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Dormancy as a Strategic Response to Detrimental Public Policy

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Organizations in democratic societies often encounter detrimental public policies that are later reversed through rather predictable political cycles. The standard organizational responses to detrimental public policies examined in the literature include exiting the market altogether, attempting to change the public policy through various political strategies, or passively complying with the policy. However, these responses might not be suitable when a detrimental policy is likely to be reversed. In this paper, I consider organizational dormancy, which entails a temporary reduction in an organization’s level of activity, as a viable alternative response. I propose that some organizations might be able to undergo a period of strategic inactivity in response to the onset of a detrimental public policy and maintain this inactivity until a favorable public policy returns. I also propose that such dormancy is rewarded when the favorable policy returns. An investigation of a panel of private commercial banks in the Indian banking industry from 1981 to 2004 lends support to this proposal.

Keywords: public policy; politics; policy reversals; dormancy; India, banking

Introduction

Organizations in democratic societies are often challenged by the need to appropriately respond to detrimental public policy changes that are potentially short lived. Both partisan priorities (Henisz and Zelner 2003; Hibbs 1977, 1987) and populist pressures (Alesina et al. 1992, Downs 1957, Henisz and Zelner 2003, Nordhaus 1975) can prompt policy makers to devise public policies that have detrimental effects on organizations (i.e., policies that require organizations to undergo undesirable adaptations, at least from the perspective of important stakeholders) (Holburn and Vanden-Bergh 2008, Zelner et al. 2009). Recent examples in the United States include restrictions imposed on knowledge-intensive firms with respect to the hiring of foreign nationals, which has made it difficult for U.S.-based firms to acquire talent from other countries; stringent capital adequacy and liquidity requirements for banks, which has reduced bank managers’ discretion over lending activities and constrained banks’ potential growth; a moratorium on embryonic stem cell research for biotech firms that pushed these firms to look for alternative stem cell sources or abandon their research altogether; antichain store legislation in several U.S. states that restricted areas of operation and the expansion of chain stores; and compensation caps for top managers that made it difficult for firms to remain competitive in the managerial labor market. However, such public policies can be short lived, as incumbent policy makers may predictably be replaced by new individuals who advance opposing priorities or give in to populist pressure to relax or even reverse existing policies (Alesina 1988, Alesina et al. 1992). Hence, when organizations respond to unfavorable changes in public policy, they must consider that these changes might be transient.

The literature on organizational responses to public policy changes spans several decades and is rich and insightful (e.g., Dobbin and Dowd 1997, 2000; Hirschman 1970; Hillman et al. 2004; Marquis and Huang 2009; Oliver 1991; Oliver and Holzinger 2008). However, the responses considered in this body of research do not account for the possibility that detrimental changes in public policy might later be reversed through shifts in electorates’ political preferences.

These responses can be grouped into the three categories of exit, voice, or loyalty (Hirschman 1970). The exit option involves choosing to abandon a newly regulated market altogether to limit the damage caused by a public policy. Regulatory arbitrage hinges on this decision (e.g., Holmes 1998, Rao et al. 2011). The voice option involves opposing the detrimental public policy change, perhaps through lobbying, and seeking to reduce the policy’s harmful effects (see Hillman et al. 2004 for a review of such strategies). Loyalty describes a response wherein the firm chooses to remain loyal to the incumbent policy makers and comply with the detrimental policy (e.g., Dobbin and Dowd 1997, 2000).

Each of these responses has its advantages, but all seem inadequate if public policies are likely to be reversed following a predictable shift in the electorate’s policy preferences. Abandoning the market can prove costly in the long run, as it might be difficult for a firm to re-enter and regain legitimacy. Voicing dissent might be helpful, but it is often costly and entails delayed and shared pay-offs, which are needless if the policy is going
to be reversed. Finally, loyalty is likely to hurt a firm’s performance in the short term and may make it less fit when the unfavorable policy is reversed.

In this paper, I propose an alternative mechanism that some organizations may use to manage detrimental yet potentially reversible public policies: temporarily reducing their level of activity while the detrimental policy prevails and resuming their previous level of activity when a favorable policy returns. Such dormancy may help organizations not only reduce their exposure to the detrimental public policy and sidestep any undesirable adaptations, but also remain legitimate in the eyes of policy makers—which is essential to organizational survival (Scott 2001, Simons and Ingram 2003). I then draw on extant research on corporate political activity to identify four important sources of organizational heterogeneity that determine if an organization can use dormancy as a response to a detrimental change in public policy: (a) political awareness and capability, (b) discretion in making strategic choices, (c) fitness to the detrimental policy, and (d) capacity of limited activity to sustain the organization. Finally, I theorize how remaining dormant while the detrimental public policy is in place affects an organization’s performance when a favorable policy is implemented. I test and support my thesis by examining the shifts in branch banking activities in an unbalanced panel of 35 private commercial banks in India that were subject to a detrimental change in branching policy in 1980, and the reversal of this policy in 1991.

**Government Intervention to Increase Rural Banking in India**

Commercial banks are epitomes of capitalist organizations in developed economies, but the government of India has used the banking industry to promote several of its socialist agendas, such as unemployment reduction and poverty alleviation. One such policy that I will examine here pertains to rural banking; it was initiated in 1980, then relaxed in 1991. It is important to note that for the first three decades following India’s independence, policy makers placed hardly any restrictions on commercial banks with regard to their choice of markets. As a result, most commercial banks operated in more lucrative urban areas and ignored rural areas, as operating in them appeared highly risky and less lucrative. This state of affairs attracted the attention of several left-wing political parties, which pressurized the incumbent central government—headed by the Indian National Congress—to extensively regulate the banking sector to increase the delivery of credit to rural India, which was virtually unbanked until the late 1960s.

The Indian National Congress, under the leadership of Prime Minister Indira Gandhi, began yielding to this pressure in 1969 and introduced several stern measures to increase the delivery of credit to rural areas. One such measure was to nationalize 14 major commercial banks in India. Although nationalization increased the delivery of credit to unbanked rural areas, the remaining private banks were still reluctant to enter rural areas. As a result, in 1980, the government of India nationalized another seven private banks that had grown since the first phase of nationalization. Further, to increase private participation in rural areas, the government issued an ordinance requiring all private and state-owned commercial banks to open at least four new branches in unbanked rural areas for every new branch opened in a banked urban or metropolitan area. Consequently, banks could no longer grow bigger without serving the rather unprofitable rural areas. Most of the banks that complied with the ordinance were state owned, bringing close to 80% of the banking industry in India under government ownership and control. But several private banks reduced their branching activities substantially, and these banks were marginalized within the industry. In the view of many business historians, the new banking policies therefore had a detrimental impact on private banks (Bhasin 2006).

Industry associations in India voiced their concerns against such socialist Policies, which hampered the private sector in India during the 1980s. For example, the Confederation of Indian Industry’s theme paper in April 1991 urged Indian policy makers to implement liberal economic policies and lift several trade barriers that were hindering economic growth. With respect to the banking industry in particular, various industry associations recommended that the branching restrictions imposed on private banks be lifted and that the banking sector be liberalized. These issues were only addressed when the economy took a toll in the late 1980s because of the Indian government’s socialist policies.

The weak economy also resulted in an unstable political order, and no party was able to gain a majority in Parliament. Following a balance-of-payment crisis in 1990, a new minority government headed by P. V. Narashima Rao appealed to the International Monetary Fund and the World Bank for hefty loans, which were granted with a clause that the Indian economy be liberalized. The new government appointed several committees to get input from industry associations to kick-start the sluggish economy. These committees revealed that liberalization was unavoidable if the Indian banking industry was to be globally competitive (Kohli 2006). The government of India responded to this call by introducing several banking sector reforms in 1991 (Bhasin 2006). Although the government was still monitoring rural credit delivery, private banks were no longer required to open four rural branches for every new urban branch.

After the Indian economy was liberalized, private banks became profitable again through their newfound legitimacy (Kumbhakar and Sarkar 2003). Other areas of the Indian economy also witnessed tremendous growth. The manufacturing and service sectors, which were concentrated...
in the country’s urban and metropolitan areas, played a specifically strong role in triggering India’s economic progress. This sustained growth of the Indian economy also helped revive private banks (Bhaumik and Piesse 2003). But private banks that already had a strong focus in urban areas were best suited to cash in on their revived legitimacy and the growth opportunities in the Indian economy.

