

Corporate Political Activity and Free Riding under Market Uncertainty: An Investigation of TARP Funding

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ABSTRACT

Given that the benefits of Corporate Political Activity (CPA) are usually granted in the form of favorable industry regulation that benefits all industry participants rather than a single firm, small politically inactive firms are often able to take advantage of the benefits from CPA without investing in them. We argue that the free-riding problem is context specific. Situations of extreme uncertainty create institutional voids that enable individual firms to more fully appropriate the returns from their CPA. In this paper, we examine the influence that CPA had on the U.S. government's disbursements of TARP funding in 2008. We find that politically active firms were able to avoid the free-rider problem by obtaining more instances of TARP funding when compared to firms that were not politically active. In addition to being more likely

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1 to receive TARP funds, politically active firms received
2 larger amounts of TARP funding than those firms who
3 were not politically active.
4

5 **T**he Corporate Political Activity (CPA) literature has long
6 studied the interaction between organizations and govern-
7 ment. Although the potential of non-market activities to re-
8 sult in competitive advantage was underestimated for a long time,
9 researchers have been paying increasing attention to it in recent
10 years (Hillman et al. 2004; Lawton et al. 2013; Liedong et al. 2015).
11 A theoretical puzzle that CPA researchers have encountered is the
12 free-rider problem. A free-rider problem occurs when firms take
13 advantage of benefits provided by the actions of other firms with-
14 out incurring the costs of those actions. Much of the CPA efforts
15 by firms are aimed at obtaining favorable legislation or regulatory
16 changes. When CPA efforts by individual firms, especially large
17 firms, are successful and firms obtain favorable legislation, com-
18 peting firms within the same industry are able to take advantage
19 of the favorable legislation although they have not expended any
20 resources. 3

21 Why would large firms expend significant resources to an activ-
22 ity when they cannot fully capture the benefits from it? Not only
23 are they unable to fully capture the benefits of their CPA, but they
24 also have to share the benefits with their rivals. In contrast, it can
25 be argued that firms would engage in CPA despite the fact that
26 they have to share the benefits with other industry players be-
27 cause their own gains are not diminished by the gains of others as
28 this is not a zero-sum game. The counter argument would be that
29 managers would be reluctant to expend resources unilaterally and
30 share the gains with others. That is, despite the theoretical poten-
31 tial for free riding, the gainsharing is not equal and the firms who
32 expend resources on CPA do so because they are indeed able to
33 appropriate for themselves most of the gains from such expendi-
34 tures. Further, the ability of firms to appropriate benefits may be
35 context specific. That is, there may be some contexts that are more
36 conducive to value appropriation than others.

37 Our primary research objective in this paper is to attempt a res-
38 olution of the free-rider paradox relating to CPA. In this paper, we
39 suggest that under market uncertainty, institutional voids enable
40 individual firms to more fully appropriate the returns from their

1 CPA and thus avoid the free-rider problem. We test this by examin-
2 ing the distribution of TARP funding to banks in the United States
3 after the 2008 financial crisis.

4 The roots of the 2008 U.S. financial crisis have been traced
5 to the expansion of subprime lending in the housing sector. The
6 housing boom of the early 2000s was largely fueled by the willing-
7 ness of banks to lend to applicants with poor credit. Many firms in
8 the industry increased traditional and subprime real estate lend-
9 ing in response to this economic boom. Subprime mortgages are
10 mortgages made available to borrowers who have relatively inferior
11 credit histories and limited capacity to make down payments at
12 the traditionally accepted levels. Because these loans are riskier
13 than those made to traditional homebuyers, they carry higher in-
14 terest rates. As the housing crisis began, the high default rate on
15 subprime mortgages left many banks in difficult positions due to
16 the amount of subprime mortgages on their balance sheet.

17 The bailout plan initiated by the U.S. government to rescue trou-
18 bled banks is more formally known as the Troubled Asset Relief
19 Program (TARP). Through this program, the U.S. government pur-
20 chased assets and equity from financial institutions. TARP was
21 designed to help stabilize banks whose balance sheets were, at
22 that time, filled with troubled assets. The government believed
23 that these assets were difficult to price in the turbulent environ-
24 ment, but that the underlying assets were of higher quality than
25 the market was currently offering. It was felt that by providing a
26 market for these illiquid and difficult to value assets would stabi-
27 lize the market and all participants would be better off.

28 The infusion of cash and the implicit government guarantee
29 signaled via government ownership brought in a semblance of
30 stability to the troubled financial system and calmed the capi-
31 tal markets. The original program was authorized to spend up to
32 \$700 billion dollars to strengthen the stumbling financial sector.
33 It is estimated that the final expenditures amounted to only \$600
34 billion, and the net impact to U.S. taxpayers is an estimated loss
35 **4** of \$150 billion (Propublica 2013).

36 The TARP program provides us with a unique case of gov-
37 ernment intervention which we can use to better understand
38 business-government interactions. In the case of TARP, the gov-
39 ernment is not passing general industry regulation, but rather is
40 providing liquidity to specific firms for specific assets. This affords

us a unique opportunity to assess the gains from CPA for individual firms as this is a context in which the possibility of the free-rider problem is somewhat limited. In this paper, we analyze the CPA behaviors of banks during the financial crisis to determine if there is a clear relationship between CPA activities and gains from them. We find that this is the case, and we argue that these banks used CPA activities to help obtain benefits during turbulent times. In the next section, we review the CPA literature and then specifically examine the literature on politically active firms' response to free riders. We then develop a theoretical model and test it using primarily banking data, data on political contributions, and TARP data.

