MAKING FRIENDS IN HOSTILE ENVIRONMENTS:
POLITICAL STRATEGY IN REGULATED INDUSTRIES[1]

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ABSTRACT

We examine how regulated firms target their political strategies at multiple government institutions in order to gain more favorable regulatory agency decisions than would otherwise occur. By integrating the corporate political strategy and positive political theory literatures we derive propositions that (a) identify the political and regulatory circumstances that generate hostile environments from the firm's perspective, (b) delineate the conditions under which firms will employ an indirect strategy (i.e. target legislatures or executives) instead of a direct strategy (i.e. target regulators) to induce changes in regulator decisions; and, importantly, (c) we identify the specific political institutions a firm will target when adopting (b). Even though our structured-interaction approach to the analysis of formal institutions is quite straightforward, we are able to develop a rich set of predictions about firms' political strategy that can form the basis for future empirical testing.

"Disagreement with the merits of a proposed SEC rule is not uncommon. Chairman Levitt has indicated his disappointment that the firms fighting the proposal have not taken the opportunity to ***engage the SEC*** *but instead are focusing their resources on a* ***legislative effort*** *to limit the authority of the agency."[emphasis added]*

Tom Daschle, United States Senate

In many industries, firm performance depends on the ability of managers to shape their regulatory environment as well as on their ability to succeed directly in the market place (Mahon & Murray, 1981; Marsh, 1998; Mitnick, 1981). Firms in a wide range of sectors are regulated by government agencies that establish, monitor and enforce administrative rules on an array of policy dimensions (Buchholz, 1990). Regulatory agencies control, for instance, network pricing, investment and entry decisions in utilities sectors (Russo, 1992; 2001); product standard and testing requirements in the pharmaceutical industry (Mathieu, 1997); and environmental and worker safety rules in manufacturing sectors (King & Lenox, 2000). In determining these and other regulatory policies, regulators adopt policy positions that vary in the degree to which they are relatively friendly or hostile towards regulated firm interests (Stigler, 1971; Peltzman, 1976). Friendly actions are those that establish policies close to the firm's desired outcome. Hostile regulatory decisions, on the other hand, establish policies far from the firm's preferred position. They include, *inter alia*, delays or refusals to issue operating permits, reductions in regulated rates or the imposition of costly new production standards.

The ability of firms to manage their relationships with regulatory agencies and to gain more favorable policy rulings, particularly in hostile regulatory environments, is one means of improving overall firm performance. Indeed, scholars recently estimated that the direct cost to firms of complying with federal regulations in the U.S. amounted to more than $500bn (Crain & Hopkins, 2001). To date, however, remarkably little research exists on the strategies firms use to improve the nature of their regulatory environments other than noting that regulated firms tend to engage in more political activity than unregulated firms (Grier, Munger & Roberts, 1994). Despite widespread managerial and academic acceptance that political strategy can be an important factor in the design of overall business strategy (Baron, 1995), the political strategy literature has largely focused on one dimension, specifically the interaction between firms and elected legislators, and on the ways in which firms strive to influence legislative outcomes (Hillman & Hitt, 1999; Krehbiel, 1999; Mizruchi, 1992; Schuler, Rehbein & Cramer, 2002). Although public policies are frequently determined by non-legislative institutions such as regulatory agencies and courts, interactions between firms and these institutional players have received less attention among strategy scholars.

In this paper we contribute to the research on political strategy by examining how regulated firms *target* their political strategies at multiple government institutions in order to achieve more favorable regulatory agency rulings. Firms target an institution by expending relatively more resources on gaining its support for a regulatory policy than it expends on other government institutions, all else equal. Regulated firms can directly seek support of the regulatory agency for a more favorable ruling (for instance, by lobbying more intensively), and/or they can exert pressure *indirectly* on regulators by targeting political principals, such as legislatures and executives, who oversee and monitor regulatory agency decisions. The general question we address is how do regulated firms decide whether an indirect or direct strategy is optimal or how much weight to put on each?

Among extant research in the corporate political strategy literature, studies tend to focus on firms' direct targeting of regulators. Schuler (1996), for example, considers the U.S. steel industry's strategy of petitioning U.S. trade agencies when seeking imposition of anti-dumping duties on foreign imports. In an empirical analysis of the organization of firms' lobbying activities, De Figueiredo and Tiller (2001) examine why some telecommunications firms lobby the Federal Communications Commission using internal staff whereas other firms subcontract to external lobbying organizations. At a more conceptual level, Buchholz (1990) argues that firms increase their level of regulator interactions – for example by participating in hearings – when salient policy issues are under administrative consideration. According to these studies, regulated firms are assumed to receive improved administrative rulings by directly interacting with, or targeting, the relevant regulatory agency.

Here, we draw on the political strategy and political science literatures to examine whether such a strategy of directly focusing on the regulatory agency will necessarily be the optimal approach – or whether an indirect targeting strategy can be preferable. The implicit recommendation of the strategy literature to lobby or otherwise influence the relevant regulatory agency is based upon the assumption that the regulator has latitude to shift policy in response to the firm's approaches. This sits uncomfortably with findings from the political science literature, however, that regulators can be prevented from changing policies by legislatures and courts who have the ability to overturn agency decisions (Weingast & Moran, 1983; McCubbins & Schwartz, 1984; McCubbins, Noll & Weingast, 1987 and 1989; Ferejohn & Shipan, 1990; Tiller, 1998; Tiller & Spiller, 1999). In other words, regulators can be constrained by government institutions that have a role in shaping public policy, either through legislation or court action. This implies that a regulator who is otherwise sympathetic to the firm's position would have to implement less sympathetic regulatory policies if confronted by a hostile legislature. From the firm's perspective, targeting a constrained regulator would then be fruitless.

In order to gain some insight into how firms target their political strategies at alternative government institutions we draw on the Positive Political Theory (PPT) literature, a body of research that explicitly recognizes the interdependencies between institutional players in the policy-making process. As a branch of the political science field, PPT is centrally concerned with understanding the formal organizational arrangements of government and the implications for the design of public policy. The advantage of PPT is that it offers a structured conceptual approach to identifying environments in which regulators are hostile from the firm's perspective, and in which regulators are particularly likely to defer to the preferences of political institutions in their policy decisions. To date, however, PPT models have not explicitly included firms or other organized interest groups in analyses of interactions with multiple government institutions.

We integrate the political action and PPT literatures by outlining a model of the strategic interaction of firms, regulators and politicians in institutional settings characterized by multiple checks and balances between legislative and executive government bodies. Our model thus closely applies to firms operating in countries with presidential systems such as the United States though we later discuss extensions of our approach to parliamentary systems. We adopt the PPT approach to analyze the interaction between a firm, a regulator, a bi-cameral legislature and an executive. By considering the different alignments of policy preferences between the institutions, we (a) identify the political and regulatory circumstances that generate hostile environments from the firm's perspective, (b) delineate conditions under which firms will employ an indirect strategy (i.e. target legislatures or executives) instead of a direct strategy (i.e., target regulators) to induce changes in regulator decisions, and, importantly, (c) we identify the specific political institutions a firm will target when adopting (b). Even though our approach to the analysis of formal institutions is quite straightforward, we are able to develop a rich set of predictions about firms' political strategy that can form the basis for future empirical testing. We offer some suggestions on how such analyses might proceed.

