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RESEARCH NOTES AND COMMENTARIES

INTEGRATED MARKET AND NONMARKET STRATEGIES: POLITICAL CAMPAIGN CONTRIBUTIONS AROUND MERGER AND ACQUISITION EVENTS IN THE ENERGY SECTOR

GUY L. F. HOLBURN[1]* and RICHARD G. VANDEN BERGH[2]
[1] *Richard Ivey School of Business, University of Western Ontario, London, Ontario, Canada*
[2] *School of Business Administration, University of Vermont, Burlington, Vermont, U.S.A.*

We examine how firms use political strategies to protect economic rents created by mergers and acquisitions against dissipation by regulators. In regulated industries, regulators can impose costly merger conditions, for instance consumer rate reductions in the utilities sector, thereby reducing shareholder gains. We investigate empirically whether and how firms use election campaign contributions to politicians as a method of influencing regulatory merger approvals. In a statistical analysis of campaign contributions by all electric utilities from 1998 to 2006, we find that utilities increased their contributions in the year before they announced a merger and that merging utilities increased their contributions more in states with greater political party competition. Our findings contribute to political strategy research by providing novel evidence that firms integrate market and nonmarket strategies.

INTRODUCTION

While firm performance depends on the design and implementation of both market and nonmarket strategies, the majority of research in these fields has developed separately, implicitly treating market and nonmarket components independently. In most situations, however, the actions that firms undertake in one arena affect optimal strategy in the other. Reflecting the complementarities, a small stream of research has begun to study integrated market and nonmarket strategies, though so far this literature has remained largely conceptual (Baron, 1995; Bonardi, 2004; Schuler, Rehbein, and Cramer, 2002; Shaffer and Hillman, 2000; Shaffer, Quasney, and Grimm, 2000).

In this paper we conduct the first statistical study of integrated strategy, providing new evidence that firms, at least in one industry, design market and nonmarket components of strategy in concert. Our setting is the U.S. electric utility industry, which has undergone considerable restructuring through corporate mergers and acquisitions (M&A) following federal deregulation reforms since 1992

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*Correspondence to: Guy L. F. Holburn, Richard Ivey School of Business, University of Western Ontario, 1151 Richmond Street North, London, Ontario N6A 3K7, Canada. E-mail: gholburn@ivey.uwo.ca
GUY L. F. HOLBURN and RICHARD G. VANDEN BERGH contributed equally to this paper.

(Becher, Mulherin, and Walkling, 2012). A frequently stated rationale for utility mergers is the ability to achieve economies of scale and scope, thereby creating the opportunity for shareholders to appropriate economic rents. Mergers of utilities, however, require regulatory approval from state-level regulatory agencies who set rates. As a condition of approval, regulators have often required merging utilities to reduce rates, thereby shifting some of the expected economic rents from shareholders to consumers. Regulators have broad discretion in setting conditions for approval, creating regulatory risk for the merging parties.

Here we investigate how utilities use nonmarket strategies to protect shareholder rents created during M&A from dissipation by stringent merger approval conditions. Since utilities have only a limited set of tactics for directly influencing regulatory agency decisions—primarily by providing information on regulatory proposals—they have an incentive to exert indirect influence through political channels such as legislative committees and state governors, who oversee agency decision-making, appointments, and budgets. We focus our attention on utilities' financial contributions to state politicians' election campaign funds as our primary measure of nonmarket strategy. We thus examine the extent and conditions under which firms seek *political* support through campaign contributions for favorable *regulatory* approval of proposed mergers. While we test our predictions in the context of the electricity sector, the general thesis, as well as our methodological approach, can be applied to other regulated industries—such as telecommunications, pharmaceuticals, or banking—providing rich opportunities for future research and theoretical development.

