Integrated market and nonmarket strategy: Political knowledge and the resource-based view of the firm

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INTEGRATED MARKET & NONMARKET STRATEGY:
POLITICAL KNOWLEDGE AND THE RESOURCE-BASED VIEW
OF THE FIRM

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ABSTRACT
This paper contributes to the political strategy literature by focusing on the role of
organizational knowledge about the political environment in explaining firm-level
differences in political engagement. We combine insights from the learning literature
and from the literature on political markets to develop a unique typology of political
knowledge highlighting the degree of institution-specificity and the degree of firm-
specificity of political knowledge. We use this typology to explore two questions. First,
we consider governance mechanism choices: when firms want to develop one type of
political knowledge or another, which governance mechanism should they consider?
Second, we look at how the different kinds of political knowledge could or should lead
to some form of competitive advantage in political arenas.
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INTRODUCTION

Why does the propensity to engage in the political process vary across firms? Existing research on corporate political strategy emphasizes the role of external or industry-level factors in explaining such differences - the concentration of firms within an industry, the costs of collective action (Olson, 1965; Stigler, 1971; Grier, Munger and Roberts, 1994), the existence of industry associations (Weymouth, 2010), the degree of public procurement (Masters and Keim, 1985), and the attractiveness of political markets, including the extent of interest group rivalry (Bonardi, Hillman and Keim, 2005). To explain firm-level variations, however, recent literature has explored the idea that firms acquire or develop specific nonmarket resources or capabilities, which anchor their political activities (Bonardi, 2011; Dahan, 2005; Holburn and Zelner, 2010; Oliver and Holzinger, 2008).

Among other political assets, this literature stresses the importance of political knowledge in order to navigate nonmarket environments of different nature. As suggested by Holburn and Zelner (2010):

“The capacity to choose the right resources ex ante (Makadok, 2001)—to identify key local political actors and their preferences—represents an especially important component of political capabilities for MNEs entering new host countries. MNEs suffer a liability of foreignness (Zaheer, 1995) relative to domestic competitors and interest groups as a result of local actors’ superior jurisdiction-specific political resources, including detailed knowledge of the
identities and preferences of key local political actors and, in many cases, direct ties to these actors.”

Other literature also support the idea that political knowledge is critical to what firms do, including the literature on political connections (Faccio, 2006) and political lobbying (Kersh, 1986). Little is known, however, about what political knowledge really is. While there is a growing literature that explores the fit between integrated market and nonmarket strategies and the characteristics of the political market (e.g., Baron, 1995; de Figueiredo, 2009; Kingsley et. al., 2012), researchers have only implicitly addressed the importance of political knowledge as a component of integrated strategy. From our reading of the literature we found that no scholars have developed a deeper understanding of political knowledge, the tradeoffs associated with developing it, and how it affects the design of integrated strategy.

In this paper we contribute to the political strategy literature\(^1\) by focusing on the role of organizational knowledge about the political environment in explaining firm-level differences in political engagement. Organizational knowledge enables firms to effectively employ, manipulate and transform various organizational resources into desired outputs (Nonaka, 1991). It may be embedded explicitly or tacitly in entities such as tools, tasks, technologies and people. When replication or transmission are difficult, internally-generated organizational knowledge can serve as the basis for sustained competitive advantage and superior performance in the market place (Nelson and Winter, 1982). Several previous studies and case-study evidence suggest that firms can develop knowledge of their political

\(^{1}\) For recent surveys of the corporate political activity literature see Hillman et. al. (2004) and Lawton et. al. (2013).

De Figueiredo (2009) provides a survey of literature addressing integrated market and nonmarket strategy.
environment through experience in dealing with local governments, stakeholders and political actors in a jurisdiction (Suarez, 1998). However, as far as we are aware, no research has provided a framework to think about the types of political knowledge that are valuable for firms or how they are learnt or acquired. This is one purpose of our paper.

