Corporate political activity and firm performance: the moderating effects of international and product diversification

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Abstract

Prior research has found that corporate political activity (CPA) can both positively and negatively impact firm performance. Combining agency theory with the resource-based view, we examine the relationship between domestic lobbying (a key form of CPA) and firm performance by explicating the moderating effects of international and product diversification. We argue that expansion into international and product markets increases a firm's resources and reduces agency costs in domestic lobbying. Our results, based on a sample of 737 firms, show that lobbying is positively associated with performance for firms that are diversified in both international markets and along product-lines; whereas lobbying is counter-productive for purely domestic and undiversified firms. Our results contribute to the literature on the firm performance implications of corporate political activity by highlighting the roles of international and product diversification.

Keywords: Lobbying; Corporate Political Activity; International Diversification; Product Diversification; Agency Theory; Resource Based View

1. Introduction

Corporate political activity (CPA) - defined as corporate attempts to shape public policy - is of critical importance to both domestic firms and multinational corporations (MNCs), and is an integral aspect of firm strategy (Henisz and Zelner, 2003; Hillman et al., 2004; Lawton et al., 2013). Understanding the engagement of firms with nonmarket political actors therefore continues to draw the attention of management researchers (Holburn and Vanden Bergh, 2014; Mbalyohere and Lawton, 2018; Rajwani and Liedong, 2015; White III et al., 2018). However, as Mellahi et al. (2016:147) have observed, the nature of the relationship between CPA and firm performance 'remains elusive'. Consequently, there is a need to explore why some firms benefit from political activities, such as lobbying or donating to political campaigns, while others do not (Kim, 2019).

Prior studies suggest that a firm's 'market' strategy has an impact on the 'nonmarket' (or political) arena, making it an important boundary condition of the relationship between CPA and performance (Hadani and Schuler, 2013; Lux et al., 2011). In our paper, we examine two key dimensions of market strategy, namely international and product diversification, and ask: *to what extent do international and product diversification shape the relationship between domestic CPA and firm performance?* We focus on international and product diversification as the key market-strategies that shape the relationship between domestic CPA and firm performance for a variety of reasons. First, prior research on CPA has shown that there is a relationship between CPA and diversification (Dieleman and Sachs, 2008; Hillman and Hitt, 1999; Shirodkar and Mohr, 2015a). Product diversification exposes firms to an expanded range of nonmarket actors in different industries (Hillman et al., 1999; Lux et al., 2011). Similarly, international diversification requires firms to consider a broader range of policy processes and governance actors in a global context (Blumentritt and Nigh, 2002; Blumentritt and Rehbein, 2008). Although both product and

international diversification may therefore impact domestic CPA (Bonardi, 2011; Bonardi and Bergh, 2015), their impact on the CPA-performance relationship remains an unexplored puzzle in the nonmarket strategy field. Notably, the international business literature has by and large focused on CPA at a host subsidiary level (Eden and Molot, 2002; Hillman and Wan, 2005; Mbalyohere and Lawton, 2018; Puck et al., 2013; White III et al., 2018; White III et al., 2014), and there is less research on whether a firm's internationalization impacts the effectiveness of its domestic CPA. Second, although the direct impact of diversification on performance has been studied extensively (Hutzschenreuter and Guenther, 2008), its interaction with other strategic considerations, such as CPA in our case, remains underexplored (Haug et al., 2018). While it would be tempting to simplify our research by concentrating on either international or product diversification, examining both forms of diversification offers a more holistic view, considering that firms might view them as alternatives (Hutzschenreuter and Guenther, 2008; Kumar, 2009; Mayer et al., 2015).

To answer our research question, we studied 737 large United States (US) based firms. Our findings suggest that domestic lobbying (as a form of CPA) impacts firm performance negatively, in general. This finding is consistent with prior arguments based on agency theory (Cao et al., 2018; Fama, 1980; Jensen and Meckling, 1976; Schiff et al., 2015). However, and more importantly, we show that both international and product diversification positively moderate the CPA-performance relationship. Our subsequent split-sample analysis suggests that the positive effect of CPA on performance is most pronounced for firms which are diversified along both dimensions of diversification, while the CPA-performance relationship is negative for firms that are neither internationalized nor product diversfied.

Our paper makes several important contributions to the CPA literature by considering the boundary conditions of the CPA-performance relationship. The positive implications of CPA for

performance noted in the earlier literature and typically rooted in the resource-based view (Wernerfelt, 1984) are increasingly contested (Cao et al., 2018; Hadani et al., 2016). Work based on agency theory has contributed to this skeptisism. This puts the spotlight on contextual factors that shape the CPA-performance relationship, including the role of market strategies (Mellahi et al., 2016). Our research shows that international and product diversification enable firms to better utilize their political resources and to reduce agency costs associated with domestic lobbying. To the best of our knowledge we are the first to explicate these effects of international and product diversification on the CPA-performance relationship. Both international and product diversification have been previously noted as important variables in the analysis of CPA. Hence, our insights present an extension of prior work which, for example, has considered how conflicts in organizing CPA across diversified business units can be minimized (Shaffer and Hillman, 2000), how CPA can be coordinated when operating internationally (Blumentritt and Nigh, 2002), and how product diversification by foreign subsidiaries helps reduce dependence on the host government (Shirodkar and Mohr, 2015a).

Second, while many prior studies have taken either an agency or resource based perspective on the CPA-performance relationship, we are able to integrate the arguments rooted in the two literature streams. Corporate diversification, an important 'market' strategy - as it captures an organization's reach across both product and international markets - offers the opportunity to leverage resources across industries (Palich et al., 2000) and geographies (Hitt et al., 2006; Mayer et al., 2015). As Bonardi (2011) suggests, what is a 'political resource', remains insufficiently understood, and we explore this by examining the resources brought about by product and international diversification into domestic lobbying. Diversification also increases the pressure on firms to improve their governance structures and to develop their internal capital

market. This in turn leads to more effective monitoring of lobbying activity, reducing the scope of agency problems. Overall, we propose that international and product diversification affect not only a firm's ability to exploit and develop its wider political resources (Bonardi, 2011), but also the ability to effectively integrate CPA with its market-based strategy, by aligning shareholder interests. We thus link agency based ideas with the resource based view to explore the role of different resources such as finance and knowledge in CPA.