INTEGRATED MARKET AND NONMARKET STRATEGIES

The nonmarket strategy research field has developed significant insights into how firms strategically interact with and shape their external environment.[1] Recent research has begun to identify more precisely when, or under what conditions, firms simultaneously invest in, or integrate, market and nonmarket strategies. The approach in this literature is to understand how firms can shape the competitive environments in which they operate through nonmarket strategy (de Figueiredo, 2009). One ploy is for incumbents to seek support for legal or regulatory barriers that prevent competitive entry (Baron, 1997). Or potential competitors may implement nonmarket strategies specifically to overcome barriers to entry.[2] Conversely, firms with superior nonmarket capabilities may utilize nonmarket strategy to offset a competitive disadvantage in market competition, for instance arising from higher costs than those of competitors (Marsh, 1998; Schuler, 1996). In this sense, nonmarket strategies are complements to market strategies since they enable firms to increase the economic rents they earn in the marketplace (Baron, 1999).

Missing in this literature, however, are statistical tests of the thesis, namely that firms engage in nonmarket strategy when doing so enables them to improve their performance in the marketplace. In the rest of this section we outline our specific institutional setting and develop testable hypotheses that guide a novel empirical analysis of the relationship between market and nonmarket strategies.

Embarking on mergers and acquisitions in the utilities sector creates costs and risks for the firms involved. In addition to uncertainties about the magnitude and timing of synergies from combining the operations, assets, and cultures of separate organizations, regulatory agencies can also affect expected outcomes. Pending mergers must obtain the approval of state Public Utility Commissions (PUCs), which have jurisdiction to approve or deny electric utility mergers.[3] PUCs are the primary state-level regulatory agencies that oversee utilities, setting electricity rates and approving operating costs and investments. State laws establish a 'public interest' criterion for merger approval that permits PUCs to share anticipated cost savings with consumers in the form of rate reductions. As an illustration, in the proposed merger between Duke Energy and Cinergy in 2006, PUCs

[1]For surveys of the literature see de Figueiredo (2009), Hillman, Keim, and Schuler (2004), Lux, Cook, and Woehr, (2011) and Shaffer (1995).

[2]To illustrate, 'big box' retailers such as Wal-Mart and Target must often counteract opposition from labor unions, local businesses and/or activists when seeking municipal approvals to build new stores (Baron and Diermeier, 2007).

[3]Electric utility mergers are also subject to review by the Federal Energy Regulatory Commission and the Department of Justice (Graniere and Burns, 1996).

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in the five states where the companies operated obtained rate reductions worth $246 million. Furthermore, PUCs have considerable discretion to redistribute economic rents since there is no established legal standard that dictates the amount or proportion of merger cost savings to be shared with consumers. This has led to the failure of some proposed mergers when PUCs and utilities have not been able to agree on the value of rate reductions.[4] More generally, PUCs have adopted divergent approaches to the conditions they have imposed on proposed mergers. As one consulting firm commented, 'State regulatory approvals present the largest uncertainty and risk in utility mergers and acquisitions' (Boston Consulting Group, 2007).

Nonmarket strategies can enable firms to manage their regulatory environments and to mitigate regulatory risks in M&A proposals (Clougherty, 2003, 2005). One approach is for firms to participate directly in regulatory hearings and to provide information and expert testimony. Due to procedural requirements, regulators must base their decisions on facts and evidence provided to them; failure to do so can trigger a judicial reversal. Firms that demonstrate compliance with policy goals with coherently argued cases can thus influence regulatory outcomes. A complementary nonmarket strategy to participation in regulatory arenas is for firms to exert indirect influence on regulators through political channels (Holburn and Vanden Bergh, 2004, 2008). Although regulatory agencies have authority to make policy without the need for formal political approval, they still have an incentive to account for political preferences. For example, the executive typically controls the appointments process for heads of regulatory agencies: state regulators who stray too far from gubernatorial preferences in their rulings and orders may thus risk nonreappointment in the future. In addition, the legislature can sanction wayward agencies by conducting public hearings and committee investigations into agency actions or even by enacting legislation that curtails agency jurisdiction. Agency budget approvals and appropriations present another mechanism for elected politicians to shape agency decisions.