THEORETICAL BACKGROUND

Corporate Political Activity

The predominant focus of strategic management research has been the pursuit of sustainable competitive advantage by firms. Actions that lead to competitive advantage and profitability were examined at the business unit and firm levels. There is an increasing realization that firms gain competitive advantage and profitability not only through market strategies but also through non-market strategies. These non-market strategies typically occur in political markets and they complement or sometimes even substitute for market strategies. Empirical evidence suggests that non-market competition has a substantial impact on firm performance (Hillman et al. 1999; Marsh1998). Non-market actions can take a variety of forms such as campaign contributions, lobbying, cooptation of political elites through board memberships, formation of and contribution to PACs, bribery, etc. The most common among them by U.S. corporations tend to be donations to campaigns through PACs and the hiring of Washington lobbyists. Business firms are generally apolitical, more concerned about effecting regulatory changes relating to their domain of activities or bringing about favorable changes to the tax code rather than supporting one political party or the other. They often donate money to both parties in an effort to have a voice in the conversation, either proactively or reactively,

1 whenever pertinent regulation is discussed (Hillman et al. 2004;
2 Shaffer 1995). This approach has been found to be effective even
3 when corporate elites are more likely to personally support one po-
4 litical party or the other (Bonica 2016). For this reason, CPA is con-
5 sidered one of the most potent tools in their nonmarket arsenal.

6 The substantial influence of CPA in Washington politics has
7 led researchers to examine the CPA process. Non-market strategy
8 research is still in its early stages of development and the focus of
9 research has been mostly on basic questions such as who engages
10 in non-market activities, what motivates them to do so, and what
11 are its performance consequences (Hillman et al. 2004). While
12 each of these areas have received some attention in the literature,
13 CPA research had disproportionately focused on antecedents of
14 CPA by attempting to understand what types of firms are most
15 likely to engage in CPA. Thus, we have a better understanding of
16 what types of firms, in general, engage in CPA. These firms often
17 are large, in highly regulated industries or dependent on govern-
18 ment contracts, and have high firm slack allowing for spending on
19 CPA (Hillman et al. 2004).

20 While CPA research has focused on antecedents, a small sub-
21 set of studies examine CPA's influence on performance outcomes.
22 A number of empirical studies have found support for a positive
23 relationship between CPA and firm performance, operationalized
24 as financial performance, market performance, or other favor-
25 able nonfinancial outcomes (De Figueiredo and Silverman 2006;
26 Fisman 2001; Hadani and Schuler 2013; Hansen and Mitchell
27 5 2000; Marsh 1998). While the evidence does indeed suggest an
28 empirical regularity, drawing a causal connection between CPA
29 and performance outcomes presents some challenges because of
30 the difficulty of mapping the linkages between specific political
31 activities and their outcomes. The differential distribution of gov-
32 ernment assistance to troubled banks provides us with a unique
33 opportunity to establish such a causal linkage.

34 35 ***The Free-Rider Problem***

36
37 A free-rider problem is said to occur anytime one party enjoys
38 the benefits of some good or service while not actually paying for
39 that right. There is a significant body of literature in economics on
40

the free-rider problem and its consequences (Grossman and Hart 1980; Groves and Ledyard 1977). The free-rider problem is most commonly observed in the consumption of public goods where property rights are not clearly defined or imposed. Public goods have two characteristics that make them easily subject to the free-rider problem: *non-excludability* and *non-rivalry*. That is, non-paying consumers cannot be denied access to them and consumption by one does not necessarily reduce the amount available to others. Once free-riding behavior becomes prevalent in a situation, there are two possible consequences: *overconsumption* because there is no cost to the free rider and *underprovision* because it takes away the incentive for any one actor to invest his resources in the creation of the good or service. Free riding has been observed in a number of contexts such as team work where a team member gets rewards even after shirking his fair share of work (Albanese and Van Fleet 1985), and labor unions where a non-dues paying employee gets the benefits of collective bargaining (Estreicher 2015).

Non-market activities such as corporate political activities are far more prone to free-rider problem than market activities. The reason the free-rider problem is so prevalent in non-market competition is because in non-market actions, success usually means that regulation has been influenced in some way. This can be the implementation of favorable regulation, or the delay or lessening of unfavorable legislation. Firms that invest heavily in CPA are shown to influence these regulations, but regulation is not handed out at the individual firm level (Hillman et al. 2004). Most often, legislation is relevant to most or all firms within an industry. For this reason, firms who invest heavily in CPA and are successful in their corporate political activity actions often find that they have no choice but to share the benefits of their CPA with their competitors. The prevalence of free riding and how firms attempt to get around the problem varies by industry (Oliver and Holzinger 2008).

In market competition, there is often room for small, specialized competitors to survive and thrive by carving out a niche for themselves. They may not have the resources that their bigger competitors possess but have a clearly identified and loyal market segment they serve. The fact that they cannot match the industry titans in terms of R&D or advertising expenditures does not necessarily make it impossible for them to be profitable. However, in the case of non-market activities such as CPA, such a niche

1 strategy is far less feasible. In order for CPA to have an impact, it
2 has to meet and exceed a certain threshold level of resource expen-
3 ditures. The non-market closer resembles an auction in which the
4 largest spenders gain the majority of the control that CPA provides
5 (Freeman 2012). For this reason, we see that CPA is dominated by
6 large firms who give the most in CPA year in and year out. Smaller
7 firms have difficulty competing with larger firms in CPA. They
8 often choose to opt out of CPA spending and free ride when they
9 can (Drope and Hansen 2008; Lawton et al. 2013). The effective-
10 ness of this strategy varies by industry and location. In Indonesia,
11 large and well-connected firms used CPA to restrain competition
12 through the adoption of international certification standards
13 (Bartley 2010). In a domestic example, Lux (2016) found that in the
14 U.S. coal industry, the political free-riding strategy was ineffective.
15 Lux argued that this was due to the importance of non-market
16 factors in this highly regulated industry.

17 Firms have tried several different approaches in an effort to
18 maximize the gains from CPA spending and minimize the benefit
19 that free riders receive. Olson (1965) first examined how individual
20 and groups can overcome the free-rider problem using collective
21 action (Lawton et al. 2013). Collective political action is one way
22 in which firms minimize the free-rider problem inherent in CPA.
23 Collective political action is CPA that firms engage in with other
24 6 companies. Lux et al. (2012) argues that collective political action
25 provides three advantages to participating firms. These include
26 the benefit that multiple firms can be more persuasive to political
27 actors than individual firms, multiple firms engaged in the same
28 behavior reduce the risk that an individual firm will be sanctioned
29 for improper behavior, and finally CPA costs per firm are reduced
30 by sharing these costs with other firms that desire similar political
31 action.