Responding to a Potentially Reversible Detrimental Regulation

In most democratic settings, public policies are the outcome of contested bargaining within and outside of the government (Downs 1957, Gutmann 1993, Held 1987). Since no policy satisfies all constituents, there are always demands for policy changes (Laver 2005). Consequently, a policy that is detrimental to certain firms in one period might be reversed or at least relaxed in the following period if there are shifts in the policy preferences of the electorate. A suitable organizational response to a detrimental public policy should therefore take the possibility of policy reversal into account. The range of responses considered in existing research fall into one of three categories identified by Hirschman (1970): exit, voice, and loyalty. While each has its advantage in terms of dealing with a detrimental policy, none account for the possibility that the policy will be reversed due to shifts in electoral preferences.

Viability of Exit. Exit is a widely advocated and observed response to detrimental policies. However, abandoning the market is not always easy because of sunk costs (Caves and Porter 1976, Hölzl 2005, O’Brien and Folta 2009). In fact, it might not even be permitted in some situations. For example, America’s Interstate Commerce Commission refused to let U.S. railway companies exit their unprofitable railway operations (Levin 1981). Policy makers in India similarly erected prohibitive labor market regulations (Görg 2005) and restrictions on the repatriation of foreign direct investments (Lukauskas and Minushkin 2000) to constrain exit tactics. In addition, when a policy is reversible, abandoning the market during conditions of adversity can of course prove costly in the long run, as re-entering and regaining legitimacy when a more favorable policy is implemented may be difficult. For example, in 1977 Coca Cola exited the Indian market in response to policies that were detrimental to multinationals. When Coca cola re-entered India following the reversal of the detrimental policy in 1990, it had lost legitimacy in the eyes of Indian consumers and struggled hard to regain it (Business Week 2003). Similarly, many of the foreign banks that left Shanghai following the implementation of China’s communist policies found it very difficult to regain their lost legitimacy when they returned because of substantial changes in the business climate Kuilman (2005).

Viability of Voice. Voicing—the opposition of the policy—can certainly help restore a favorable policy, but it often requires costly collective efforts that may be deemed illegal in certain jurisdictions. Lobbying and campaign contributions are perfectly legitimate in some nations, but are illegal or tightly restricted in many developing countries (Gibbs et al. 2002). In India, Reliance Telecom, Unitech Wireless, and Swan Telecom have recently been accused of illegally lobbying for elected representatives to get preferential allotments of the 2G telecommunications spectra; the companies and their lobbyists are consequently facing criminal charges (The Economic Times 2011). Walmart came under similar heavy scrutiny when it disclosed that it had spent $25 million on lobbying between 2008 and 2012 in an attempt to gain permission to enter the Indian market (Nelson 2012). Further, even when voicing tactics are legal, the pay-offs must often be shared with free-riders (Lenway and Rehbein 1991, Olson 1965). It can also take several policy debates—often spanning an entire election cycle—before a voicing effort bears fruit (Ramírez and Eigen-Zucchi 2001).

Viability of Loyalty. Organizations that choose compliance might in fact be worse off than those that do not when policy reversibility is possible. Compliance to a detrimental regulation often requires replacing successful organizational routines with new, unfamiliar ones (e.g., Holburn and Vanden-Bergh 2008). This always entails a certain risk of failure (Hannan and Freeman 1984, p. 151), and even if failure does not occur, a radical adaptation can make a firm less fit when a more favorable policy environment returns. In fact, reversing a radical change may prove impossible, leaving an organization uncompetitive in the new environment (e.g., Greenwood and Hinings 1988).

Viability of Other Hybrid Responses. Oliver (1991) considered the utility of hybrid responses related to exit, voice, and loyalty. Organizations have evaded detrimental policies by adopting a symbolic adherence through loose coupling, such as erecting structural façades to mask their non-compliance. However, recent research suggests that mere façades may be unable to resist institutional pressure when transparency prevails and sanctions for noncompliance are feared (Short and Toffel 2010). For example, mandatory disclosures and surprise audits may make loose coupling unsustainable in highly regulated industries such as banking and insurance (Short and Toffel 2010).

Another alternative response that Oliver (1991) considered is compromise. An example of compromise is a firm that strikes a balance with policy makers by adopting some aspects of a policy, but rejecting others. Although striking a balance between competing interests appears desirable, how this can be achieved is not clear. In particular, it is often difficult to identify an appropriate political constituent to compromise with when there are multiple constituents to please (Holburn and Vanden-Bergh 2008).
Oliver (1991) also considered the response of defiance, which is often a last resort. Open defiance of a public policy can prevent an organization from continuing to operate legally in the jurisdiction of the government enforcing the policy. For example, firms that cooperated with Iran were banned from operating in the United States, and their U.S. assets were frozen. An act of defiance can thus prove to be suicidal.

Since exit, voice, loyalty, and their hybrids can all prove unwarranted when an unfavorable policy is reversed, reversibility is an important point of departure in evaluating the effectiveness of possible responses to that policy. If a detrimental public policy is potentially reversible, the best strategy is one that allows the firm to remain legitimate while reducing the negative impacts of the policy while it lasts.

**A Theory of Organizational Dormancy**

**Organizational Dormancy**

Organizational scholars who have compared organizations to living organisms have generated thought-provoking insights about complex organizational phenomena (e.g., Hannan and Freeman 1977, Nelson and Winter 1982). Studies in the population ecology of organizations explicitly demonstrate that complex organizational phenomena can be explained by metaphors derived from the population dynamics of the animal kingdom (Amburgey and Rao 1996, Swaminathan 1996). Another apt example is the seminal work of Nelson and Winter (1982), who used the Darwinian concepts of variation, selection, and replication to explain the process of organizational evolution. It is also important to note a recent study by Marquis and Huang (2010), which used the concept of exaptation from evolutionary biology to explain how organizations repurpose successful old routines when they become seemingly obsolete. Inspired by this tradition of scholarly work, I use the metaphor of dormancy from physiological ecology to theorize how organizations respond to potentially reversible detrimental public policies.

*Dormancy* (also called torpor, aestivation, and hibernation) is a term used in physiological ecology to describe the flexibility of an organism’s metabolism in response to predictable changes in the physical or biological characteristics of the environment—which eventually help the organism to increase its rate of reproduction (see McNab 2001). During dormancy, organisms remain only minimally active, insulating themselves from adverse climatic conditions while remaining able to resume their normal metabolic rate when the environment returns to a favorable state.

I expect that organizations might emulate organisms in dormancy by reducing their activity to buffer against a detrimental public policy and become active again when the policy is reversed. I formally define organizational dormancy as *a temporary reduction in an organization’s activity following the onset of a detrimental public policy that allows it to avoid unwanted radical adaptation and rejuvenate when a favorable policy returns*. Remaining dormant enables organizations to avoid the damage caused by full compliance and to conserve their routines. It promises some of the benefits of exit without a loss of legitimacy, and allows for voice tactics in the quest for a policy reversal.

Anecdotal evidence suggests that organizations do engage in such behavior. For example, in 1962 the U.S. government enacted the Kefauver Harris Act, which made new drug approval a more arduous and protracted process (Kronquist 2011). Although some firms and industry associations lobbied for the act to be amended, most firms substantially reduced their R&D activity (Reed et al. 2006). However, the drastic drop in pharmaceutical innovation bred discontent among consumers (Kronquist 2011). This pushed the government to enact the Prescription Drug User Fee Act of 1992, which required pharmaceutical firms to pay higher fees for drug approval in return for a speedier approval process. The new act thus allowed pharmaceutical firms to revive their earlier level of innovation (Cantor 1997).

A core assumption for a theory of organizational dormancy is that public policy changes in democratic settings are susceptible to opportunistic reversals following shifts in electorates’ political preferences. The central argument that relies on this assumption is that organizations may be able to overcome the negative consequences of a detrimental public policy by reducing their level of activity while the policy prevails—lying dormant—and resuming normal activity only when a more favorable policy returns. A dormant organization can remain legitimate during the course of a detrimental policy without undertaking any radical adaptation that might undermine its performance when the policy is reversed. Next, I further develop this theory, starting with the identification of important scope conditions.