Firms that build political support for their preferred policy goals can therefore indirectly influence regulatory outcomes. Several tactics may be deployed: lobbying is one mechanism through which firms can communicate their views on policy to political actors (de Figueiredo and Silverman, 2006). Creating coalitions of supportive interest groups and constituencies can also encourage greater political support (Hillman and Hitt, 1999; Lord, 2003). The method that we focus on here is the use of financial contributions to political election campaigns.[5] Research suggests that organized interests attempt to influence legislative and executive policy decisions by making campaign contributions as a *quid pro quo* (Snyder, 1990; Stratmann, 1998). Financial contributions targeted at pivotal legislators, or those in marginal constituencies, have the potential to affect vote outcomes on legislative bills or amendments. Few studies, however, have examined whether, or under what conditions, special interests utilize campaign contributions to politicians to influence decisions made in regulatory arenas (Vanden Bergh and Holburn, 2007). Here we propose that utilities will increase their campaign contributions in the period around the announcement of a merger or acquisition and the subsequent PUC approval process. By increasing contributions, firms have the opportunity to gain explicit or implicit political support for a merger, which is communicated to PUC officials. Although it is possible that contributions may increase after regulatory approval as an ex post 'reward', we anticipate that utilities' campaign contributions will increase in the period before a public announcement is made—as utilities seek political approval in advance. During the preannouncement period, utilities have private information about the proposed deal that protects them from opposition from affected interest groups as well as from the additional media or public

[4]In 2006 the New Jersey Board of Public Utilities (BPU) rejected Exelon's offer of $600 million in credits for New Jersey customers in return for the BPU's approval of merger with Public Service Enterprise Group (New York Times, 2006). This decision came shortly after more than half the members of the New Jersey Assembly sponsored a resolution opposing the deal and calling on the BPU to reject it.

[5]Reporting on the proposed merger involving Constellation Energy Group Inc., *The Daily Record* (2006) provides an illustration of indirect influence; 'The biggest recipients [of campaign contributions] included top politicians and lawmakers that oversee the committees that typically hear energy legislation. Gov. Robert L. Ehrlich Jr. received a $4,000 contribution from Constellation's political action committee in November. Also that month, just weeks before the company went public with its merger plans, the company PAC gave $2,000 to Speaker of the House Michael E. Busch and $1,000 to Sheila E. Hixson, chairwoman of the House Ways and Means Committee.'

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scrutiny of campaign contributions that may be expected following public announcement. Hence:

Hypothesis 1: Regulated firms will increase their political campaign contributions in the period before regulatory review of a proposed merger.

We further expect that campaign contributions will be more important in certain political environments. In jurisdictions where incumbent political parties have large majorities, the risks of future electoral defeat will be smaller, all else equal, thereby reducing the value that politicians place on marginal campaign contributions (Ansolabahere, de Figueiredo, and Snyder, 2003). On the other hand, when political party competition is fierce—as gauged by slim majorities in the legislature—the value of incremental votes for politicians increases (Bonardi, Hillman, and Keim, 2005). Existing research finds that regulatory policy tends to tilt in favor of consumers in politically competitive states (Fremeth and Holburn, 2012), which would imply greater rate reductions required for M&A approval. As a result, when political competition is intense and when regulatory agencies are actively considering policy proposals (e.g. for M&A), utilities have a greater incentive to exert counter pressure through targeted political strategies. Hence:

Hypothesis 2: Regulated firms will make greater political campaign contributions in the period before regulatory review of a proposed merger in states with greater political party competition.

EMPIRICAL APPROACH

To test our predictions we use panel data on political campaign contributions by investor-owned electric utilities (IOUs) in the states in which they operate.[6] Since both 'acquirer' and 'target' utilities in a merger proposal must each obtain approval from regulators in their home states, we collected data on campaign contributions by all utilities in their home states. The panel consists of monthly observations for the population of 218 state-level IOUs that existed between 1998 and 2006. In this period there were 43 proposed corporate merger and acquisition transactions, involving a total of 151 state-level IOUs, with a combined deal value of over $200 billion.[7] The typical merger thus involved approximately four state-level IOUs. Utility M&A transactions are almost always 'friendly' rather than 'hostile' due to the need to obtain state regulatory approvals, and in our sample there is no instance of a hostile bid. Announced M&A proposals generally have the support of each merging utility, and public announcement occurs after private negotiations over terms between utilities' senior management.