32 Small firms have been found to attempt to free ride in an effort
33 to gain from the CPA efforts of larger firms (Hillman et al. 2004).
34 As we have shown, the success of this strategy is highly dependent
35 on specific industry characteristics. In highly regulated industries
36 dependent on government involvement, it has been found that
37 firms that are not political underperform those that engage in CPA
38 behaviors (Lux 2016). Although prior empirical research suggests
39 that firm performance improves with CPA (Hillman et al. 2004),
40 there is no evidence to suggest that firms engaging in CPA were

able to obtain political benefits that non-political firms missed out on. That is, it is unclear why firms would engage in CPA and spend significant resources on them if they are unable to capture the benefits exclusively for themselves and instead must share such benefits with their competitors who have not spent any resources at all. This is particularly puzzling considering that large firms in many industries are spending millions of dollars on CPA every year (Opensecrets 2014). Our argument in this paper is that firms engage in CPA because in many instances it is possible for them actually to capture a lion's share of the benefits. We further argue that in situations of unusual and excessive uncertainty, there is more room for political players to capture a substantial share of the benefits from their non-market activities. A better understanding of the prevalence and context specificity of free riding is important for both the firm that is investing in CPA as well as those who hope to free ride on their rival's CPA expenditures.

Responding to Market Uncertainties

The interaction between governments and firms during environmental uncertainty is a well-documented phenomenon. Organizations have been found to use political mechanisms and means to create an environment that is better for their interests (Hillman et al. 2009; Salancik and Pfeffer 1978). During times of environmental uncertainty, both firms and governments behave differently than when they are under conditions of market stability (Kingsley, Bergh, and Bonardi 2012). In highly uncertain situations, the normally adversarial relationship between firms and governments often give way to one of the greater cooperation because both firms and governments are motivated by the desire to reduce uncertainty and bring about some degree of stability. TARP was just one example where the government partnered with the private sector in an effort to restore confidence during a period of extreme uncertainty. The market uncertainty in 2008 was extreme, affected all banks and financial institutions, and was beyond the capability of a single institution to change. In the finance literature, this is described as market risk (Brealey and Myers 2003) because individual actions at the firm level are unable to control the risk (Burgers et al. 1993).

1 An interesting characteristic of political markets in many de-
2 veloped, institutionally mature countries is reciprocal resource
3 dependency. That is, firms are dependent on governments for a va-
4 riety of critical resources, for favorable regulation as well as lenient
5 enforcement of existing regulation, for procurement contracts, etc.
6 (Salancik and Pfeffer 1978). Given this high level of dependency,
7 they try to manage it through political or non-market strategies
8 (Kingsley et al. 2012; Meznar and Nigh 1995). Politicians, in con-
9 trast, are increasingly dependent on businesses for financial sup-
10 port, given the increasing cost of political campaigns. In a country
11 like the United States where campaigns are much longer and elec-
12 tions more frequent than in other democracies, the dependence of
13 politicians on businesses tend to be even higher. The relationship
14 of mutual dependence that exists between politicians and busi-
15 nesses can lead to three possible kinds of outcomes. In institution-
16 ally developed economies where the rules of the game (North 1990)
17 are reasonably well established, firms supplement their product
18 market strategies with political strategies such as lobbying and
19 campaign contributions. The disclosure rules ensure that actions
20 stay within the parameters prescribed by the law and that they
21 are transparent. In countries where institutions are still evolving,
22 firms typically attempt “state capture” (Becker 1983). Alternately,
23 in situations where government officials have high degrees of dis-
24 cretion and institutional development is at a very early stage, di-
25 rect bribing of officials for favors received may be more efficient
26 than political strategies.

27 An environment like the one during the financial crisis cre-
28 ates uncertainties not only about future outcomes, but also about
29 institutional processes. Given that these situations are without
30 precedent, it is unclear to industry participants what actions the
31 government will take, what regulatory and administrative struc-
32 tures will be created to deal with the crisis, the amount of resources
33 that will be allocated, and how the beneficiaries will be chosen.
34 Although the United States is an economy characterized by a high
35 level of institutional development, situations of extreme uncer-
36 tainty create what resembles an “institutional void” (Khanna and
37 Palepu 1997). In such situations, critical resources are centralized
38 and controlled by those in authority (Hoskisson, et al. 2000). This
39 is precisely the kind of situation that lends itself to what is often
40 referred to as “state capture” in the economics literature (Hellman

et al. 2003; Martin et al. 2007). State capture refers to situations in which industry participants are able to actively engage, manipulate, and change the “rules of the game” to their collective or individual advantage (Becker 1983). This is accomplished through a variety of political strategies such as PAC contributions, lobbying, campaign contributions, and coalition building (Hillman and Hitt 1999).

In order to understand the dynamics of the relationship between governmental actors and firms in an industry, it is useful to draw on the insights from the partner selection literature. Partner selection has been found to be highly influenced by the risk in the external environment. For example, during times of stability in the external environment, but uncertainty at the firm level, firms are willing to seek out new relationships and partners (Beckman et al. 2004). On the contrary, during times of market uncertainty, like we saw in the banking industry in 2008, firms are less willing to seek out new partners. Instead, they tend to rely on and reinforce existing relationships. Firms interact with past partners because assessing the quality of a new partner is difficult during times of market uncertainty (Podolny 1994). In addition, in the face of environmental uncertainty, it has been found that organizations form close relationships with partners who share similar ideals (Sjöstrand 1992). CPA, whether it is lobbying or campaign contributions, is aimed at establishing and nurturing relationships. Relationships, once established, are expected to provide rich returns over time. The job of a lobbyist is to use their network to find constituents with goals similar to the firms who hired them. We also find that firms give contributions to political actors with interests similar to their own. During times of economic uncertainty, we expect that rather than seeking out new partners, firms and government actors are more likely to turn to their existing relationships by seeking help from each other. In the next section, we build on these theoretical bases and build our hypotheses on both antecedents and outcomes of CPA during the market uncertainties of 2008.

