure* power" (1995, p.8), meaning that it is expected not to operate outside its mandate and to organize elections within a reasonable timeframe, typically within two years after having been appointed. Third, since interim governments are installed at the time of a power vacuum, they often lack support from supporters of the ousted regime and possibly other local factions, causing them to commonly encounter violent dissent during their tenure (Hegre, Ellingsen, Gates, & Gleditsch, 2001; Hellyer, 2017).

Although interim governments are mandated with the task of ushering in a democratic new normal, they not always are, or remain, committed to that task. Studies of political transition periods have documented that a substantial number of interim governments have failed to honor their mandate to organize free and fair elections within a reasonable timeframe (Geddes, Wright, & Frantz, 2014; Guttieri & Piombo, 2007). Sometimes interim governments have never truly been committed to democratization, aiming to become permanent rulers from the start. In such cases, they may postpone elections under the pretense of 'national interest', and use their prolonged tenure to consolidate control over state resources and the media, close pacts with political allies, and coopt members of the opposition through coercion and intimidation (Lewis, 1994; Thomas, 1971). Military interim regimes in Latin America, for example, have often extended their tenure to cement their control over the military budget, military appointment and promotion procedures, and local arms industries (McGuire, 1995).

In other cases, interim governments may initially be committed to democratization but gradually develop the view that their country is insufficiently prepared for democratic elections, either because of a perceived lack of well-organized political parties (Shain & Linz, 1995), or because they expect the country to be worse off after such elections due to a perceived threat of radicals gaining control (Ibrahim, 1992). Conversely, interim governments may initially show little commitment to democratization but gradually start to behave more responsibly under pressure of powerful foreign nations or with technical and human support from them (BBC, 2005; Seely, 2005)

Being mostly outsiders, prospective and actual investors in local firms typically lack knowledge about an interim government's true commitment to democratization and thus face a significant information asymmetry throughout the regime's rule. Although interim officials may make public statements suggesting that they are highly committed to democratization, investors are unlikely to trust such statements since a regime intent on perpetuating its rule is unlikely to publicly express these intentions in fear of provoking a public backlash or undermining its international legitimacy. Investors are therefore likely see an interim government's public claims as 'cheap talk', defined as costless, nonbinding messages that fail to provide credible assurance that an actor will honor its promises (Farrell & Rabin, 1996).

Prior research has shown that informationally-disadvantaged parties may seek to reduce the information asymmetries they face by attempting to collect private information from insiders and experts (Bergh, Ketchen, Orlandi, Heugens, & Boyd, 2018). Investors aiming to gain insight into an interim government's commitment to democratization will likely have two possible sources of private information at their disposal: regime officials and local political analysts. Although the creation of ties with officials may sometimes be effective means of gaining access to private political information (Hillman & Hitt, 1999), such ties have been shown to be costly to establish and maintain in institutionally-underdeveloped contexts (Marquis & Qian, 2014; Okhmatovskiy, 2010), and may even turn into liabilities when an incumbent government is succeeded by a regime with a different political stance (Darendeli & Hill, 2016; Siegel, 2007). Given interim regimes' supposedly temporary tenure, investors may thus be particularly hesitant to form ties with interim officials to obtain private information on the latter's political intentions. Moreover, since interim governments with the intention to prolong their mandate will typically keep that intention private, local political analysts are unlikely to be suitable sources of private information either. Below we argue that investors will therefore infer an interim government's commitment to democratization from relatively crude yet objective pieces of public information and that they will rely on that information to decide on investments in locally-active firms.

4.2.2 How interim-government dominance shapes investor reactions

The behavioral perspective on investor decision-making suggests that when investors cannot reduce information asymmetries by accessing private information, they tend to resort to so-called informational 'signals', understood as crude pieces of public information that may serve as proxies for unobserved intentions or characteristics (Schijven & Hitt, 2012; Shiller, 2003). For example, since investors generally cannot gain direct insight into managers' motives for an acquisition, they have been found to base their reaction to acquisition announcements on various public attributes of the deals concerned, such as the closeness of the industry codes of the acquirer and acquired firm, and the extent of stock payment and advisor involvement (Schijven & Hitt, 2012). Likewise, investors have been found to use the behaviour of the national government under which a firm operates as a signal that reduces information asymmetries (e.g., Miller, Li, Eden, & Hitt, 2008; Schuler, Shi, Hoskisson, & Chen, 2017). Bell, Moore and Filatotchev (2012), for example, find that in the context of initial public offerings by foreign firms, investors infer the likelihood that management of these firms will serve their interests from the degree of protection of minority investor rights in the home countries of these firms. Similarly, El Nayal, Van Oosterhout and Van Essen (2018) document that whether investors perceive politician appointments to the board of directors as value-adding or value-destroying depends on the level of perceived corruption in the country in which the firm operates.

Building on this literature, we argue that since investors generally cannot access private information about an interim regime's true commitment to democratization, they will infer that commitment from readily available informational signals. Specifically, we argue that investors will scrutinize spells of political violence for signals that enable them to better ascertain the interim government's true intentions. Defined as "collective attacks within a political community against the political regime, its actors –including competing political groups as well as incumbents– or its policies" (Gurr, 1970, p. 3-4), political violence entails the physical contestation of power between governmental actors, such as state security forces, and non-governmental actors, such as civilians, over the right to, or manner of governance. Due to its physicality, political violence may lead to injuries and deaths, damage to private property, and severe disruptions to daily life (Darendeli & Hill, 2016; Jamali & Mirshak, 2010). Examples of political violence include demonstrations, street skirmishes, assassinations, ambushes, armed assaults, and military incursions (Acemoglu, Robinson, & Santos, 2013; Oetzel & Oh, 2014; Witte et al., 2017).

Studies of political violence in the political science literature have shown that regime dominance, or the degree of pre-emptive and reactive force exercised by the government in its confrontations with non-governmental actors, is a direct function of the political constraints that the regime faces and the political objectives it upholds (Acemoglu et al., 2013; Downes, 2006; Stanton, 2016; Straus, 2012). Governments are likely to exercise restraint against civilians when they are bound by or committed to a political system that is responsive to public demands (Davenport, 2007); when they are highly protective of their perceived legitimacy within the international community (Goodman & Jink, 2004); or when they lack broad domestic support among the populace (Stanton, 2016). In contrast, governments are more inclined towards a heavy-handed use of force if the objective of the regime is to eliminate political opposition and deter any future dissent or challenges to its authority (Kalyvas, 2006). Moreover, because a regime's political objectives may change over time (Henisz, 2000a), so may its use of force against opponents.

Because a government's use of violence tends to reflect its political objectives, investors will likely consider an interim government's observed dominance during spells of violence to be a useful proxy for its commitment to democratization. Moreover, since that commitment may change over time, investors are likely to treat the degree of interim-government dominance during each spell of violence as a separate signal that conveys new information. Specifically, we contend that investors will interpret higher interim-government dominance during a given spell of violence as a signal of lower governmental willingness to establish a democratic new normal at that time. The reason is that an interim government that uses strong force against civilians exhibits behaviour that is at odds with an intention to establish democratic norms of inclusivity, accountability, and respect for human rights (Davenport & Armstrong II, 2004). In fact, as the legacy of authoritarianism in these cases is typically very recent, investors are likely to expect interim governments that are truly committed to realize a democratic new normal to display maximal restraint in their use of violence, so as to convincingly distance themselves from the authoritarian practices of the previous regime (Shain & Linz, 1995).

Since interim governments are assigned the task of establishing a democratic new normal, and since high interim-government dominance signals a lack of government commitment to that task, high interim-government dominance can be said to constitute an 'expectancy violation' (e.g. Graffin, Haleblian, & Kiley, 2016), meaning that it will likely change investors' expectations about the future state of the country. Specifically, high interim-government dominance during a given spell of violence will likely cause investors to lower their estimate of the probability that the country will become a democracy. As a result, they will likely revise upwards their estimate of the level of political uncertainty faced by locally-listed firms for two reasons.

First, the perceived reduction in the probability of democratization associated with high interim-government dominance during a spell of violence implies a perceived increase in the probability of a return to authoritarianism, which research has shown to entail greater uncertainty for businesses than democracy (Jensen, 2008). Under authoritarian regimes, firms are more likely to encounter rent-seeking government officials and unexpected changes in business policies, including expropriation decisions (Henisz, 2000b; Treisman, 2007). Furthermore, autocracies offer less transparent decision-making processes, making it harder for firms to monitor the legislative process as it unfolds and anticipate changes in policy.