Finally, we contribute to studies interested in the political behaviour of multinational companies (MNCs) (Ahammad et al., 2017; Boddewyn, 2016; Boddewyn and Brewer, 1994; Sun et al., 2021). Most prior studies on the performance implications of CPA have focused either on the domestic context, or on the benefits to subsidiaries of MNCs within specific host countries (Frynas et al., 2006; Henisz and Delios, 2004; Puck et al., 2013; White III et al., 2014). For instance, in emerging economies, the development of dynamic capabilities in building relationships with institutional actors has been found to improve the performance of MNCs' foreign subsidiaries (White III et al., 2014). Internationalization, however, increases the complexity of the firm in terms of the political activities that need to be coordinated (Blumentritt and Nigh, 2002), yet also improves firms' political knowledge base (Holburn and Zelner, 2010). Our study expands these debates by examining whether and to what extent internationalization benefits MNCs' CPA in their home base. We suggest that international diversification improves the performance implications of lobbying at home, making domestic CPA more effective. We thus add to the consideration of international aspects that are often neglected in the CPA literature (Mellahi et al., 2016), by linking the international aspects of market strategies to domestic CPA activities (Funk and Hirschman, 2017).

In the following sections we develop our hypotheses, followed by a description of our variables and analytical approach. We then explain our results and finish with a discussion of the implications of our research.

2. Theory and Hypotheses

2.1 Corporate political activity, lobbying and firm performance

Corporate lobbying is a distinct corporate political activity (CPA) that involves firms providing information to policymakers, reporting research findings and testifying in legislative hearings (Hillman and Hitt, 1999; Hillman and Wan, 2005; Kim, 2008). Most countries offer legitimate business-government interfaces (Deng and Kennedy, 2010; Shirodkar and Mohr, 2015b). As lobbying is "information-based" and includes a diverse group of stakeholders, it has been argued that lobbying enhances organizational legitimacy (Banerjee and Venaik, 2018; Kline and Brown, 2019).

CPA, and in particular lobbying, aims to influence governmental policies in a way that is favourable to the firm (Baron, 1995; Boddewyn, 2003; Hillman and Hitt, 1999; Hillman et al., 2004). By investing in CPA, firms can develop political capital – a resource that can be combined with market-based strategies to gain competitive advantage (Dahan, 2005). The resource based view (RBV) (Wernerfelt, 1984) suggests that CPA can positively impact firm performance by raising costs of rival firms (McWilliams et al., 2002), gaining preferential access to financing (Leuz and Oberholzer-Gee, 2006), as well as leading to lower taxes (Richter et al., 2009). Lobbying has been linked to favorable legislative decisions (Lord, 2000), greater market capitalisation (Hillman, 2005), reduced policy risk (Holburn and Zelner, 2010), higher equity returns (Kim,

2008), positive returns (Cooper et al., 2010) and higher firm value in stock markets (Goldman et al., 2009) as well as improved financial performance (Shaffer et al., 2000).

There is, however, increasing skepticism that CPA has a positive impact on firm performance (Cao et al., 2018; Hadani and Schuler, 2013; Rajwani and Liedong, 2015). A recent meta-analyis by Hadani et al. (2016) suggests that CPA, at best, has a modest impact on firm-level outcomes and that agency problems are likely to play an important role. This work suggests that managers, as agents of shareholders pursue political activities out of self-interest (Den Hond et al., 2014; Mantere et al., 2009; Rasche, 2015; Sun et al., 2012) and intentionally or unintentionally engage in lobbying in ways that do not benefit the firm (Hadani, 2012). Managers may have their own personal agendas (e.g. seeking higher compensation or reducing unemployment risk) when engaging in lobbying at the expense of shareholders (Cao et al., 2018). CPA, for example, is often used by top managers to obtain political appointments (Coates IV, 2012). At other times, managers involved in lobbying may have political ideologies that are not aligned with those of the firm and may support candidates from certain political parties, even when it is not in the interest of the firm (Unsal et al., 2016). This suggests that while 'firms may be apolitical, managers may not' (Aggarwal et al., 2012). Unsal et al (2016), for instance, found that Republican-oriented CEOs in the US spent larger amounts on lobbying and also made larger political donations than apolitical or Democrat-oriented CEOs.

We therefore argue that, overall, the agency costs incurred through lobbying will outweigh its resource benefits, and therefore impact firm performance negatively. Hence, we propose the following *baseline* hypothesis.

Hypothesis 1. Increased domestic lobbying intensity has a negative effect on firm performance.

2.2 The moderating effect of international and product diversification

While we expect the agency costs of domestic lobbying to outpace its performance benefits, the mixed picture from prior studies suggests that boundary conditions are likely to be at play here. A particularly interesting line of inquiry opens when we consider the interaction of CPA with market strategies. As we know, international and product diversification enhance the ability of the firm to leverage its resources and capabilities across different arenas, and create opportunities for economies of scope (Ahuja and Novelli, 2017). Yet, surprisingly, diversification has not been considered as a potential boundary conditions shaping the relationship between CPA and firm performance.

Both the resource-based view (RBV) (Wernerfelt, 1984) and agency theory (Mitnick, 1992) provide valuable insights into the impact of diversification on the CPA-performance relationship. From an RBV perspective, 'political resources' include money used in supporting politicians, information or knowledge used in lobbying, and votes that firms can provide to policymakers through constituency building political activities (Bonardi, 2011). Diversification generates opportunities to develop and exploit improved political resources in a variety of international and product markets which can be leveraged across the firm. International diversification, for example, can enhance a firm's overall knowledge base as firms learn from their foreign subsidiaries operating in different institutional contexts (Bonardi and Bergh, 2015; Geringer et al., 2000). At the same time, international diversification also demands the development of new political resources such as legitimacy (Boddewyn, 2016). We suggest that the political resources developed through international and product diversification can make domestic lobbying more effective. Also, both forms of diversification reduce agency costs in domestic lobbying, consequently reducing the

negative effect of CPA on firm performance. Below, we discuss first the effect of international diversification and then consider the impact of product diversification.

Internationally diversified firms have a greater opportunity to develop broad political resources and networks that may be difficult to replicate (Mellahi et al., 2016), particularly, by domestically focused firms that do not have the same reach across institutional domains. International diversification broadens the scope of the scanning of the political and external environment, and gives firms access to policy networks on a global scale (Detomasi, 2007; Henisz, 2016). At the same time, international diversification requires that political activities conducted at foreign subsidiaries are "internally consistent" with those of the MNE (headquarters), and its home institutions (Hillman and Wan, 2005). This involves coordination between subsidiaries and the headquarters (Blumentritt, 2002). In this process, internationally diversified firms can benefit from the transfer of "generic" political knowledge and skills from foreign subsidiary managers (Dahan, 2005). This enhances their ability to generate organizational legitimacy, skills in political organization, and access to privileged information from political contacts (Harvey and Novicevic, 2004) that can be used to gain first mover advantages in the home market (Frynas et al., 2006). Thus, although the idiosyncratic subsidiary-specific aspects of political capital may not be utilizable in the home country, these generic political benefits created by international diversification can be leveraged to increase the effectiveness of domestic lobbying, resulting in positive consequences for firm performance (Holburn and Zelner, 2010; Oliver and Holzinger, 2008).