As an illustration, consider the example of a ‘big box’ retail chain store, such as Wal-Mart or Target, which wishes to obtain local municipal council approval to open a store in a new city. What types of political knowledge does a firm need to successfully obtain such approval? And how can the knowledge be acquired? At the most basic level firms need to understand the institutional process through which permitting decisions are made: how to initiate an application, what documentation to submit, voting rules on relevant committees and the full council, appeals mechanisms, and so forth. Since retail developments can elicit varying degrees of local opposition, firms must also assess the likely nature and intensity of organized stakeholder action, such as from labor unions, small business associations and competitors, all of which may exert influence, either positive or negative, on the council. In addition, knowledge of the general preferences of individual councilors and city staff towards new retail sites will enable firms to assess the unconditional probability of obtaining a favorable decision. Knowledge of councilor preferences regarding the specific application at hand is also important as market and nonmarket conditions can be heterogeneous even in a single municipality. Especially critical, however, is knowing how to effectively bargain with or obtain the support of pivotal decision-makers (Krehbiel, 1998; Holburn and Vanden Bergh 2004). To gain political support, through formal and informal mechanisms, requires knowledge of the value that politicians place on additional assets that the firm can provide – such as employment guarantees, local sourcing commitments, funding of charities or community projects, or electoral campaign contributions – as well as the cost to the firm of
making such offers. Identifying and crafting mutually beneficial ‘trades’ can be a lengthy process of discovery and negotiation as each deal is idiosyncratic. In the case of the opening of a new Target store in Harlem, New York, one observer noted that:

“the preparations were extreme: nearly 10 years of calculated philanthropy and schmoozing across Harlem, an effort that Minneapolis-based Target has characterized as smart community relations but critics suggested was akin to bribery. Long before the ribbon-cutting, Target had wooed notable Harlem residents with dinner parties, struck deals to carry exclusive gear designed by neighborhood luminaries, and sponsored prominent charitable projects and events, including the refurbishing of a school library and the sprucing up of a rundown lot near the store on 117th Street.”

*New York Times, August 13, 2010*

In this paper we combine insights from the literature on knowledge (Dosi and Marengo, 2007; Hayek, 1945) and from the literature on political markets (Bonardi, Holburn and Vanden Bergh, 2006) to develop a unique typology of political knowledge that simplifies the situation above into two main dimensions, the degree of institution-specificity and the degree of firm-specificity of political knowledge, which we elaborate on below. Armed with this typology, we consider two questions that are central to develop a Resource-Based view of firms’ nonmarket activities. First, we consider governance mechanism choices: when firms want to develop one type of political knowledge or another, which governance mechanism should they consider? Second, we look at how the different kinds of political knowledge could or should lead to some form of competitive advantage in political arenas. This question is far from obvious, in fact, because it is often unclear whether firms should develop political knowledge to generate a competitive advantage. In what follows, we consider these questions in turn.
POLITICAL KNOWLEDGE

A now relatively large literature in management shows the importance of knowledge in a firm’s strategy, both as a source of competitive advantage (Miller and Shamsie, 1996) or as a fundamental determinant of its existence (Grant, 1996; Kogut and Zanger, 1992). Knowledge that has been accumulated in the past leads an individual or an organization to select a different view of the causal relationships that determine how events happen (knowledge of what) and of what should be done (knowledge of how), than what would have otherwise been selected (Dosi, Faillo and Marengo, 2008). This knowledge may then be translated into formal or informal organizational routines and structures. Organizations cope with individuals’ rational limitations by building structures that guide behaviors (Simon, 1961; Cyert and March, 1992). Crossan, Lane and White (1999) detail how new knowledge is originally accumulated with new insights or ideas identified by individuals within an organization, how this knowledge is shared, given inter-subjective meaning, adopted for action and finally embodied in the creation of an organizational routine.

Why knowledge should play an important role in political environments

Miller and Shamsie (1996) show how knowledge, as it allows to coordinate or re-coordinate various assets within a firm, is particularly important for firms in changing and unpredictable environments. Similarly, Dosi and Marengo (2007) also argue that problems “may occur in circumstances whereby agents have an imperfect understanding of the world in which they operate due to (a) a lack of information, (b) an imprecise knowledge of its structure, (c) mastery of only a limited repertoire of actions in order to cope with whatever problem they face.” These situations typically exist in political environments. Participation in political processes is plagued with uncertainties and transaction costs (Dixit, 1998; North,
For example, the policy preferences of politicians (Mayhew 1974; Keim and Zeithmal 1986), the nature of interest group competition (Wilson 1980), and the efficacy of political tactics (Bonardi, Holburn and Vanden Bergh 2006) are each subject to uncertainty. Thus one would expect firms to value political knowledge and to seek means to develop or acquire it.