Second, the perceived reduction in the probability of democratization may cause investors to anticipate sustained or even more severe violence. Specifically, when an interim regime lacking democratic legitimacy visibly resorts to repression towards a population that only recently ousted its authoritarian predecessor for similar reasons, investors will likely fear a civilian backlash that could further lower the interim regime's willingness to organize democratic elections, prolong the interim period until order is restored, or even cause the interim regime to collapse. At the same time, a dominant interim government may feel compelled to continue exercising violence against civilians out of fear of being prosecuted for human rights abuses if it were to relinquish power to an electorally-accountable regime (McGuire, 1995). The possibility of sustained political violence, in turn, implies higher uncertainty for locally-listed firms as such violence can disrupt firms' access to factors of production such as labor and raw materials (Bodea & Elbadawib, 2008), as well as future revenue streams due to dampened consumerist proclivities (Hiatt & Sine, 2014).

Since investors will likely associate interim-government dominance with political uncertainty, higher degrees of such dominance should lead to downward adjustments of investor valuations of locally-listed firms. The reason is that political uncertainty may force firms to postpone investments or certain activities until the uncertainty has either materialized or receded (Julio & Yook, 2012; Kozikhode, 2016; Rivoli & Salorio, 1996), at the expense of future cashflows and investor returns. Moreover, higher political uncertainty renders firms' existing strategic plans less useful and complicates the development of new strategic plans (Hiatt & Sine, 2014). We therefore hypothesize:

Hypothesis 1. *The higher an interim government's dominance during a spell of political violence, the more negatively investors will react to such a spell.*

4.2.3 Firm Vulnerabilities to Political Uncertainty

Although investors are likely to negatively adjust the valuation of locally-active firms in response to higher interim-government dominance, the degree to which they do so will likely vary across firms. The reason is that investors will likely consider some firms to be more vulnerable to the resulting political uncertainties than others. This view is consistent with extant business and management research on political uncertainty, which has documented that not all firms are equally vulnerable to such uncertainty (Dai et al., 2017; Delios & Henisz, 2003; Frynas & Mellahi, 2003; Slangen, 2013).

As political uncertainty stemming from interim-government dominance may materialize in many different ways (Henisz, 2000a, 2000b), a firm's vulnerability to such uncertainty is hard to predict precisely. Investors are therefore likely to gauge that vulnerability by relying on readily observable firm characteristics as proxies. This is consistent with the view developed by Schijven and Hitt (2012), who found that investors use several characteristics of acquiring firms as signals for the synergies these firms are likely to realize from an acquisition. In the case of interim-government dominance, we argue that investors can infer a firm's vulnerability to the resulting political uncertainty from three firm-level informational signals: the firm's foreign footprint, its strategic growth potential, and its ownership structure.

Foreign footprint. While some firms realize most or all of their sales domestically, others have a substantial foreign footprint (Hendriks et al., 2018). Firms with a larger foreign footprint are not only less dependent on domestic demand, but also have more opportunities to shift domestic production or sales abroad, given the greater magnitude of their extant foreign activities such as production plants or distribution networks (Dai et al., 2017; Kogut & Kulatilaka, 1994). Consequently, their financial performance is likely to suffer less when domestic political uncertainty stemming from high interim-government dominance materializes unfavorably and causes domestic demand to decrease (Kim, Hwang, & Burgers, 1993; Witte et al., 2017). Investors will therefore likely use a firm's observed foreign footprint as a proxy for its vulnerability to political uncertainty resulting from interim-government dominance. Specifically, investors will likely consider firms with a larger foreign footprint to be less vulnerable to such uncertainty. Accordingly, we hypothesize:

Hypothesis 2. *The negative relationship between an interim government's dominance during a spell of violence and investor reactions to such a spell is weaker for firms with a larger foreign footprint.*

Strategic growth potential. Firms differ in their growth potential, that is, in terms of the degree in which their strategic growth prospects have been fully realized at a given point in time. All else equal, firms with higher growth potential are likely to be valued higher in equity markets due to the forward-looking nature of market valuations of public equity. A firm's market-to-book ratio is an easy to understand and readily available informational signal for the market's best estimate of the firm's growth potential under the expectation of a stable or at least predictable external environment (Laamanen, 2007). When that expectation is violated because of an adverse exogenous shock, some of the assumptions underlying firms' growth prospects may no longer hold, leading investors to adjust their valuation of the firm in line with the new reality (Palmrose, Richardson, & Scholz, 2004).

Research from finance, accounting, management, and applied psychology, has already documented that firms for whom stakeholders, including investors and analysts, have higher expectations, are penalized disproportionately when those expectations are deemed unlikely to be realized (Brooks, Highhouse, Russell, & Mohr, 2003; Dreman & Berry, 1995; Haleblian, Pfarrer, & Kiley, 2017). Skinner and Sloan (2002), for example, have documented that firms with high growth prospects experienced larger drops in their stock price after negative earnings surprises. Along similar lines, we argue that an increase in political uncertainty stemming from higher interim-government dominance during spells of political violence will cause the share price of firms with high strategic growth potential to suffer more than that of firms with low growth prospects. The reason is that firms' tendency to postpone investments and strategic planning in response to increased political uncertainty will likely be perceived by investors to result in a greater drop in the future cash flows of firms that were thought to have high strategic growth potential. For these firms, 'freezing' investments and strategic planning until the uncertainty is resolved implies that they are no longer likely to meet the ambitious growth potential that investors considered them to have, leading investors to significantly revise downward their expectation of these firms' future cash flows. Therefore:

Hypothesis 3. *The negative relationship between an interim government's dominance during a spell of violence and investor reactions to such a spell is stronger for firms with strategic growth potential.*

Ownership concentration. Firms may also be less vulnerable to the effects of interim-government dominance if they possess resources and capabilities that make them more resilient in the face of heightened political uncertainty (Dai et al., 2017; Delios & Henisz, 2000; Holburn & Zelner, 2010). Prior experience in countries with violent conflict, for example, has been found to enhance firms' ability to respond more appropriately to the onset of conflict elsewhere (Delios & Henisz, 2003; Oh & Oetzel, 2017). In a similar vein, Buckley, Chen, Clegg and Voss (2017) show that higher levels of organizational slack may offer protection against unfavorable developments that might result from political uncertainty, increasing managers' inclination to invest in politically more hazardous countries.

A firm's ownership structure may also be a source of competitive advantage at times of uncertainty (Aguilera & Crespi-Cladera, 2016; Connelly, Hoskisson, Tihanyi, & Certo, 2010). Firms differ in the extent to which their outstanding equity is concentrated in the hands of one or a few large shareholders ('blockholders') or dispersed over many highly liquid or diversified investors. In contrast to the latter, large blockholders have been shown to be able to influence firms' strategic choices, have a longer-term investment horizon, display a higher tendency to use their private resources to 'prop-up' their firms during temporary crises (Heugens, Van Essen, & Van Oosterhout, 2009; Shleifer & Vishny, 1997), and have a lower tendency to exit the firm due to the illiquidity of the large and dedicated nature of their investment (Edmans & Holderness, 2017). Together, these attributes are likely to make firms less vulnerable to the political uncertainty resulting from interim-government dominance.

First, having effective control over the investment, contracting, and financing policies of their firms, blockholders are able to influence how their firms adapt to a changing political environment (Driffield, Jones, & Crotty, 2013; Stulz, 2005). Such agility is especially valuable when swift and coherent decision-making by the firm is required. Second, because of their longer-term horizons, blockholders are less likely to engage in short-term stock shuttling in response to exogenous shocks (Hill & Snell, 1989). In contrast, blockholders are typically more willing to 'sit out' the uncertainty, absorbing short-term losses in return for longer-term returns (Kozikhode, 2016). Third, investors may perceive political uncertainty as less problematic when firms can rely on the capacity of their owners to 'prop' up their firms during times of crisis (Friedman, Johnson, & Mitton, 2003). Because ownership of large block holdings is indicative of an investor's wealth (Carney & Gedajlovic, 2001), concentrated ownership may thus serve as a substitute for organizational slack in helping firms survive political uncertainty. Taken together, we thus expect investors to interpret the presence of a large controlling blockholder as a beacon of dedication and stability that may help their firms overcome the political uncertainty that interim-government dominance causes. We therefore hypothesize:

Hypothesis 4. *The negative relationship between an interim government's dominance during a spell of violence and investor reactions to such a spell is weaker for firms with more concentrated ownership.*

4.3 METHODS

4.3.1 Empirical Context: Political Violence in Egypt during the 'Arab Spring'

We tested our hypotheses by examining political violence in Egypt following the overthrow of president Hosni Mubarak's autocratic government. The ouster of that government, and the events that transpired afterwards, were part of the broader wave of uprisings against authoritarian governments that swept the Middle East and North Africa in early 2011, and which collectively became known as the 'Arab Spring'. Following mass demonstrations against police brutality, rampant corruption, and economic hardship, Mubarak's 30-year rule officially collapsed with his resignation on February 11th, 2011. Immediately afterwards, the Supreme Council of Armed Forces (SCAF) took temporary control of the country for what was supposed to be six months. Elections were postponed however and the SCAF extended its rule by an additional ten months. Mohamed Morsi -of the previously outlawed Muslim Brotherhood- became Egypt's first democratically-elected President in May 2012, but his tenure was quickly marred by allegations of economic incompetence, authoritarianism, and the imposition of an exclusionary Islamist ideology that was incompatible with modern democratic politics. In a move described as a step to "restoring democracy",[14] a military coup removed Morsi from power in July 2013 after the eruption of large-scale demonstrations against his rule. The army thereafter instated a *second* interim government, this time led by the Head of the Supreme Court, Adly Mansour. Finally, in a new round of elections, Abdel Fatah el-Sisi, the former Minister of Defense under Morsi and leader of the coup that overthrew him, was elected President in May 2014.