Moreover, international diversification exposes the firm to a wide range of stakeholders, including global non-governmental organizations (NGOs), auditors, and other governance actors (Doh et al., 2015). These stakeholders put greater pressure on the firm to develop legitimacy at

both domestic and international levels (Boddewyn, 1995; Zhang et al., 2016). From an agency perspective, internationally diversified firms must respond to these pressures through the development of effective governance structures which allow them to monitor their board members' and senior managers' actions more closely (Filatotchev and Wright, 2011). For instance, internationally diversified firms are likely to increase the size and diversity of their top management team, as doing so has been found to engender better strategic control and monitoring at the board level (Ahmadi et al., 2018). Due to these additional control and governance mechanisms in internationally diversified firms, we expect that managers, including CEOs, are less likely to be able to act in their self-interest when engaging in lobbying in their home country. Lobbying efforts thus become more closely aligned with the interrerests of shareholders. Overall, international diversification thus both enhances political resoures and reduces agency costs associated with lobbying. We therefore hypothesize that:

Hypothesis 2a. International diversification positively moderates the relationship between domestic lobbying intensity and firm performance.

Product diversification can similarly increase the breadth of firm-level resources (both knowledge-based and financial) and reduce agency costs in lobbying. While there are similarities with international diverisification, the specific mechanisms differ, because resources, for example, are developed and transferred within the same institutional setting. Firms offering a variety of product lines or operating in multiple industries are confronted by wider array of policy issues and must deal with a greater number of regulations. This leads product diversified firms to develop broader political knowledge generated through interactions with a greater number of policymakers and stakeholders (Kang, 2013; Su and Tsang, 2015). As such, product diversified firms have the

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opportunity to share these political resources and knowledge from multiple product-related business units or industry segments. Doing so can enable managers enagaged in lobbying to become aware of the wider socio-political issues, leading to more effective lobbying. The benefits of greater levels of product diversification for the effectiveness of lobbying are, however, not limited to such informational advantages. The engagement in a wider array of policy arenas deepens the relationships with policymakers through repeated interaction and enhances the political connectedness of the firm, which has been shown to positively impact outcomes (Ridge et al., 2017).

Additionally, product diversified firms benefit from cashflow availability (or utilization) from "internal capital markets", which can be used for lobbying expenditure[1], and therefore have to rely less on external financing, e.g. from banks and shareholders (Aivazian et al., 2019). Since the corporate headquarters in a product-diversified firm "owns" the business units to which it allocates financial resources (unlike external funding sources), the use of internal capital for lobbying is likely to be better monitored, reducing the scope for agency problems (Gertner et al., 1994). We therefore expect that in product diversified firms the financial resources used in CPA are used more efficiently and in line with shareholder interests. As such, both resources based and agency considerations suggest the positive moderating effect of product diversification. We therefore hypothesise:

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1. Internal capital (generated at foreign subsidiaries) is also available to internationally diversified firms (Mudambi, 1999), however the transfer of this capital to MNE headquarters is subject to fluctuating exchange rates, tax differences, government policies and ethical concerns (Chkir and Cosset, 2001; Singh and Nejadmalayeri, 2004). Thus, while internal capital among internationally diversified firms may be more utilizable for alleviating financial constraints on foreign subsidiaries located in high-priced or absent local capital-markets (Fisch and Schmeisser, 2020), it is less likely that such capital will be utilizable to support MNE-level lobbying expenditures, unlike in the case of product diversified firms.

Hypothesis 2b. Product diversification positively moderates the relationship between domestic lobbying intensity and firm performance.

Figure 1 summarises our theoretical framework.

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3. Data and Methods

3.1 Sample

The empirical setting for this study is the United States (US) where we selected all companies appearing on the Fortune 500 at least once between 1998 and 2010. We focus on the US context because lobbying constitutes a legitimate activity for businesses to voice their policy-related opinions in the US (Hillman et al., 2004; Schuler et al., 2002). Lobbying, a primary form of CPA, involves the transfer of information between firms and governments, and may take a variety of forms such as presenting statistics, facts, arguments, reports, testifying as witnesses, or a combination of these (Hillman and Hitt, 1999). Although lobbying does not involve direct payments made to politicians, it can involve financial contributions to political campaigns (De Figueiredo and Silverman, 2006). Lobbying constitutes the biggest source of political expenditure by firms and interest groups in the US. Lobbying expenditure in the US is publicly reported and this provides a rich data source for academics. After excluding firms with missing data, we ended up with a final panel dataset yielding a total of 737 firms with 4,384 firm-year observations.

3.2 Measures

Our dependent variable, *firm performance,* is captured by the accounting-based measure - return on assets (RoA) (Miller and Yang, 2016; Peng and Luo, 2000; Xu et al., 2020). RoA is the most widely used and accepted performance measure in diversification research (Keats and Hitt, 1988; Mayer and Whittington, 2003; Palich et al., 2000; Stadler et al., 2018). This accounting based measure is particularly appropriate for our sample, which includes firms that are not always listed publicly on financial markets. Although some studies focusing on the operating performance outcomes of CPA have relied on the alternative accounting based measure, return on sales (RoS) (Fan et al., 2007; Hadani and Schuler, 2013), such a revenue-based performance measure would result in high correlations with our sales-based diversification measures. RoA was measured in percentage as net operating income before extraordinary items divided by total assets. Annual data on RoA was obtained from the Worldscope database.

Our key independent variable is a firm's domestic *lobbying intensity* - the ratio of aggregate company level annual lobbying expenditure reported by a firm in a given year normalized by its annual net sales (in 1000 US$) (Adelino and Dinc, 2014; Mathur et al., 2013). We collected yearly data on firms' lobbying expenses from the 'Center of Responsive Politics' (CRP), available via the Opensecrets website (www.opensecrets.org/lobby). Data for CRP is gathered directly from the Federal Election Commission, which records lobbying data of US firms. The CRP does not include bribes and other forms of obtaining political influence, and has been used in a number of previous studies (Duso and Jung, 2007; Goldman et al., 2009; Schuler et al., 2002; Shirodkar et al., 2017).