MANAGING REGULATORY ENVIRONMENTS

Current Approaches

Firms seeking to influence public policies face multiple government institutions that participate in policy-making procedures and that can influence final policy decisions (Hillman & Keim, 1995). While legislatures and executives enact policies through the periodic passage of statutes, regulatory agencies, operating under legislative oversight, are frequently responsible for interpreting, implementing and enforcing statutes through the design of administrative regulations in a wide range of industries. Courts also have an effect on policy outcomes, by determining whether new legislation is constitutionally valid, or whether administrative rulings are consistent with enabling statutes.

Although the vast majority of the extant political strategy literature focuses on firms' interactions with legislative actors (Hillman & Hitt, 1999; Keim & Zeithaml, 1986; Schuler, Rehbein & Cramer, 2002), we consider whether the insights derived in these studies also may apply to firms' interactions with regulators. Broadly, the literature addresses two main questions: *how* to influence policy makers and *when* to engage in political strategies. We examine each in turn.

Hillman and Hitt (1999) provide a useful taxonomy of how firms implement political strategies, identifying the choice of tactics (informational, financial, constituency building), the level of participation (collective, individual) and temporal consistency (relational, transactional) as central strategic dimensions. On some aspects, such as the level of participation, firms have the same choices in deciding how to influence regulators as they do when influencing elected politicians. For example, firms may lobby regulators either individually or collectively as part of an organized interest group in order to convey information about policy alternatives and consequences. De Figueiredo and Tiller (2001) find that large firms tend to lobby individually when there is a risk that sensitive information might leak out through a trade association lobbying body.

On other dimensions, however, the strategies that firms apply to their interactions with legislators do not translate as smoothly to the regulatory arena. First, in the choice of tactics, firms typically do not have the opportunity to make financial transfers to regulatory officials or to provide constituency-building services. Regulators are usually appointed rather than elected, and prohibited from accepting resources from the firms they oversee. Providing salient information is thus the main tactic available to firms when directly interacting with regulatory bodies (Buchholz, 1990). By contrast, Schuler, Rehbein and Cramer (2002) find that firms carefully craft the mix of such tactics when dealing with legislators, balancing the relative emphasis on financial or informational approaches for instance. Second, since regulators generally devise and implement policy on an on-going basis, transactional relations based on one-off specific policy issues become less feasible. As Hillman and Hitt suggest, regulated firms are more likely to adopt a longer-term, relational approach to their non-market interactions. Thus, while recent theoretical and empirical work suggests that firms strategize over the methods by which they work with elected legislators, only a limited range of such methods apply to regulator interactions.

A related body of research, commonly referred to as the Life Cycle Model (Buchholz, 1990), considers the timing of firms' political strategies: *when* should firms intervene in the policy process in order to gain maximum influence? This approach relates the development over time of public policies to the firms' optimal political strategies. The Life Cycle Model (LCM) depicts a linear policy-making process, with policy moving through three distinct stages: first, public opinion formation when issues become salient in public arenas such as the media; second, policy formulation in legislative or executive institutions; and, third, policy implementation by regulatory and judicial institutions. Strategic prescriptions for firms based on the LCM have concentrated on the first two stages. Hillman and Hitt (1999) argue that firms will initially rely on grassroots constituency-building activities during the public opinion formation stage, then engage in financial and informational strategies during the policy formulation stage. Others suggest that influence should be directed as early as possible in an issue's life cycle in order to shape the construction of the issue (Keim, 2001). Success at an early stage could pre-empt the need for subsequent action in regulatory or judicial arenas.

While the LCM derives general strategic prescriptions for firms that are founded on a clear model of the broader policy-making process, we argue that it is less relevant for industries already regulated by government agencies. First, the emphasis of the LCM has been on preventing policy issues from developing or progressing to the point where regulatory strategies are required. Second, the linear policy model does not describe the typical policy process in regulated sectors such as electricity, telecommunications and pharmaceuticals where new public policies or proposals frequently originate within regulatory agencies - rather than within legislative institutions or public arenas. This implies that regulated firms primarily need to manage their interactions with regulators, potentially as well as with legislative actors, though the LCM is relatively silent on how best to achieve this.

In sum, much of the existing political strategy literature does not distinguish between regulated and non-regulated firms or provide many insights on how regulated firms can improve their policy environment. Here, we contribute to this broader stream of research by addressing a strategic issue that is of particular importance to regulated firms: *whom* to target? Regulated firms have direct interactions not only with regulatory agencies but also with legislators and legislative committees who oversee agency decisions. Since formulating public policies in regulated industries is a time-consuming and continuous task, requiring high levels of expertise, legislatures typically delegate authority to agencies to design and implement regulatory policies (Bawn, 1995; Epstein & O'Halloran, 1994). At first blush, one might infer that firms should target their political strategies at working with regulatory officials. However, regulatory agencies do not operate entirely independently from legislative, executive and judicial institutions: regulators' decisions are subject to subsequent oversight by legislative committees and the associated threat of being overturned by the enactment of new legislation (Weingast & Moran, 1983; McCubbins & Schwartz, 1984). Political institutions also appoint regulators and set their budgets – issues that regulators care about. Regulators may also be challenged in appellate courts by affected parties. Regulators thus make policy decisions in the shadow of potential political or judicial retribution. From the regulated firm's perspective, the strategic question is how much weight to put on influencing regulators directly – through lobbying – and how much weight to put on targeting indirect channels – influencing legislative or executive institutions – in order to put pressure on the regulatory agency.

Hostile Regulatory Regimes and Corporate Political Strategy

In order to address this issue, we build on the LCM approach by drawing on the insights from Positive Political Theory (PPT) which explore interactions between regulatory agencies and legislative, executive and judicial institutions. In the same way that the extant political strategy literature uses the Life Cycle Model of the public policy process to develop implications for firm strategy in non-regulated industries, we use PPT to develop a basic understanding of the policy-making process that applies specifically to *regulated* firms. Understanding precisely why firms sometimes confront hostile regulatory policies enables us to then tease out strategic prescriptions for ameliorating them. In general, hostile regulatory policies arise when the regulator places a greater weight on opposing interest groups' preferences than on the firm's.

The PPT literature enhances our understanding of how institutional *suppliers* of public policy interact with each other to generate public policy (Bonardi, Hillman & Keim, forthcoming; Getz, 1997; Hillman & Keim, 1995; Schuler, Rehbein & Cramer, 2002; Weingast & Marshall, 1988). An important insight from this body of research is that regulatory agencies, even though having their own natural preferences over policy decisions, are likely to act strategically with respect to other institutions in the policy-making process. For instance, if regulators face retribution from legislators if they were to implement 'extreme' policies, they will tend to moderate their policy decisions. Regulatory policies are thus determined by the structured interactions of self-interested government institutions, namely executive, legislative, administrative and judicial bodies. (Holburn & Vanden Bergh, 2002 and 2004; McCubbins, Noll & Weingast, 1989; Weingast & Moran, 1983).

The implication of such strategic institutional behavior is that observed hostile regulatory policies may be driven not by regulatory agencies with intrinsically hostile preferences, but instead by unfavorable political conditions that induce regulator compliance. The extant PPT literature models the interactions between regulators and political institutions to identify the situations or 'regimes' where regulators will defer to political actors and those regimes where they have regulatory discretion to implement their preferred policies. To date, however, firms or organized interest groups have typically been excluded from analytical models of the policy process. Our goal here is to extend this analysis by introducing a firm as an additional actor into the structured-interaction approach of the PPT literature, and hence to develop insights into the design of political strategy. Different types of regulatory regimes have quite different implications for how firms will respond when selecting the targets of their political strategies.