**Scope Conditions for a Theory of Organizational Dormancy**

*Ban Versus Restriction of Activities.* One theory of dormancy rests on the assumption that it is possible to continue operating legitimately with minimal activity. However, when regulations are very stringent, policy makers can completely ban a certain activity. Organizations then do not have the option of reducing their activity, but need to shut down altogether, and/or move to another jurisdiction, and/or diversify into another line of business. The case of prohibition in the United States is a good example of this. When prohibition was enforced in several states, numerous breweries went out of business, others moved to neighboring states without prohibition, and still others went into a related business such as soft drink production.
After Prohibition was lifted, the brewing industry revived to a certain extent (Hiat et al. 2009). This was possible because all breweries were affected by the ban in the states where it was enforced and once the ban was lifted, those breweries that had maintained a presence in the state via related operations were able to cash in quickly. If there had been a call for the substantial reorganization of activities rather than a ban, dormancy would have been a more viable option than exit. For example, when the Bush administration imposed stringent restrictions on the federal funding of embryonic stem cell research, U.S. biotech firms could have obtained nonfederal funding for their research or identified nonembryonic sources for stem cell research. However, these responses would have entailed costly transformations that might have been unnecessary if the biotech firms considered that the incumbent conservative government would be replaced by a more liberal government in the near future, which would likely reverse the detrimental policy. Remaining dormant would therefore have been a viable solution.

Hence, the theory of organizational dormancy does not apply when a regulation bans organizations’ core activities. My study fits this scope condition as the regulation does not ban the urban expansion of banks, but does substantially restrict it.

**Political Opportunity.** The viability of dormancy as a response to a detrimental public policy rests on the fundamental assumption that public policies are susceptible to the change efforts of disgruntled social actors. But according to the social movement literature, dissatisfaction with a policy only motivates parties with specific interests to engage in collective action to effect change to that policy, whereas it is the political system that determines whether such action has value, is encouraged, and translates into a meaningful, desirable change in public policy. An example of this is the rise of the social movement that whether such action has value, is encouraged, and translates into a meaningful, desirable change in public policy. The greater an organization's dependence on the state apparatus for legitimacy and survival, the more loyal the organization becomes to the incumbent government. Thus, state dependence forces an organization to play along with the whims and fancies of incumbent governments, whether doing so will be efficient for it in the long run or not (Kozhikode and Li 2012). Hence, I expect that even if it is rational for organizations to remain dormant during the course of a detrimental regulation, those owned or controlled by the state might not be able to do so. Therefore, I only consider the case of private banks in this study, as they fit the scope conditions of independence from the state.

**Organizational Heterogeneity in Adopting Dormancy**

Some organizations are better positioned than others to use dormancy as a strategic response. An organization’s capacity and willingness to enter into dormancy in response to a detrimental regulation will be influenced by its political awareness and capability, the level of discretion it can employ in making strategic choices, its relative fitness in relation to the environment created by the regulation, and its ability to sustain itself with a reduced level of activity.

**Political Awareness.** Research on corporate political activity research suggests that political awareness allows an organization to quickly anticipate and effectively respond to policy changes that affect them (Oliver and
Holzinger 2008; Useem 1985). Hence, adequate information about policy makers, their opponents, and the policy-making process is essential for organizations considering dormancy. But existent research acknowledges that organizations have different levels of political awareness (Delios and Henisz 2003, Kozhikode and Li 2012, Useem 1984).

One source of this heterogeneity is the ties an organization enjoys with political players in the government and the opposition. Baron (1995, p. 61) recognized that even though firms might hire external agents such as political advisors, lobbyists, and lawyers to pursue their interests in the government arena, the value added by these agents cannot substitute the awareness among a firm’s managers about prevalent political issues, interests, and institutions (Useem 1985). Such an awareness is a firm-specific advantage that helps an organization customize its strategies to meet its nonmarket needs. One way that firms have cultivated this awareness among managers is by setting up offices near government headquarters (Useem 1985). Proximity to government headquarters allows managers to speak one on one with the “who’s who” in politics and gain inside information that their competitors might not have access to. Useem (1985) recognizes the benefits of setting up a DC office for U.S. firms: “the most meaningful political information is acquired from personal circulation of managers in Washington: extended association with a senate committee, who” in politics and gain inside information that their (Useem 1985). Proximity to government headquarters check and balance on the policy-making process and can that a fragmentation of political power can act as a scrutiny.

organizations must reduce their exposure to government and even ban organizations’ core activities. So dormant the government to implement more stringent regulations to serve the intended policy’s purpose. This can prompt dormancy may allow an organization to buffer itself from a White House staff, or an agency commission yields to enter dormancy, as they may have quicker access to capital of New Delhi in this study) will be more willing on the company” (p. 23; italics added).

In alignment with this view, I expect that firms with an office near government headquarters (the Indian national capital of New Delhi in this study) will be more willing to enter dormancy, as they may have quicker access to information about the implementation of the detrimental policy as well as the likelihood and timing of its potential reversal. Therefore:

**Hypothesis 1.** Organizations with greater political awareness (i.e., having a New Delhi office) are more likely to reduce their level of activity in a detrimental policy environment.

**Discretion and Exposure to Political Pluralism.** Though dormancy may allow an organization to buffer itself from the perils of a detrimental policy in a legitimate manner, it might still be frowned on by policy Makers, as it fails to serve the intended policy’s purpose. This can prompt the government to implement more stringent regulations and even ban organizations’ core activities. So dormant organizations must reduce their exposure to government scrutiny.

Research on comparative political systems indicates that a fragmentation of political power can act as a check and balance on the policy-making process and can reduce government intervention in general (Lijphart 1996). Recent research indicates that fragmented governments reduce government intervention most effectively under political pluralism—when different branches of government are controlled by different political outfits (Kozhikode and Li 2012).

Fragmented governments are most typical in federal political systems. Governmental power in a federal system is split between central and subnational governments. When different political parties control national and subnational governments, voters’ power will ensure that no one branch of government enjoys unbridled control of public policy and that each level of government disciplines the other (McKinnon 1997, Tiebout 1956). Organizations should be able to employ greater decision-making discretion in such situations. When a subnational unit experiences political pluralism—as is the case when the subnational government is controlled by a party different from the party that controls the national government—organizations will be subject to less government scrutiny (Kozhikode and Li 2012) and hence have more discretion to adopt dormancy as a strategic response to the detrimental regulation. To the contrary, when sub-national units are controlled by the same party that controls the national government, there will be greater scrutiny of organizational actions, making dormancy a more difficult choice. Consequently, organizations with a strong presence in politically pluralistic states may be able to enter dormancy more confidently than organizations with a stronger presence in nonpluralistic subnational units. Therefore:

**Hypothesis 2.** Organizations with greater exposure to politically plural states are more likely to reduce their level of activity in a detrimental policy environment.

**Relative Fitness to the Detrimental Environment.** Although a detrimental change in public policy can affect all organizations, some might be better off because of variations in the impact that the policy change has on their level of fitness. But the same detrimental public policy might be experienced differently by different organizations (Madhavan et al. 1998). The extent to which a detrimental public policy requires an organization to adopt unfamiliar practices and undergo radical adaptations can signify how detrimental the policy indeed is to that organization. For example, when the commercial banking industry in the United States was deregulated, commercial banks entered a consolidation phase. This resulted in several acquisitions led by banks founded in locations that had always enjoyed less restrictive branching practices and that were already capable of taking advantage of the new situation presented by liberalization (Marquis and Huang 2010). Hence, the need to adopt unfamiliar practices or make radical adaptations is critical to the evaluation of the detrimental impacts that a focal public policy will have on an organization.
Research shows that organizations tend to become very cautious when the environment demands that they adopt an unfamiliar practice or make a radical adaptation to organizational routines (Newman 2000). But some organizations might be relatively better suited to meet the demands of the detrimental policy in that their routines and practices might be already aligned with the requirements of the detrimental policy. These organizations do not require substantial reorganization to conform to the detrimental public policy, which enables them to gain instant legitimacy with policy makers and helps them continue performing well. This argument is aligned with ecology theory, which asserts that the environment favors the fittest (Hannan and Freeman 1977). As a result, the top managers of firms that are better suited to a detrimental policy tend to sustain their level of activity and can reap the benefits of compliance without reorganizing their routines. But organizations that have to substantially reorganize their routines to comply with the detrimental policy will be more likely to choose dormancy as a response to that policy. Therefore:

**Hypothesis 3.** The better an organization’s fit with the prescriptions of a detrimental new public policy, the less likely it will be to reduce its level of activity in the detrimental policy environment.