We hypothesize that the impact of domestic lobbying intensity on firm performance is moderated by the levels of *international diversification* and *product diversification.* We used an entropy measure to capture the level of diversification in both dimensions based on a firm's sales attributed to its 4-digit SIC product segment and in its home market (i.e. US) compared to foreign

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markets. These entropy measures capture the extent of a firm's diversity by considering both the number of geographic and product segments and the relative importance contributed by each segment (Hitt et al., 1997; Jacquemin and Berry, 1979; Palepu, 1985). We used the SIC-based entropy index to capture a firm's level of product diversification (Jacquemin and Berry, 1979; Palepu, 1985). This index has been used extensively (Bowen and Wiersema, 2005; Chakrabarti et al., 2007; Wiersema and Bowen, 2008) and is regarded as one of the most valid and reliable measures of product diversity. The index is computed as $\sum$ Pi ln (1/Pi), where Pi is the share of a firm's total sales attributed to product segment i, and ln (1/ Pi) is the weight of each product segment i. We calculated the total entropy index by using annual data from the Worldscope database on a firm's sales in each of its 4-digit SIC business segments. For international diversification, we calculated the geographic entropy measure based on a firm's annual sales in its US (home) market compared to that in five geographic regions: Europe, Americas (except U.S.), Asia/Pacific and Other (Hitt et al., 1997; Jacquemin and Berry, 1979; Palepu, 1985). It is computed as $\sum$ Pi ln (1/Pi), where Pi is the share of a firm's total sales attributed to geographic segment (i), and ln (1/Pi) is the weight of each geographic segment (i). Both entropy measures have a minimum value of zero for domestic and single business firms, and rises with the extent of international and product diversity respectively.

We include various firm-, industry- and governmental-level control variables in our model. First, we control for a firm's additional type of political activity in terms of its political action committee (*PAC)* contributions, in order to account for the multiplicity of CPAs (Schuler et al., 2002). Data for PAC contributions was also obtained from the CRP, from which our lobbying data was populated, and again normalized by a firm's annual net sales (in 1000 US$). In line with previous studies, our models also control for *firm size* (log of total assets), *capital intensity* (capital

expenditures to total assets), and *leverage* (total debt to total assets). Data was obtained from the Worldscope database. Schuler et al. (2002), Andres (1985), and Masters and Keim (1985) emphasize the importance of industry, economic and regulatory factors in influencing a firm's lobbying behavior. Therefore, we control for *industry size* and *industry regulation*. Industry size is captured by the industry's total assets, where data was generated based on firm-level data in the respective 2-digit SIC industry. To control for industry regulation we include a dummy, indicating if the 2-digit SIC industry of a firm's core business is highly regulated - such as transport and public utilities, telecommunications, oil and gas, chemicals, or the banking and finance sector (Grier et al., 1994; Hadani and Schuler, 2013). We also add *senate control* as an indicator variable, equal to one if the Democratic Party controlled the Senate in a given year and zero if the Republicans were in control (Holburn and Vanden Bergh, 2014). Finally, we control for time effects by including year dummies.

3.3 Model specification and analysis

To test our hypothesized relationships, we used panel regression analysis with interaction terms. A Hausman-Test indicated that the fixed-effect specification is more appropriate than a random-effects specification. The inclusion of fixed effects allowed us to estimate within-firm changes in our dependent variables while controlling for time-invariant unobserved firm heterogeneity, which could have influenced the results.

Our basic model describes the relationship between lobbying intensity and performance as follows:

Firm performance$_t$ = β0 + β1 lobbying intensity$_{(t-1)}$ + β2 international diversification$_{(t-1)}$ + β3 product diversification$_{(t-1)}$ + β4 controls$_{(t-1)}$ + β5 year$_t$ + ui + εi

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Our additional models includes interaction terms between lobbying intensity and diversification, both in terms of international and product diversification. The following specification applies:

Firm performance$_t$ = β0 + β1 lobbying intensity$_{(t-1)}$ + β2 international diversification$_{(t-1)}$ + β3 product diversification$_{(t-1)}$ + β4 lobbying intensity$_{(t-1)}$ x diversification strategies + β5 controls$_{(t-1)}$ + β6 year$_t$ + ui + εi

In these equations, we also control for time effects by including year dummies. The independent variable, moderators and control variables are lagged by one year. In our models, *ui* includes the firm specific characteristics and *εi* is the idiosyncratic error term.

3.4 Endogeneity issues

We are aware that prior research has indicated endogeneity issues between performance and other firm-level variables such as diversification strategies; and therefore, a firm's CPA might be influenced by existing firm characteristics such as prior performance (Hadani and Schuler, 2013). To ensure that endogeneity is not a major concern for our estimations we conducted a Durbin-Wu-Hausmann Test (augmented regression test) for endogeneity of the lobbying intensity variable (Davidson and MacKinnon, 1993; Greene, 2008). We estimated a two-stages-least-square (2SLS) instrument variable (IV) regression and included the lagged values of industry lobbying expense and industry lobbying intensity, both calculated based on our sample firms, as instruments (Kim, 2008), to correct for endogeneity. These instruments satisfy the conditions for over- and under-identification and valid instruments (Baum and Mark, 2007; Baum et al., 2003; Cragg and Donald, 1993; Kleibergen and Paap, 2006; Sargan, 1988; Stock et al., 2002) in the total sample at 5% significance levels (Underidentification test (Anderson canon. corr. LM statistic): p=0.000; Sargan

statistic (overidentification test of all instruments): p=0.0849). We then tested for endogeneity of the lagged value of firm level lobbying intensity in this regression. The null-hypothesis of exogeneity could not be rejected (p=0.6060) indicating that no endogeneity of our direct effect of lobbying intensity is found.

We also tested for potential reverse causality, flipping the panel regression specification and the lag structure. More specifically, we regressed lobbying intensity as the dependent variable on lagged firm performance and the entire set of lagged controls. This multivariate test indicates that past performance is not significantly related to subsequent intensity of lobbying expenses (p=0.616). Thus, controlling for covariates, the reverse effect of firm performance on lobbying intensity is insignificant. This indicates that reverse causality is unlikely to drive our results to a significant degree.

4. Results

4.1 Main results

In Table 1, we present the descriptive statistics and the correlation matrix of our final sample including our dependent, independent and control variables. Table 2 reports the descriptive statistics and pairwise correlations, which present values below the 0.7 critical level, thus reducing multicollinearity concerns (Cohen, 2003). We also calculated the variance inflation factors (VIF) for the explanatory, moderator variables and control variables in the preliminary analysis to ensure that multicollinearity is not an issue. The VIFs for the independent and moderator variables, remain under 6.52 (below the suggested cut-off point of 10), indicating that multicollinearity is not an issue (Neter et al., 1985).