Our objective is to identify the impact of M&A events on the campaign contributions of each utility engaged in an M&A proposal. A concern for our methodological approach is that, since utilities are unlikely to engage in mergers on a random basis, those utilities that do merge may differ from those that choose not to and that the differences may be correlated with campaign contributions. For instance, some states may have more investor-friendly business climates, or some IOUs may have established better relationships over time with state regulators and politicians. Unobservable characteristics—say in utility management quality—could causally influence both merger decisions and political campaign contribution strategy, which would then confound empirical identification of the impact of mergers.

We address this concern by exploiting the panel structure of the data, which allows us to use a differences-in-differences model. The differences-in-differences methodology has gained recognition in management and economics research in recent years as it permits researchers to make stronger causal claims when there are concerns about important but omitted variables (Antonakis *et al.*, 2010). Using the method we can compare the change in campaign contributions in the treatment group (i.e. utilities undergoing an M&A event)

[6]We include in our data political campaign contributions made by companies, political action committees, and individuals in the electric utility sector to election candidates for government office. Campaign contribution data was acquired from the National Institute for Money in State Politics (IMSP). IMSP assigns individual contributions to a company and industry sector based on employer affiliation. Our sample begins in 1998 since the IMSP data is 80% complete for 1998 and nearly 100% complete for 1999 and beyond.

[7]Merger and acquisition transaction data was gathered from three primary sources: the Edison Electric Institute; the American Public Power Association; and SDC Platinum from Thompson Reuters.

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before and after the treatment to the change in campaign contributions in the control group (nonmerging IOUs). By comparing changes, we are able to control for observed and unobserved utility characteristics that are time-invariant and that might be correlated with the merger decision as well as with campaign contributions. By considering changes in contributions in the treatment group, we are controlling for omitted fixed characteristics such as management quality; and by including changes in contributions in the control group, we control for time-varying factors that are common across both control and treatment groups. The differences-in-differences model is specified as a linear regression model with two-way fixed effects:

$$Y_{it} = \alpha \mathbf{M}_{it} + \beta P_{it} + \gamma \mathbf{MP}_{it} + \Gamma \mathbf{X}_{it} + \lambda_i + \delta_t + \varepsilon_{it}$$

where Y_{it} is the amount of monthly campaign contributions by utility i in month t, $\mathbf{M}_{it}$ is a vector of indicator variables relating to the timing of merger and acquisition events for a utility, P_{it} is a measure of political party competition in the state in which a utility operates, $\mathbf{MP}_{it}$ is a vector of interaction terms between the merger event indicators and political competition, and $\mathbf{X}_{it}$ is a vector of control variables that vary across both utilities and time. IOU (λ_i) and monthly time (δ_t) fixed effects control for unobserved utility and temporal heterogeneity. We assume that the utility time-varying error term, ε_{it}, is distributed independently of λ_i and δ_t. Although our dependent variable is truncated at zero, we use a linear regression model instead of a Tobit model since the conditional expectation function of a Tobit is the same as a linear specification when the main treatment—a merger event—is a dummy variable (Angrist and Pischke, 2008). In this model, $\alpha + \gamma$ is the differences-in-differences estimate of the average effect of a merger event on utility campaign contributions.[8]

The dependent variable for our analysis, *Campaign Contributions*, is the amount of monthly political campaign contributions made by an IOU or its parent company to state legislators and legislative candidates in the state in which the IOU operated. The average such monthly contribution in our sample is $1,193. Compared to federal-level campaign contributions, state-level contributions are much smaller in magnitude, reflecting the lower cost of state election campaigns.

To test our first hypothesis we use indicator variables for the distinct time periods around an IOU's M&A transaction. *Prereview*, our treatment variable, has a value of one for each month in the 12-month period prior to the announcement of a merger/acquisition and zero otherwise. *Review* is equal to one in the months after the merger is announced and while the regulatory review is in progress, and zero otherwise. *Postreview* is equal to one each month in the 12-month period after the regulatory review is completed. For our second hypothesis, we create a measure of political party competition—*Legislature Competition* $= 1 - \frac{|Total\ Democrats - Total\ Republicans|}{Total\ Legislators}$—for the state legislature where the IOU is located. *Legislature Competition* equals zero when one party controls 100 percent of the legislature (minimal competition) and equals one (maximum competition) when the Democrats and Republicans have an equal number of seats.