HYPOTHESES

An understanding of both the antecedents and outcomes is necessary to develop a theory of CPA. Researchers have investigated

both these aspects from the very beginnings of CPA research (Hillman et al. 2004). Accordingly, we develop our hypotheses on the antecedents and outcomes of CPA in the specific context of the financial crisis of 2008.

Antecedents of CPA

Prior literature on CPA shows two competing theoretical arguments. One argument is that the free riding problem would make larger players reluctant to undertake CPA because they cannot fully capture the benefits from it. On the contrary, empirical results demonstrate a positive relationship between firm size and CPA (Lux et al. 2011). That is, CPA is dominated by the largest firms within an industry. This is attributed to the auction like returns of CPA investment (Freeman 2012) in which the largest spenders obtain a disproportionately large share of influence in the non-market arena. In the context of the banking industry, we expect to find this relationship especially true. Although the banking industry in the United States is more fragmented than most developed countries, the trend toward consolidation has been evident in the last two decades with a relaxation of regulatory barriers and consequent spate of acquisitions. Increasingly, banking is dominated by large domestic and multinational banks with branches all over the United States. There are also many examples of strong regional banks and community credit unions which are highly competitive in the regions that they operate with a substantial local customer base. While these local and regional banks, often, have a large enough customer base to have successful operations, they do not have the scale to wield much power in the national non-market arena. CPA investment, unless they reach a certain threshold level or critical mass, is unlikely to have any meaningful impact. Second, the smaller banks are fully aware that in the face of an environmental threat of unprecedented proportions, their larger rivals would certainly engage in CPA that could benefit them as well. Therefore, we expect that large domestic and multinational banks are likely to engage in more CPA than smaller banks.

Hypothesis 1: There is a positive relationship between a banking firm's size and CPA.

For a firm to engage in a strategic action, the two basic prerequisites are capacity and motivation. While size provides the capacity, we believe the motivation to invest in CPA will show variation within the industry. That is, some banks are likely to be more motivated to engage in CPA than others and such motivation will be a direct result of a bank's need for government goodwill, ties, and help. In the buildup to the financial crash of 2008, many banks began to engage in subprime lending and increased real estate lending. Real estate lending went through a major overhaul in the early part of the 2000s as both the banks and governments wanted to see home lending increased to both escalate the availability of the wealth building opportunity of home ownership and to stimulate the economy. Banking is one of the more regulated industries in almost every country with the central banks playing a critical role as regulator, inspector, and lender of last resort. In addition, banks are supported by deposit insurance in most countries. Thus, the government's role as implicit guarantor of the liabilities of the banks and the partnership between the banks, the central bank, and the government to stimulate economic growth makes banking a unique industry. The loosening of government regulation of bank lending to real estate customers did not just happen by chance. Given that real estate loans were a lucrative source of profits for the banks, we expect that the firms who were heavily engaged in real estate lending were the same firms who were engaged in CPA in an effort to influence the scope and implementation of any regulatory changes in real estate lending.

Hypothesis 2: There is a positive relationship between a banking firm's real estate portfolio size and CPA.

CPA Outcomes

Given the substantial resources committed by firms to CPA, it can and should be viewed as a strategic decision. Strategic actions by firms have clear competitive goals. Unlike other strategic actions, however, CPA has the potential for free riding by competitors. Therefore, it is only natural that those firms that engage in CPA will take steps to capture the benefits from their actions to the

1 extent they can. Although prior literature does point in the direc-
2 tion that politically active firms have higher performance than free
3 riders (Lux 2016) there is no clear evidence that indicates CPA can
4 deliver benefits directly to the politically active firm. A free market
5 environment with a free press makes it difficult for the govern-
6 ment to show favoritism toward a specific single firm or change the
7 regulatory environment in such a way that enables an individual
8 firm to emerge as the winner.

9 Although blatant favoritism by the government is difficult, the
10 very fact that firms engage in CPA year after year clearly suggests
11 that they are not doing so altruistically to benefit all industry par-
12 ticipants. We suggest two possibilities. First, firms active in CPA
13 are indeed able to appropriate a majority of the benefits from their
14 investment by developing isolating mechanisms although it is un-
15 clear at this point what these mechanisms are. Second, even if
16 under normal circumstances benefits from CPA are unclear and
17 appropriation of benefits from them difficult, during periods of ex-
18 treme environmental turbulence, these benefits make the differ-
19 ence between survival and failure and those who have invested in
20 CPA tend to reap significantly higher benefits than those who have
21 not made such an investment.

22 The housing crash of 2008 that led to the recession happened
23 in an environment that was turbulent in the extreme. Consumer
24 confidence levels had fallen, credit markets had frozen up, unem-
25 ployment rates were approximating double digits, the stock market
26 had crashed and the very economic future of the nation was seen
27 to be in peril. To address this economic crisis, the government
28 announced the TARP funding. This was a plan in which the gov-
29 ernment would support some banks by buying illiquid assets as
30 a way to insure the stability of the financial system and return
31 confidence to the American people. This was a case of selective
32 intervention in the market in which the government was able to
33 inject funds into troubled banks differentially. That is, some banks
34 received large infusions of cash, other got less, and some got none.
35 Such differential treatment raises the possibility that firms with
36 political relationships would benefit more than firms with no such
37 established contacts. We predict that, in this case, politically ac-
38 tive firms will be more likely to receive TARP funding than those
39 firms that do not engage in political activity.

Hypothesis 3: There is a positive relationship between the amount spent on CPA by a banking firm and the likelihood of gain from CPA.

In most cases, the decision to engage in political activity is a binary one (Lux 2016). Most firms decide to give political funding within a reasonable range of their competitors in similar industries. The banking industry is somewhat unique with regard to CPA because of the wide disparity in the scale and scope of the banks. Some of the big American banks are among the biggest in the world, whereas a large number of banks are relatively small in scale and limited in their geographic scope. The largest banks in the United States are also some of the largest politically active organizations. These banks have invested in political relationships for decades and devote massive amount of resources to CPA. When faced with financial distress, these larger banks are most likely to use their political connections and demand and successfully obtain larger disbursements of TARP funding, even after controlling for firm size. For this reason, we propose that there will be a positive relationship between CPA expenditures and TARP awards.