We now outline three fundamental types of regulatory regime, each of which is hostile from the firm's perspective, that are generated by different underlying political conditions. While our analysis of these regimes is based on a PPT model of the interaction between a regulatory agency, a bicameral legislature and an executive branch of government, we discuss here only the intuition that explains why regulators implement adverse policies. This lays the groundwork for extending the model to include a firm and for an analysis of political strategy. The context for our analysis is the United States where regulatory agencies such as the Federal Communications Commission or state Public Utility Commissions have been delegated authority by the relevant legislature to implement a statute. The regulatory agency is thus the active institution determining public policy in its domain. It does so under the oversight of the House, Senate and executive branch; the House and/or Senate have the option of introducing new legislation to modify or strike down the regulator's decision. In order to overturn the regulator through an alternative policy via statute, it must pass in both chambers of the legislature and be signed by the executive. To simplify the analysis, we consider the interaction between political institutions and a single firm rather than multiple competing firms. While this assumption imposes some limitations on our conclusions, it nonetheless represents situations where firms are relatively well organized politically compared to competing interest groups. This may occur when the benefits to the firm are highly concentrated and the costs to other interests are relatively dispersed (Wilson, 1980). Indeed, Baumgartner and Leech (2001) find in a random sample of 137 policy issues that firms are typically not engaged in hotly contested battles with other interest groups.

The three regimes are distinguished by different configurations of institutional policy preferences on a single regulatory policy dimension (Poole & Rosenthal, 1997). In keeping with existing PPT models (Ferejohn & Shipan, 1990; Vanden Bergh & de Figueiredo, 2003), we assume that each institution has a representative natural or 'ideal' policy position that it prefers to others, *all else equal*. The ideal points of the legislature and executive reflect two basic factors: the preferences of relevant voter-constituents that determine their electoral success (the ideal point of a legislative chamber reflects that of the median member) (Mayhew, 1974); and political ideology (Kalt & Zupan, 1984). As an example, the ideal policy positions on environmental pollution issues for politicians in states with significant manufacturing employment bases will tend to be less in favor of mandating costly pollution control regulations than politicians in states dominated by service sector employment. [1] We further assume, consistent with prior studies, that the ideal point of the regulatory agency reflects that of the appointing political institution(s) (Bawn, 1995; Vanden Bergh & de Figueiredo, 2003). In common with other studies (Krehbiel, 1999), we assume that the effect of a firm's political tactics is to gain the support of an institution for a policy other than that institution's ideal point. Since politicians value the resources that the firm can provide (financial or informational) they may support a policy other than their ideal in exchange for these resources.[2] An institution's actual policy *decision* thus reflects the combination of its ideal policy preference, the interaction with other institutions, and the firms' political resource contributions.

Regime 1: Hostile, Unconstrained Regulator

In the first type of regulatory regime, the regulatory agency has the ability to rule at its preferred position without the credible threat of subsequent statutory override. In the absence of firm political activities, an agency that is naturally disposed against the firm's position will implement policies that are relatively hostile. Such a regime occurs when the regulator has 'moderate' preferences relative to the *legislature and executive*. It is helpful to represent the three regimes on a single dimensional liberal-conservative policy space where each institutional actor has an ideal policy position (see Figure 1). The ideal policies for each of the firm, regulator, house, senate and executive are represented by F, R, H, S and E respectively. Consistent with the PPT approach, we assume that each institution's benefit or utility deriving from a policy declines at an increasing rate in the distance of the policy outcome from its ideal[3], and increases in the amount of political resources received from the firm. All else equal, each institution prefers a policy that is closer to its ideal point.

A moderate regulator's ideal point lies within the range between the minimum and maximum ideal points of the house, senate and executive (we refer to this range as the 'political core'). One would expect to see this type of regime when policy preferences are quite heterogeneous across legislative and executive branches of government. This is more likely to occur when the house, senate and executive are controlled by different political parties. In this regime, the regulator has discretion to rule at its ideal point, R, since there is no alternative policy that each of the house, senate and executive jointly prefer. Consider an attempt by the house to make policy more liberal by introducing a new bill – which would overturn the regulator's ruling

– that is to the left of the status quo on our policy dimension. In response, the senate would veto any such bill as enactment would leave it worse off, thus maintaining the status quo. Since the regulator is not constrained by the legislature or executive in this type of regime, the regulator is the *pivotal* institution and the equilibrium resides at R. Absent the firm's political activities, the regulator maximizes its utility by setting policy at R. By pivotal, we mean that a change in the policy supported by that institution induces a change in the location of the status quo regulatory policy.

INSERT FIGURE 1 HERE

Which institution does the firm target in its political strategy in seeking to shift regulatory policy outcomes away from such a hostile equilibrium? By providing new information on policy alternatives and consequences (i.e. lobbying), by making campaign contributions or by engaging in grassroots support-building activities, the firm is able to shift the policy supported by the target institutional actor. The firm is then able to gain the support of that institution for a policy other than that which would obtain in the absence of the firm's political activities. Given that the regulator in Regime 1 has the discretion to implement its preferred policy, the firm will target its strategy on directly encouraging the regulator, for example by lobbying, to promulgate a new rule that moves policy closer to F. Even though the house in Regime 1 is subsequently made worse off compared to the status quo, there is no alternative policy that makes all political actors jointly better off. The absence of a credible political response thus enables the regulator to respond to the firm's proposal. This means that the firm uses its political strategy to shift policy to the right of R in Regime 1. Even though the regulator reduces its utility, *all else equal*, by moving policy away from its ideal point, it is sufficiently compensated by the firm's informational resources so that net it is just better off than by leaving policy at R.

The precise location of the regulator's ruling depends on the cost to the firm of its political strategy and the benefit in terms of a more conservative policy. In general, the firm will invest in gaining the support of the regulatory agency up to the point where the marginal cost just equals the marginal benefit. If it is relatively inexpensive to gain the support of the regulator for alternative policies, the firm will be able to achieve a ruling some distance from R and much closer to F. To achieve policies between R and E (the conservative boundary of the political core), the firm need only target the regulator. [4] This leads to our first proposition:

> *Proposition 1: Regulated firms will target their political strategies at the regulatory agency when the regulator has 'moderate' policy preferences relative to the legislature and executive.*

Regime 2: Friendly, Constrained Regulator

Regulatory agencies do not always make policy decisions free from the credible threat of a legislative override, however. We consider first the situation where a regulator that is relatively aligned with the firm is nonetheless extreme compared to the preferences of the political actors (see Regime 2 in Figure 1). (Unlike a moderate regulator, an *extreme* regulator has an ideal policy point that is outside the 'political core'). Such an environment may occur following political elections which lead to a change in party control of the legislature and/or executive but not immediately in regulatory agencies where heads are appointed for fixed terms that do not coincide with election years.

In this setting the regulator will be concerned that the legislature and executive will overturn an agency decision at or close to the regulator's ideal point. Suppose for instance that a friendly regulator ruled at R. Since R is outside the political core, the senate or house could propose an alternative to the left of R that each political institution would prefer since the alternative would be closer to each of their ideal points. The legislature and executive could thus feasibly overturn the regulator's policy. Recognizing this constraint, the regulator establishes the status quo through a ruling that is as close to its ideal as possible without triggering a statutory response. Here, the agency will rule at the ideal point of the executive: this is the closest position to the agency's ideal that is insulated from political override.[5] Any attempt by the house or the senate to move policy away from E and closer to their ideal points will be vetoed by the executive.