This study covers the interim regimes of the SCAF (23 March 2011 to 29 June 2012) and President Mansour (4 July 2013 to 7 June 2014), which we collectively refer to as the 'interim period'. As is typical of political transitions, Egypt's interim period saw recurring violence between government forces and an eclectic mix of non-governmental actors with varied grievances. For example, remnants of the deposed regime frequently protested against their exclusion from politics and debarment from elections, whereas political activists often took to the streets in an attempt to gain popular legitimacy by confronting an incumbent regime.

The interim period was also characterized by the seemingly ambiguous commitment of the interim regimes to a comprehensive process of democratization. For example, both regimes regularly embraced a rhetoric that affirmed their commitment to the holding of swift elections and to broader democratic reform (Alsharif & Nasralla, 2014; Freedom House, 2012). At the same time, they also engaged in behavior that was not clearly indicative of a real desire for inclusive democratization, nor a genuine intention to ultimately submit to civilian authority (Kirkpatrick, 2011). Under the SCAF, for example, the use of military tribunals against protesters, the imprisonment of activists, the postponement of parliamentary elections and the dissolution of that parliament afterwards, prompted concerns of a military power-grab even among senior EU and US officials (Zayed & Fayed, 2012). Under President Mansour, media censorship became more common, demonstrations

[14] Quote from US Secretary of State, John Kerry (Austin & Mohyeldin, 2013).

were criminalized, and the Muslim Brotherhood was officially classified as a terrorist organization. Following a particularly bloody bout of clashes between protesters and army forces, The Guardian described popular sentiment in Egypt at that time as follows:

> "Egypt's fragile transition to democracy is slipping into turmoil. It is not just the killings, or the repetition of the generals' heated denials – on Thursday they insisted that they had nothing to do with the bloodshed, had no preference for who should be president, and had no desire to cling to power. It is that the process that was supposed to deliver a transition to democracy appears to have been undermined at almost every turn by Egypt's de facto rulers, creating a growing sense of disillusionment." (Beaumont, 2012)

Others commented on the how the government's heavy-handedness could backfire and bring in a renewed period of social strife and unrest:

> "The police and SCAF are revealing their true colours with this brutal attack on Egyptians. They have succeeded in only one thing today, and that is mobilising even more of Egyptian society against them." (Shenker, 2011)

In the meantime, members of the business community often took to the press to voice their concerns with the challenges of doing business in the interim period. Lamenting the inability to credibly ascertain the interim regime's commitment to peacefully transfer power to a civilian government at the end of the interim period, the CEO of Mobinil, one of Egypt's largest telecommunication providers, described the challenges facing his firm as follows:

> "It's difficult to forecast, it's difficult to plan. I'm not sure what to do and in what scenario I will go to my board seeking what kind of budget for 2012. Do we go with aggressive investment or should we hold, waiting to see? We lack visibility." (Fayed, 2011)

In sum, despite popular demands for and expectations of democratization, as well as an official governmental position advocating it, Egyptians confronted state behavior that was not always congruent with a shift to a democratic new normal. Egypt's interim period thus represents a rich and dynamic context in which to study how investors respond to signals about an interim regime's commitment to establishing this new normal.

4.3.2 Data and sample

An event study is useful for our purposes because it is uniquely geared to capturing investor reactions to exogenous events, including violent ones (McWilliams & Siegel, 1997). The event study methodology assumes that events revealing new information to investors, such as reports of violence between governmental and non-governmental actors, are evaluated for their anticipated consequences for firms, and that these consequences are swiftly incorporated into a firm's stock price (e.g. Abadie & Gardeazabal, 2003; Drakos, 2010; Eldor & Melnick, 2004; Guidolin & La Ferrara, 2007). Although the occurrence of political violence is generally anticipated in countries undergoing political transitions, some of the specificities of violent events—such as their length, casualty count, and, most importantly in our context, the interim government's dominance during the event—are hard if not impossible to predict upfront (Czinkota, Knight, Liesch, & Steen, 2010; Oetzel & Oh, 2014). As such, each spell of violence constitutes an informational event that enables investors to update their assessments of an interim government's commitment to establishing a democratic new normal.

We compiled all discernible incidents of political violence during the interim period in Egypt using the following steps. First, we collected all front-page news articles from Egypt's most widely-circulated independent daily newspaper, *Al-Masry Al-Youm* (AMAY), during our focal period. The choice of leading stories in a highly-read newspaper ensures that our sample includes events that are likely to be picked up and reacted upon by investors. Since AMAY is an independent newspaper, we further expect it to serve as a more objective news source than state-owned newspapers (Blaydes, 2006). We extracted a total of 4,942 front-page articles over the focal period, corresponding to an average of 6 front-page articles per day. Second, we instructed an Arabic-speaking research assistant to carefully read all of the articles and identify those reporting acts of political violence in Egypt. Following Gurr (1970), we regarded as an act of political violence any physical attack involving governmental personnel and resulting in at least one casualty. This operationalization of political violence has the advantage of not requiring the identification of the initiating party or motive behind the violence, which is an inherently complex and subjective task (Kalyvas, 2003). For example, whether a violent act was 'politically-motivated' or 'terrorist' in nature, or whether it began as a provocation against government personnel by armed protesters or as a peaceful march that was dispersed by government forces, is prone to be an editorially-malleable decision that differs across media sources (Hamdy & Gomaa, 2012). Furthermore, compared to events that only result in injuries, those with one or more casualties are more likely to attract investors' attention.

Using our operationalization of political violence, the assistant identified 133 front-page articles that reported acts of such violence, corresponding to 2.7% of the articles. These acts include sit-in dispersals by government forces; clashes between government forces and demonstrators; police and military campaigns against civilians (often referred to as 'criminals', 'terrorists' and/or 'militants'); and armed attacks and ambushes against government forces stationed at government properties such as police stations, prisons, municipality buildings, and army checkpoints.[15] To assess the reliability of the coding, one of the authors of this study independently coded a random selection of 423 (8.6%) of the articles, generating an assuring 97.2% inter-rater agreement rate.

An inspection of the dates on which the acts of political violence were reported in AMAY showed that these dates were sometimes clustered. The likely reason is that political violence is more likely to flare around politically sensitive periods such as the anniversary of Mubarak's overthrow, or the reshuffling of the cabinet. Moreover, political violence may be reciprocal in nature, implying that the perpetrators of a violent act may become the targets of a violent counteract the next day. Consequently, events of political violence may last several days, leading us to define such events as periods of consecutive days of reported political violence (cf. Acemoglu, Hassan, & Tahoun, 2017), or 'spells' of violence. A spell begins when an article reports an act of political violence and lasts as long as at least one other act of such violence is reported every next day. A day without reported political violence thus serves as the natural cut-off point of the spell. The 133 identified acts of political violence were thus reduced into 94 spells. The average and maximum number of violent acts per spell was 1.4 and 5 respectively, while the average number of days between consecutive spells was 8. The average number of casualties during a spell was 13.