Hypothesis 4: There is a positive relationship between the amount spent on CPA by a banking firm and the amount of gain from CPA.

Mediating Influence of CPA on TARP

TARP funding was designed to allow the government to buy risky and difficult to value assets from banks. At this time, many of these risky assets were mortgage loans, because of the rise in sub-prime lending leading up to the 2008 recession. In addition to the direct relationship between real estate lending and CPA, we expect that the amount of real estate lending a company undertakes will be positively related to TARP disbursements. For this reason, we propose the following hypothesis.

Hypothesis 5a: A banking firm's real estate portfolio size will be positively related to amount of gain from CPA.

Hypothesis 5b: The positive relationship between a banking firm's real estate portfolio size and the amount of gain from CPA will be mediated by firm CPA.

Our full hypothesized model can be found in Figure 1.

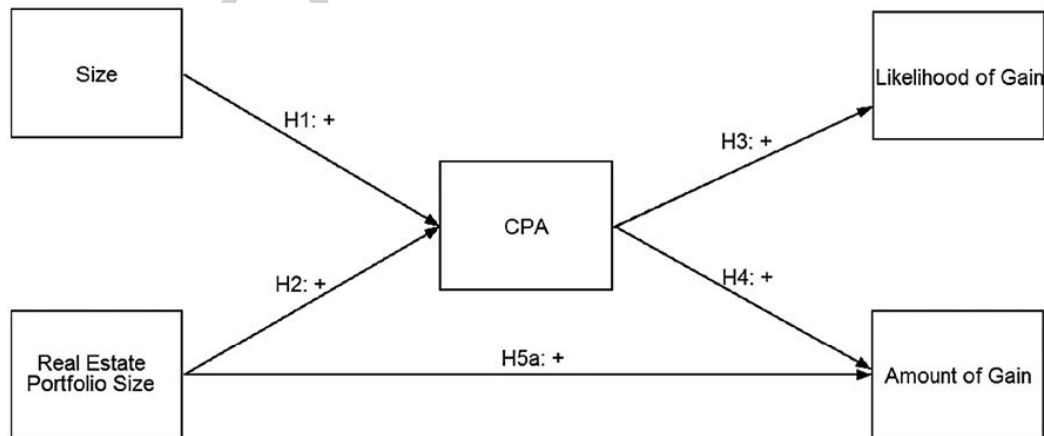
METHODS

Data

We compiled data from five different publicly available databases in order to test our relationships of interest. The main database that we relied upon is maintained by the Federal Reserve Bank of Chicago and serves as a holding place for financial data for all banking entities such as commercial banks and bank holding companies which are regulated by the Federal Reserve System, Federal Deposit Insurance Corporation, and the Comptroller of the Currency. Data are available for firms as early as 1978.

Further, we relied upon data collected by two non-partisan non-profit organizations for our dependent variables of interest. The Center for Responsive Politics and ProPublica both provide information concerning public policy issues and have been recognized for their contributions in investigative journalism (Pulitzer 2010; Society of Professional Journalists 2013). The Center for Responsive

FIGURE 1 Hypothesized Model.



H5b: Partial mediation of the Real Estate Portfolio Size and Amount of Gain relationship by CPA

1 Politics was established by U.S. Senators Frank Church and Hugh
2 Scott in order to “Inform citizens about how money in politics af-
3 fects their lives, empower voters and activists by providing unbi-
4 ased information, and advocate for a transparent and responsive
5 government” (OpenSecrets 2014). The primary mechanism used
6 by the Center for Responsible Politics to accomplish their stated
7 mission is the website “OpenSecrets.org.” The OpenSecrets web-
8 site serves as a resource for data concerning lobbying and federal
9 campaign contributions. ProPublica is an “independent, non-profit
10 newsroom that produces investigative journalism in the public in-
11 terest.” (ProPublica 2014). Established in late 2007, the ProPublica
12 website provides investigative reporting and access to several data-
13 sets maintained by ProPublica to provide hard data concerning pol-
14 icy decisions. Among the many datasets available from ProPublica
15 is one concerning TARP disbursements and repayments.

16 Since neither the ProPublica nor the OpenSecrets websites pro-
17 vide hard identifiers such as the Research Statistics Supervision
18 Division (RSSD) ID or an FDIC ID to match specific banks to their
19 political activity or TARP disbursements, we conducted a manual
20 match in order to combine the various datasets. We searched the
21 National Information Center (NIC) database to match the name,
22 location, and organization type of firms listed on the ProPublica
23 and OpenSecrets website to an exact RSSD ID that enabled ac-
24 curate name matching. The NIC database is a repository run by
25 the Federal Reserve that provides detailed information concern-
26 ing banking organizations in the United States. Of the financial
27 organizations listed in the ProPublica database of TARP recipi-
28 ents, we were able to confidently match 668 out of 684 banks, a
29 matching rate of 97.7%. Of the financial organizations listed in the
30 OpenSecrets database, we were able to confidently match 220 out
31 of 229 banks, a matching rate of 96.1%.

32 We also collected data from the U.S. Department of Agriculture
33 Economic Research Service (USDA ERS) concerning population
34 and metropolitan classifications. Among other data available from
35 USDA ERS, we accessed data that allowed us the ability to distin-
36 guish between urban and metropolitan areas.

37 Due to data constraints, we limited our sample to commercial
38 banks or bank holding companies that were active during 2008
39 and for which financial data was available. Our final sample con-
40 sisted of 8,730 financial institutions representing every state in

the United States. Banks in Illinois, Texas, Minnesota, Iowa, and Georgia represented 29.82% of our sample. About 7,738 banks were classified as commercial banks by the Federal Reserve, the rest of our sample was listed as bank holding companies. Of our final sample, 314 banks received TARP disbursements and 112 were engaged in corporate political activity. Correlations among our variables can be found in Table 1.