In spite of this importance, research on the role of knowledge in political environments is limited to a handful of articles. Oliver and Holzinger (2008) suggest that firms develop political knowledge and dynamic capabilities to strategically manage their political and regulatory environment. Examples of this can be found in historical and longitudinal case studies of corporate lobbying. Suarez (1998), for instance, showed that pharmaceutical and electronic U.S. companies lobbying on a similar issue over the 1976-1993 period consistently behaved in reference to what they knew in the previous period. Martin (1995), studying health care debates in the 1990s found similar patterns, stressing the role of regional and national associations as a repository of what firms knew in political arenas through their past experiences. Vogel (1983), in his study of the politicization of the corporate environment, also suggests that firms develop knowledge based on their interaction with the opponents that frequently defeat them in political arenas, such as environmental and consumer groups. However, what this political knowledge actually is about, or how there might be different types of knowledge that might be more or less useful, dependent on the environment, is something that remains unclear.

A related stream of research examines how firms can benefit from political knowledge acquired through political connections (Hillman, 2005). Firms that establish close ties with elected politicians - through appointing politically connected board members or senior management - tend to benefit from higher stock prices (Hillman and Hitt, 1999), easier access to capital, lower tax rates, larger market shares (Faccio, 2007), broader diversification
opportunities (Mahmood and Mitchell, 2004) and even improved chances of securing government bailout (Faccio, Masulis and McConnell, 2006). Again, this literature suggests that political knowledge can be important for firms, but why and when this is the case is still a puzzle. In other words, the concept of political knowledge remains a black box, and a theoretical framework is needed to start opening this black box. In the next section, we provide such a framework by focusing on some of the key characteristics for why political knowledge might matter for firms. This will help us identify different types of political knowledge, which will allow, later on, a discussion of when these different types can be important and how they can be obtained.

**Four types of political knowledge**

Following the retail example outlined in the Introduction we argue that firms’ political knowledge can be considered along two dimensions: institution-specificity and firm-specificity. At the theoretical level, the framework we develop is based on two sets of insights. First, it draws on the literature on organizational knowledge which suggests that some knowledge components are generalizable to multiple circumstances, but also that other components are very local, i.e., conditional on specific conditions regarding time and space (Hayek, 1945). In the case of political environments, specific conditions consist of the types of institutional environments in which an individual or a firm operates. Institutions differ not only in terms of formal rules but also in informal rules, such as norms and non-written practices, that can take time to learn (North, 1994). These considerations drive the first dimension of our framework, the degree of institution-specificity of political knowledge, which we elaborate on below.
The second dimension of our framework finds its roots in the literature on political markets which argues that public policy-making can be modeled as the outcome of interactions between demanders (firms, interest groups, activists, etc.) and suppliers (politicians, regulators, courts) (Buchanan and Tullock, 1962; Stigler, 1971). From this perspective, firms that develop corporate political strategies provide assets of value to policy-makers (e.g., campaign resources, policy information, credit claiming opportunities, etc.) (Bonardi, Hillman and Keim, 2005; Hillman and Hitt, 1999). Salient knowledge includes information about how to gain access to influential politicians and regulators; and also knowledge of the value to policy-makers of the firms’ assets (Bonardi, 2008). Firms might also decide to commit some of its economic assets to political means, a practice referred to as ‘asset freezing’ in the literature (Bonardi and Urbiztondo, 2013), if it has knowledge about the fact that these economic assets could be highly valued by policy-makers. Investment in high visibility green technologies, keeping under-performing plants operating, etc. are examples of political behaviors, based on economic assets, which might have value for some policy-makers. The political value of a firm’s assets and business depends on the idiosyncratic preferences of policy-makers and is subject to considerable uncertainty. But such knowledge may be discovered. This is the basis for the second key dimension in our framework, the degree of firm-specificity of political knowledge.

The degree of institution-specificity of political knowledge. Political knowledge can be either more generic or, conversely, more tailored to a specific institutional environment. Knowledge of the principles about how to organize a grass-roots campaign or how to cultivate interest group coalitions, for instance, is common from one jurisdiction to another. Existing theoretical and empirical literature supports this idea. Holburn and Zelner (2010) argue that firms develop generalizable political knowledge when they deal with their home
governments and institutional environments, which can be redeployed in other institutional areas. This implies that part of the political knowledge that firms possess is of a generic nature and can be leveraged in multiple jurisdictions.

On the other hand, part of what firms learn in a political environment is naturally institution-specific. Baron (2001), for instance, details the different information structures that determine the nature of the policy-making game in various institutional settings. The legislative process, for instance, operates differently in presidential and parliamentary countries (Holburn and Vanden Bergh, 2008). Understanding how to navigate policy-making in a jurisdiction additionally requires an appreciation of the policy preferences of different parties, including those in formal positions of authority as well as stakeholders, organized interest groups and other constituents who may be affected by policy outcomes. Firms may find well-organized hostile opponents to their preferred policies in some environments, or more supportive actors in others, both of which can change due to political elections or demographic trends (Keim and Zeithaml, 1986). Gathering information on policy positions and patterns of alliances or coalitions between parties enables firms to determine whether opportunities exist to initiate or lobby for favorable policy changes and the optimal method for affecting change.