To conduct our event study of investor reactions to an interim government's dominance during a given spell of political violence in Egypt, we first used *Datastream* to

[15] 4,201 of the front-page articles reported news other than the occurrence of violent acts. Another 608 reported violent acts that did not meet our specific operationalization of political violence, for instance because the act did not involve government personnel or result in casualties.

obtain the historic stock prices of 125 firms listed on the Egyptian stock exchange. We then employed a standard market model to estimate the relationship between the returns of each of these firms and a benchmark index over a pre-event estimation period. Because the stock price movements of the focal firms perfectly predict the performance of an Egyptian stock market index, we used as the benchmark index the MSCI Emerging Market Index, which includes 23 other national stock market indices besides the Egyptian one. In line with prior studies (e.g., Hillman et al., 1999), the estimation period we used for calculating the expected return on a firm's stock started 285 days and ended 30 days before the start of the event window for each spell of violence. The start date of an event window was defined to be the day before AMAY reported the first violent act within a spell. This was done because newspapers typically report acts of violence the day after their occurrence, whereas investors may already hear about them on the day they occur (via social media, for example).[16] The end date of an event window was defined to be the final consecutive day of reported violence. For example, a series of fatal clashes between civilians and government forces that took place on the 15th, 16th, and 17th of March, 2014 were reported in AMAY on the 16th, 17th, and 18th of March, respectively. Since these acts of violence took place on consecutive days, we grouped them into a single spell, with an event window covering the four days from the 15th to the 18th of March, 2014. By contrast, an isolated incident of political violence reported on October 10th, 2011 constitutes a separate spell with a two-day event window running from October 9th to October 10th.

4.3.3 Event Study: Cumulative abnormal returns (CARs) as the dependent variable

We calculated the daily abnormal return on a firm's stock, $AR_{i,t}$, using the following standard market model:[17]

$$AR_{i,t}=R_{i,t}-\left(\hat{a}_i+\hat{b}_i\cdot R_{m,t}\right)$$

where $\hat{a}_i$ and $\hat{b}_i$ are the coefficients from the OLS regression $R_{i,t}=a_i+b_i\cdot R_{m,t}+e_{i,t}$, and $R_{i,t}$ captures the return on firm 's stock on day t of the estimation window; $R_{m,t}$ is the return of

[16] For 91% of the acts of political violence, their date of occurrence was reported in the newspaper articles. In 98.5% of these cases, the occurence date was the day before the newspaper article appeared, supporting the validity of our approach of using that date as the start date of an event window.

[17] We obtained qualitatively similar results when using mean-adjusted expected returns, which are based on the average of the stock's daily returns over the estimation period (Brown & Warner, 1985).

the MSCI Emerging Market index on day t of that window; a_i the intercept and b_i the slope coefficient (stock-i-specific and time-independent parameters); and $e_{i,t}$ the random disturbance estimate of the market model. Cumulative abnormal returns, $CARs_{i,t}$, were calculated by summing the daily abnormal returns realized during each event window.

To test our hypotheses, we subsequently estimated the following multivariate regression model with CARs as the dependent variable:

$$CARs_{i,j} = \alpha + \beta_1 X_j + \beta_2 Y_i + \beta_3 ID_j + \beta_4 ID_j * M_i + e_{i,j}$$

where X_j is a vector of control variables at spell-level, Y_i is a vector of control variables at firm-level, ID_j is the independent variable, interim-government dominance, M_i is a vector of moderators at firm-level, and $e_{i,j}$ is the random error term.

4.3.4 Independent variables

We measured *Interim-government dominance* during a spell of violence by the ratio of non-governmental deaths to total deaths during that spell, with non-governmental deaths being defined as deaths of any individuals other than government personnel involved or called to the event. Our measure is based on the expectation that the degree of force employed by the interim government in its clashes with non-governmental actors will be reflected in the distribution of casualties among both parties. More concretely, we expect an interim government's heavy-handed use of force during a given spell of violence to result in a greater share of non-governmental casualties in the total casualty count of that spell, and that investors will interpret this share as indicating higher interim-government dominance. For example, a violent confrontation between security forces and protesters that results in the death of nine protesters but only one police officer, receives a high interim-government dominance value of 0.9, suggesting the significant use of force by the interim regime against a threat that may have not warranted such a forceful response. In contrast, spells of violence that produce lower counts of non-governmental casualties relative to government casualties, signify *ceteris paribus* the exercise of greater restraint by the interim government. Although not all articles reporting a violent act specified the identity or ideological affiliation of the non-governmental casualties, all of them did state the total number of casualties and the number of governmental ones, allowing us to compute our measure for every act and spell.

The first moderating variable is a firm's *Foreign footprint*, which we measure by the ratio of a firm's foreign sales to total sales (Hendriks et al., 2018), with larger values indicating that a greater fraction of the firm's revenues was realized outside of Egypt. We measured a firm's *Strategic growth potential*, the second moderating variable, by its market-to-book ratio, defined as the market value of its outstanding shares divided by the book value of its common equity. A firm's market-to-book ratio indicates the extent to which investors value the firm over and above its book value, and has been widely used as a proxy for the firm's growth prospects (Almazan, De Motta, Titman, & Uysal, 2010; Iyer & Miller, 2008; Kogan & Papanikolaou, 2014; Laamanen, 2007; Malhotra, Zhu, & Reus, 2015). Finally, we measured firms' *Ownership concentration*, the final moderating variable, as the percentage of their outstanding shares held by the five largest shareholders (Demsetz & Lehn, 1985; Hu & Izumida, 2008). Higher values indicate the concentration of firm ownership in the hands of a few blockholders.

4.3.5 Control variables

We control for spell-level and firm-level attributes that might also affect investor reactions to spells of political violence. We first control for the severity of the violence occurring during a given spell. Irrespective of the identity of the casualties, we expect stock markets to react more negatively to a greater loss of human lives (Eldor & Melnick, 2004), in part because severe violence could prompt a backlash from the aggrieved party. We measured *Number of casualties during spell* as the sum of the fatalities among both government forces and civilians. For the few acts of political violence for which AMAY reported a casualty range (e.g., "between 20 and 30 deaths") or conflicting figures (e.g., eyewitness vs. Ministry of Health accounts), we used the mean value.[18]

Prior studies have shown that the geographical attributes of conflict can influence firms' vulnerability to it (e.g., Dai et al., 2013, 2017). We thus measured *Concentration of*

[18] We identified one extreme spell of violence in our sample, which took place between the 14th and 16th of August, 2013 and generated a total of 343 casualties, of which 304 were civilians and 39 were government forces. Following the ouster of President Mohamed Morsi in July, a six-week sit in was staged by his supporters at the Rabaa al-Adawiya Square in Cairo. After the collapse of initiatives aimed at peacefully dispersing the sit-in, security and army forces raided the square and cleared it out within hours. The raid, popularly dubbed the "Rabaa Massacre", resulted in significant deaths among protesters, making it the deadliest incident of violence since the overthrow of Mubarak. To explore whether this outlier drives our results, we reran all of our models without this spell. We obtained qualitatively similar results, indicating that our results are not caused by outliers.

violence during spell using a dummy variable equal to one if the violence occurred in only one city, with the expectation that localized violence has a less negative effect on firms relative to more spatially dispersed violence (Witte et al., 2017). We included a *Spell occurs in Cairo* dummy since investors may consider violence in the country's economic and political center as more consequential. We also note that following Mubarak's overthrow, Sinai -the rugged peninsula in the north-east of the country- transformed into a hotbed for extremists and that frequent military operations were mounted there by the central government in response. We thus entered a *Spell occurs in Sinai* dummy to account for the possibility that such a spell is associated with a particular degree of interim-government dominance.[19] Finally, because more proximate conflict puts firm assets in greater harm's way (Dai et al., 2013), we added a *Spell occurs near firm's HQ* dummy if violence took place in the city where the firm is headquartered.

Even though the attributes and outcomes of violence are difficult to predict *ex ante*, the occurrence of specific violent events may at times be more, or less, anticipated than other times. For example, because most pre-planned demonstrations in Egypt were scheduled on a Friday (Acemoglu et al., 2017), we expect violence occurring on that day to have been more anticipated, yet potentially more severe due to the large-scale mobilization of protesters and security personnel. Conversely, spells that took place during Ramadan –the Muslim holy month in which acts of violence are religiously abhorred- may be less anticipated, but potentially less severe as well. We thus included *Spell begins on Friday* and *Spell occurs in Ramadan* dummies. We also included *Regime tenure at start of spell,* measured as the number of days between the start of the interim government's rule and the occurrence of the spell, as investors may anticipate more violence during the immediate aftermath of the prior regime's overthrow. Finally, we entered the length of each spell in days, since longer spells of violence may yield more negative CARs.