The pivotal institution for the firm has thus shifted from the regulator in an unconstrained regulator context to the executive in this example. Attempts by the firm to influence the friendly regulator alone will not change the binding constraint created by a house, senate and executive that are all to the left of (i.e. more liberal than) the regulator. Instead, for the firm to move policy closer to F, it must target the political institution that is *closest* to the firm's ideal (the executive in this example), which will then induce the regulator to rule closer to F. Relaxing this constraint – lobbying or making financial contributions such that the pivotal political institution supports a policy closer to the firm's ideal – enables the friendly regulator to update its ruling in the same direction. That is, the regulator makes a rule to the right of E. Again, the position of the final equilibrium ruling occurs at the point where the marginal cost of gaining the support of the pivotal political institution just equals the marginal benefit of improved policy.

> *Proposition 2: Regulated firms will target their political strategies at the political institution whose ideal point is* ***closest*** *to the firm's ideal point when the regulator's policy preferences are aligned with the firm but 'extreme' relative to the legislature and executive.*

Regime 3: Hostile, Constrained Regulator

In the third type of regulatory regime the regulator similarly has extreme preferences compared to the legislature and executive though now it is opposed – i.e. hostile – to the firm's position (see Figure 1). A hostile regulator in this situation is prevented from ruling at its ideal point by the prospect of statutory override by political institutions that are more sympathetic to the firm's interests than the regulator. Now, however, the constraining political institution is that *furthest* from the firm's ideal – the house rather than the executive in the example in Figure 1. Any regulatory policy to the left of the house's ideal point will trigger a response from the legislature in the form of a bill that lies closer to H and S. Since the regulator does not wish to be overturned by the legislature, the regulator will promulgate a policy as close as possible to its own ideal without triggering a statutory response. In Figure 1, the policy equilibrium in the absence of the firm's influence is located at the House's ideal point.

In this type of regime, the political institution furthest from the firm's ideal is the pivotal institution (compared to the institution closest to the firm in the Friendly, Constrained Regulator regime). In order to move policy closer to F, then, the firm targets its political strategy on the most *opposed* political institution. Doing so obtains the support of that institution for a policy other than its ideal point (i.e. to the right of H in Regime 3, Figure 1). Gaining the support of this, the pivotal institution, for a more favorable policy will induce the regulator to accordingly update its rulings closer to F. Attempts by the firm to influence non-pivotal institutions alone (the executive or senate in Figure 1) will not change the binding constraint created by the pivotal institution (the house). Indeed, for small movements in policy, the senate and executive are made better off by the house supporting a more conservative policy. Hence:

Proposition 3: Regulated firms will target their political strategies at the political institution whose ideal point is ***furthest*** *from the firm's ideal point when the regulator's ideal policy preferences are opposed to the firm and 'extreme' relative to the legislature and executive.*

In sum, we have analyzed the strategic interaction between a regulated firm and government institutions, building on existing models of regulatory behavior, to generate some testable predictions about which policy-making institution the firm will target. The structured interaction approach to political strategy assumes that firms pursue a particular policy objective while at the same time seeking to minimize associated political strategy costs. At an abstract level, one may view the firm as solving a linear programming problem where the firm's objective is to maximize the net benefits of its political activities (Nayyar & Kazanjian, 1993). The critical constraints for the firm are not internal resource constraints but instead external, political constraints. The set of constraints for the firm specifies the relative configuration of veto points among different branches of government which determine the final public policy.

Our approach helps us to identify the environments when regulated firms are more likely to directly lobby regulators when seeking public policy changes rather than indirectly put pressure on agencies by gaining the support of political actors such as legislative committees who oversee agency behavior. We are able to predict whether, in the latter case, firms will seek the support of political institutions that are relatively hostile or those that are relatively friendly.

We further highlight that whether a regulatory agency implements friendly or hostile policies does not depend solely on the policy preferences of the regulatory agency. For instance, a regulator that is aligned with the firm will have to temper its decisions if opposed by a politically unified legislature and executive that has the inclination to cut its budget, not reappoint the regulator or to pass an overriding bill (as in Regime 2). Similarly, a naturally hostile regulator may implement policies that are relatively favorable to the firm if political institutions are closely aligned with the firm's position. It is thus the interaction between regulator and political preferences, rather than naïve regulator preferences alone, that affects the extent to which firms confront more or less favorable policy environments.

Although we concentrate on understanding how firms develop strategies in hostile regulatory environments, our framework also enables us to consider friendlier circumstances. In general, the closer (further) is the pivotal institution to (from) the firm's ideal point, the more friendly (hostile) is the regulatory regime. When a friendly regulatory agency is pivotal – i.e. unconstrained by political institutions – the agency will implement favorable policies from the firm's perspective without the need for lobbying by the firm. In this type of situation, where the policy equilibrium is naturally close to the firm's preferred position, the firm does not invest heavily in political strategy activities. Figure 2 summarizes this insight along with our first three propositions.

INSERT FIGURE 2 HERE

Naturally, our analysis does not predict the *total* amount of electoral campaign contributions or lobbying the firm expends on each political institution. Aggregate campaign contributions to individual elected politicians, for instance, depend on a variety factors including prior political experience, incumbency, electoral vote margin, membership of legislative committees, party affiliation and ideology (Grier, Munger & Roberts, 1994). For simplicity we have also omitted from our model any variation in the saliency of policy for political actors: for policies that are highly salient in election outcomes, politicians will be less willing to provide policy favors for firms if doing so would significantly reduce electoral support - thereby making political strategies less effective and, in the limit, not worthwhile from a cost-benefit perspective. A more involved model would account for variation in saliency though the broad thrust of our conclusions would still remain. Our contribution here is to argue that the institutional location of a politician – whether that individual is a member of the *pivotal* institution – also affects the firm's overall calculus on whether to expend resources on that individual and, if so, how much.

THEORETICAL EXTENSIONS

Having established our informal structured-interaction model of firm-regulator-politician behavior, we now apply our approach in examining several further issues that have received attention in the political strategy literature: the overall attractiveness of political markets; firm political strategy in parliamentary government systems; and firm strategy in dynamic political environments. In doing so, we highlight how *supply-side* factors shape the design of firms' political strategies.

The Analysis of Political Markets: Appointed versus Elected Regulatory Agencies

Recent work on corporate political strategy has sought to determine the characteristics of 'attractive' (i.e. profitable) political markets for firms in much the same manner as Porter did for product markets (Porter, 1980). Bonardi, Hillman and Keim (forthcoming) argue that public policies arise from the interaction of demanders – firms, organized interest groups, voters – and suppliers of such policies – regulatory agencies, legislatures, executives and courts. Favorable political markets arise, for example, when firms confront minimal demand-side rivalry, such as when consumers or competitors are poorly organized in lobbying political actors; in these environments firms will be more able to gain political support for their preferred policies to be implemented.

While this stream of research emphasizes demand-side conditions, our approach complements the broader analysis with a supply-side view of political markets that integrates multiple political institutions. Independent of interest group rivalry, our analysis predicts that some political environments are naturally more hostile than others from the firm's perspective. We highlight here one particular institutional feature – the selection method of regulatory agency heads – that research has demonstrated can have strong implications for the location of a regulator's ideal policy preference (Gormley, 1983; Besley & Coate, 2003). While in the United States agency heads are usually appointed by executives (i.e. state governors or the President), it is not uncommon for heads of some agencies to be directly elected by the voting electorate. Heads of agencies regulating the public utility, agriculture, and insurance sectors, for instance, are each elected in more than ten states. Theoretical and empirical studies suggest that, compared to appointed agencies, elected agencies tend to place greater weight on consumer interests than those of regulated firms (Besley & Coate, 2003).