**The degree of firm-specificity of political knowledge.** By firm-specific, we mean knowledge of the political value attributed to the firm’s business assets, operating practices and strategy. While firms create value for consumers in the market place, they also create benefits, and potentially costs too, for politicians in their jurisdiction, for example through the creation of local jobs, the augmentation of labor force skills and enhanced taxation revenues, or their attitude towards the natural environment, each of which can affect politicians’ future electoral prospects. Wal-Mart and Target likely have a deep understanding
of the firm-specific political impact of locating a store in a new neighborhood and of how to adjust their market-based strategies to achieve political objectives. The literature on the integration of market and nonmarket strategy stresses that what distinguishes a firm from other competitors in the market place is a critical aspect of the design and success of a successful and meaningful political action (Baron, 1995a and 1995b). In that spirit, Bonardi (2008) underlines the importance of leveraging firms’ specific technologies and assets as a way to influence public policies. Judging political value, however, can be a difficult exercise, particularly for firms that are inexperienced in a jurisdiction as the following quote illustrates:

“BHP Billiton Ltd. said it was withdrawing its hostile $38.6-billion offer for Potash Corp., but company officials took the unusual step of outlining why they felt Ottawa's decision was wrong. The Australian company laid out what it called “unparalleled” promises it made on jobs and investment, including commitments to spend $370-million on infrastructure in two provinces, to give five-year employment guarantees at Potash Corp.'s Canadian mines and to move 200 jobs from outside the country to Saskatchewan and Vancouver.”

Globe and Mail, November 14, 2010

**Four types of political knowledge.** Considering these two dimensions simultaneously we obtain four types of a firm’s political knowledge, as represented in Figure 1. First, with a low degree of institutional and firm-specificity, is *Generic political knowledge*, such as a

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2 We recognize that each dimension is most likely continuous in nature. However, for simplicity and to begin the research conversation we employ a discrete characterization for each, resulting in a 2x2 framework.
framework for assessing generic political decision making processes; this may be applied in any jurisdiction. Second, *Institution-specific political knowledge* consists of a high degree of institution-specific knowledge, such as the knowledge of pivotal politicians’ policy preferences on a given topic (Vanden Bergh and Holburn, 2007), or the rules and procedures governing agency decision-making (de Figueiredo and Vanden Bergh, 2004).

Third, *Firm-specific political knowledge* reflects an understanding of the political value of the firms’ assets or operating practices in any political environment, for instance the value attributed to local sourcing practices or to paying above minimum-level wages for employees. These will have value in any political environment. Many firms might in fact develop firm-specific political knowledge as a precautionary mechanism in case a more integrated market and nonmarket strategy would become necessary, for instance if a new regulation affecting one specific firm (instead of the whole industry) could be put in place. Fourth, *Firm-institution-specific political knowledge* consists of the knowledge of the value of such firm activities in a particular jurisdiction and reflects the idiosyncratic preferences of local politicians, regulators and stakeholders. This type of political knowledge is the one a firm will need when directly challenged in a particular political market.

[INSERT FIGURE 1 HERE]

Note that firms will often combine these different types of knowledge in the context of their political strategies, and that they might have more or less of each of these types of knowledge at any single moment.
Since firms differ in their need for political knowledge as a component of their integrated strategy, they also organize and develop political knowledge in different ways. In this section, we explore the mechanisms that firms can utilize to develop the political knowledge type they need. Our logic here is that firms can get political knowledge through two complementary mechanisms: first, by choosing between market-based solutions and integrated solutions—or, to use Williamson’s term, hierarchy (Williamson, 1975); second, by learning political knowledge, either experientially (Suarez, 1998) or by observing others—i.e., vicariously (Haunschild, 1993). We examine these two mechanisms in turn, and then explore how they might interact to develop the different kinds of political knowledge identified above.