Finally, we included the following firm-level controls: *Firm size,* measured by the natural logarithm of the book value of the firm's assets; *Firm performance*, measured by the firm's return on equity; and *Firm leverage,* measured by the ratio of the firm's total debt to total assets. Because ownership identity can also influence the capacity of investors to

[19] We obtained qualitatively similar results across all models when we excluded Sinai-based spells from our analysis.

contribute strategic guidance and financial support in times of need (García-Canal & Guillén, 2008; Park & Song, 2001; Van Essen, Engelen, & Carney, 2013; Van Essen, Van Oosterhout, & Carney, 2012), we controlled for *State ownership, Foreign ownership,* and *Institutional ownership.* These were measured by the percentage of shares held by government agencies; non-Egyptian individuals or organizations; and financial institutions such as banks, hedge funds, and pension funds, among the firm's five largest shareholders, respectively (Boyd & Solarino, 2016; Faccio & Lang, 2007). All firm-level variables were obtained from *Datastream* and *Thomson Eikon,* and measured for the year preceding the spell. Our final sample comprises 6,908 firm-spell observations. [20]

4.3.6 Analytical Strategy

Because the CARs on a firm's stock may be correlated across spells, we clustered the standard errors of the regression coefficients by firm (Brauer & Wiersema, 2012; Colin Cameron, Gelbach, & Miller, 2011). Furthermore, to account for potential differences in investor reactions across both interim governments, we included regime-fixed effects. Likewise, we included industry-fixed effects based on two-digit SIC codes to control for potential industry-specific variations in investor reactions to violence (e.g., Burger et al., 2016). We used OLS regression analysis to estimate all our models.

4.4 RESULTS

Table 4.1 summarizes the descriptive statistics and pairwise correlations of the variables used in our analysis. The average CAR generated by a spell of political violence is -0.17% ($p<0.001$), which is substantial. Drakos (2010), for instance, examined 10,282 terrorist attacks across 22 countries from 1994 to 2004 and found that their average CAR was -0.05%. Table 4.2 provides the results of the multivariate regression models, with Model 1 containing only the control variables to which we add each of our variables of interest in the subsequent models. Importantly, we note that consistent with prior research, *Number of*

[20] We noted a sizeable drop in observations due to missing values for firms' *Foreign footprint*, presumably because firms in Egypt are not required to report geographic breakdowns of their revenues. In unreported robustness tests, we reran all our models without this variable, resulting in a sample of 10,552 firm-spell observations. We obtained qualitatively similar results.

casualties during spell is negatively related to CARs, with more severe violence triggering steeper declines in stock prices ($\beta = 0.0001$, $p<0.001$).

Model 2 tests our baseline hypothesis, which predicted a negative relationship between interim-government dominance and investor reactions to spells of political violence. The coefficient of *Interim-government dominance* is negative and statistically significant ($p< 0.001$), thus supporting Hypothesis 1. The size of the coefficient indicates that spells of violence characterized by the maximum value of *Interim-government dominance* of 1 (i.e. if all casualties during the spell are civilians) yield CARs that are 0.35% lower than spells of violence with the minimum *Interim-government dominance* value of 0.

Models 3 and 6 lend support to Hypothesis 2, as both of them yield a statistically positive coefficient of the interaction between *Interim-government dominance* and a *Firm's foreign footprint* ($p<0.05$). This indicates that interim-government dominance has a less negative effect on CARs among firms with larger foreign footprints. In contrast, we do not find support for Hypothesis 3, as the coefficient of the interaction between *Interim-government dominance* and *Strategic growth potential* is insignificant in both Model 4 and Model 6. We do find support for Hypothesis 4, however, as the interaction between *Interim-government dominance* and *Ownership concentration* is significantly positive ($p<0.01$) in Models 5 and 6, indicating that interim-government dominance has a less negative effect on CARs among firms with more concentrated ownership structures. Figures 4.1 and 4.2 show the two significant moderating effects graphically.

4.4.1 Supplementary Analyses

We conducted two additional analyses to further probe our findings. First, because the interim period that we analysed was characterized by two different regimes (SCAF and Mansour), we split our sample into the two respective time periods to assess whether our results are robust across them. For both periods, we continue to find support for Hypotheses 1 and 4. Moreover, we now find marginal support for Hypothesis 3 for the second interim period. By contrast, we no longer find support for Hypothesis 2, perhaps because of the smaller size of the subsamples in combination with the high percentage of sample firms without a foreign footprint (as reflected in their low average foreign footprint of 2.7%).

Table 4.1 Descriptive Statistics and Correlations

#	Covariates	Mean	S.D.	1	2	3	4	5	6	7	8	9
1	CARs	-0.0017	0.0356									
2	Interim-government dominance	0.6264	0.4312	-0.0775*								
3	Foreign footprint	2.7446	13.9126	0.0034	0.0023							
4	Strategic growth potential	1.5589	1.3989	-0.0242*	0.0179	-0.0098						
5	Ownership concentration	2.7446	13.9126	-0.0104	-0.0074	-0.0551*	0.2511*					
6	Number of casualties	13.4469	37.9831	-0.0771*	0.1614*	-0.0026	-0.0116	0.008				
7	Concentration of violence	0.7077	0.4548	-0.0628*	-0.1551*	0.0048	0.0214	-0.0016	-0.2895*			
8	Spell occurs in Cairo	0.4126	0.4923	-0.1008*	0.1942*	0.0014	0.0177	-0.0116	0.1474*	-0.1759*		
9	Spell occurs in Sinai	0.3101	0.4626	0.0872*	0.0088	-0.0026	-0.0109	0.0076	-0.0663*	0.1741*	-0.3253*	
10	Spell near firm's HQ	0.3217	0.4671	-0.0741*	0.1470*	0.0441*	-0.0497*	-0.0779*	0.1197*	-0.1735*	0.5944*	-0.4616*
11	Spell begins on Friday	0.1642	0.3704	-0.0758*	0.1669*	-0.004	-0.0283*	0.0018	-0.0607*	-0.2333*	0.1700*	0.0240*
12	Spell occurs in Ramadan	0.106	0.3078	0.0510*	-0.0989*	-0.0009	0.0026	0.008	0.0588*	-0.0094	-0.0764*	0.1353*
13	Regime tenure at start of spell	181.487	110.2206	-0.1073*	0.1249*	0.0111	0.0255*	-0.0226	-0.2304*	0.0666*	0.2308*	-0.2350*
14	Length of spell	1.3735	0.8485	0.0783*	0.0019	-0.0059	-0.0282*	0.0091	0.1614*	-0.3466*	-0.2902*	0.0376*
15	Firm size	14.8479	1.5022	0.0097	-0.0047	0.3011*	-0.0431*	0.0905*	0.0048	0.0026	-0.0091	0.0045
16	Firm performance	-1.1395	135.9402	0.0002	0.0016	-0.4410*	0.2652*	0.0494*	0.0042	0.0268*	-0.0101	0.0073
17	Firm leverage	0.1648	0.1796	-0.0012	-0.0022	0.3375*	-0.0233	-0.1054*	0.002	-0.0234	0.0045	-0.0029
18	Firm state ownership	25.7049	31.3118	-0.0166	0.0026	-0.1563*	0.1252*	0.4603*	-0.0027	0.0052	0.0024	-0.0014
19	Firm foreign ownership	17.3714	28.136	0.0109	-0.0074	0.1685*	0.1692*	0.3106*	0.0067	0.0062	-0.0138	0.0084
20	Firm institutional ownership	0.7497	1.6693	0.0028	-0.0011	0.1538*	0.0674*	-0.0686*	-0.0029	-0.0127	0.0042	-0.0047

#	Covariates	10	11	12	13	14	15	16	17	18	19
11	Spell begins on Friday	0.0814*									
12	Spell occurs in Ramadan	0.0469*	-0.1526*								
13	Regime tenure at start of spell	0.1068*	0.1076*	-0.4145*							
14	Length of spell	-0.0325*	-0.0214	0.1395*	-0.2052*						
15	Firm size	0.1089*	-0.0017	0.006	-0.0137	0.0031					
16	Firm performance	-0.0400*	-0.0314*	0.0226	-0.0331*	-0.0171	-0.1451*				
17	Firm leverage	0.0446*	0.0215	-0.0113	-0.0028	0.0179	0.1921*	-0.2282*			
18	Firm state ownership	-0.1340*	-0.0057	0.0003	0.0034	-0.007	-0.1816*	0.0735*	-0.4320*		
19	Firm foreign ownership	0.1051*	-0.0047	0.0103	-0.0262*	0.0014	0.3732*	-0.0977*	0.1087*	-0.3572*	
20	Firm institutional ownership	0.0354*	0.0168	-0.0132	0.0227	0.008	0.1028*	0.0124	0.0184	-0.0324*	0.1313*

Note. N=6,908. CARs= Cumulative Abnormal Returns. Firm size is log transformed. Correlations marked with an * are significant at $p < .05$