Measures

Dependent Variables

Likelihood of gain from CPA and the amount of gain from CPA. We measured two aspects related to gain related to CPA. We measured the likelihood of gain from CPA using a dummy variable coded as 0 if a firm did not receive TARP disbursements and a 1 if they did for our logistic analysis. We measured the amount of gain from CPA as a log transformation of the actual TARP disbursements made to particular entities in \$USD denominations. As previously noted, data concerning TARP disbursements were gathered from ProPublica.

CPA We measured CPA as a log transformation of the total amount of campaign contributions (in \$USD) sent to political campaigns irrespective of party affiliations. As previously noted, data concerning campaign contributions was gathered from OpenSecrets. Campaign contributions is an appropriate proxy for total CPA because there is a clear quid pro quo involved in direct contributions to a campaign and subsequent favors received.

Independent Variables

Real Estate Portfolio Size. We measured the size of a firm's real estate portfolio relative to the size of the firm by dividing the total size of a firm's outstanding mortgage loans by the firms total loan portfolio. Larger values represent a greater percentage of investments in mortgage loans. Using a relative measure allows us to reduce the impact of different firm sizes. In addition, a firm's awareness of competitive factors and the desire to affect policy should increase as a firm becomes more dependent upon a single type of loan.

7

TABLE 1 Correlation Matrix (N = 8,730)

Variable	M	SD	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) Bank holding company	0.12	0.32	1						
(2) HQ in urban area	0.52	0.50	0.14	1					
(3) Firm age (Years)	60.54	44.51	-0.33	-0.39	1				
(4) Firm size (Log[Total assets])	12.22	1.51	0.45	0.32	-0.18	1			
(5) Real estate portfolio size (% of Total assets)	0.93	0.06	0.16	0.18	-0.15	0.24	1		
(6) Total campaign contributions (\$)	0.09	0.80	0.05	0.04	-0.01	0.13	0.05	1	
(7) Log(Total TARP disbursements)	0.60	3.13	0.39	0.09	-0.18	0.21	0.09	0.16	1

1 **Firm Size** We used the log of total assets as the measure of firm
2 size.

3 **Control Variables**

4 **Firm Age** We measured the age of the firm as the length of time
5 in years from the firms founding until 2008, the date of the TARP
6 disbursements (Hadani and Schuler 2013).
7

8 **Bank Holding Company** We created a dummy variable to identify
9 if a firm was a commercial bank or bank holding company. The
10 distinctions were based upon the filing status listed with the
11 Federal Reserve Board. A bank holding company is a specific legal
12 corporate structure where a parent corporation has a controlling
13 interest in at least one bank. A bank holding company is allotted
14 greater operational flexibility including an increased ability to
15 raise capital and lobby ("Bank Holding Companies" 2015) and is
16 subject to different risk factors than the traditional commercial
17 bank (Gregory and Hambusch 2015).
18

19 **HQ in Urban Area** We generated a dummy variable to separate
20 firms headquartered in urban areas from those headquartered
21 in metropolitan areas based upon data from the USDA ERS. We
22 categorized firms with Rural Urban Commuting Area codes 1 or 2
23 as metropolitan, all others were categorized as Urban. Past surveys
24 have demonstrated that urban and rural banks have different
25 economic and competitive concerns, especially as it relates to
26 population changes and mortgage lending (Dahl 1999). Moreover,
27 the impact of the housing crisis was felt differently between urban
28 and rural areas with the crisis mostly affecting urban areas.
29

30 **Analysis**

31
32
33 Of the variables of interest, two are continuous measures and one
34 is a dichotomous measure. For our two continuous measures, CPA
35 expenses and amount of gain from CPA, we chose to analyze the
36 data using path regression with maximum likelihood estimation
37 using Stata's structural equation modeling command which al-
38 lowed us to estimate both of our continuous measures simultane-
39 ously. For our dichotomous measure, likelihood of gain, we chose
40

TABLE 2 Path Regression (Maximum Likelihood Estimation)

	Full Model	
	CPA Expenses	Amount of Gain
Bank holding company	−0.01 (0.0427)	3.56*** (0.2304)
HQ in urban area	0.01 (0.0171)	0.08 (0.0624)
Firm age (Years)	0.00† (0.0002)	0.00*** (0.0006)
Firm size (Log[Total assets])	0.07*** (0.0111)	
Real estate portfolio size (%)	0.27*** (0.0687)	1.05*** (0.2573)
Total campaign contributions (\$)		0.53*** (0.0891)
Constant	−1.00*** (0.1310)	−4.22*** (0.3387)
Observations	8,730	8,730
R ²	0.02***	0.17***

Robust Standard errors in parentheses

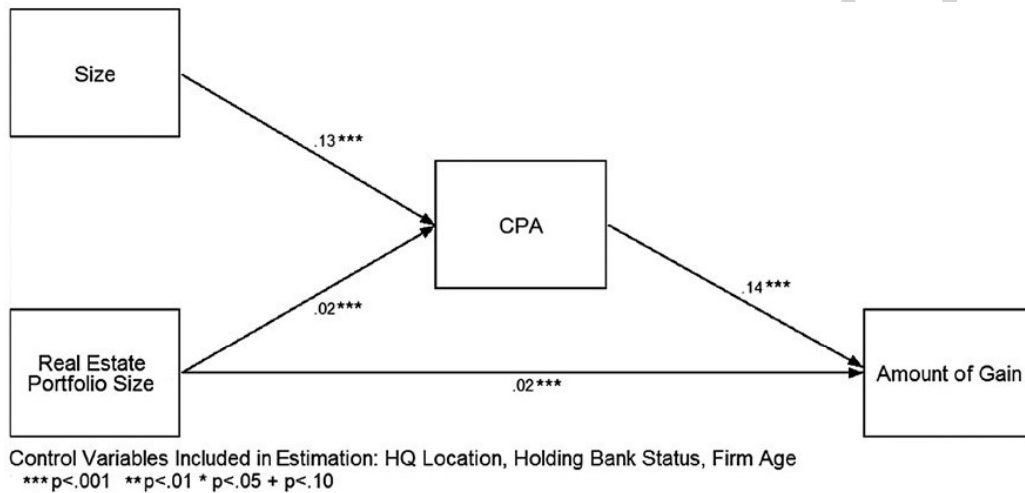
*** $P < 0.001$; ** $P < 0.01$; * $P < 0.05$; † $P < 0.10$.

to analyze the data using logistic regression. Data constraints prohibited us from analyzing the data using longitudinal methods that would strengthen causal inferences.