Market versus hierarchy to acquire political knowledge. Firms may acquire political knowledge in the market place for instance by hiring lobbyists or consultants who have political ties or knowledge of policy-making in a jurisdiction (Kersh, 1986). However, there are limits to using market contracts as a method for obtaining such expertise (de Figueiredo and Kim, 2003; de Figueiredo and Tiller, 2001). The challenge for external consultants in brokering ‘trades’ or agreements with political actors is that effectively doing so may require deep knowledge of the firm’s market-based assets, resources, capabilities and market strategy in some contexts. For instance, while a lobbyist may understand the political value that a legislator places on the construction of a corporate headquarters or new manufacturing facility in the legislator’s jurisdiction, he or she is less likely to appreciate the organizational implications or additional cost to the firm of locating there rather than in the optimal location from a market-based calculation. Similarly, accurately valuing potential public policy alternatives depends on the lobbyist understanding the full cost and revenue implications for the firm as well as for its competitive position relative to other firms. Such information asymmetries between a lobbyist and the firm regarding the firm’s market based assets and
strategy make it difficult for an external lobbyist to identify mutually-beneficial trades with politicians. Contracting for lobbying services thus becomes a challenge when performance may not be easily measured ex post or specified ex ante.

**Experiential versus vicarious learning to develop political knowledge.** Previous work suggests that learning is an important mechanism to acquire knowledge in political environments (North, 1990). As indicated by Bonardi, Holburn and Vanden Bergh (2006), Dean and Brown (1995) or Suarez (1998), one key mechanism there is experiential learning, in which firms learn by doing. Another mechanism, however, is also likely to play an important role: vicarious learning (Levitt and March, 1988). Vicarious learning, which implies that firms learn from the experience of others, has received much attention from organizational theorists and economists in the study of knowledge spillovers (Thornton and Thompson, 2001). There is now robust evidence of such vicarious learning, especially under conditions of uncertainty, across many different contexts (Haunschild, 1993; Haunschild and Miner, 1997; Beckman and Haunschild, 2002; Haveman, 1993; Greve, 1996, 1998; Greve and Taylor, 2000; McKendrick, 2001; Baum, Xiao, and Usher, 2000; Lant and Mezias, 1992; Haunschild and Sullivan, 2002). When facing high uncertainty, as is the case in political environments, firms are more likely to learn from the actions of other firms (e.g., Mezias and Lant, 1994; Haunschild and Miner, 1997; Mezias and Eisner, 1997), which should indicate that vicarious learning should play an important role to develop political knowledge.

**How firms can develop the four different kinds of political knowledge**

In this section, we relate our typology of the different kinds of political knowledge (see Figure 1) with the two knowledge acquisition mechanisms identified above. At the bottom left of our typology, generic political knowledge is mostly explicit and publicly observable.
Short-term contracts with external lobbying firms is probably enough to acquire this type of knowledge. Firms that view generic political knowledge as optimal do not need to develop large scale internal resources. For those firms that do decide to develop generic political knowledge internally, they will be able to develop this type of political knowledge through vicarious observation of other firms or interest groups in the political markets. As firms observe others engaging in political and regulatory arenas, they are likely to learn about the basic public policy process and how to operating in the political environment. As suggested by Kim and Miner (2007), firms learn much by observing others struggle, make mistakes and fail.

On the other hand, firms will likely acquire and/or develop institution-specific political knowledge as part of their integrated strategy, which might require some degree of experiential learning. However, firms have outside options there. Becoming an active member of a trade association and/or long-term contracts with external lobbyists are solutions for institution-specific knowledge because policy-makers change and it is important to update the knowledge over time. Firms’ ability to seize some market opportunities might depend from it. However, firms do not need to share sensitive information about their market investments with policy makers in order influence policy outcomes. To the extent that other firms in an industry are affected by policy, trade association membership may be the best option. Otherwise the firm may need to develop longer term contracts with external lobbyists.

For those firms that choose to develop institution-specific political knowledge internally, vicarious learning in a firm’s local jurisdiction will be critical. Interactions between other firms and policy-makers in a jurisdiction reveal cues or signals about different aspects of the policy environment: for instance, the willingness of elected politicians to
sponsor or resist reform proposals; policy positions of elected and appointed officials on contentious issues; and the degree of organization of supportive or hostile stakeholders. While some aspects of the policy environment may be difficult to observe, others are only revealed during periods of engagement between firms and governments. Firms may initiate policy reviews through administrative filings or else trigger public discourse on policy issues in the media and government arenas. Participation by firms, interest group and policy-makers in regulatory or judicial hearings is another source of information pertinent to a jurisdiction. Policy-making processes thus reveal information to firms that provides benefit in terms of configuring political strategies and reducing uncertainties about possible policy outcomes.