Table 4.2 Results of OLS Regression with CARs as the Dependent Variable

Variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Interim-government dominance (H1)		-0.00348***	-0.00357***	-0.00329**	-0.01146***	-0.01143***
		(0.001)	(0.001)	(0.001)	(0.003)	(0.003)
Interim-government dominance X Firm's foreign footprint (H1)			0.00003*			0.00005**
			(0.000)			(0.000)
Interim-government dominance X Firm's growth potential (H2)				-0.00012		-0.00061
				(0.001)		(0.001)
Interim-government dominance X Firm's ownership concentration (H3)					0.00012**	0.00013***
					(0.000)	(0.000)
Number of casualties during spell	-0.00013***	-0.00012***	-0.00012***	-0.00012***	-0.00012***	-0.00012***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Concentration of violence during spell	-0.01004***	-0.01035***	-0.01034***	-0.01034***	-0.01033***	-0.01031***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Spell occurs in Cairo	-0.00157	-0.00138	-0.00138	-0.00138	-0.00139	-0.00137
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Spell occurs in Sinai	0.00480***	0.00531***	0.00531***	0.00531***	0.00532***	0.00529***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Spell occurs near firm's HQ	-0.00170	-0.00130	-0.00131	-0.00131	-0.00126	-0.00127
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Spell begins on Friday	-0.01034***	-0.00971***	-0.00970***	-0.00971***	-0.00971***	-0.00972***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Spell occurs in Ramadan	-0.00069	-0.00112	-0.00111	-0.00111	-0.00109	-0.00107
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Regime tenure at start of spell	-0.00003***	-0.00003***	-0.00003***	-0.00003***	-0.00003***	-0.00003***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Length of spell	0.00087	0.00093	0.00093	0.00093	0.00094	0.00094
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)

Firm's strategic growth potential	-0.00092*	-0.00091*	-0.00091*	-0.00083*	-0.00090*	-0.00050
	(0.000)	(0.000)	(0.000)	(0.001)	(0.000)	(0.001)
Firm's foreign footprint	-0.00001	-0.00001	-0.00003	-0.00001	-0.00001	-0.00004
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Firm's ownership concentration	-0.00002	-0.00002	-0.00002	-0.00002	-0.00010+	-0.00010*
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Firm's size	0.00032	0.00031	0.00031	0.00031	0.00032	0.00032
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Firm's performance	0.00000	0.00000	0.00000	0.00000	0.00000	0.00000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Firm's leverage	-0.00411	-0.00409	-0.00407	-0.00407	-0.00421	-0.00420
	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)	(0.004)
Firm's degree of state ownership	0.00000	-0.00000	-0.00000	-0.00000	-0.00000	0.00000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Firm's degree of foreign ownership	0.00003	0.00003	0.00003	0.00003	0.00003	0.00003
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Firm's degree of institutional ownership	-0.00007	-0.00007	-0.00007	-0.00007	-0.00007	-0.00007
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Constant	0.00862	0.01092	0.01101	0.01079	0.01586+	0.01584+
	(0.008)	(0.008)	(0.008)	(0.008)	(0.009)	(0.008)
R-squared	0.0526	0.0541	0.0541	0.0541	0.0550	0.0551

Notes. N=6,908; Industry and regime dummies are included but not shown; robust standard errors in parentheses and clustered by firm.
† $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

Figure 4.1 The effect of interim-government dominance on CARs for firms with a small and large foreign footprint, respectively

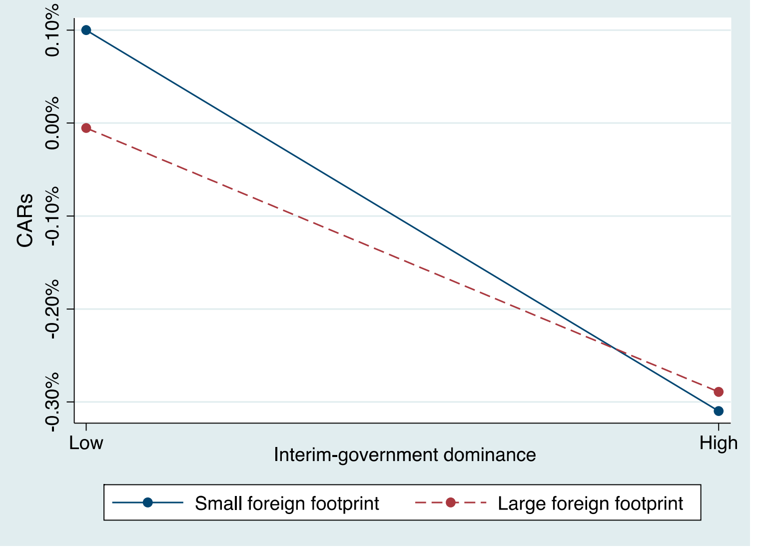
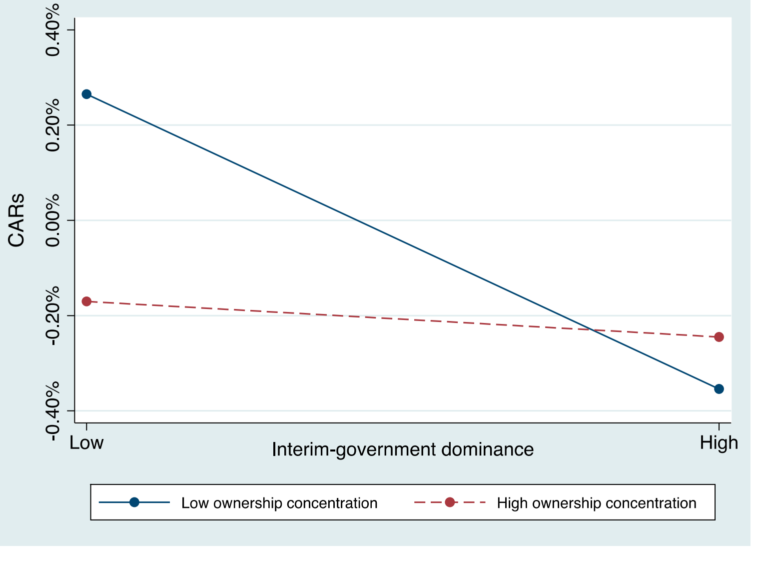


Figure 4.2 The effect of interim-government dominance on CARs for firms with low and high ownership concentration, respectively



Second, we tested our hypotheses for the non-interim period in post-Mubarak Egypt, which consisted of the regimes of Presidents Mohamed Morsi and Abdel Fattah el-Sisi. We note that both presidents came to power through elections. As such, we expect third parties to have naturally perceived their power as *de jure*, and their rule as popularly-legitimated. Because this contrasts with the *de facto* and circumstantially-imposed rule of interim governments, *a priori* we would not necessarily expect to obtain findings similar to those for the interim period. Using the same data collection and coding procedure as before, we extracted 4,644 front-page news articles under the Morsi and el-Sisi regimes, of which 157 pertained to political violence. Those events were then consolidated into 97 spells. Results of the multivariate regression analyses for these spells indicate that, rather than having a negative effect on CARs, regime dominance actually has a significantly positive effect on CARs during the non-interim period ($p<0.05$). Moreover, we do not find any significant moderating effects of our firm-level variables for this period. We elaborate on these findings in the next section.

4.5 DISCUSSION AND CONCLUSION

Despite the prevalence and unique mandate of interim governments, we know very little about how investors perceive and respond to the political uncertainty that these governments produce through their use of violence. Examining stock market responses to spells of political violence during the interim government in Egypt from 2011-2014, we find that investors react more negatively to the higher use of force by the government against civilians, suggesting that investors perceive higher interim-government dominance to jeopardize the supposed transition to a democratic new normal and hence as a source of greater political uncertainty. Negative investor reactions to higher interim-government dominance are weaker for firms with larger foreign footprints and those with higher ownership concentration, however, suggesting that firms are differentially vulnerable to the specific political uncertainty that results from interim-government dominance.

4.5.1 Theoretical Implications

Our findings make several contributions to the literature. First, they contribute to the management literature on political uncertainty in developing countries, and specifically to the sizeable body of research examining the consequences of political uncertainty on firm strategies and performance (Delios & Henisz, 2003; Duanmu, 2014; García-Canal & Guillén, 2008; Henisz & Delios, 2001, 2004; Jia & Mayer, 2017; Kobrin, 1979). Within this strand of research, scholars have predominantly focused on the policy-based uncertainty deriving from public officials' unconstrained influence over policy areas that are of direct relevance to firms (Hendriks, Slangen, & Heugens, 2018; Henisz, 2000a; Holburn & Zelner, 2010). Much of this research has moreover adopted a relatively stable view of the political environment in which firms and their stakeholders are able to carefully assess their options before strategically deciding on how to best respond to such uncertainty (Arregle, Miller, Hitt, & Beamish, 2013). This study, in contrast, has investigated how investors cope with political uncertainty in the specific and extreme context of post-authoritarian regime change, wherein the old 'rules of the game' have ceased to exist, but where new rules have yet to be established. In that regard, our findings not only inform future research on the effects of extreme uncertainty on firm valuations, but also shed light on an overlooked *source* of political uncertainty in countries undergoing democratic transition—namely, an interim regime's perceived lack of commitment to its mandate of democratization.