Table 2 reports the results of our regression analysis. In Model 1, we include only the control variables. The coefficient estimates for the control variables are, by and large, as expected. Although the R² is relatively low, the models as a whole are significant as indicated by the significant F-values. In Model 2, we add lobbying intensity as our independent variable which increases the R² statistic as compared to Model 1. As hypothesized, we find a significant negative impact of lobbying intensity on firm performance (ß=-13.759, p=0.000). Hence, we find support for our baseline Hypothesis 1.

In Models 3 – 5, we tested our hypotheses 2a and 2b about the impact of a firm's level of diversification on the lobbying-performance relationship. We added our interaction terms between lobbying intensity and international diversification (model 3) and between lobbying intensity and product diversification (model 4), separately, as well as jointly (model 5). The R² statistics show that the model fit increases when the interaction terms are added. In Model 3, we find a positive and significant coefficient estimate of the interaction term *lobbying intensity x international diversification* (ß=153.42, p=0.000). The coefficient of the interaction term *lobbying intensity x product diversification* (model 4) is also positive and significant (ß=120.42, p=0.004). Hence, we find support for hypotheses 2a and 2b. With increasing levels of diversification, the negative effect of lobbying intensity on firm performance is reduced.

The nature of these interactions between lobbying intensity and diversification strategies is further illustrated in figures 2 and 3. The figures show the relationship between lobbying intensity and firm performance at different levels of international diversification (figure 2) and product diversification (figure 3). In illustrating theses interaction effects at different levels we do consider that both international and product diversification levels are bounded at 0 and cannot turn negative. Considering the distribution of these independent variables, we therefore display the relationship between lobbying intensity and firm performance when intentational or product diversification are 0, at their mean level, and one standard deviation above the mean level. Both interaction plots show the increasing effect when international and product diversification are higher, respectively reducing and counterbalancing the negative impact of lobbying intensity on performance.

4.2 Robustness checks

To assesses the robustness of our results, we performed several additional tests (the results are available upon request). First, we excluded all observations from our sample where firms did not report any lobbying expenses. Excluding firms with zero lobbying intensity from our analysis (resulting in a smaller subsample of 2,619 firm-year observations) did not affect our findings. Next, we re-estimated our models in several, different subsamples. First we analyzed a subsample of small firms with firm size below the median of all firms in the sample (2,192 firm-year observation) as small firms might be less able to engage in lobbying activities due to resource constraints. In addition, we re-ran our analysis in a subsample of firms which are active in unregulated industries based on their 2-digit core industry (3,069 firm-year observations). While

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prior research has pointed to the effectiveness of lobbying in highly regulated industries, we wanted to make sure that our results also hold in unregulated industries where the influence of politicians is more subtle. Our findings remained the same in both subsample analyses. As our results suggest that lobbying activities might become more useful for firms with internationally diversified sales, we ran our models for a subsample of domestic firms reporting no sales outside the US (1,158 firm-year observations). We find that lobbying intensity has a significantly negative impact in domestic firms, suggesting that the costs of lobbying outpace the benefits. In an additional robustness check, we applied the number of employees instead of firms' total assets to account for firm size. Our results remain robust. Finally, we included the squared terms of international and product diversification in our models to account for their possible curvilinear relationships with firm performance. Again, our results remain the same.

4.3 Subsequent analysis

We conducted an additional split-sample analysis (see Table 3) to offer additional nuance on the interplay between lobbying, international, and product diversification. We created four subsamples based on the entropy score of firms' product and international diversification strategies (as described in our measures of these variables). Our first subsample includes 260 firms (1,743 observations) pursuing both product and international diversification simultaneously. That is, for these firms the entropy score of both product and international diversification is above zero. In contrast, 136 firms (741 observations) are pursuing no international and product diversification at all. These focused, domestic firms have an entropy score of zero for both, product and international diversification levels. Further, we created two subsamples for purely product diversified firms (entropy score > 0) with zero international diversification (75 firms, 417 observations), and purely

internationally diversified firms (entropy score > 0) with zero product diversification (266 firms, 1,483 observations).

INSERT TABLE 3 ABOUT HERE

Model 1 (see Table 3) includes firms that are both internationalized and product-diversified. We found a significant positive impact of lobbying on performance among these firms, thus, showing that firms diversified along both international and product dimensions are able to generate positive returns from lobbying. In contrast, a significant negative impact of lobbying on firm performance is identified in model 2, for firms pursuing neither product nor international diversification. Finally and additionally, we find no significant impact for firms which are only diversified on one dimension, either product or geographic markets (models 3 and 4). The results pertaining to models 3 and 4 of the split-sample analysis have to be interpreted differently from the main anlysis (i.e. hypotheses 2a and 2b). The split-sample analysis does not capture the extent to which a firm is diversified but merely whether it is diversified at all. With this in mind, there are two suggestive insights worth considering. First, the moderating effect of international and product diversification is dependent on the "extent" of diversification. This makes sense, since firms require more than merely a "presence" in a new geographic or product market to reap the benefits. Secondly, there is likely to be a joint effect. Despite being unable to capture the extent of product and international diversification in the split-sample analysis we see that firms engaged in both forms of diversification show a positive CPA-performance relationship while those engaged in neither show a negative CPA-performance relationship. Overall, this suggests that there is a joint effect that is worth considering in future research.

5. Discussion

5.1 Theoretical implications

Our study was motivated by our desire to understand if key firm-level market strategies, specifically, international and product diversification, shape the relationship between domestic CPA and firm performance. We find that lobbying (a distinct manifestation of CPA) is negatively associated with firm performance but international and product diversification positively moderate the relationship. The contingent effects of both dimensions of diversification on the lobbying-performance relationship are therefore confirmed. Our findings shed light on the hitherto unexplored factors affecting the mixed empirical results for the relationship between CPA and performance (Hadani and Schuler, 2013).

These findings extend the literature by providing insight into the boundary conditions affecting the relationship between CPA and performance. This allows us to offer a number of contributions to the CPA literature. First, by integrating insights from the resource-based view and agency theory, we provide a framework that allows us to bring international and product diversification, two central corporate (i.e. market-based) strategy choices, into the nonmarket strategy conversation. This complements prior research on the relationship between diversification and CPA that has looked at how diversification affects political strategy choices. For example, product diversification enables firms to reduce their dependence on relational CPA (Shirodkar and Mohr, 2015a), but also increases the potential of conflict in CPA decisions (Shaffer and Hillman, 2000). As diversification is commonly seen as an opportunity to leverage resources across industries (Mayer et al., 2015; Palich et al., 2000) and geographies (Hitt et al., 2006), we provide a fresh view on this by explaining under which conditions lobbying can become more effective.