Table 2 presents the results of our estimation for CPA expenses and Amount of Gain. For robustness we chose to use robust standard errors in our analysis. Figure 2 presents a diagram of the estimated paths of interest with standardized coefficients. Results of our logistic analysis can be found in Table 3. We tested for multi-collinearity using Stata's *collin* command. All variance inflation factors were below 2.0, well below the general cut-off of 10 (Kutner et al. 2004; Wooldridge 2009).

Results

Table 2 shows our test of hypotheses 1, 2, 4, and 5a. Hypothesis 1, suggesting a positive relationship between firm size and CPA expenses, found strong support ($P < 0.001$). Larger firms engaged in higher levels of corporate political activity. Hypothesis 2, suggesting a positive relationship between a firm's real estate portfolio size and its CPA expenses, found strong support ($P < 0.001$). Firms that held a larger stake in mortgage lending engaged in higher levels of corporate political activity. Hypothesis 4, suggesting a positive

FIGURE 2 Standardized Model Coefficients from Path Regression.**TABLE 3** Logistic Regression (Odds Ratio's Reported).

	Received TARP	
	(1)	(2)
Bank holding company	13.87***(1.8814)	13.74***(1.8913)
HQ in urban area	1.30†(0.1928)	1.23 (0.1850)
Firm age (Years)	0.98***(0.0030)	0.98***(0.0031)
Total campaign contributions (\$)		1.43***(0.0593)
Constant	0.00***(0.0006)	0.00***(0.0006)
Observations	8,730	8,730
Pseudo R ²	0.286	0.310
DF	3	4
Chi ²	772.7	837.7
LR Test	-966.0***	-933.5***

Standard errors in parentheses

***P < 0.001; **P < 0.01; *P < 0.05; †P < 0.10.

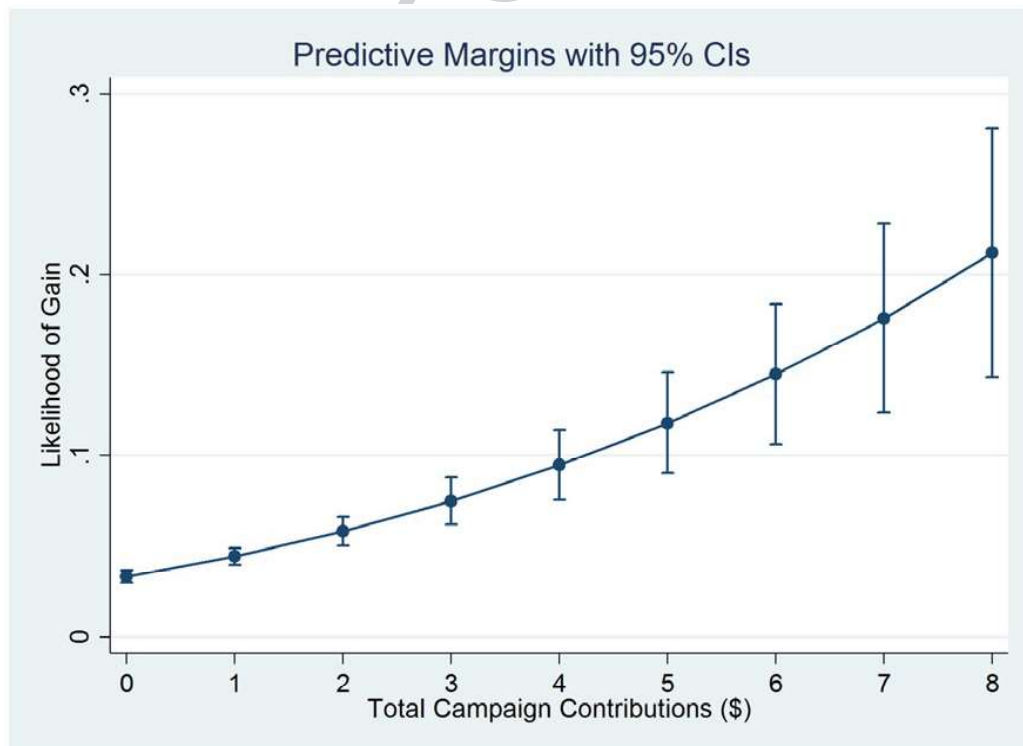
relationship between CPA expenses and the amount of gain from CPA, found strong support ($P < 0.001$). Firms that spent more on CPA received greater amounts of gain. Hypothesis 5a, suggesting a positive relationship between a banking firm's real estate portfolio

size and amount of gain, found strong support ($P < 0.001$). Banking firms with a real estate portfolio received a larger amount of gain.

Table 3 shows our test of hypothesis 3. Model 1 is our base model. Model 2 is our full model. A likelihood ratio test confirms that adding CPA expenses to the model results in a significant ($P < 0.001$) improvement in model fit. Hypothesis 3, suggesting a positive relationship between a firm's CPA expenses and their likelihood of gain from CPA, found strong support ($P < 0.001$).

Figure 3 graphs the marginal effects of additional CPA expenses and the likelihood of gain from CPA. In our context, it is expected that firm's amount of gain from CPA should be directly related to a firm's real estate portfolio size since we measured gain as the amount of disbursements under TARP, a program implemented due to the mortgage crisis. Post hoc analysis revealed that firms that had some CPA expenses were 14.88 times more likely

FIGURE 3 Marginal Effects of Increases in CPA Expenses on Likelihood of Gain.



($P < 0.001$) to receive gain from CPA than firms that did not have any CPA expenses.