The pro-consumer bias of elected regulators suggests that the ideal policy positions of elected regulators generally lie to the left of appointed regulators on a pro-consumer/pro-regulated firm policy dimension. This does not necessarily imply that elected regulators will always implement pro-consumer policies - a politically unified legislature and executive that placed greater weight on regulated firm interests would temper the actions of an elected agency.

Nonetheless, even without knowing the precise location of political institutions' ideal policies (e.g. of the Governor, House and Senate), we are able to make a probabilistic prediction about the type of regulatory regime that exists in any given state: since elected regulators are more likely to have ‘extreme’ preferences relative to the governor and legislature than appointed regulators, jurisdictions with elected regulators are more likely to have *constrained* regulatory regimes (e.g. Regime 3 in Figure 1). Similarly, since the ideal policy positions of appointed regulators will tend to reflect the preferences of the appointing institutions (typically the Governor with the consent of the Senate), jurisdictions with appointed regulators are more likely to have *unconstrained* regulatory regimes (e.g. Regime 1 in Figure 1). From the regulated firm’s perspective, the pivotal institution in elected-regulator states is thus more likely to be the governor or legislature while in appointed-regulator states it is more likely to be the regulator. All else equal, then:

Proposition 4: Regulated firms are more likely to target their political strategies at political institutions than at the regulatory agency when regulatory agency heads are elected. In appointed regulator jurisdictions, firms are more likely to target the regulatory agency.

Firm Strategy and Intertemporal Political Dynamics

In addition to teasing out implications for how firms navigate the threats created by elected regulators, our model yields insights into firm strategy in an intertemporal context. Periodic elections in political jurisdictions can have the effect of replacing incumbent coalitions with new political parties that have different policy positions. An emerging political economy literature finds that in environments characterized by greater political volatility – where control of state offices by incumbent parties tends to be short lived – public policies also tend to exhibit greater volatility (Henisz, 2004). Some states in the U.S. exhibit considerable instability in party control: in Maine for instance, party control over the last 25 years has flip-flopped between the Democrats and Republicans four times in the senate, three times in the house and four times in the governor's office. Massachusetts, by contrast, has experienced long-term Democrat control of the legislature (with large majorities) and only two changes in control of the governor's office since 1979. Policy volatility creates challenges for firms and investors when the performance of market-based investment strategies depends on long-term policy stability and predictability, as is particularly the case in infrastructure industries for example.

How do firms design political strategies in unstable political environments such as Maine? Hillman and Hitt (1999) suggest that firms will adopt more transactional approaches - where campaign contributions, for instance, are exchanged as a quid pro quo for immediate policy favors - since opportunities to develop long-term cooperative relations with key political power brokers are limited. When firms expect extant regimes to persist, on the other hand, they will utilize a stronger relational political strategy over time, developing close ties with pivotal political or regulatory officials in order to improve flows of credible information and mutual trust.

We argue that regulated firms also respond to political volatility by shifting the target of their political strategies. Generally in more unstable political environments, there is a greater likelihood that appointed regulators will have 'extreme' rather than 'moderate' ideal policy positions compared to political institutions. Regulatory agencies typically consist of several commissioners who are appointed for terms that do not coincide with those of the executive or legislature. At any one point in time, then, agencies include the appointees of prior governments. In stable regimes where past and current governments are controlled by the same parties or coalitions, regulator ideal policy positions will reflect those of current incumbent parties, implying that regulators are more likely to be in the political core and hence ‘moderate’ (e.g. Regime 1).

By contrast, in volatile political environments appointed regulators reflect, at least in part, the preferences of historic political coalitions which differ from current incumbents. Regulatory agencies are then more likely to have ‘extreme’ preferences compared to political institutions. With time, as political actors appoint new regulators when agency commission positions become available, regulatory agencies will shift from being extreme to moderate in their policy outlooks. We thus expect firms will target their political strategies at alternative institutions as follows:

Proposition 5: Regulated firms are more likely to target their political strategies at political institutions than at the regulatory agency in environments characterized by greater political volatility, all else equal.

Firm Strategy in Parliamentary versus Presidential Institutional Systems

Although our structured-interaction approach focuses here on presidential electoral systems with multiple checks and balances, it is also possible to apply it to analyses of corporate political strategy in countries with parliamentary institutions such as Canada and the U.K. In parliamentary countries the executive branch – such as the cabinet – is typically a constituent part of the legislative branch (Moe & Caldwell, 1994). Members of the cabinet are members of, and selected from, elected parliamentary representatives. The governing party, or coalition of parties, relies on its majority within the parliament to propose and enact legislation. Strong party organization and discipline help to ensure that a voting majority is achieved for the government’s legislative proposals. Political power is thus much more concentrated in parliamentary than in presidential systems (Vogel, 1986). The corollary is that it is easier for a parliament than a legislature in a presidential system to punish an errant agency. In terms of our framework, we can represent the ideal policy preference of a unicameral parliament such as the U.K. with a single ideal point. The regulatory agency still has a separate ideal point (which can arise if, for example, commissioners are appointed by previous parliaments). In this sense, regulatory agencies have less discretion to design regulatory policies that stray too far from the preferences of the elected parliamentary majority party or coalition (the ‘political core’ in Figure 1 shrinks to a single point).

What are the implications for how regulated firms target their political strategies in parliamentary institutions as compared to presidential systems? Hillman and Keim (1995) argue that firms in general will tend to focus more on the executive branch (i.e. the cabinet and associated ministries) than on voting members of parliament whereas in the U.S. relatively greater weight will be placed on the legislature. To the best of our knowledge, no research has considered the balance of regulated firms’ political strategies on regulatory agencies versus elected politicians in different national settings. Our framework suggests that, all else equal, regulated firms will place relatively greater emphasis on gaining the support of elected politicians in parliamentary than in presidential environments. Since regulatory agencies have to pay especially close attention to parliament’s policy position (agencies cannot be ‘moderate’ as in Regime 1 in Figure 1), firms will be less successful in lobbying the agency unless they simultaneously gain the support of parliament.

In sum, reframing our structured-interaction model in a parliamentary context yields insights into how differences between countries in the formal institutions that govern the relationships between regulatory agencies and political principals generate expected differences in firms' political strategies, including the targeting of institutional venues that shape policy decisions.[6] Although simple, our predictions lend themselves to empirical testing. One might observe such differences by examining the local strategies of multinational firms that operate in several institutional environments, for instance tobacco or pharmaceutical firms. While existing research finds that MNCs tailor their financial campaign contributions to national political environments (Hansen & Mitchell, 2001), there are no studies yet on comparative regulatory strategies. Our sixth proposition is thus:

Proposition 6: Regulated firms will target their political strategies more at political institutions than regulatory agencies in parliamentary government systems as compared to presidential systems, all else equal.

OPPORTUNITIES FOR EMPIRICAL ANALYSIS

We now suggest two broad approaches for empirically testing our propositions. The first method relies on a cross-sectional analysis of regulatory regimes in various political jurisdictions (e.g. the 50 states in the U.S.) and the correlation with a measure of firm political strategy. Much of the state-level data required for such an investigation is publicly available. For instance, detailed historic data on individual firms' electoral campaign contributions to candidates for political office in most states is available through the Institute on Money in State Politics. Such data allows the researcher to determine whether particular firms, industries or other interest groups are targeting the governor, house or senate in their financial-political strategies.