We include state-level political and economic variables to control for other factors that could affect campaign contributions. *Election Year* equals one during years (varying by state) in which there was an election for state politicians. *Republican Control* and *Democrat Control* are also indicator variables, equal to one if the Republican or Democrat Party, respectively, controlled all three branches of government in a given state and year. Political alignment creates new opportunities for legislative reform, potentially acting as a supply-side driver of campaign contributions. We gathered state-level partisan data and election-year information from various editions of the *Book of the States*. *Population* measures the size of the state's population (in millions) in each year; we expect campaign contributions to increase with state size. Finally, we also control for the effect of the state business cycle as this may influence political preferences on policies and regulations in the utility sector: *Change in Per Capita Employment in the State* and *Change in Per Capita State Domestic Product* are annual percentage change variables calculated using data

[8]The central identifying assumption is that the change in campaign contributions in the control group (nonmerging utilities) is an unbiased estimate of the counterfactual. We are unable to assess this assumption directly though we have not identified any differences in campaign contribution patterns or trends between control and treatment groups outside merger events. It is thus likely that campaign contributions by merging utilities (the treatment group) would have been similar to the control group had they not been subjected to the treatment (merger).

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Table 1. Descriptive statistics

Sample	All firms All months		Non-M & A firms All months		M & A firms All months excl. Prereview		M & A firms Prereview months only	
Variable	Mean	SD	Mean	SD	Mean	SD	Mean	SD
Campaign contributions ($)	1193.49	4054.28	1222.29	5039.40	1149.85	3449.42	1404.97	4081.62
Prereview	0.08	0.28	0.00	0.00	0.00	0.00	1.00	0.00
Review	0.13	0.34	0.00	0.00	0.20	0.40	0.10	0.30
Postreview	0.11	0.31	0.00	0.00	0.16	0.37	0.11	0.32
Legislature competition (%)	0.782	0.178	0.786	0.178	0.780	0.176	0.778	0.196
Republican party control	0.258	0.438	0.261	0.439	0.259	0.438	0.240	0.427
Democrat party control	0.151	0.358	0.139	0.346	0.166	0.372	0.090	0.286
Election year	0.541	0.498	0.544	0.498	0.540	0.498	0.544	0.498
Population (millions)	7.717	7.219	7.673	8.399	7.770	6.613	7.488	6.766
Change in per capita state employment (%)	0.002	0.015	0.003	0.014	0.001	0.015	0.009	0.012
Change in per capita state domestic product (%)	0.043	0.024	0.044	0.025	0.043	0.024	0.043	0.026
Rate review	0.127	0.332	0.132	0.339	0.128	0.335	0.097	0.297
Allowed return on equity (% points)	12.17	1.55	12.04	1.42	12.20	1.58	12.35	1.61
Number of observations	21,141		6,477		12,887		1,777	
Number of observations for Allowed ROE	15,892		4,348		10,183		1,361	

from the Bureau of Economic Analysis. Table 1 provides descriptive statistics for all the above variables and for subsets of the data.[9]

RESULTS

Table 2 presents the results of several models that estimate the statistical relationship between M&A events and political campaign contributions. Overall, the models perform well with r-squared values up to 49.8 percent and with expected coefficient signs on most control variables.

We focus initially on Model 1, our primary specification for which the dependent variable is measured as the dollar value of campaign contributions and turn to the variables of central theoretical interest, the *Prereview* indicator of the period before merger review, and *Legislature Competition*, the measure of political party competition. Since we include an interaction term for these variables in our models, it is not possible to rely on the estimated statistical significance of a single coefficient as a guide to overall statistical significance, as this depends on the values of the underlying variables (Brambor, Clark, and Golder, 2006). We thus calculate the marginal effect of *Prereview* and the 95 percent confidence interval, conditional upon the value of the interaction term *Legislature Competition*. In order to facilitate interpretation of the coefficients we illustrate the effects graphically in Figure 1. The x-axis depicts the range of the data for *Legislature Competition*, the y-axis the marginal change in campaign contributions when *Prereview* equals one. Statistical significance is represented by the dotted 95 percent confidence interval lines. The effect is significant at the five percent level when the range between the two dotted lines does not cross zero (represented by a horizontal line). Based upon the estimated marginal effects, we also calculate percentage changes in campaign contributions, which we present in Table 3.