In order to test hypothesis 5b, we used the Sobel-Goodman test for mediation. In line with Preacher and Hayes (2004), we generated bootstrapped standard errors in order to more accurately assess the indirect effect of a firm's real estate portfolio on the amount of gain from CPA, as mediated by the firm's CPA expenses. Hypothesis 5b found strong support ($P < 0.001$), suggesting the positive relationship between a firm's real estate portfolio and the likelihood of gain from CPA is mediated by a firm's CPA expenses. Approximately 20.4% of the impact of a firm's real estate portfolio size on the amount of gain from CPA is mediated by the firm's CPA expenses.

DISCUSSION

Understanding the factors that influence when free riding is more or less of a problem is important to firms engaged in CPA and those firms attempting to free ride on the benefits of CPA. Although there has been some inquiry into the nature of free riding, the most powerful examples thus far have been stories and anecdotal evidence. In addition, the CPA literature has long struggled to attach concrete outcomes to CPA. In this paper, we have made an initial attempt to examine how those firms that engage in CPA are able to appropriate the benefits from it and bypass free riders during times of extreme market uncertainty.

In addition to outcomes, we examined two important antecedents to CPA. First, we found that firm size was strongly related to CPA in the banking industry during the 2008 financial crisis in the United States. This is consistent with the previous research on CPA (Hillman et al. 2004; Lux et al. 2011). Firm size is consistently one of the strongest antecedents of CPA in the literature and our findings show that remains true in this instance. Furthermore, we find that firms with large real estate portfolios were more likely to engage in CPA than firms with smaller real estate portfolios. This suggests the possibility that the banks were more aware of the degradation of their real estate assets than they publicly admitted and were investing in political capital just in case things took a turn for the worse. Banks with stronger and more balanced loan portfolios were less likely to engage in CPA.

Along with the finding that firm size and real estate portfolios were associated with CPA, we found that there was a clear relationship between CPA and TARP funding. TARP funding was both more likely to occur in politically active firms, and political firms obtained more of the available TARP funds than those not engaged in CPA. This clearly suggests that politically active firms are able to appropriate the value generated by their political expenditures and that they are also able to, by and large, avoid free riding by firms that do not expend resources on CPA. As mentioned previously, this would likely be difficult in a normal competitive environment, but in the market uncertainty of the economic crisis, firms were able to obtain TARP funding and seek legitimation for it on the basis of societal good. These banks gained governmental assistance not merely because they were too big to fail. Even when controlling for firm size, firms who engaged in CPA received more TARP funding than those who did not.

Finally, we found partial mediation of the relationship between the percentage of loans from mortgage lending held by the firm and total TARP disbursements by corporate political activity. It is expected that firms who engaged in more mortgage lending would receive the majority of the TARP funding, if only because they had more troubled assets that fit the TARP criteria. The finding that CPA partially mediates the relationship between real estate portfolios and TARP suggests that having troubled assets was necessary but not sufficient to take full advantage of the TARP program without also being engaged in political activity.

Future Directions

In this paper, we found that firms were able to take advantage of the turbulent environment and obtain direct CPA benefits. They were able to convince political constituents to provide more TARP funding to politically active firms. This increase in TARP was found in both likelihood and amount of dollars disbursed. The key question here is whether the extreme market uncertainty during the financial crisis facilitated value appropriation by politically active banks or whether this was the result of some other contextual characteristic. Therefore, generalization beyond the context of this study may be unwarranted. Empirical investigation of other

1 industry contexts should enable us to more clearly identify other
2 factors that may facilitate or hinder potential free riding by in-
3 dustry participants and value appropriation by politically active
4 players.

5 When a crisis threatens an industry, an obvious response is
6 collective action. Collective action has many advantages compared
7 to individual CPA by a single firm. First, by pooling resources, it
8 reduces the cost an individual firm needs to incur (Hillman and
9 Hitt 1999). Second, it has been found that collective action can be
10 more successful than individual action (Frye 2002). This is be-
11 cause collective action results in positive outcomes for the entire
12 industry and therefore has greater social legitimacy. Also, it gives
13 more bargaining power to members of their industry in their ne-
14 gotiations with the government. Third, business associations pro-
15 vide a channel of ongoing communication between the government
16 and the private sector (Doner and Schneider 2000). Despite these
17 obvious advantages of collective action, firms still engage in indi-
18 vidual CPA. It would be useful to identify the contextual conditions
19 that firms consider in choosing between individual and collective
20 action (Hansen et al. 2005; Ozer and Lee 2009). It has also been
21 found that there are situations in which firms pursue both individ-
22 ual and collective action (Masters and Keim 1985; Schuler 1996).
23 It is possible that if firms are seeking industry-wide favorable
24 regulation or protection collective action could be the preferred
25 path. However, in a situation like TARP assistance where the total
26 amount of funds available is finite, all firms are competing for allo-
27 cation from a fixed pool and one firm's gains could come at another
28 firm's expense, making this an inherently competitive situation
29 that calls for individual action.

30 31 CONCLUSION

32
33 Firms have been engaged in CPA and other non-market actions
34 for years. Engaging in CPA often makes firms vulnerable to free
35 riding by their rivals. Previous research has suggested that politi-
36 cally active firms can outperform free riders (Lux 2016), or they
37 can convince more firms to join in collective political action (Olson
38 1965) lessening the free-rider problem. The very prevalence of CPA
39 by firms suggests that either the complex calculus of gains is such
40

that firms stand to gain despite free riders or that in many situations they are able to appropriate most of the value generated by their political activities. We were able to demonstrate in this paper that there is a clear link between CPA and firm level outcomes, in this case TARP funding, in which politically active firms obtained direct benefits that nonpolitically active firms were less likely to receive. We argue that situations of extreme uncertainty create institutional voids which enable individual firms to appropriate returns from their political investments, and greatly mitigate the free-rider problem. The findings of this study suggest that the free-rider problem is context specific and that the bigger players in an industry have considerable understanding of what these contextual conditions are. We believe we have made a promising beginning in understanding firm political behavior in situations of extreme uncertainty. Future research into the investigation of the free-rider problem, its context specificity, and strategies firms can pursue to appropriate value for themselves can advance our understanding of nonmarket strategies.

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