Second, by unraveling investors' reliance on informational signals to estimate the impact of an event on individual firms, our study contributes to the small but growing literature on the behavioral perspective on investor decision-making (Schijven & Hitt, 2012; Shiller, 2003). Specifically, we have argued and shown that in response to the information asymmetries that characterize the interim period, investors will rely on readily available signals to infer both the interim governments' true intentions, as well as the firm-specific vulnerabilities to the political uncertainty that these inferred intentions create for individual firms. As such, our study demonstrates, first, how management scholars may capitalize on the "untapped complementarities and room for interdisciplinary borrowing" at the intersection of business and political conflict research (Jamali & Mirshak, 2010, p. 444). Specifically, by drawing on an instrumental understanding of governmental violence from the political science literature – which suggests that a regime's use of force against non-governmental actors reveals its true political objectives (Davenport, 2007)- we highlight the informational value of violence. That is, our findings suggest that even if political violence were to be "the ultimate hassle facing the firm" (Dai et al., 2013, p. 556), it can also transmit useful informational cues about the regime's true political intentions and commitments. For firms and their investors, such signals are likely to be especially useful when there is little time to act more strategically, when a regime's public proclamations cannot be taken at face value (Henisz & Delios, 2001, 2004), and where adopting relational strategies with government are less feasible (Marquis & Raynard, 2015).

In similar vein, our study shows that investors simultaneously gauge informational signals at the firm-level in order to infer the extent to which particular firms are vulnerable to the increased political uncertainty resulting from interim-government dominance. Specifically, we have investigated three readily-observable, firm-level attributes that investors are likely to expect to mitigate or exacerbate the adverse effects of higher interim-government dominance: their international footprint, their strategic growth potential, and the concentration and dedication of their ownership base.

Our findings support only two of these mechanisms, however. Firms with larger foreign footprints were found to be less negatively affected by high interim-government dominance, presumably because of their more limited exposure to the domestic market and their ability to shift to alternative markets to secure their operations and revenue streams. In that regard, our findings corroborate the claim by Dai and colleagues (2017: p.1481) that "the value of opportunities in a country is a negative function of their substitutability outside of the country, where the decision to abandon operations depends on the presence of correlated options elsewhere". A weakening effect was also observed for firms with more concentrated ownership, suggesting that a concentrated and dedicated ownership base may serve, and be perceived, as a beacon of commitment and stability during times of great uncertainty (Heugens et al., 2009).

Third, our study builds on recent research in the business and management literature documenting whether, and to what extent, political violence affects firms depends on the attributes of this violence. For example, prior studies have found that more severe instances of violence -as measured by the aggregate number of casualties - have a greater negative effect on firm activity and performance (Hiatt & Sine, 2014; Oetzel & Oh, 2014;

Witte et al., 2017). Others have noted that whether firms are likely to weather through the uncertainty posed by violent conflict or exit the market entirely, hinges on the size of the conflict zone (Dai et al., 2013) as well as its proximity to the firm (Dai et al., 2017). We contribute to this body of literature by demonstrating that the behaviour of the national government, a key party in political violence, can constitute an additional contingency that may explain the perceived firm-specific consequences of conflict. Our findings demonstrate that, in the context of interim governments, regime heavy-handedness -as captured by the relative casualty count among civilians during spells of violence- signals the regime's lower commitment to democratization, and that this increases the political uncertainty that firms and their investors face.

In contrast, we observe that investors are more likely to react *positively* to such heavy-handedness under established (non-interim) governments. One possible explanation for these diverging findings is that when developing country governments are not specifically mandated or expected to democratize, political uncertainty for investors is less likely to reflect the regime's lack of commitment to democracy and political freedoms, but its capacity to govern and remain in power instead (Guillén & Capron, 2015; Tyler, 2006). Under such conditions, investors are likely to understand the show of force by the government as a signal for its ability to prevail and rule, which may actually reduce political uncertainty. This may explain why markets often react positively to autocratic practices in countries wherein democracy is not expected or particularly well-established (The Economist, 2017). Overall, we interpret our findings to indicate that regime dominance has direct implications on investor perceptions, and that these perceptions are contingent on the specific type of regime under which firms operate. More broadly, our study underscores the importance of more explicitly incorporating the role of national governments in future management research on violent conflict.

4.5.2 Practical implications

Our study has implications for interim government officials as well as managers and investors in countries that have recently undergone violent regime change, or are at the risk of undergoing one. For interim officials, this study provides compelling evidence that the manner in which government actors use force against civilians in the interim period can either undermine or sustain the confidence of financial markets during this turbulent period. Specifically, our findings show that interim-governmental behaviour that is perceived as being inconsistent with a mandate of genuine democratization is likely to be regarded by investors as a source of political uncertainty, and thus a source of concern. For governments undergoing democratization, therefore, we show that there is value in restraint, not only for moral reasons, but for economic ones.

Another key insight of this study is that firms are not equally vulnerable to the anticipated adverse effects of political uncertainty: those that are more foreign-focused and those benefiting from a more concentrated and dedicated ownership stand to be less affected by heightened local political uncertainty. For managers, our study thus points to the value of strategic flexibility that geographic diversification may provide to the firm under these conditions. For investors, our study suggests that an investment strategy that accounts for the presence of large dedicated owners to cope with the specific political uncertainties arising from interim governments after regime change may be rewarding. This recommendation is consistent with prior research showing that concentrated ownership also reduces investors' exposure to the risks of state expropriation under authoritarian regimes (Stulz, 2005). Firms with concentrated ownership thereby seem to be advantageously buffered against both the risks associated with authoritarian regimes, as well as the risks that follow these regimes' overthrow.

4.5.3 Limitations and Future Research

Our study has limitations that may identify opportunities for future research. First, our study focuses on only one manifestation of interim-government dominance, the use of force in violent confrontations with civilians, but that is unlikely to be the only signal that investors may use to infer the regime's commitment, or lack thereof, to a democratic new normal. Scholars at the intersection of business and human rights research may be interested in examining, for example, whether investors under interim governments similarly react negatively to civilian arrests and imprisonments, or the introduction of anti-democratic legislation that limits individuals' freedom of expression, or grants unmerited amnesty to members of the ousted regime (e.g. Olsen, Reiter, & Wiebelhaus-Brahm, 2011).

Second, as is the case with single-country studies, our analyses could further benefit from replication in other countries that have also had interim regimes. In particular, future research on political uncertainty may find substantial value in unpacking interim governments into different types (Shain & Linz, 1995). For example, though we refer to 'interim governments' as a monolithic concept, interim regimes may be further sub-classified into caretaker regimes (wherein the ousted leader agrees to remain in power until a new one is elected, e.g. under Chile's Pinochet and South Korea's Chun Doo Hwan), power-sharing regimes (wherein the ousted leader and the opposition share executive power temporarily before elections are held e.g. post-apartheid South Africa and post-Velvet Revolution Czechoslovakia), or internationally-administered regimes (wherein a multinational organization, coalition or foreign power oversees the national political transition e.g. the United Nations Transitional Authority in Cambodia and the Coalition Provisional Authority in Iraq). How political uncertainty is differentially perceived by firms and their stakeholders under these regimes may provide novel and timely insights to scholars and practitioners alike.

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SUMMARY

In their pursuit of competitive advantage, firms will sometimes resort to the political domain in search of opportunities to advance and secure their economic interests. While academic interest in the business-government interface has seen remarkable growth in recent years, there remain important gaps in the existing body of knowledge as to *why*, *when*, and *how* firms will engage with the government in different institutional contexts. In this dissertation, I supplement the extant resource-dependence understanding of business-government relations with other theoretical lenses to answer the following questions: (1) what are the antecedents of corporate political activity (CPA) that *transcend* the firm's direct political dependencies? (2) what are the firm- and country-specific conditions that *jointly* determine the expected benefits and costs of CPA? and (3) how do firms and their stakeholders cope with political uncertainty in circumstances wherein conventional forms of CPA are *not* readily available?

In two studies of this dissertation I focus on one particular type of CPA: the appointment of current and former politicians on firms' boards of directors. Using 14 OECD Member States as my empirical context, I find, first, that politcian appointments are prevalent even among the world's most economically-developed economies. Nonetheless, important differences do exist across these countries in terms of the expected firm-value to be derived from CPA. Specifically, I find that the degree of perceived corruption in a country increases both the benefits to the firm of being politically connected, but also the agency-based risks of being *too* politically connected. Second, I find that prior studies may have inadvertently overlooked the broader implications of politician appointments by conceptualizing CPA as a dependence-management strategy that is exclusive to the firm's political environment. Specifically, findings of this dissertation suggest that CPA can additionally be employed to help firms attain and secure relational capital from a broader set of non-political stakeholders, including financiers and members of the public.