Figure 1 presents the graphical results estimated from Model 1. We observe positive and statistically significant coefficient values for states

[9]In Table 1 we also provide the descriptive statistics for subsamples of the data, which enables us to make some comparisons. When we split the data into firms that merge during our sample time period and into firms that do not merge (second and third sets of columns), we do not find any discernible differences in the firm-level and state-level variables between these two subsets.

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Table 2. Impact of merger events on campaign contributions (OLS regressions)

Dependent Variable:	Model 1 Campaign contributions ($)	Model 2 Campaign contributions (ln)	Model 3 Campaign contributions (ln)	Model 4 Campaign contributions (ln)
Events in Sample:	All M&A proposals	All M&A proposals	Completed M&A proposals	All M&A proposals
Prereview	−491.647	−0.867***	−1.506***	−1.121***
	(407.953)	(0.299)	(0.336)	(0.383)
Review	−187.434	−0.783***	−0.819***	−0.849***
	(348.847)	(0.256)	(0.238)	(0.287)
Postreview	−119.713	−0.385	−0.353	−0.343
	(369.852)	(0.271)	(0.268)	(0.310)
Legislature competition	1319.474***	3.425***	3.177***	4.521***
	(496.357)	(0.364)	(0.355)	(0.456)
Legislature competition	846.995*	1.164***	2.057***	1.476***
x Prereview	(503.072)	(0.369)	(0.417)	(0.472)
Legislature competition	396.147	0.897***	1.009***	0.937***
x Review	(430.011)	(0.315)	(0.302)	(0.361)
Legislature competition	30.090	0.307	0.258	0.221
x Postreview	(455.599)	(0.334)	(0.337)	(0.391)
Republican party control	−167.194*	0.067	0.052	0.248***
	(91.888)	(0.067)	(0.071)	(0.091)
Democrat party control	402.937***	0.037	0.045	0.137*
	(91.490)	(0.067)	(0.072)	(0.082)
Election year	1083.893***	0.971***	0.960***	1.148***
	(102.920)	(0.075)	(0.081)	(0.095)
State population (million)	356.030***	0.420***	0.445***	0.461***
	(90.315)	(0.066)	(0.082)	(0.091)
Change in per capita state	6213.158*	−1.231	−0.196	0.818
employment (%)	(3256.750)	(2.387)	(2.422)	(2.839)
Change in per capita state	525.871	3.583***	3.153***	3.419***
domestic product (%)	(1236.852)	(0.907)	(0.923)	(1.219)
Rate review	—	—	—	0.045
	—	—	—	(0.067)
Allowed return on equity	—	—	—	0.220***
	—	—	—	(0.032)
Utility FE	Yes	Yes	Yes	Yes
Month FE	Yes	Yes	Yes	Yes
Observations	21,141	21,141	20,716	15,892
R^2	0.30	0.498	0.498	0.461

Robust standard errors in parentheses; constant term not reported; *$p < 0.10$, ***$p < 0.01$.

with average and above average levels of *Legislature Competition*, thus providing support for Hypothesis 1. That is, we find evidence that utilities increase their political activities in the period before they announce a merger, consistent with a strategy of firms seeking political support in advance of regulatory review. The magnitude of the effect is economically meaningful: in the average state, utilities increase their campaign contributions by 13.8 percent in the year before announcing an M&A proposal. The positive slope of the estimated relationship supports Hypothesis 2; namely that campaign contributions will be greater in more politically contested states. Again, the estimated magnitude of the effect is substantial: in a state with a high level of political party competition in the legislature (specifically, one standard deviation above the sample mean), a utility increases its campaign contributions by 26.3 percent in the year before announcing a merger. Estimated coefficients for values of *Legislature Competition* substantially below the mean of that