Accurately identifying underlying policy preferences of political and regulatory institutions, and hence the precise regulatory regime, is likely to be a more challenging, but still feasible, task. Public statements by policy-makers and observed legislative votes on particular issues reflect the impact of firms' political efforts (as well as ideological considerations), making these biased measures of underlying ideal positions on policy. Political ideology scores and measures of partisan control, however, have the potential to provide proxies for regulatory regimes. Hanssen (2004) uses an innovative approach to developing *state*-level ideology scores for each house and senate based on well-established federal measures (Poole & Rosenthal, 1997). Such ideological scores have been found to consistently explain approximately 90% of the variation in legislative voting on a wide range of policy issues. State-level scores enable researchers to gauge the policy distance between legislative chambers on a liberal-conservative axis. Similar scores for regulatory agencies may be imputed as the weighted average of the scores for legislative and executive institutions that appoint agency heads. Although we only sketch the outline here, we believe the ingredients exist for empirical identification of regulatory regimes.

As an illustration of how political strategy researchers can use cross-sectional variation in institutional environments, we consider here a specific application to the U.S. electric utility sector. Electric utilities are regulated at the state level by Public Utility Commissions (PUCs) that determine rates, investment and entry into the industry (Holburn & Vanden Bergh, 2006; Hyman, 2000). Across the fifty U.S. states there is natural variation in political environments and the design of regulatory institutions that we argue has implications for the ways in which utilities target their political strategies. A central difference between the states is whether PUC commissioners are elected by voters or appointed by the state governor and legislature. Research has shown that, on average, elected PUCs tend to allow utilities to earn lower financial rates of return and to set consumer rates at lower levels than appointed PUCs (Holburn & Spiller, 2002;

Besley & Coate, 2003). This provides a setting for us to demonstrate how researchers can empirically examine Proposition 4. We collected all publicly-available data from the Institute on the Money in State Politics on political campaign contributions by electric utilities in each of approximately 40 states to legislative and gubernatorial candidates during the years 2000 and 2002. Ten of these states have elected PUCs, the remaining have appointed PUCs. While there are limitations to using PAC data as a measure of firm political strategy (Milyo, Primo & Groseclose, 2000; Schuler, Rehbein & Cramer, 2002), it can provide insights into one dimension of firm influence activities. In Table 1 we present the average percentage of total contributions received by each type of candidate that came from electric utilities.

INSERT TABLE 1 HERE

The comparison of the relative importance of political contributions in the two state types is striking: in every instance, electric utilities' contributions were larger, relative to total contributions, in elected than in appointed states. For example, electric utilities made contributions to 2002 House candidates in appointed-PUC states totaling 1%, on average, of all contributions received. The equivalent figure for contributions to House candidates in elected-PUC states was significantly greater at 1.95%. The same pattern holds for contributions to gubernatorial candidates as well as to candidates for the senate, and in both years examined: electric utilities contributed relatively more to politicians in elected- than in appointed-regulator states.

Although we do not attempt to control for other explanatory factors here, these simple descriptive statistics are illustrative of our prediction that utilities will seek to shape regulatory policy by targeting political institutions more in elected- than in appointed-PUC states. Future research could undertake a systematic statistical analysis using these types of data and identify which specific institution is pivotal in each state, enabling rigorous tests of our propositions.

The second approach to empirical investigation uses time series data within a single jurisdiction and looks for changes in firm political strategy following a change in the regulatory regime. Suppose that an election turned a heterogeneous political environment into one where party control was aligned among the legislature and executive. If the consequence of such a change was to turn the regulator from being moderate to extreme (i.e. Regime 1 to Regime 2), we would expect the firm to shift its political strategy towards political actors and away from the regulator. Specifically, after the regime change we would expect the firm to devote a greater share of political strategy expenditures on the pivotal political institution.

We again use the electric utility industry to illustrate – in the case of a single state – how time series variation might be leveraged to test our framework. New Jersey experienced a dramatic change in party control of political institutions at the end of 2001. State elections in November 2001 resulted in the Republicans losing the governor's office *and* their majorities in both the assembly and senate (see Table 2). The Board of Public Utilities (BPU), however, consisting of up to five commissioners appointed by the governor, remained dominated by Republican appointees for two years after the elections – implying that, compared to the political alignment with the Republican governor and legislature up to 2001, the BPU would have been constrained by the new Democrat political environment in 2002 and 2003 (akin to Regime 2 in Figure 1). The utilities, therefore, would have had an incentive to target the pivotal political institution (i.e., closest to their ideal) to gain support for maintaining status quo policy implemented by the BPU. During this political shift, even though the Republicans lost their previous majority in the 2001 election, the senate became evenly split with the Democrats and

Republicans each holding 20 seats in 2002 and 2003. Compared to the assembly that had an outright new Democrat majority, the senate was finely balanced between competing parties. Although difficult to conclusively identify, it seems likely that the senate would have been the pivotal political institution in 2002/03 and hence the target for utility support.

INSERT TABLE 2 HERE

It is interesting to note that electric utilities substantially re-allocated their campaign contributions between the assembly and senate in the post-election period. In the 2002/03 cycle, electric utilities spent more than 80 percent of their campaign contributions on candidates for the senate. This was a substantial increase on the 2000/01 cycle when the equivalent share was 45 percent.[7] In other words, electric utilities placed substantially greater emphasis on targeting the senate following the dramatic change in political control of elected government institutions that likely made the senate pivotal.

This example suggests only a potential correlation between changes in political conditions and changes in political strategies. We present it here as an example of the type of empirical approach and data that researchers could employ in a broader scale study of the framework's propositions. A statistical analysis that incorporated political regime shifts in other states and other time periods, as well as control variables, could help determine whether the pattern of firm behavior observed in New Jersey is representative of a more general targeting strategy.

DISCUSSION

As many governments have sought to reduce their scope of activity within national economies in the recent past – through privatization of state-owned organizations, joint public-private partnerships or outsourcing of administrative functions – private firms are increasingly engaging in businesses that were once the sole domain of the state. However, while governments are shifting the emphasis on ownership from the public to private sectors in industries as diverse as electricity to prison construction and management, they are still maintaining a degree of regulatory control over critical policy dimensions. Firms in a wide array of industries are thus subject to regulatory oversight of some aspects of their business such as product pricing, input sourcing or process techniques. Even in industries not traditionally regulated, the growth of environmental interest groups has led to the threat of new regulations being imposed (King & Lenox, 2000). For many firms, then, understanding how to manage their regulatory environment is an important part of their overall business strategy.

In this paper we examine how regulated firms target their political activities across multiple government institutions -- a strategic issue that has not yet received attention in the political action literature. Drawing on both political science and management literatures, we develop a stylized model of the interactions between a firm, a regulatory agency and multiple political institutions, where observable constitutional rules govern the policy-making process, including the powers of initiation and veto. In keeping with prior research, we adopt the view that both public and private actors behave in a self-interested manner; each actor seeks to maximize its payoffs given the political constraints created by other actors in the process. The firm, anticipating the subsequent behavior of public actors given their preferences and the overall policy process, is able to calculate its optimal political strategy.

We derive propositions that explicitly consider the conditions when firms find it optimal to target legislatures or executives instead of regulators in order to indirectly shift regulatory rulings. The critical assumption in our paper is that regulatory agencies behave strategically with regard to their political principals. Since legislatures and executives have the ability to punish errant agencies through budgetary cuts, committee hearings and the enactment of new statutory constraints, regulators have an incentive to make policy rulings that account for political preferences. As such, regulator-determined public policies are shaped not by regulators alone, but also by the shadow of legislative and executive bodies. Our structured interaction model leads us to identify distinct regulatory 'regimes' defined by whether the regulatory agency has 'extreme' or 'moderate' underlying policy preferences relative to the political institutions. In different types of regime, regulatory agencies either have discretion in policy-making or else are constrained by elected political institutions.