As firms develop greater levels of firm-specific political knowledge as a component of their integrated strategy, a tighter linkage between the firm’s market strategy and its nonmarket influence efforts will be required. This type of knowledge has to be developed internally, and a specific organization has to be put in place in order to do so. However, in the case of Firm-specific political knowledge (the bottom right quadrant in Figure 1) much of this political knowledge is likely to be developed vicariously as it does not apply to a specific institutional environment. Experiential knowledge is less critical there.

The situation is different for Firm-Institution specific political knowledge (Upper right quadrant in Figure 1). Many aspects of what firms can leverage in their negotiations with policy-makers relate to the political value of the firm’s assets and practices. As a further example, a firm’s decision to off-shore specific operations may create economic value for the firm but result in negative political value due to local job losses. In a specific institutional environment, the firm’s managers responsible for off-shoring may not understand how much political value this might have and for whom. As this example makes clear, some of the unknown and unobservable components of political knowledge are in fact related to firm-
specific factors that the firm can leverage in a political context. Because of this, Firm-Institution-specific knowledge cannot easily be learnt vicariously. Instead, firms learn through their own experience which of the firm’s assets and technologies (or other characteristics) are valuable in the context of a political negotiation.

Our general argument about the governance of political knowledge is depicted in Figure 2, which builds on Figure 1 but concentrates on the mechanisms available for firms to develop the different kinds of political knowledge. Going from left to right in Figure 2, firms tend to integrate more the political function and develop their own political or regulatory affair department (instead of building their nonmarket strategies on political knowledge acquired through external contracting). Going from the bottom left to the bottom right, firms also rely less and less on vicarious learning and more and more on experiential learning to acquire the political knowledge they need.

POLITICAL KNOWLEDGE AND COMPETITIVE ADVANTAGE

From the perspective of the Resource-Based view, the type of political knowledge that is the most likely to create a sustainable competitive advantage for a firm is the one that is the most difficult to imitate or to replicate (Wernerfelt, 1984; Keim and Zietheaml, 1986; Barney, 1991). Our framework would then suggest that firm-institution specific political knowledge should be the type that will most likely generate a sustainable competitive advantage in a given political environment. However, one has to consider important tradeoffs associated with developing the various types of political knowledge before concluding that the only value enhancing type is firm-institution specific political knowledge. Since
corporate political activities are generally complementary activities that have to be integrated with firms’ market strategies (Baron, 1995a; de Figueiredo, 2009), firms might not always find it value enhancing to develop firm-institution specific political knowledge. The other types of political knowledge might, in fact, be optimal from a resource-based view and an integrated strategy perspective.

We argue that the contribution of each type of political knowledge towards a firm’s competitive advantage depends upon two factors. First, the level of control that government has over the profit opportunities of the firm will determine the frequency with which a firm needs to interact with policy makers. Baron (1995) argues that the level of government control is positively correlated with the frequency of interaction with the government and that this degree of control varies across industries. For example, for firms developing video game technology the degree of government control is low. By contrast, firms developing medical technologies face much greater government control over profit opportunities. Second, firms must consider the degree of rivalry from interest groups present in the political market. A number of scholars have demonstrated that the degree of interest group rivalry varies across political markets (Wilson, 1980; Bonardi, Hillman and Keim, 2005). For example, an electric utility firm with operations in multiple political markets can face little interest group rivalry in one political market and intense interest group rivalry in another political market (Fremeth, Holburn and Spiller, forthcoming).

Within a given political market environment, firms differ on these two dimensions. Some subset of all firms faces a low level of government control. For firms that face a low level of government control, a smaller subset will face intense interest group rivalry while others face minimal rivalry. Similarly for the set of firms that face a high level of government control, a subset will face high degrees of interest group rivalry while the others
will face low levels of rivalry in the political market. We argue that a firm’s optimal choice over which type of political knowledge to acquire or develop is directly related to the characteristics of the political environment, as described by these two dimensions.

Consider a firm where the level of government control over profit opportunities is low and they face limited interest group rivalry. In this political market, the firm’s integrated strategy will be heavily weighted toward their market strategy with little to zero weight placed on nonmarket components. The opportunity costs of investing in the development and acquisition of political knowledge are high relative to the limited benefits. Policy change affecting the firm is unlikely and thus the benefit of understanding the details of the public policy making process is limited. Rival interest groups are not actively seeking to change policy in directions that hurt the firm. In these markets there is limited to no benefit to the firm of understanding how politicians and/or their constituents respond to firm investments. In many respects, any interaction with the government in this type of political market can be viewed by the firm as a simple cost of implementing their market strategy. As such it is likely optimal for the firm to place little weight on their nonmarket assets and to acquire mostly generic political knowledge when needed.