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Table 3. Marginal effect of *Prereview* on campaign contributions, conditional upon value of *Legislature Competition*[a]

Legislature competition	Model 1	Model 2	Model 3	Model 4
Mean − 1 std. dev.	16.55	−0.168*	−0.271**	−0.236
	(1.4%)	(−9.5%)	(−15.4%)	(−10.0%)
Mean − 1/2 std. dev.	92.78	−0.064	−0.086	−0.103
	(7.6%)	(−3.6%)	(−4.9%)	(−4.4%)
Mean	169.01*	0.041	0.099	0.030
	(13.8%)	(2.3%)	(5.6%)	(1.2%)
Mean + 1/2 std. dev.	245.24**	0.146**	0.284***	0.163*
	(20.1%)	(8.3%)	(16.1%)	(6.9%)
Mean + 1 std. dev.	321.47**	0.251***	0.469***	0.295**
	(26.3%)	(14.3%)	26.6%)	(12.5%)
Maximum	355.35**	0.298***	0.552***	0.354***
	(29.1%)	(16.9%)	(31.4%)	(15.0%)

*Statistically significant at 10% level; **5% level; ***1% level.
[a] Marginal effects derived from estimates presented for each corresponding Model in Table 2. Percentage changes in parentheses, calculated based on the mean value of contributions for Non-M&A firms.

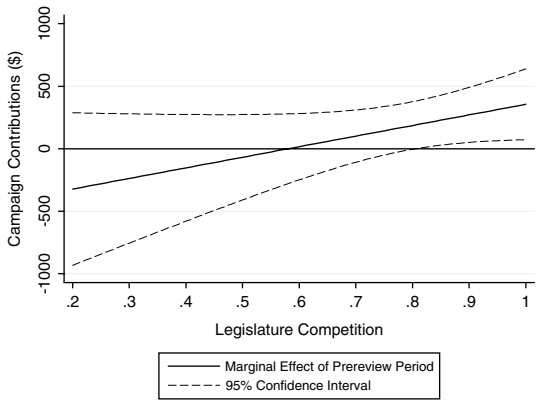

Figure 1. Marginal effect of *Prereview* on campaign contributions.

variable are not statistically significant at conventional levels.

We conduct a similar analysis for the estimated relationships between *Legislature Competition* and campaign contributions during the merger review period and the year after the review decision. The directions of the estimated effects are consistent with expectations: firms appear to increase campaign contributions also during the merger review process in most states (apart from the least politically contested) and to decrease contributions in the year after the review has concluded. The estimated effects are not statistically significant, however, at the 95 percent confidence level. We also conduct the same type of graphical analysis when the dependent variable is instead measured as the natural log of campaign contributions, which reduces the impact of outliers on coefficient estimates (Model 2). The pattern of results is very similar to that depicted in Figure 1: firms in politically competitive states tend to increase their campaign contributions before a merger is announced. Again the results are statistically significant, confirming the support for Hypotheses 1 and 2.

Building on Model 2 we test the robustness of our results to a variety of alternative model specifications, samples, and variable measures. In Model 3 we include in our sample of M&A transactions only those that were ultimately completed, omitting those that were withdrawn. The original results remain and the estimated coefficient effects almost double in magnitude (comparing columns 2 and 3 in Table 3)—implying that successful M&A proposals are associated with even greater levels of firm political activity during the *Prereview* period. In Model 4 we incorporate two time-varying firm-level variables that may be correlated with the incidence of M&A events and the level of campaign contributions: *Rate Review*, which equals one in periods when the firm has requested a PUC review of its rates and zero otherwise; and *Allowed Return on Equity*, which is a measure of firm financial performance permitted by the PUC.[10] Including these variables leaves our primary results unchanged. We do not find

[10]Data on the incidence of rate reviews and Allowed ROE were collected from a private consulting firm, Regulatory Research Associates. Data were not available for some firms, reducing the overall sample size.