**Sustainability with a Reduced Level of Activity.** When organizations choose dormancy, they will lose some revenue streams, but must still sustain minimal activity. This will require them to retain core capabilities such as human and intellectual capital by sufficiently compensating their key employees, renewing their technological licenses, and maintaining their existing facilities. They can only resume their peak level of activity when a favorable public policy is restored. Hence, organizations would need alternate means to sustain while they reduce their level of activity.

In the case of animals, fat storage serves as that alternate means. Geiser (2004) observes that animals “refuse to hibernate when lean, and rely to a large extent on stored fat or food for an energy source in winter” (p. 241). I argue that fat storage is an analogy for organizational slack. It refers to uncommitted resources that a firm can deploy with discretion to manage unexpected contingencies (Chakravarthy 1986, Dimick and Murray 1978). However, the role of slack in organizational responses to environmental changes is often disputed in the literature (Cheng and Kesner 1997).

Some scholars consider slack to be a conduit for radical adaptations that might be needed to gain fitness in the new environment (Cyert and March 1963). They argue that slack can be costly and risky and that organizations with more slack resources to leverage may gain better fitness (Hambrick and Snow 1977) and protect themselves from the risks of making radical adaptations (Baird and Thomas 1985). Organizations with very little slack will be incapable of pursuing such radical adaptations (Miles 1982). This implies that as an organization’s slack increases, its tendency to pursue aggressive reorganization to meet the demands of a changing environment will likewise increase (Cheng and Kesner 1997). These arguments imply that Indian banks will be more capable of expanding into unfamiliar rural areas if they have more slack resources and that banks with less slack will not be capable of such expansion.

Others consider slack to be a buffer that protects organizations from the changing demands of the environment (Pondy 1967). They argue that environmental fluctuations may require organizations to undergo undesirable adaptations, although organizations usually avoid adaptations that interfere with their core processes (Cheng and Kesner 1997). For organizations with more slack, slack pays the price of being less fit with the environment (Yasai-Ardekani 1986). For Indian private banks, being fit with the detrimental regulation means having a stronger presence in rural areas. As most private banks were less active in rural areas before the regulation was enforced, expansion may have required radical adaptations. Hence, banks with more slack resources will choose dormancy over expansion.

As both views of dormancy are valid, organizations may find it difficult to choose between using slack to make radical adaptations or remaining dormant while preserving their core routines. The prospect theory’s principle of loss aversion offers a solution to this paradox (Kahneman and Tversky 1984). According to this principle, social actors prefer avoiding losses to acquiring gains (Kahneman and Tversky 1984). Given that remaining active in a detrimental environment is more likely to result in losses than gains, organizations will prefer dormancy if possible. This is the case for Indian banks with more slack, which will choose dormancy to cut potential losses.

This argument is consistent with organizational slack research, which observes that the value of slack as a buffer is more pronounced when a substantial adaptation is required to gain fitness in a changing environment and organizations lack control over their environment (Cheng and Kesner 1997). Since India’s banks do not have much control over the policy-making process and the country’s rural banking policy is detrimental to them, they are more likely to use their slack resources to remain dormant than to pursue risky expansion into rural areas.

Although the literature on organizational growth indicates that slack is also needed for expansion, these arguments do not imply that a bank with low slack will expand extensively into rural areas (Penrose 1959). Organizations with very little slack cannot expand even if they aspire to and will be pushed into dormancy until they exhaust whatever slack they have left, and then perish. But when organizations maintain sufficient slack, they have the discretion to choose between dormancy and growth. As previously indicated by the principle of loss aversion, organizations will choose to use their slack for
dormancy rather than expansion, as the former reduces losses and the latter creates them. Thus, the extent to which an organization prefers to enter dormancy will be an increasing function of the amount of slack resources it maintains, which leads to a U-shaped relationship between organizational slack and dormancy. Therefore:

**Hypothesis 4.** *During the detrimental policy environment, up to a certain threshold of organizational slack, any increase in an organization's slack will result in an increase in the level of activity (likelihood of dormancy decreases), but beyond that threshold, any increase in slack will result in an decrease in the level of activity (likelihood of dormancy increases).*

**Consequence of Dormancy**

So far I have portrayed dormancy as a viable strategic response to detrimental public policy changes that are potentially reversible. If this is true, organizations that remain dormant during the period of the detrimental policy should be able to revive their previous level of activity when a favorable policy resumes and should be able to perform better than peers that remained active during the period of the detrimental public policy. This is possible because a reduction in activity enables organizations to withstand the pressure of the detrimental public policies without having to make any radical, undesirable adaptations. That is, organizations that reduced their level of activity during the period of the detrimental public policy would have been able to retain core capabilities that are highly valuable under a favorable policy. When a favorable policy returns, organizations that strategically reduced their activity will therefore respond more quickly to the opportunities accorded by the new policy than organizations that did not reduce their activity. In contrast, organizations that stayed active during the period of the detrimental policy might have substantially reorganized valuable core capabilities to meet the demands of that policy. This argument is aligned with the research on organizational track changes discussed earlier (see Greenwood and Hinings 1988). That stream of research suggests that organizations might often have to make reorganization attempts to meet environmental demands. Such organizations might consider returning to their previous state if they fail to successfully reorganize or their reorganization is no longer needed (as in my case) (Greenwood and Hinings 1988). Unfortunately, the reorganization achieved by some of these organizations will have been so extensive that reverting back to the original state is difficult (Greenwood and Hinings 1988). This leads the organization into a state of unresolved excursion, in that it is neither fully reorganized nor returned to its original state.

I expect that organizations that stayed active under the detrimental policy would fail to take advantage of a favorable public policy when it returns because of the difficulty of having to perhaps undergo a new radical adaptation while reversing a previous radical adaptation. But organizations that chose to remain dormant while the detrimental public policy lasted would have retained their core capabilities, allowing them to perform well when a favorable policy resumes. Indian banks that were active during the detrimental public regulation would have entered the unfamiliar terrain of rural banking extensively, which would have required an appreciably reorganization of routines (e.g., lending to customers with weak credit histories or lending to farmers rather than salaried individuals). That reorganization comes with substantial sunk costs. Banks might be unable to shed some of their undesirable and costly adaptations once the regulation is reversed. For example, eliminating their rural branches might not be possible. In fact, the Reserve Bank of India (RBI) prohibits closure of rural branches, even those that operate at a loss. In its 2013 circular to banks, RBI stated “As a matter of policy, closure of even loss making branches at rural centres having a single commercial bank branch is not permitted, as closure would render the centre unbanked.” This substantially reduces a bank’s chances of moving away from less lucrative rural areas and exploiting new opportunities in urban areas after the detrimental regulation is reversed. In contrast, banks that remained dormant would not be burdened with such sunk costs, allowing them to continue building familiar urban banking operations with relative ease. Therefore:

**Hypothesis 5.** *Organizations that reduced their level of activity during temporary periods of detrimental public policy will perform better when a favorable policy environment returns than those that adapted to the temporary policy.*

**Research Methods**

**Data and Measurement**

Bank-level data for testing the hypotheses were extracted from the RBI archives. The data on the regulations pertaining to Indian banking were obtained from publications of the RBI and the Ministry of Finance. Since the period between 1980 and 1990 was the most detrimental for private banks’ expansion activities and the period after 1990 was more favorable for expansion, the observation period was 1980 through 2004, the most recent year for which data were available.