Firms that face greater levels of government control are more likely to adopt institution specific political knowledge as opposed to generic political knowledge. This hypothesis is fairly intuitive. As the level of control by government increases so too does the frequency of interaction between the government and the firm (Baron, 1995a). Thus, the incremental benefit to the firm of developing institution-specific knowledge is more likely to outweigh the added cost of developing institution specific relative to maintaining only generic political knowledge.
As the level of interest group rivalry in the political market increases, we posit that firms are more likely to develop firm specific political knowledge. Active rival interest groups, whether advocacy groups or other firms within an industry, will present arguments that emphasize how policy change affects the stakeholders of the rival interest group as well as the constituents of policy makers. For a firm to counteract a rival interest group, it will need capabilities to understand and articulate how policy affects the value of their own assets, their own stakeholders, etc. Furthermore the firm will need to articulate how these value changes affect the political prospects of the policy makers. To develop this deeper understanding will be costly to the firm relative to maintaining generic knowledge. However, the benefits of this Firm-specific knowledge are more likely to outweigh the costs when interest group rivalry increases. At low levels of rivalry the firm does not need to incur the costs of developing this knowledge because they do not need to counteract opposing attempts to influence the policy outcome.

When interest group rivalry is high but government control over market opportunities is low, then firms might concentrate on acquiring Firm-specific political knowledge. This might be mainly for precautionary reasons, in case the government might decide to regulate a particular activity that was not regulated before, and for which the firm would be particular affected.

On the other hand, when both interest-group rivalry and government control over market opportunities are high, firms need to develop Firm-Institution-specific political knowledge as it will be critical to keep an edge over rival interest groups in a jurisdiction in which a particular government body has decided to push forward a certain policy.

As these two factors increase in importance so too does the weight the firm must place on its nonmarket strategy in developing an integrated strategy for sustainable competitive
advantage. In Figure 3, we capture our main hypotheses about the relationship between characteristics of the political market and the firm’s optimal choice of political knowledge type. Figure 3 assumes that every firm has, to a certain degree, all four kinds of political knowledge, but that the knowledge needed depends on the competitive situation the firm is facing. Boxes characterizing political knowledge represents how important each kind of political knowledge is (so, with low government control of profit opportunities and low interest group rivalry, the most important type of political knowledge to develop/acquire is Generic Political Knowledge; the others are much less valuable in that case). Note that Figure 3 does not say anything about how much political knowledge a firm needs overall, but just how much of each type is likely to be needed in each situation (which we call the firm’s political profile here).

[INSERT FIGURE 3 HERE]

CONCLUSION - DISCUSSION

This paper is the first attempt to develop a conceptual framework of different types of political knowledge and of how they can be developed or acquired by organizations. Whereas most of the existing literature in management, economics and political science focuses on factors related to industry characteristics or to firm size in explaining organizations’ decisions to engage in political activities, our paper suggests that political knowledge should also be considered as an important factor. Our approach has several implications for future research on firms’ nonmarket strategies, as discussed below.

One of the contributions of our paper is to explain why firms differ in their abilities to manage their political environments and hence in their levels of political engagement
(Boddewyn and Brewer, 1994; Dean and Brown, 1995; Oliver and Holzinger, 2008). Unlike research in the competitive strategy field on how and why firms develop or acquire heterogeneous technological and market-based capabilities, relatively few studies have addressed the same regarding nonmarket strategy. Even though our paper does not explicitly articulate a theory of firms’ idiosyncratic nonmarket capabilities, we believe that it provides some useful pieces in order to do so. Our analysis implies that a firm’s nonmarket capabilities originate in the different types of political knowledge identified earlier. Since these four types of political knowledge have different characteristics in terms of imitability or replicability, they also have different implications in terms of competitive advantage in political environment. In particular, Firm-Institution-specific knowledge is by far the hardest to imitate and therefore the one that will create an advantage over non-market competitors.

However, we also point out that political knowledge is not always there to generate a competitive advantage in a political environment, but rather to complement market capabilities that will generate an overall competitive advantage for the firm. Instead of focusing squarely on the imitability or the replicability of knowledge as in the market version of the Resource-Based View, it is therefore critical to look at the knowledge profile that the firm needs to put in place in order to propose an effective integrated strategy (Baron, 1995a; Bonardi, 2004; Kingsley, Vanden Bergh and Bonardi, 2012).