Our findings support our argument that whilst domestic lobbying (in general terms) is negatively associated with firm performance, international and product diversification offer firms the opportunity to develop and leverage wider political resources and reduce agency costs in domestic lobbying. While research on the relationship between nonmarket and market strategies has mostly focused on competitive strategies (Holburn and Vanden Bergh, 2014), a wider contribution of our work is thus the extension to the realm of corporate diversification strategy. Previous research has explored the importance of integrating market and nonmarket strategy (Baron, 1997), however, a limited number of empirical studies have considered the relationship between nonmarket strategy and diversification strategies.

Second, our split-sample analysis is suggestive of the idea that lobbying has a positive performance benefit if firms diversify along both product and international dimensions. This finding links to a line of research that has highlighted the positive interaction and learning effects between product and international diversification (Geringer et al. 2000; Mayer et al. 2015). Specifically, it reinforces our line of argument (relating to hypothesis 2a and 2b) that product and international diversification enable firms to gain additional political resources and knowledge which can be reintegrated into the firms' domestic lobbying (Bonardi, 2011), put greater pressures on developing legitimacy in political behavior (Boddewyn, 2016; Boddewyn and Brewer, 1994); improve the governance structures of firms (Filatotchev and Wright, 2011) and provide corporate financing options that lead to reduced agency costs (Denis et al., 1997). Overall, being diversified into multiple industry segments as well as in international markets will increase the benefits from nonmarket (particularly, political) activity. In contrast, and in line with our wider argument, for undiversified and purely domestic firms, domestic lobbying is associated with negative performance (in line with our hypothesis 1). Our split-sample analysis finds that when firms are

diversified purely along one dimension of diversification (either product or international), the effect of lobbying on firm performance is insignificant. Although this finding is not directly comparable to our interaction analysis – one factor being that the split sample analysis does not differentiate between different diversification levels – the finding does suggest that further work is needed to explore the interplay between different levels and forms of diversification and lobbying.

Third, our study enriches our understanding of CPA of internationally active firms which, typically, are subject to 'dual pressures' for achieving legitimacy in their home and international contexts (Hillman and Wan, 2005), a theme that has been shown to be of increasing importance (Ahlstrom et al., 2020; Hasija et al., 2019). Nevertheless, as Rajwani and Liedong (2015) have highlighted, international aspects are often neglected in the nonmarket strategy literature. Therefore, our study complements this work, including studies such as Funk and Hirschman (2017), by combining the international aspects of CPA with corporate-level market strategies. We thereby contribute to an evolving line of enquiry that links domestic political resources and nonmarket activities to international strategy (Fernández-Méndez et al., 2018; Holburn and Zelner, 2010) and expand this work to directly consider implications for performance. Placed in the context of this literature, our finding is suggestive of potential further research. Our study focused on domestic lobbying activities in the United States (U.S.), a country with notable international reach and political influence. It would therefore be useful to compare the findings for the U.S. context with those for countries with more limited international power and influence.

5.2 Managerial implications

Our findings have a number of managerial implications. Given that CPA is a costly activity, managers are always concerned about the costs versus benefits of CPA. As we find an overall negative effect of CPA on firm performance, we emphasize the need for caution in relation to political activity. From a managerial perspective our findings underline that managers need to carefully consider the linkages beween nonmarket and market strategies and ensure appropriate integration to ensure the effectiveness of CPA. Our arguments and findings underline that such action must be accompanied by the development of robust governance mechansims to counter the risks of increasing agency costs. The findings in this study highlight specifically that the benefits from lobbying only accrue when appropriately linked to the firms' corporate strategy, suggesting that focused firms need to be particularly cautious. Executives need to consider international and product diversification not only as an insurance to the costs associated with CPA, but also as a way to learn from wider industries and institutions. Our subsample analysis reinforces this argument and points to the opportunites offered by learning and resource leveraging across both international and product diversification. A general point emerging from our work is that the implication of corporate strategy choices for other aspects of a firm's strategy, such as CPA, deserve greater attention.

5.3 Limitations and future research

Like all studies, our study has some limitations that create potential avenues for further research. Although our paper emphasizes the integration of market and nonmarket strategy to realize positive performance implications in the nonmarket arena, its scope is limited to two, albeit, key aspects of corporate strategy. Although comparable to similar studies in the field, the relatively low R-squared values suggest the need for incorporating additional factors. Future research therefore could account for other types of corporate strategies, such as vertical integration, as well

as consider business-level strategic choices. Likewise, in regard to nonmarket strategy, we focus on lobbying, and although it is one of the most important forms of CPA in the US (Richter et al., 2009), we do not account for other tactics such as coalition building with interest groups, such as NGOs, charities, trade associations and media. Due to our data limitations, we are unable to account for the wide variety of CPA tactics used by firms. We control for firms' PAC contributions, however. Future research can therefore explore a variety of tactics in the US, both at state and federal levels, and also analyze the impact of different laws and institutional actors on CPA. Future research may also look at the different patterns of CPA combinations before, during, and after specific issues impact firms, and the performance implications of these CPA combinations. A second important limitation in both theoretical and empirical terms is that we are unable to distinguish between related and unrelated diversification, which forms an important distinction in research on diversification. In particular, we also do not address the complexity associated with intra-firm conflicts that may arise when a firm engages in unrelated forms of diversification. We encourage future research to take this up, as this may require qualitative forms of enquiry which are beyond the scope of our study. Third, an important limitation is that, although we use agency theory and its related mechanisms (such as, in relation to corporate governance) in our theoretical arguments, we are unable to include these in our empirical analysis, primarily, due to our data limitations. We call upon future research to include these variables (such as CEO and board characteristics) to provide a more micro analysis of the agency factors that could enrich the understanding of the relationships between CPA, diversification and firm performance. Finally, the linkage between international diversification and domestic lobbying may be impacted by the state of the international political economy. We therefore suggest that future research should consider other timeframes, for example the recent Covid-19 pandemic. Although our data allows

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us to test our hyoptheses in a robust manner, recent events may have impacted the strategies of firms from both market and nonmarket perspectives. Consideration of these additional factors could further improve the explanatory power of the models included in our analysis.