I included all 35 private commercial banks that existed during the period of the detrimental policy. Although most of these commercial banks continued to exist for several years during the post-1990 period of favorable policy, a few were acquired by other banks. For example, the Bank of Madura was acquired by ICICI Bank and the Nedungadi Bank was acquired by a Punjab National Bank. I included these banks in the analyses prior to their acquisition.
Dormancy. Several factors were taken into account in coding organizational dormancy. The definition of dormancy indicated that it is a strategic decline in the level of an organization’s activity in relation to its level of activity prior to the imposition of the detrimental regulation. Consequently, the measurement of dormancy should first show that a company’s level of activity has been reduced in comparison to its previous level of activity. Second, the measurement pertains to a reduction of activity and not a total stoppage of activity, so it should be continuous. Finally, since dormancy is considered a strategic response, its measurement should reflect a reduction in an organization’s activity that is weighted by its capability to expand. Taking these considerations into account, I measured dormancy as the rate of a deviation from the prediction for the number of new branches established by a bank. In particular, I adopted Haveman’s (1993) approach in considering size to be a significant predictor of organizational expansion (i.e., number of new branches established before and during periods of deregulation). On this basis, I used a negative binomial regression for a 10-year period before the detrimental regulation was enacted (1971–1980). I first regressed bank size (number of existing branches at \( t - 1 \)) and its squared term on the number of new branches established by a bank. Based on the estimates from this regression, I then predicted the number of new branches that each bank should have opened in a certain year given its size during the period of regulation. Next, I measured the extent to which the actual number of new branches opened by a bank during this period deviated from the predicted number. The following formula is used to estimate this rate of deviation:

\[
\text{Dormancy} = \frac{(\text{Predicted New Branches} - \text{Actual New Branches})}{\text{Predicted New Branches}}
\]

The higher this value, the lesser the bank’s expansion relative to the prediction. My approach is consistent with the approach adopted by animal physiologists who capture drops in the metabolic rate of dormant animals (Reynolds 1985, Brown and Lee 1969). As I am interested in the reduction of branch activity and not only the deviation from prediction, I coded the variable organizational dormancy as a spline function:

\[
\text{Dormancy} = \begin{cases} 
(Predicted \text{ New Branches} - Actual \text{ New Branches})/Predicted \text{ New Branches} \\
0 & \text{if } (Predicted \text{ New Branches} - Actual \text{ New Branches})/Predicted \text{ New Branches} > 0; \\
0 & \text{if } (Predicted \text{ New Branches} - Actual \text{ New Branches})/Predicted \text{ New Branches} \leq 0
\end{cases}
\]

This measure compares a bank’s branch expansion activity before and after the detrimental regulation was enforced. Since predicted values are estimated based on organizational size, the measure accounts for organizations’ capacity to expand. The greater the value of this variable, the more dormant a focal bank is in a focal year. The lowest value of this variable is 0, as it is truncated at 0, the point where the bank expands beyond the level I predicted. The highest value of this variable is 1, the point where the focal bank did not open a single branch in a given year.

Political Awareness. The best way to capture political awareness is to look at direct links between banks and elected politicians, such as links forged through campaign contributions and board memberships. Such data are not available for the Indian firms selected for my study period. However, political scientists in the United States often use an indicator variable for the presence of a Washington office as a proxy for a firm’s ability to influence public policy and a firm’s awareness of policy changes (see Useem 1985). I used this approach by coding a variable political awareness as 1 if a bank had an administrative office in the same zip code (110001) as the Indian Parliament. This zip code is a prominent hub for the national government and its many bureaucracies in New Delhi. The government quarters of India’s national political elite are also located in this zip code. A bank’s managers should be more politically aware if the bank has a nonbanking administrative office, such as zonal office or a regional office in this zip code.

Exposure to Political Pluralism. Some organizations might have greater exposure to such politically plural states than others (Kozhikode and Li 2012). To code an organization’s exposure to political pluralism, I first defined a politically plural state as one in which the state government had been formed by a political party that was different from the one controlling the national government. Then I coded the variable exposure to political pluralism as the ratio of the number of politically plural states in which a bank had a branch to the total number of states that were actually politically plural in a given year.

Organizational Fitness. An organization’s fitness must be defined with respect to a particular environment (Hannan and Freeman 1977). An organization will be fit in an environment if it possesses the capabilities necessary to take advantage of that environment. If it is less fit, it has to undergo radical adaptation to gain that advantage (Péli 2009). In 1980, some Indian banks that were already active in rural areas would have required very little adaptation to remain fit when the new detrimental policy was implemented. Hence, I measured organizational fitness as the proportion of rural branches in a bank’s portfolio of branches.
Organizational Slack. The amount of cash reserves and surplus a bank holds provide an explicit measure of its slack. This measure has often been used as a proxy in academic work (e.g., George 2005). Since the data I had regarding the cash reserves and surpluses of the banks in my sample were skewed, I coded organizational slack as the natural log of the amount of cash reserves and surplus maintained by a given bank in a given year.

Net Dormancy. To test the influence that dormancy in the detrimental environment had on a bank’s performance after policy had been reversed, the variable net dormancy was defined as follows.

First, I computed net predicted new branches and net actual new branches, respectively, as the total number of predicted branches that each bank would open during the entire period of the detrimental policy (1981–1990) and the total number of branches actually opened by each bank during that period. Then I computed the extent to which net actual new branches deviated from net predicted new branches as follows:

\[
\text{Net Dormancy} = \frac{(\text{Net Predicted New Branches} - \text{Net Actual New Branches})}{\text{Net Predicted New Branches}}
\]

The higher this value, the less extensive is the bank’s expansion relative to the prediction during the detrimental policy (1981–1990). I coded the variable net dormancy as a spline function, just as I did for organizational dormancy:

\[
\text{Net Dormancy} = \begin{cases} 
\frac{(\text{Net Predicted New Branches} - \text{Net Actual New Branches})}{\text{Net Predicted New Branches}} & \text{if } \text{Net Predicted New Branches} > 0; \\
0 & \text{if } \text{Net Predicted New Branches} = 0; \\
\frac{(\text{Net Predicted New Branches} - \text{Net Actual New Branches})}{\text{Net Predicted New Branches}} & \text{if } \text{Net Predicted New Branches} \leq 0.
\end{cases}
\]

The greater the net dormancy, the more dormant the organization was during the period of the detrimental policy.

Performance. Financial performance was the dependent variable in Hypothesis 5. Since most banks in the sample were not listed on any Indian stock exchange, no market-based performance metric was available. Consequently, performance was quantified as return on assets (ROA), which represented the ratio of net income to total assets. This approach is consistent with existent research that uses an accounting measure of performance in the absence of market-based measures (Krishnan and Kozhikode 2015).

Control Variables. A set of firm-level control variables was also included in the regression equations. Previous studies have shown that an organization’s age and size influence its expansion activities and performance (e.g., Haveman 1993). Size was constructed as the number of existing branches a bank had. Age was coded as the number of years each bank had been established. Each bank’s financial performance during the period of the detrimental policy was another control; it was included to rule out the possibility that it was merely poor performance that led banks to reduce their level of activity. As a bank could of course remain fully active without expanding its number of branches, two variables were included to control for a bank’s reliance on nonbranch banking activities. The first was the ratio of deposits to total liabilities. The greater the value of this variable, the greater the bank’s reliance on branch banking as a source of funds. The second control was the ratio of investments to advances—a bank’s investment in securities divided by its total outstanding loans. The greater the value of this variable, the less a bank relied on branch banking to generate revenue. Finally, prior research shows that different states in India use different strategies to deal with central government policies (Sinha 2005). Consequently, a bank may respond differently to a detrimental policy because of characteristics pertinent to its home state. I therefore controlled for each bank’s state of origin.

Research Design and Analysis

Testing all the hypotheses involved two sets of analyses. The first set tested Hypotheses 1–4. The dependent variable in that set was organizational dormancy. In the second set of analyses that tested Hypothesis 5, the regressions predicted the performance consequences of dormancy in the postdetrimental policy period. In that set of analyses the dependent variable was ROA and the key independent variable was net dormancy during the period of the detrimental policy period. In all models, the time-variant independent variables were lagged by one year.