Our paper also brings new insights to the question of whether nonmarket capabilities can be developed internally within organizations or whether they can be acquired by contracting for lobbyists or government relations experts (de Figueiredo and Kim, 2003). Our framework suggests that generic and institution-specific knowledge can be obtained from external sources. However, for firm-institution specific political knowledge, there are significant transaction costs associated with contracting for their acquisition in the market place. Unlike in
competitive goods and services markets where numerous transactions enable firms to readily understand consumers’ willingness-to-pay, the infrequency of transactions or negotiations in the political realm creates uncertainty for firms about the political value of their businesses. Political preferences vary from jurisdiction to jurisdiction, and can change over time with the election cycle. Policy-makers may also deliberately obscure their true policy positions from public view due to perceived election ramifications, further complicating the task of organizations that seek favorable policy decisions.

Contracting for political services under such conditions of uncertainty and asymmetric information becomes challenging. Instead, we argue here that firms’ direct experiences in political processes and bargaining can uncover hidden information about the value that politicians and regulators place on the firm’s business and assets in their jurisdiction. Direct interaction between firms and policy-makers thus allows for firms to learn firm-institution-specific political knowledge that would otherwise not be obtainable through external lobbyists. In this sense, we point to organizational experience in a jurisdiction as a major mechanism for the development of idiosyncratic political capabilities (Dean and Brown, 1995).

Returning to our earlier example of Target in opening its store in Harlem, it was not sufficient for the firm to simply rely on its prior (and extensive) experience elsewhere in opening new retail premises to shape its approach for gaining permit approval in Harlem. The firm likely understood that it would face opposition from a variety of stakeholders; a bigger uncertainty at the outset would have been how to create offsetting benefits in the community to gain the necessary level of political support in council. Establishing an organizational presence in the community to explore potential factors and approaches over an extended time period was one way for the firm to develop the requisite firm-institution specific political knowledge.
Relatively, our analysis sheds light on why empirical studies have found a positive correlation between political connections of firms’ senior executives or board members and measures of firm performance such as stock price movements, access to capital and so on (Faccio, 2006; Faccio, Masulis and McConnell, 2006; Hillman, 2005). Connections and relationships with policy-makers can provide access to a firm, but this may not be sufficient for creating value. Instead, we argue that as politically-connected executives develop deep knowledge over time about a firm’s operations and business, they become better able to identify the political value of the firm’s business and hence to recognize opportunities for mutually beneficial policy ‘deals’ with government and other stakeholders. Future research could test this thesis by examining how the impact of board level or executive political connections on firm performance evolves with the tenure of such executives.

We also believe our paper can provide new avenues for research in international business. One of these avenues relates to the study of how nonmarket capabilities developed in one institutional area can be redeployed to other institutional arenas in the context of foreign markets entry. Holburn and Zelner (2010), for instance, find support for the idea that there are indeed nonmarket capabilities that can be redeployed across international markets. The framework developed in our paper suggests that these re-deployable nonmarket capabilities are based in generic political knowledge and firm-specific political knowledge. On the other hand, we argue that there are also important aspects of firms’ nonmarket capabilities that cannot be redeployed in foreign countries, especially institution-specific and firm-institution specific political knowledge. Future research should try to identify the full implications of these differences on firms’ internationalization decisions.
References


Figure 1: Typology of political knowledge

- **Institution-specific political knowledge**
  - E.g. Knowledge of formal and informal processes governing policy-making in a jurisdiction, and of policy-makers’ preferences; knowledge of political risks and opportunities in a jurisdiction

- **Firm-institution-specific political knowledge**
  - E.g. Knowledge of political value conferred on a firm’s business in a particular jurisdiction; and of how to structure a deal or implicit contract with policy-makers in a jurisdiction

- **Generic political knowledge**
  - E.g. Basic knowledge of mechanisms for achieving political influence (e.g. lobbying, political campaign contributions, coalition building)

- **Firm-specific political knowledge**
  - E.g. Knowledge of the typical value conferred by policy-makers on a firm’s business, and knowledge of risk of political value associated with the firm’s market assets

- **Institution-specificity of political knowledge**
  - HIGH

- **Firm-specificity of political knowledge**
  - HIGH
Figure 2 – Optimal governance structure for acquisition and development of political knowledge

Institution-specific knowledge developed through:
- Trade association membership
- Long term contracts with lobbyists

Firm-institution-specific knowledge developed through:
- Fully integrated nonmarket capabilities with experiential learning

Generic political knowledge developed through:
- Short term contracts with external lobbyists and vicarious learning

Firm-specific political knowledge developed through:
- Vertical integration of political capabilities

Firm-specificity of political knowledge
Figure 3: Optimal Choice of Political Knowledge Type