6. Conclusions

In conclusion, our study extends our understanding of the relationship between CPA and firm performance by explicating the moderating role of international and product diversification. CPA has been found to positively impact firm performance in several prior studies (Hillman et al., 1999; Shaffer et al., 2000), however, recent studies have challenged this, attributing the negative implications of CPA to agency costs and conflicts (Cao et al., 2018; Hadani et al., 2016). Subsequently, there has been a greater call for research on the factors that condition the CPA-performance relationship (Mellahi et al., 2016). We contribute to CPA research by suggesting that both international and product diversification improve the political resources and knowledge held by firms, puts pressure on achieving greater legitimacy in both home and international contexts, and reduces agency costs through improved governance structures. Specifically, we contribute to the growing research domain on how internationalization improves firms' knowledge of the nonmarket environment at home by learning from their overseas ventures (Holburn and Zelner, 2010; Sun et al., 2021). We also contribute to strategic management research on the advantages of product diversification, suggesting that the development of internal capital markets can enhance the monitoring of board members, thus reducing the agency costs in lobbying. Prior studies have also argued about the interplay between product and international diversification (Chang and Wang, 2007; Mayer et al., 2015; Tallman and Li, 1996). We show that when firms are highly diversified (in both international and product arenas), their agency costs can be considerably

reduced, so that positive firm-performance implications from their domestic CPA can be achieved.

In sum, we provide a more holistic framework about the integration between market and nonmarket strategies and their effect on firm performance.

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TABLES

Table 1: Descriptive Statistics and Correlations

	Variables	Mean	Std. Dev.	VIFs	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(1)	Return on Assets	5.701	11.454		1.000									
(2)	Lobbying intensity	0.017	0.308	1.02	-0.1026*	1.000								
(3)	International Div.	0.569	0.445	1.35	0.0662*	-0.0370*	1.000							
(4)	Product Diversification	0.272	0.353	1.11	0.0140	-0.0197	0.2127*	1.000						
(5)	Political Action Committee	0.814	1.451	1.10	0.0207	0.0020	-0.1727*	-0.0026	1.000					
(6)	Firm Size (log)	15.488	1.387	1.31	0.0137	-0.0955*	0.1085*	0.1346*	0.1939*	1.000				
(7)	Firm Leverage	-736.407	54506.39	1.00	0.0028	0.0007	0.0182	-0.0130	-0.0080	-0.0089	1.000			
(8)	Firm Capital Intensity	6.955	11.996	1.17	-0.1116*	0.0641*	-0.1564*	-0.0876*	0.1309*	0.1982*	-0.0087	1.000		
(9)	Industry Size[2]	161657.1	152442.5	1.29	-0.0274	-0.0153	-0.3748*	-0.1257*	0.1468*	0.1479*	-0.0100	0.0894*	1.000	
(10)	Senate control	0.393	0.489	6.51	-0.0891*	-0.0197	0.0365*	-0.0072	0.0400*	0.0811*	-0.0185	-0.0098	0.0675*	1.000
(11)	Regulated Industry	0.300	0.4.58	1.31	-0.0050	-0.0064	-0.2228*	-0.1634*	0.1768*	0.3041*	-0.0231	0.3056*	0.2466*	0.006

[2] The mean and standard deviation of industry size is in millions;
* $p < .1$; Number of observations = 4384

Table 2: Impact of Lobbying Intensity on Performance (RoA) depending on Diversification Strategies

	Model 1	Model 2	Model 3	Model 4
International Div.	3.849***	3.335***	1.895	3.315**
	0.003	*0.010*	*0.149*	*0.010*
	(1.312)	(1.292)	(1.313)	(1.291)
Product Diversification	0.825	0.900	0.694	-0.119
	0.434	*0.386*	*0.502*	*0.914*
	(1.054)	(1.038)	(1.035)	(1.097)
Political Action Committee	-0.012	-0.015	-0.121	-0.039
	0.958	*0.949*	*0.602*	*0.867*
	(0.236)	(0.232)	(0.232)	(0.232)
Firm Size	-4.020***	-4.375***	-4.276***	-4.288***
	0.000	*0.000*	*0.000*	*0.000*
	(0.451)	(0.445)	(0.444)	(0.446)
Firm Leverage	0.000	0.000	0.000	0.000
	0.870	*0.872*	*0.893*	*0.866*
	(0.000)	(0.000)	(0.000)	(0.000)
Firm Capital Intensity	-0.100***	-0.073***	-0.071***	-0.075***
	0.000	*0.000*	*0.000*	*0.000*
	(0.018)	(0.018)	(0.018)	(0.018)
Industry Size	0.000	0.000	0.000	0.000
	0.600	*0.274*	*0.368*	*0.264*
	(0.000)	(0.000)	(0.000)	(0.000)
Senate control	-0.222	-0.140	-0.352	-0.182
	0.789	*0.864*	*0.666*	*0.824*
	(0.830)	(0.817)	(0.815)	(0.817)
Regulated Industry	1.336	1.014	1.299	1.212
	0.494	*0.597*	*0.497*	*0.528*
	(1.951)	(1.921)	(1.914)	(1.920)
Lobbying Intensity		**-13.759***	**-14.199***	**-13.830***
		0.000	*0.000*	*0.000*
		(1.239)	**(1.237)**	**(1.238)**
Lobbying Intensity x International Div.			**153.428***	
			0.000	
			(27.791)	
Lobbying Intensity x Product Div.				**120.242***
				0.004
				(42.190)
Constant	67.322***	72.824***	71.701***	71.389***
	0.000	*0.000*	*0.000*	*0.000*
	(7.042)	(6.950)	(6.927)	(6.962)
Observations	4384	4384	4384	4384
R^2	0.05	0.08	0.09	0.08
F	11.09	17.03	17.80	16.64
P	0.000	0.000	0.000	0.000

Standard errors in parentheses, P-values in italics, time dummies excluded, one year lag between the dependent and independent variables. ** $p<0.01$, ** $p<0.05$ * $p<0.1$

Table 3: Split Sample Analysis: Lobbying Intensity on Performance (RoA) depending on Diversification Strategies