The dependent variable used to test Hypotheses 1–4 was truncated at 0, the point at which the bank expands beyond the predicted level. At the upper level it was truncated at 1, the point at which a bank had not opened even a single branch in a given year. Tobit models are used because they are appropriate for truncated dependent variables (Tobin 1958). Further, as the data had a panel structure, a random effects Tobit model was specified using the xtobit routine in Stata. For the second dependent variable, the performance of banks for the period following the detrimental regulation, I used an unconditional fixed effect specification (manually including bank dummies in an ordinary least squares model), as the key independent variable net dormancy was time invariant.
Tobit models, which predicted organizational dormancy. This model therefore supported Hypothesis 2. During a period of detrimental but potentially reversible public policy, politically aware organizations are more likely to choose dormancy than their less politically aware peers.

Model 3 tested the prediction of Hypothesis 2 that greater exposure to political pluralism will be more likely to trigger dormancy in response to detrimental public policies. As predicted, this coefficient was positive (0.589) and significant (p < 0.01). The marginal effects for political awareness indicate that banks that have an administrative office near the Indian Parliament have a predicted value of dormancy that is 58.9% higher than banks that do not have an administrative office in that vicinity (i.e., political awareness = 0). This model therefore supported Hypothesis 1. During a period of detrimental but potentially reversible public policy, politically aware organizations are more likely to choose dormancy than their less politically aware peers.

Model 2 tested the prediction of Hypothesis 1 that greater political awareness will be more likely to trigger dormancy in response to detrimental public policies. As predicted, this coefficient was positive (0.589) and significant (p < 0.01). The marginal effects for political awareness indicate that banks that have an administrative office near the Indian Parliament have a predicted value of dormancy that is 58.9% higher than banks that do not have an administrative office in that vicinity (i.e., political awareness = 0). This model therefore supported Hypothesis 1. During a period of detrimental but potentially reversible public policy, politically aware organizations are more likely to choose dormancy than their less politically aware peers.
will deter organizations from choosing dormancy. Model 4 (Table 3) tests this effect. The regression coefficient (all two-tailed tests).

<table>
<thead>
<tr>
<th>Covariates</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>0.004*</td>
<td>0.004*</td>
<td>0.004*</td>
<td>0.012*</td>
<td>0.004*</td>
<td>0.005**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>(0.01)</td>
<td>(0.00)</td>
<td>(0.00)</td>
</tr>
<tr>
<td>Size</td>
<td>0.000</td>
<td>−0.000</td>
<td>−0.000</td>
<td>0.002†</td>
<td>−0.000</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>(0.00)</td>
<td>(0.00)</td>
</tr>
<tr>
<td>Return on assets</td>
<td>3.713***</td>
<td>3.307***</td>
<td>−1.270</td>
<td>2.872**</td>
<td>2.914**</td>
<td>−0.823</td>
</tr>
<tr>
<td></td>
<td>(0.99)</td>
<td>(0.98)</td>
<td>(2.20)</td>
<td>(1.03)</td>
<td>(1.12)</td>
<td>(2.08)</td>
</tr>
<tr>
<td>Ratio of deposits to total liabilities</td>
<td>−0.815*</td>
<td>−0.910**</td>
<td>−0.899*</td>
<td>−0.069</td>
<td>−0.565</td>
<td>−0.583</td>
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<tr>
<td></td>
<td>(0.37)</td>
<td>(0.35)</td>
<td>(0.39)</td>
<td>(0.47)</td>
<td>(0.39)</td>
<td>(0.36)</td>
</tr>
<tr>
<td>Ratio of investments to advances</td>
<td>−0.085</td>
<td>−0.057</td>
<td>−0.079</td>
<td>0.034</td>
<td>−0.068</td>
<td>0.034</td>
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<td></td>
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<td>(0.22)</td>
<td>(0.22)</td>
<td>(0.21)</td>
<td>(0.21)</td>
</tr>
<tr>
<td>Political awareness (H1)</td>
<td>0.589**</td>
<td>0.589**</td>
<td>0.589**</td>
<td>0.509**</td>
<td>0.509**</td>
<td>0.509**</td>
</tr>
<tr>
<td></td>
<td>(0.20)</td>
<td>(0.20)</td>
<td>(0.20)</td>
<td>(0.20)</td>
<td>(0.20)</td>
<td>(0.20)</td>
</tr>
<tr>
<td>Exposure to political pluralism (H2)</td>
<td>0.941*</td>
<td>0.941*</td>
<td>0.941*</td>
<td>0.780*</td>
<td>0.780*</td>
<td>0.780*</td>
</tr>
<tr>
<td></td>
<td>(0.39)</td>
<td>(0.39)</td>
<td>(0.39)</td>
<td>(0.38)</td>
<td>(0.38)</td>
<td>(0.38)</td>
</tr>
<tr>
<td>Organizational fitness (H3)</td>
<td>−1.924*</td>
<td>−1.924*</td>
<td>−1.924*</td>
<td>−0.142*</td>
<td>−0.142*</td>
<td>−0.142*</td>
</tr>
<tr>
<td></td>
<td>(0.89)</td>
<td>(0.89)</td>
<td>(0.89)</td>
<td>(0.07)</td>
<td>(0.07)</td>
<td>(0.07)</td>
</tr>
<tr>
<td>Organizational slack (H4)</td>
<td>−0.021*</td>
<td>−0.021*</td>
<td>−0.021*</td>
<td>0.008</td>
<td>0.008</td>
<td>0.008</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(0.01)</td>
<td>(0.01)</td>
<td>(0.01)</td>
<td>(0.01)</td>
<td>(0.01)</td>
</tr>
<tr>
<td>Organizational slack squared (H4)</td>
<td>−1.564***</td>
<td>−1.564***</td>
<td>−1.564***</td>
<td>−1.564***</td>
<td>−1.564***</td>
<td>−1.564***</td>
</tr>
<tr>
<td></td>
<td>(0.36)</td>
<td>(0.36)</td>
<td>(0.36)</td>
<td>(0.36)</td>
<td>(0.36)</td>
<td>(0.36)</td>
</tr>
<tr>
<td>Constant</td>
<td>1.881***</td>
<td>1.942***</td>
<td>1.519**</td>
<td>1.300*</td>
<td>1.898***</td>
<td>1.564***</td>
</tr>
<tr>
<td></td>
<td>(0.43)</td>
<td>(0.41)</td>
<td>(0.48)</td>
<td>(0.51)</td>
<td>(0.41)</td>
<td>(0.36)</td>
</tr>
<tr>
<td>(\chi^2)</td>
<td>63.94</td>
<td>77.90</td>
<td>63.58</td>
<td>40.42</td>
<td>69.24</td>
<td>92.41</td>
</tr>
<tr>
<td>Log likelihood</td>
<td>−163.90</td>
<td>−159.26</td>
<td>−160.89</td>
<td>−158.03</td>
<td>−161.68</td>
<td>−68.66</td>
</tr>
<tr>
<td>LR (\chi^2) test</td>
<td>9.27**</td>
<td>6.01*</td>
<td>11.74***</td>
<td>4.43†</td>
<td>190.48***</td>
<td></td>
</tr>
<tr>
<td>Akaike Information Criteria</td>
<td>357.79</td>
<td>350.52</td>
<td>353.79</td>
<td>348.06</td>
<td>357.37</td>
<td>335.08</td>
</tr>
</tbody>
</table>

Notes: \(N = 310\) firm years for 35 banks. Fixed effects for origin states included. Significance levels: †\(p \leq 0.1\); *\(p \leq 0.05\); **\(p \leq 0.01\); ***\(p \leq 0.001\) (all two-tailed tests).

Policy, organizations with a greater exposure to politically plural locations can more easily choose dormancy. Hypothesis 3 predicts that greater organizational fitness will deter organizations from choosing dormancy. Model 4 (Table 3) tests this effect. The regression coefficient for organizational fitness was negative (−1.924) and significant (\(p \leq 0.001\)). As organizational fitness is a proportion-based measure that ranges from 1 to 0, the coefficient for this variable indicates that for a 10% increase in the proportion of rural branches in a bank’s portfolio (i.e., organizational fitness), there is an associated 19% decrease in the predicted value of dormancy. Hence, Hypothesis 3 received strong support. Organizations are less likely to remain dormant in response to a detrimental public policy if their capabilities fit the demands of that policy.