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that the incidence of rate reviews has an association with campaign contributions though the *Allowed Return on Equity* has a statistically significant and positive relationship—consistent with firms seeking political support for favorable regulatory decisions on this policy dimension. In other analyses we implemented a Tobit model instead of a linear regression model since campaign contribution data is always nonnegative; we experimented with alternative pre- and postreview window periods, including 3, 6, and 18 months instead of 12 months; and we restricted our sample to just those utilities that underwent an M&A proposal to control further for potential differences between merging and nonmerging firms. To control for other political contexts, we also experimented with measures of interest group competition (from public consumer advocates) and regulatory agency resources (Bonardi, Holburn, and Vanden Bergh, 2006). In all of these cases the results were qualitatively very similar to the pattern of results discussed above, demonstrating strong robustness of our primary findings.

DISCUSSION AND CONCLUSION

In this paper we examine how firms seek to create economic value by integrating market and nonmarket strategies. Our general thesis is that firms engaged in valuable market transactions will simultaneously invest more in *political* activities when there is a greater risk of government dissipation—through *regulatory mechanisms*—of economic rents. We hypothesize that firms will seek political support for merger approval by regulatory agencies in the period before regulatory review commences and that firms will invest more in building political support in more politically-contested environments. In a statistical analysis of political campaign contributions by electric utilities over a nine-year time frame that controls for firm-level characteristics, we find that firms significantly increased their campaign contributions during the 12-month period before the public announcement and subsequent regulatory review of a proposed corporate merger. As expected, the prereview increase was more pronounced in states with greater political party competition.

By focusing on a specific strategic event in the market environment, such as a corporate M&A proposal that has the potential to create substantial economic rents, we can assess how firms adapt and integrate nonmarket strategy in the time period around the event as compared to business as usual. Crucially, the differences-in-differences model allows us to control for potential alternative explanations for our results (e.g., unobserved firm-level factors such as local interest group conditions in firms' geographic markets) that may be correlated with campaign contributions.

Our analysis contributes to existing scholarship on nonmarket strategy in several ways. It provides some of the first empirical evidence for the prediction that firms use an indirect strategy of targeting pivotal political actors who can exert influence on regulatory agencies—as a complement to a direct strategy of lobbying agencies—in order to shape agency decisions. Such a strategy is salient for many firms given that a wide variety of industries are regulated to some degree, though nonmarket strategy research has largely focused on just direct influence strategies and tactics. Although we do not measure actual regulatory decisions on mergers in our setting, the timing of campaign contributions is consistent with an indirect targeting approach. A natural extension for future work would be to assess the impact of political contributions on regulatory outcomes in merger reviews, for instance approval or denial of merger requests or the extent of rate reductions imposed on merging firms.

Second, our findings shed new light on whether, or under what conditions, firms pursue a 'transactional' approach to political strategy, characterized by a short-term *quid pro quo* exchange of firm resources for public policy favors between firms and politicians (Hillman and Hitt, 1999). Existing research argues that regulated firms are more likely to eschew transactional strategies and to rely instead on 'relational' strategies developed with policy makers over a lengthy period of time. The short-term temporal spike in campaign contributions we observe suggests that regulated firms may well, in fact, pursue both types of strategies simultaneously or even that the efficacy of short-term transactional approaches depends on having established a long-term relationship. Data restrictions unfortunately prevent us from observing the history of utilities' campaign contributions prior to 1998 to test such predictions, but this would be a fruitful area for future research in another setting with a more extensive data time series.

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Naturally there are limitations to our analysis that should lead to some caution in the conclusions. While we attempt to control for unobserved firm heterogeneity, we are not able to discount completely the potential for time-varying changes in characteristics, for instance turnover in senior executive leadership, that may herald contemporaneous adjustments to both market and nonmarket strategies. A further limitation is that we do not assess other aspects of firms' nonmarket strategies such as lobbying or coalition building, which may complement or substitute for campaign contributions and which would provide a more comprehensive picture of how firms design integrated strategies. Nonetheless, despite these and other challenges, we contribute to existing research on nonmarket strategy by providing new evidence on how firms proactively manage their external political environment to protect their resources from dissipation by agency regulation.

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