	Product Div / Internat. Div	No Product Div / No Internat. Di	No Product Div / Internat. Di	Product Div / No Internat. Di
Lobbying Intensity	90.008**	-9.499***	-30.056	-19.695
	0.031	*0.000*	*0.363*	*0.705*
	(41.728)	(1.417)	(33.052)	(51.954)
International Diversification	-5.467**		6.359***	
	0.023		*0.006*	
	(2.397)		(2.305)	
Product Diversification	0.382			-2.855
	0.846			*0.492*
	(1.960)			(4.153)
Political Action Committee	-0.356	-0.092	0.182	2.459***
	0.504	*0.822*	*0.731*	*0.000*
	(0.532)	(0.407)	(0.530)	(0.631)
Firm Size	-5.195***	-5.980***	-5.223***	-2.631*
	0.000	*0.000*	*0.000*	*0.087*
	(0.904)	(0.958)	(0.838)	(1.532)
Firm Leverage	-0.000	0.000	-0.000	0.000
	0.509	*0.260*	*0.183*	*0.716*
	(0.000)	(0.000)	(0.000)	(0.000)
Firm Capital Intensity	-0.048**	-0.077**	-0.186**	0.179
	0.031	*0.027*	*0.023*	*0.162*
	(0.022)	(0.035)	(0.082)	(0.128)
Industry Size	0.000	0.000	-0.000	-0.000*
	0.151	*0.108*	*0.724*	*0.059*
	(0.000)	(0.000)	(0.000)	(0.000)
Senate control	-1.234	-4.863**	2.318	-3.686
	0.362	*0.011*	*0.204*	*0.221*
	(1.353)	(1.899)	(1.825)	(3.009)
Regulated Industry	-3.332	2.902	9.019**	14.085**
	0.278	*0.750*	*0.048*	*0.020*
	(3.070)	(9.116)	(4.558)	(6.017)
Constant	88.397***	96.046***	80.698***	46.561**
	0.000	*0.000*	*0.000*	*0.036*
	(14.072)	(15.652)	(12.076)	(22.098)
Observations	1743	741	1483	417
R^2	0.07	0.17	0.09	0.20
F	5.67	6.52	4.14	5.85
p	0.000	0.000	0.000	0.000

Standard errors in parentheses, P-values in italics, time dummies excluded, one year lag between the dependent and independent variables.

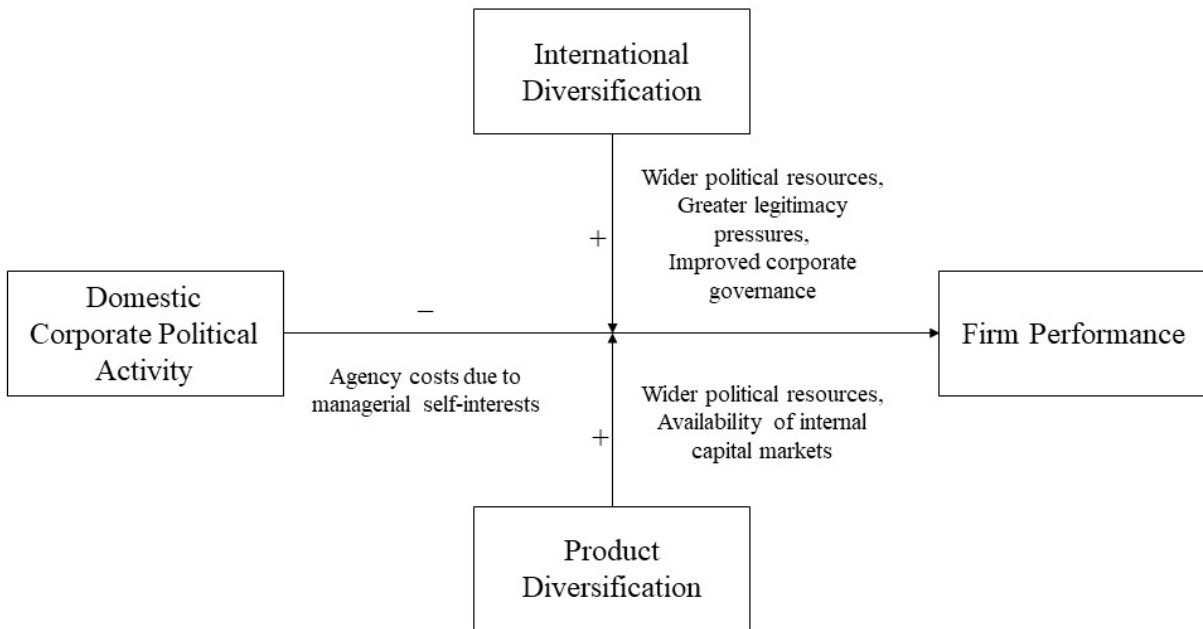*** $p<0.01$, ** $p<0.05$, * $p<0.1$

FIGURES

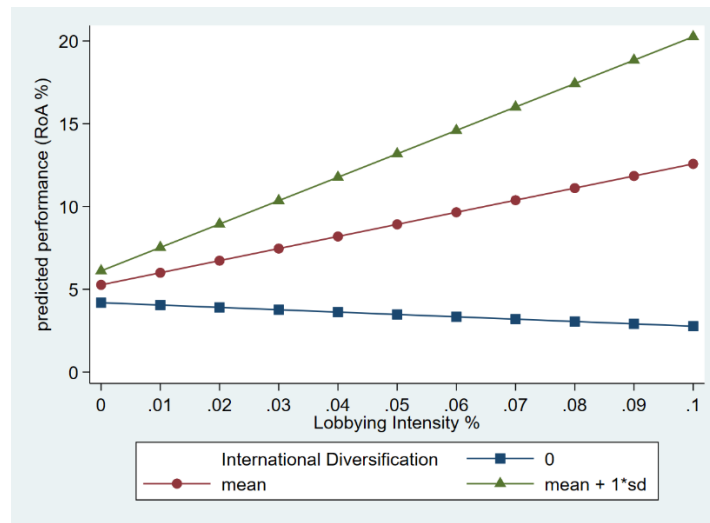**Figure 1:** Theoretical Framework

Figure 2: Moderating effect of international diversification on the relationship between lobbying intensity and firm performance
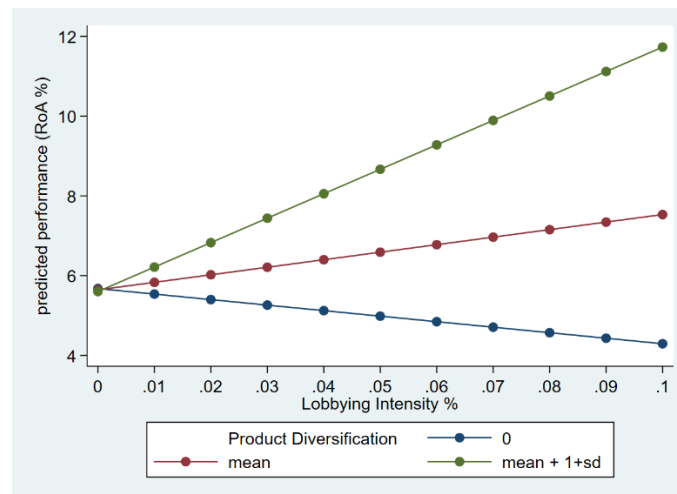

Figure 3: Moderating effect of product diversification on the relationship between lobbying intensity and firm performance