Hypothesis 4 predicts that the availability of more organizational slack will have a U-shaped relationship with dormancy. This hypothesis could be tested by interpreting the effects of the linear and square terms of organizational slack. Hypothesis 4 is supported by Model 5, which shows that the coefficient for organizational slack is negative (−0.142) and significant (\(p \leq 0.01\)) and the coefficient of organizational slack squared is positive (0.021) and significant effect (\(p \leq 0.01\)). Therefore, the extent of dormancy reduces with an increase in organizational slack, up to a certain level of slack. Beyond that level, an increase in organizational slack results in an increase in dormancy. The inflection point was computed from the coefficients for organizational slack and organizational slack squared:

\[
\beta_{\text{Organizational Slack}^2} = -\frac{(\beta_{\text{Organizational Slack}} - 2\beta_{\text{Organizational Slack}^2})}{2} = 3.39.
\]

That is, for up to 3.39 units of organizational slack (i.e., approx. INR 245 million), a one-unit increase in organizational slack (i.e., when organizational slack increases 10 times in rupee value) would result in a 14.3% decrease in the predicted value of dormancy. Beyond 3.39 units, a one unit increase in organizational slack would result in a 2.1% unit increase in the predicted value of dormancy. Refer to the online supplement (available at http://dx.doi.org/10.1287/orsc.2015.1027) for an illustration of this effect.

The Akaike information criteria (AIC) of Models 2–6 are lower than that of Model 1, suggesting that these models offer a better fit, despite having more parameters. Further, among the nonnested models (Models 2–5), Model 4 has the lowest AIC and hence the most explanatory power, followed by Models 4, 3, and 5. Similarly, the results of the likelihood ratio tests (LR \(\chi^2\) tests)
Table 4  Panel Data Unconditional Fixed Effects Ordinary Least Squares Regression on Bank Performance, 1991–2004

<table>
<thead>
<tr>
<th>Covariates</th>
<th>Model 1</th>
<th>Model 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>-0.001***</td>
<td>-0.005***</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(0.00)</td>
</tr>
<tr>
<td>Size</td>
<td>-0.000</td>
<td>-0.000</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(0.00)</td>
</tr>
<tr>
<td>Ratio of deposits to total liabilities</td>
<td>0.005</td>
<td>-0.017</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(0.01)</td>
</tr>
<tr>
<td>Ratio of investments to advances</td>
<td>-0.000**</td>
<td>-0.000**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(0.00)</td>
</tr>
<tr>
<td>Political awareness</td>
<td>0.016</td>
<td>0.019†</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(0.01)</td>
</tr>
<tr>
<td>Exposure to political pluralism</td>
<td>-0.013</td>
<td>0.040***</td>
</tr>
<tr>
<td></td>
<td>(0.01)</td>
<td>(0.01)</td>
</tr>
<tr>
<td>Proportion of rural branches</td>
<td>0.018</td>
<td>-0.113</td>
</tr>
<tr>
<td></td>
<td>(0.19)</td>
<td>(0.17)</td>
</tr>
<tr>
<td>Organizational slack</td>
<td>0.002</td>
<td>0.005**</td>
</tr>
<tr>
<td></td>
<td>(0.00)</td>
<td>(0.00)</td>
</tr>
<tr>
<td>Net dormancy (H5)</td>
<td>0.835***</td>
<td>(0.11)</td>
</tr>
<tr>
<td>Constant</td>
<td>0.105*</td>
<td>-0.291***</td>
</tr>
<tr>
<td></td>
<td>(0.05)</td>
<td>(0.07)</td>
</tr>
<tr>
<td>Adjusted $R^2$</td>
<td>0.299</td>
<td>0.388</td>
</tr>
<tr>
<td>$Δ \text{adjusted } R^2$ (p-value)</td>
<td>0.099*</td>
<td></td>
</tr>
</tbody>
</table>

Notes. $N = 418$ firm years for 35 banks; Fixed effects for origin states included. Significance levels: *$p \leq 0.1$; **$p \leq 0.05$; ***$p \leq 0.01$; $***p \leq 0.001$ (all two tailed tests).

Comparing the likelihood ratios of Models 2–6 with that of Model 1 (the baseline) indicate that Models 2–6 significantly improve on Model 1. However, in Model 6 the nonlinear effect of organizational slack is not significant. Hence, it appears that organizational slack is not as important as the other hypothesized effects. So Hypothesis 4 has limited support in this study.

Consequences of Dormancy

The final analysis examined the relationship between dormancy and performance after a detrimental policy is reversed. Table 2 provides summary statistics and a correlation matrix relating to the variables used in this analysis; Table 4 provides the unconditional fixed effect regression coefficients from this analysis. Hypothesis 5 predicts that banks that remained dormant under the detrimental public policy would perform better when a more favorable policy returns. In line with this prediction, the coefficient of the net dormancy term was positive (0.835) and significant ($p \leq 0.001$) in Model 2 of Table 4. The marginal effects of net dormancy indicate that a 10% increase in this variable resulted in an 8.35% increase in ROA. An examination of the change in $R^2$-squared from Model 1 to Model 2 revealed that Model 2 had significantly more explanatory power than Model 1.

Discussion

In this study, I propose that organizational dormancy is a viable response to detrimental policy changes that are perceived to be potentially temporary. I challenge the implicit assumption put forth in existent research on corporate political activity that public policy changes are enduring. To the contrary, I emphasize that any new public policy in a democratic setting is usually susceptible to change. Based on this premise, I theorized that some organizations may be able to avoid the negative consequences of adhering to detrimental public policies by remaining dormant during the period of the policy and resuming their level of previous activity after the policy is reversed. I also theorized that remaining dormant during a detrimental policy will enable an organization to perform better when a favorable policy resumes.

The results from observations of 35 private banks in India that experienced a major and detrimental public policy change largely support the study’s core claims. Following the detrimental change in bank branching policy, Indian private banks were more likely to reduce their rate of branch expansion if they (a) were more politically aware, (b) were more exposed to politically plural locations, (c) were concentrated more in urban areas, and (d) had either a very low level or a very high level of slack resources. The results also show that after 1990, when the detrimental policy was replaced by a more favorable one, organizations that were dormant under the detrimental policy performed better than those that had complied with the policy. Together, these results lend support to a theory of organizational dormancy.

Contributions to Research on Organizational Adaptation and Change

This study makes a major contribution to research on organizational adaptation and change by introducing the concept of dormancy and theorizing how it serves as an organizational adaptation to detrimental policies that could be reversible. Dormancy can help firms avoid exiting harmful radical adaptations and time-consuming efforts to change policy. The value of the concept of dormancy to organizational theories of adaptation and change is evident when we compare it with other related constructs in the pertinent literature.

Comparison with Track Changes. The literature on organizational track changes indicates that organizations tend to change courses over their lifetime for both internal and external reasons (Armenakis and Bedeian 1999). Some of these courses are reversible; others are not (Greenwood and Hinings 1988). Organizations that choose inertia resist the pressure to change and follow the same course throughout their lifetime. Aborted excursion refers to a temporary organizational change in response to environmental pressures. The organization reverts to its original course when the pressures abate or the changed course fails. Reorientation is a successful and systematic transformation to a new course that is nonreversible. Unresolved excursion is a failed attempt at reorientation.
in that an organization pursues a change in course but never reorients or returns to its initial state.

Organizational dormancy resembles both inertia and aborted excursions. Like inertia, dormancy results from an organization’s unwillingness or inability to adapt its core routines to undesirable environmental shifts. A dormant organization adapts its level of activity to ensure that its core routines remain intact, whereas an inert organization tries to retain both its core routines and level of activity, which can require it to develop undesirable routines. For example, an inert bank facing detrimental regulations for rural expansion would retain its core level of activity in urban areas. The cost of this is that the bank would accumulate unprofitable rural branches, necessitating undesirable routines that might not be reversible. In contrast, a dormant bank would have reduced its level of activity and continued to operate mostly in urban areas, thus preserving core routines without taking on undesirable routines. Like aborted excursion, dormancy entails a temporary shift in course. But aborted excursion starts as an attempt to create a completely transformed organizational state or a façade to signal compliance, whereas dormancy entails a substantial temporary reduction in activity. Further, organizations that choose aborted excursion do not anticipate returning to their previous state, and those that choose dormancy expect that a favorable policy in future will facilitate such a return.