In the final study, I examine a substantively different context—namely, the transitional period that succeeds the collapse of an authoritarian regime in a developing country, but precedes the establishment of a democratic alternative. In doing so, the study sheds light on a form of government that has thus far gone unexamined in the literature on the business-government interface: *interim* governments. Combining a behavioral view of investor reactions with insights from the political science literature on civil conflict, I forward a new perspective on how investors remedy the information asymmetry that exists between them and interim governments, without necessarily having to resort to CPA. Importantly, the study identifies a new source of political uncertainty that governments in institutionally less-developed countries can pose to firms and their stakeholders.

Taken together, the findings of this dissertation demonstrate promising opportunities for multi-level, inter-theoretic, and inter-disciplinary research on CPA and the business-government interface. In today's increasingly politicized business environment, research of this kind is ever more important for business and society alike.

SAMENVATTING (DUTCH SUMMARY)

In hun streven naar een concurrentievoordeel nemen bedrijven met enige regelmaat hun toevlucht tot het politieke domein, op zoek naar mogelijkheden om hun economische belangen te bevorderen en veilig te stellen. Hoewel de academische interesse in het raakvlak tussen bedrijven en de overheid de afgelopen jaren opmerkelijk is gegroeid, blijven er belangrijke hiaten bestaan in de bestaande kennis over waarom, wanneer en hoe bedrijven en de overheid in verschillende institutionele contexten met elkaar om zullen omgaan. In dit proefschrift vul ik de bestaande resource-afhankelijkheidsconceptie van zakelijke relaties tussen bedrijven en overheid aan met andere theoretische invalshoeken om de volgende vragen te beantwoorden: (1) wat zijn de antecedenten van bedrijfspolitieke activiteit ('Corporate Political Activity', hierna afgekort als CPA) die de directe politieke afhankelijkheden van de onderneming overstijgen? (2) wat zijn de bedrijfs- en land specifieke voorwaarden die gezamenlijk de verwachte voordelen en risico's van CPA bepalen? en (3) hoe kunnen bedrijven en hun stakeholders omgaan met politieke onzekerheid in omstandigheden waarin conventionele vormen van CPA niet direct beschikbaar zijn?

In twee studies van dit proefschrift richt ik me op een bepaald type CPA: de benoeming van huidige en voormalige politici in de raden van bestuur van bedrijven. Als ik de 14 OESO-lidstaten als mijn empirische context beschouw, constateer ik ten eerste dat politieke benoemingen voorkomen in zelfs de meest economisch ontwikkelde economieën van de wereld. Desalniettemin bestaan er in deze landen belangrijke verschillen wat betreft de verwachte waarde voor het bedrijf die uit de CPA voortkomen. Concreet laten de resultaten van mijn onderzoek zien dat de mate van waargenomen corruptie in een land de voordelen voor bedrijven om politiek verbonden te zijn vergroot, maar ook als risico heeft te politiek verbonden te zijn.

Ten tweede merk ik op dat eerdere studies onopzettelijk de bredere implicaties van afspraken met politici over het hoofd hebben gezien door CPA te conceptualiseren als een strategie voor afhankelijkheidsmanagement die exclusief is voor de politieke omgeving van het bedrijf. Specifiek suggereren de bevindingen van dit proefschrift dat CPA bovendien kan worden gebruikt om bedrijven te helpen bij het bereiken en veiligstellen van relationeel kapitaal van een bredere verzameling niet-politieke belanghebbenden, waaronder investeerders en het algemeen publiek.

In de laatste studie onderzoek ik een inhoudelijk andere context - namelijk de overgangsperiode die volgt op de afzetting van een autoritair regime in een ontwikkelingsland, en voorafgaat aan de oprichting van een democratisch alternatief. Hiermee werpt de studie een licht op een vorm van bestuur die tot nu toe niet is onderzocht in de literatuur over de relatie tussen bedrijfsleven en overheid: interim-regeringen. Door een gedragsmatige kijk op reacties van beleggers te combineren met inzichten uit de politieke-wetenschappelijke literatuur over burgerconflicten, bied ik een nieuw perspectief op hoe beleggers de informatie-asymmetrie tussen hen en interim-regeringen verhelpen, zonder noodzakelijkerwijs hun toevlucht te nemen tot CPA. Belangrijk is dat de studie een nieuwe bron van politieke onzekerheid identificeert die overheden in minder ontwikkelde landen kunnen vormen voor bedrijven en hun aandeelhouders.

Samengevat tonen de bevindingen van dit proefschrift veelbelovende mogelijkheden voor multi-level, inter-theoretisch en interdisciplinair onderzoek naar CPA en de interface tussen bedrijfsleven en overheid. In de steeds meer gepolitiseerde bedrijfsomgeving van vandaag de dag is dit soort onderzoek steeds belangrijker voor zowel het bedrijfsleven als de samenleving in het algemeen.

ABOUT THE AUTHOR

Omar El Nayal (1988) obtained his M.Phil. degree in Business Research, and his M.Sc. degree in Hospitality Management from the Rotterdam School of Management (RSM), Erasmus University, The Netherlands. After completing his B.A in Finance at the American University in Cairo, he worked as an economist at the Ministry of Finance of Egypt, and as the Business Development Manager of a local tour operator based in Cairo. He started his PhD trajectory in September 2014 at the Department of Strategic Management and Entrepreneurship of RSM, working under the guidance of Prof. dr. Hans van Oosterhout and Dr. Marc van Essen. As part of his PhD trajectory, he spent two months as a visiting scholar at the University of South Carolina and the University of Southern California.

Omar's general research interest centers around firms' nonmarket strategies across different institutional contexts. He focuses in particular on the business-government interface, and the various ways in which firms attempt to influence politics with a view to advancing and securing their economic interests. He has expertise in event study methods, multi-level analysis, and panel data analysis. Besides research, Omar is passionate about teaching and strives to bring new and interactive teaching methods to the classroom.

Omar is currently a visiting scholar at RSM. In February 2019, he will join the Católica-Lisbon School of Business and Economics in Portugal as Assistant Professor of Strategy.

PORTFOLIO

Working Papers

Papers under review:

El Nayal, O., van Oosterhout, J. & van Essen, M. "Board of Thrones? Unraveling Investor Reactions to Politician Appointments"

El Nayal, O., van Essen, M., Slangen, A. & van Oosterhout, J. "Towards a Democratic New Normal? Investor Reactions to Interim-Government Dominance During Spells of Political Violence"

Other working papers:

"Politician Appointments as Strategic Responses to Community-Based Legitimacy Threats" (with Hans van Oosterhout and Marc van Essen)

"Outsourcing Politics: Shareholder Activism and the Make-or-Buy Decision of Corporate Lobbying" (with Hans van Oosterhout)

"The Effect of Target CEO Equity Risk Bearing on Acquisition Premium Decisions" (with Mirko Benischke and Grigorij Ljubownikow)

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"The Politicized Workplace: Unraveling the Determinants of Campaign Contributions by Employees"

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Research visits

Two research visits to the Darla Moore School of Business (University of South Carolina) in Columbia, South Carolina, to collaborate with Dr. Marc van Essen on the three studies of this dissertation (2017 & 2018)

Research visit to USC Marshall School of Business (University of Southern California) in Los Angeles, California, to collaborate with Dr. Nan Jia (2018)

Teaching and supervising activities

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Executive International M.Sc. in Corporate Communication
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Corporate Governance (2017)
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Doing Business in Europe (2017)
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Paper: *"Politician Appointments as Strategic Responses to Community-Based Legitimacy Threats"*

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Nano-conference on Corporate Governance, Rotterdam School of Management, The Netherlands (2017)

Paper: *"Board of Thrones? Unraveling investor reactions to politician appointments"*

Invited Presentation, Católica Lisbon School of Business and Economics, Portugal (2017)

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Invited Presentation, HEC Paris, France (2017)

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Academy of Management Annual Meeting, Vancouver, Canada (2015)

Organization, Leadership & Society Conference on the Politicization of the Firm, Paris, France (2015)

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China Research Day, University of Southern California, United States (2018)

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Social Movements, Stakeholders and Nonmarket Strategy Professional Development Workshop, Academy of Management Annual Meeting, Atlanta, United States (2017) & Vancouver, Canada (2015)

Strategy and the Business Environment Conference, University of Rochester, New York, United States (2016)

InterEuro Research Consortium on Lobbying, Center for European Policy Studies, Brussels, Belgium (2014)

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