As we develop in detail in the paper, the implication of our regime analysis for regulated firms is that they may be able to induce changes in administrative decisions not by directly influencing the regulator, for example by lobbying, but instead by shifting the policy preferences of elected political institutions. In fact, in this type of environment, a strategy of interacting solely with the regulator – as the Life Cycle Model recommends – could be counterproductive: if an extreme regulator implemented a new policy that triggered a legislative response, the new statutory policy could leave the firm worse off than the pre-existing status quo. Our analysis of which institution is pivotal in each regime enables us to predict which specific political institution will instead be the focus of the firm's approaches. We provide some suggestions on how future research can undertake empirical tests of our predictions.

Our approach is similar in spirit to existing work on business-government relations that explores how different *national-level* institutions affect firm strategy. Hillman and Keim (1995) argue for instance that firms tend to focus their political activities more on the executive branch in parliamentary systems than in presidential systems since the executive has greater control over the legislative process in the former. Our model builds on this work in a micro-institutional setting by arguing that institutional structure *per se* is not sufficient for teasing out prescriptions for the targeting of political strategy. We suggest that structure *interacts* with political preferences and the sequence of policy-making moves to determine which institution is most influential in the process. As our analysis above of different regulatory contexts in a presidential system demonstrates, substantial heterogeneity can exist in the attractiveness of political markets within a single institutional structure, depending on the configuration of political preferences.

At a broader level, one interpretation of our analysis of firms' political strategies is as a rational response to a fundamental characteristic of the political environment, namely the difficulty of making long-term, credible commitments to private actors. Incumbent politicians may influence regulatory policies while in office but they have little power to prevent future political generations from modifying or reversing them, creating uncertainty for firms whose time horizons extend beyond the expected life of current governments. Our model of the deterministic role in formulating policy of the pivotal institution – which has some discretion to set policy but whose identity may change with time or at the next election – reflects one source of policy uncertainty. In our model, the pivotal institution has the ability to trade policy favors with interested parties free from legal or constitutional constraints. While this is a simplifying assumption, our depiction of business-government interactions illustrates how targeted political strategies can benefit firms: by engaging in political and regulatory arenas, they are able to reduce the risks of detrimental policy change.

Naturally there are limitations to our analysis that should lead to caution when interpreting our conclusions. First, we have abstracted from the possibility that the House and Senate may override an executive veto. An override would reflect maximum super-majority preference for the legislative alternative versus the regulator's ruling (Krehbeil, 1999). Similarly, and also for simplicity, we have excluded legislative committees and the courts from the set of institutional players involved in the policy process (Spiller & Vanden Bergh, 2003; Spiller & Gely, 1992; Gely & Spiller, 1990). While incorporating the veto override, committees and the courts would better reflect the institutional rules of the game, the added complexity would not contribute to the qualitative insights of our analysis; the number of regulatory regime types would expand though our approach to identifying pivotal institutions would remain unchanged. More generally, we argue that firms need to understand the broader public policy process – as defined by formal decision-making rules and players' preferences – in order to identify where their political activities will have the greatest leverage.

While discerning politicians' or regulators' preferences can be a challenging task, this is precisely the type of information that is valuable to the firm. Establishing corporate government affairs offices in capitol cities, regularly interacting with government officials, monitoring interest group ratings of politicians' voting behavior (e.g. by ADA or AFL-CIO in the U.S.) and hiring expert lobbyists are all organizational mechanisms for better understanding the political environment. In the constrained optimization view, firms use such information to calculate which political institution is the binding constraint on policy. Our analysis thus enables managers to structure and interpret political environment information and to develop directions for their political strategies.

Second, we have restricted our analysis to the case of a single firm seeking to shape policy outcomes rather than multiple competing firms or interest groups. Our analysis thus represents situations where firms are relatively more organized politically than competitor interests (such as consumers). This is more likely to be the case in industries dominated by a few powerful firms. Introducing a competing group would substantially increase the analytical complexity of the model. Nonetheless, our purpose here is to focus on how the *supply-side* of political markets influences firm strategy rather than the demand-side, and this is achieved with a single interest group.

The third limitation is that by focusing on formal institutional arrangements, we have abstracted from the impact of informal institutions on firm strategy. Informal institutions, including cultures, social norms and taken-for-granted assumptions, guide and constrain behavior as do formal institutional rules (North, 1990). They can thus have a powerful effect on the scope and design of firms' political activities. Differences in bureaucratic norms, for example, in parliamentary and presidential systems can either moderate or augment firms' relative emphases on targeting political actors in the former. The U.K. civil service has a highly professionalized, career-oriented structure that promotes greater independence from political interference (Vogel,1986). Even though in theory the civil service is beholden to parliament, in practice an informal or de facto norm of autonomy has emerged over time that makes it difficult for ministers to always impose top-down political pressure. Greater de facto agency independence will prompt firms to devote more resources to interacting with the agency, all else equal. The Canadian bureaucracy, on the other hand, has not developed such strong informal independence, leading to a more politicized agency environment. While we do not attempt to incorporate an analysis of informal institutions in our model here, we note that they will affect firms' targeting strategies in presidential and parliamentary systems.

Mizruchi (1992) in an analysis of large U.S. firms' political strategies, found that the network of peer relations between firms was an important factor in the amount of campaign contributions; a firm's position relative to powerful firms in the network shaped incentives to imitate others' political strategies independent of external forces. Broader societal pressures have been documented in Hansen and Mitchell (2001): foreign firms tend to have less opportunity to engage in financial political strategies abroad if social norms perceive multinationals as lacking legitimacy and portending negative social welfare consequences. These and other factors are likely to affect regulated firms' optimal targeting of government institutions, though without a careful identification and analysis of specific mechanisms, the direction of the effects is not obvious ex ante. Understanding these effects, and more generally the relationship between, and co-evolution of, formal and informal institutional arrangements, would provide a richer appreciation of the factors shaping firms' political strategies.

To sum up, our central finding is that regulated firms should not necessarily target regulatory agencies in their political strategies when they are seeking more favorable agency decisions. In the right circumstances firms gain greater leverage by instead targeting elected political institutions which can put pressure on the agency to comply. By specifying these conditions we contribute to the existing political strategy literature which has hitherto assumed regulated firms should concentrate solely on their interactions with regulators. We leave theoretical enhancement and empirical assessment of our framework for future work.