Comparison with Abeyance. The concept of abeyance refers to social movements’ withdrawal from active mobilization when faced with nonreceptive or hostile political environment (Taylor 1989, Sawyers and Meyer 1999). Social movements sustain themselves symbolically by maintaining close ideological connections among core members, which the general public cannot observe. When a sufficient political opportunity arises, or when the political hostility abates, core members reactivate the movement’s legitimate activities, such as increasing mobilization and re-establishing activist efforts. A social movement enters abeyance in a hostile political environment just as an organization enters dormancy in a detrimental business environment. In both cases, core routines are conserved, which leads to better performance when the environment becomes more favorable.

Dormancy differs from abeyance in that the latter entails a complete withdrawal of legitimate activity—at best, social movements only maintain undercover symbolic activity. In contrast, dormant organizations continue to legitimately operate in the detrimental environment, even though they only maintain minimal levels of activity. Further, abeyance is conceived as a population-level process that affects all organizations within a movement industry. For example, Taylor (1989) observed that the entire women’s rights movement in the United States went into abeyance for a few decades to avoid a hostile political environment. In contrast, I present organizational dormancy as an organizational-level process in which organizations are heterogeneous in terms of their capacity to remain dormant. Although some banks in the study chose to remain dormant, a few others (those that were relatively more suited to the detrimental public policy) chose to expand.

Comparison with Cultural Persistence. Cultural persistence refers to the endurance of a culture over time (Zucker 1977). It resembles dormancy in that both maintain core routines. However, cultural persistence relies on an adherence to social systems that transmit cultural codes through highly institutionalized practices, such as routine socialization processes and the imposition of sanctions on individuals who violate cultural codes (Zucker 1977). When such institutionalized practices are challenged by an external shock, it can impede the maintenance and transmission of the culture, pursuing change and punishing those who resist it (Harrison and Carroll 1991).

This study shows that organizations can retain their culture and resist cultural change when they endure an external shock if they reduce their level of activity. Hiatt et al. (2009) observed cultural persistence in the U.S. brewing industry despite the prolonged prohibition in several U.S. states. Prohibition severely affected many breweries, but once it was lifted, the industry revived to a certain extent because some breweries had retained core routines by entering related sectors.

Comparison with the Absence of Strategy. Inkpen and Choudhury (1995) proposed a theory of strategy absence to describe organizations that do not strategically respond to a situation and simply drift along. This most commonly occurs when an environment changes rapidly. As dormancy means minimal activity, it can also be construed as an absence of strategy, or drifting. In light of Mintzberg’s (1978) claim that strategies involve a pattern of decisions, it can be argued that organizations only lack a strategy if their actions are random. I have conceived of and operationalized dormancy not as a mere deviation from a predicted level of activity (a presumably random process), but as an actual reduction in activity in comparison to a prediction. It therefore has a discernible pattern. Further, I show that a reduction in activity has favorable outcomes when detrimental policies are reversed. Dormancy clearly is a strategy rather than a nonstrategy.

Contributions to Research on Organizational Growth

This study makes an important contribution to the research on organizational growth strategies. Scholars often stress the importance of growth to firm survival (Eisenhardt and Schoonhoven 1990). Research often stresses that “organizations must grow, or at least avoid decline, if they wish to survive over the long term” (Reimann 1982, p. 329). This study shows that growth might in fact hurt
organizations in certain situations, leading them to consciously choose not to grow. This is an important finding that can reshape the way we think about organizational growth. Further, organizations that grow fast might be at a disadvantage in environments that do not favor growth.

I examined the value of reduced growth rates for organizations that face a detrimental yet potentially short-lived public policy; future research can consider other situations in which this strategy might be valuable. Strategic alliances are one such setting. Partners in strategic alliances often engage in learning races (Hamel 1991), which hinder the progress of the alliance, as each partner is trying to protect its competency from the other while also striving to outlearn the other (Krishnan et al. 2006). It would be interesting to explore whether deliberately growing at a slower pace can help an organization thrive in a coevolutionary race. Presumably, growing at a slower pace might allow one’s partner to be confident that his or her competency is safe and even encourage that individual to share information more freely and sustain the relationship for a longer period. Evolutionary biologists have indeed observed such behavior among coevolving or symbiotic species (see Bergstrom and Lachmann 2003). In particular, each species in a symbiotic relationship strives to grow more slowly than its partner in an attempt to gain more from the partner while sharing less—a process called “red king evolution.”

Contributions to Research on Nonmarket Strategies

This study contributes to our understanding of nonmarket strategies. First, it sheds light on firm-level heterogeneity in nonmarket responses. In particular, it identifies factors that decision makers should consider when weighing the risks of dormancy. Are they sufficiently informed about the policy environment? Do they have the discretion to adopt dormancy? Can they afford not to go dormant? Is the firm capable of implementing dormancy effectively? Future research might more closely examine these considerations. For example, it might be worthwhile to examine how a firm can best gain timely information about policy changes and identify suitable responses. Do firms with politically connected directors respond more effectively to detrimental public policy changes? Do such connections tend to promote compliance, at least symbolically? Or are such firms more likely to use their private information to help them enter dormancy more quickly?

This study’s second contribution to the research on nonmarket strategies is that it addresses the important call for research on the economic consequence of corporate political activity. Scholars in this area agree that the effectiveness of any corporate political activity can be analyzed only by considering the economic consequence of that activity (Henisz and Zelner 2003, Oliver and Holzinger 2008). But empirical research on the economic consequences of corporate political activity is rather sparse (Henisz and Zelner 2003, Hiatt and Park 2013). Consequently, several review papers on this topic have called for empirical research to address the economic consequences of corporate political activities of firms (Hillman et al. 2004, Henisz and Zelner 2003). Perhaps the first study to attend to this call for research was that by Hiatt and Park (2013); it examined firm heterogeneity in nonmarket responses and the resultant economic benefits for firms. The study showed that biotechnology firms in the United States that were able to garner the support of those stakeholders who had a sway over regulators were better capable of gaining economically valuable concessions from the regulators. The authors call for more research to address the economic consequence of different corporate political activities. My study responds to this call by showing that firms are heterogeneous in their capacity to adopt dormancy as a viable response to a detrimental but potentially short-lived public policy, and that remaining dormant during the detrimental public policy indeed allows an organization to perform better when a favorable policy returns.

Future research can fruitfully devote more attention to how firms differ in their capacity to translate dormancy into economic value. For example, one can postulate that the firm-level factors that contribute to dormancy can also contribute to the successful outcomes of dormancy. It would be equally interesting to explore whether the length of the dormant period influences a firm’s ability to revive itself successfully and generate economic value—perhaps the longer the period, the more difficult it would be to get back to previous levels of activity.

In general, the present study opens up a range of new research questions for scholars interested in organizations and public policy. Reduced expansion was the measure of dormancy in this study, but organizations can exhibit dormancy in other ways. For example, they might reduce hiring or narrow their product range. Future studies could examine and compare different types/incidences of dormancy and identify the effectiveness of each in mitigating the impact of detrimental public policies on organizations. Finally, examining dormancy raises questions about the opposite scenario. That is, what are impacts and advantages of pursuing risky opportunities temporarily in response to a sudden, favorable, but potentially short-lived policy change? What particular factors might trigger or justify such risk-taking? The techniques presented in this paper could help researchers investigate these questions.

In conclusion, the findings I have presented demonstrate that remaining dormant can be an effective response to the perils of a detrimental but potentially transient policy. Dormancy allows organizations to remain legitimate in the eyes of policy makers, to minimize the negative effects of the detrimental public policy, and to eventually perform better when a favorable public policy returns. The study has systematically identified the rationale for choosing this response to detrimental public policies.
Supplemental Material

Supplemental material to this paper is available at http://dx.doi.org/10.1287/orsc.2015.1027.

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References

Kozhikode: Dormancy as a Strategic Response to Detrimental Public Policy


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