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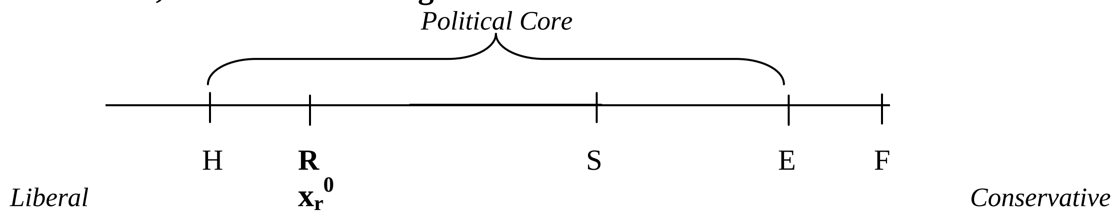
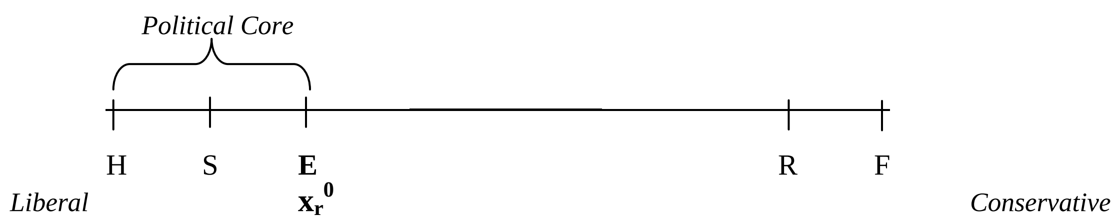
FIGURE 1

HOSTILE REGULATORY REGIMES AND POLICY EQUILIBRIA
IN THE ABSENCE OF FIRM POLITICAL ACTIVITIES

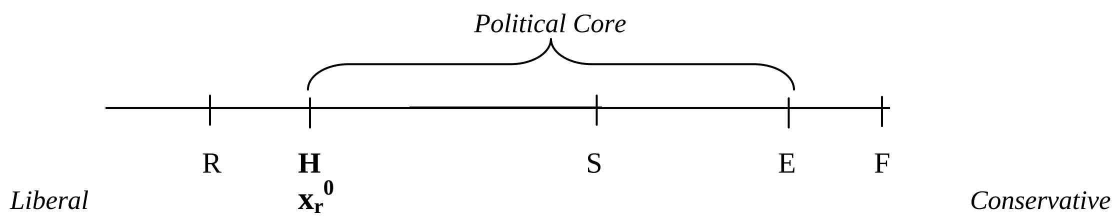
Regime 1: Hostile, Unconstrained Regulator



Regime 2: Friendly, Constrained Regulator



Regime 3: Hostile, Constrained Regulator



KEY

x_r^0 Regulator's equilibrium policy ruling in absence of firm's political strategy
R Regulator's ideal policy
H, S, E Ideal policies of House, Senate, Executive
F Ideal policy of firm

FIGURE 2

INSTITUTIONAL TARGETS OF REGULATED FIRM'S POLITICAL STRATEGY

Regulator's Position vis-à-vis Political Institutions (Legislature and Executive)

Extreme	Political Institution Most Hostile to Firm (Prop 3)	Political Institution Most Friendly to Firm (Prop 2)
Moderate	Regulatory Agency (Prop 1)	[Political Strategy Less Valuable]
	Hostile	***Friendly***

Regulator's Ideal Policy Position vis-à-vis the Firm

TABLE 1
POLITICAL CAMPAIGN CONTRIBUTIONS BY ELECTRIC UTILITIES

	2002 Candidates			2000 Candidates		
CAMPAIGN CONTRIBUTIONS IN STATES WITH ELECTED PUCS	Governor	House	Senate	Governor	House	Senate
Electric Utilities	$351,510	$720,531	$498,727	$72,888	$411,671	$320,057
Electric Utilities / All Sources (average across states in sample)	0.63%	1.95%	1.46%	1.59%	1.84%	1.32%
Number of states in sample	9	9	10	7	9	9
	2002 Candidates			2000 Candidates		
CAMPAIGN CONTRIBUTIONS IN STATES WITH APPOINTED PUCS	Governor	House	Senate	Governor	House	Senate
Electric Utilities	$1,307,752	$4,401,574	$2,760,792	$683,417	$5,151,981	$2,554,030
Electric Utilities / All Sources (average across states in sample)	0.28%	1.00%	0.91%	1.08%	1.24%	1.21%
Number of states in sample*	33	37	36	23	35	35

*The number of states is not equal across all sub-samples since campaign contribution data is not available for all 50 states for all election periods. We included in our analysis all data available.

TABLE 2
POLITICAL CAMPAIGN CONTRIBUTIONS BY ELECTRIC UTILITIES IN NEW JERSEY

	2001 Candidates			2003 Candidates		
CAMPAIGN CONTRIBUTIONS	Assembly	Senate	Senate%	Assembly	Senate	Senate %
Electric Utilities	$21,257	$17,483	45%	$4,100	$19,908	83%
All Sources	$13.3 M	$20 M	60%	$16 M	$20 M	56%
Electric Utilities / All Sources	0.2%	0.1%		-	0.1%	

POLITICAL CONTROL OF GOVERNMENT INSTITUTIONS IN NEW JERSEY

	2001	2002
Governor	Republican (DiFrancesco)	Democrat (McGreevey)
Republican seats in assembly (%)	60%	45%
Republican seats in senate (%)	60%	50%
Republican-appointed BPU Commissioners	3	3
Democrat-appointed BPU Commissioners	0	1

[1] As with the PPT literature we assume that each institution's ideal policy position is exogenous. An alternative approach, which would make ideal policies endogenous, would be to assume that the firm influences policy in two stages. In the first stage the firm invests in election campaigns in order to influence which competing party/individual wins the election. Since competing parties or individuals can have different ideal policy positions, this is one way in which firms can influence political institutions' policy preferences. In the second stage, given the results of the first, the firm implements a political strategy targeted at the appropriate institution in order to shape regulatory decisions (i.e., vote buying and/or lobbying). There is an expansive literature exploring the effect of campaign contributions on election outcomes (e.g., Levitt, 1998; Strattman, 1998). Since very little research has explored firm strategy in the second stage we focus on this here. An interesting area for future research would be to consider integrated political strategy across the two stages.

[2] This is most likely to occur when the policy is not too salient for voter-constituents, providing some latitude for the political actor to adopt a different policy without damaging future election prospects. If policy is too salient, on the other hand, political actors will be unwilling to 'trade' policy for the firm's resources, making political strategy ineffective.

[3] The assumption of utility diminishing at an increasing rate is appealing since it is rare that we see radically liberal (conservative) regulators or politicians make radically conservative (liberal) rulings.

[4] We can extend the model to include secondary targets by explicitly varying firms' marginal cost of trading with a politician. With this extension, the firm may be able to achieve policy outcomes closer to its ideal than the conservative boundary of the political core. Essentially the firm would need to relax the constraint created by the most conservative politician (E in Regime 1). While this extension creates a more complete model of firm strategy, it does not change the general results of this paper: there is a primary pivotal institution in each regime that the firm will have to influence to achieve more friendly policy outcomes. We sacrifice complexity to emphasize primary targets.

[5] If the legislature were to incur a fixed cost of proposing and enacting a statute (e.g. the costs of drafting and negotiating a bill), the regulator would have a wider degree of discretion than the political core: it could rule a little bit to the right of E in Regime 2 and still be safe from political override. While introducing such adjustment costs into the model might approximate reality more closely it would not lead to significant additional insights on the situations when regulators are constrained by political institutions.

[6] It is interesting to note that researchers have frequently commented on how regulated firms typically adopt a cooperative or consensual approach to their relations with government in the U.K. but a conflictual approach in the U.S. (Vogel, 1986). Our informal model of the interactions between regulated firms, agencies and politicians provides a potential explanation for this observed behavior: in presidential systems, firms can gain the support of a 'moderate' regulator but disagree, or conflict, with an opposed political institution since doing so need not trigger adverse legislation – in Regime 1 in Figure 1, for example, the House is powerless to override the agency, leaving the firm free to contest its position. In parliamentary systems such as the U.K., by contrast, firms by necessity must adopt a cooperative approach to working with governments since the ruling party has absolute legislative power – implying that any obstruction by the firm can be readily overridden.

[7] In aggregate there was no similar general shift in campaign contributions from non-utility sources. Furthermore, due to the state election rules following a national census, each seat in the assembly and senate was up for election in both election periods.