

The political embeddedness of business networks: Evidence from firms' responses to climate change

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Abstract

Over the past two decades, network scholarship has repeatedly raised the issue of the limited attention given to socio-political considerations in the study of business-government relationships. It seems paradoxical that the theoretical understanding of political embeddedness of business networks remains limited, despite an increasingly globalized world, and the associated interconnectedness this brings between firms and governments. Firms' responses to climate change constitute a case in which governmental actors are deeply embedded in wider business networks. Previous research on political embeddedness of business networks raises questions about *how* the formulation and implementation of government policy changes affect the business network itself. In an attempt to further our understanding of the issues these questions pose, it is vital to recognize and study the interconnectedness of these networks as it allows an unveiling of the fundamental *barriers* and *enablers* of organizational responses to climate change. The study is based upon an in-depth analysis of Chinese Electricity Industry Networks. Findings suggest that governmental interventions at *any* point in the network may spread across the wider inter-business networks, policy-business networks as well as inter- and intra-governmental networks. Hereby, we posit that governmental intervention acts as *both*, barrier and enabler of organizational responses to climate change. The present study contributes to our understanding of the embeddedness of business networks in a wider political context.

Keywords: political embeddedness, business networks, climate change

1. Introduction

Over the past decade, IMP scholars have extended their research agenda to encompass the concept of "embeddedness" (Welch and Wilkinson, 2004) in their investigations into the multiplicity of temporal, spatial, social, political, and technological forms of embeddedness (Halinen and Törnroos, 1998). Specifically, the study of political embeddedness (e.g. Welch and Wilkinson, 2004) has contributed to new insights about business networks that show that the "*delimitation of political actors from business transactions leads to conclusions far from the real business world*" (Hadjikhani and Sharma, 1999, p. 256).

Although the study of socio-political embeddedness has offered rich contributions to our understanding of business relationships and business networks, the role of political embeddedness of and in business networks when responding to climate change has received little attention. In this article, we examine just this; the political embeddedness of business networks when a series of government policy changes are taken as a countermeasure for climate change. In particular, and in what we hope is a novel approach to a timely, increasingly important and acknowledged research agenda, we focus on the barriers and enablers of organizational responses to climate change.

2. Previous research

Political embeddedness consists of four different forms, namely, 1) political institutions, 2) political actors, 3) political activities and 4) political resources (Halinen and Törnroos, 1998; Welch and Wilkinson, 2004). Combined they act as the political settings for business networks and build a

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framework of rules and regulations in which business networks are obliged to operate (Salmi, 1995). Each form of political embeddedness has different effects: political institutions are concerned with changes in political systems and politico-social values; political actors are involved with network facilitation and disruption by governments; political activities are focused on lobbying and publicity; and political resources are engaged in building legitimacy (Halinen and Törnroos, 1998; Welch and Wilkinson, 2004). Notwithstanding the prominence of each form, in this article, we are primarily interested in political activities as this is typically applied when investigating the formulation and implementation of government policy changes (Jansson et al., 1995; Welch and Wilkinson, 2004).

In the political activities form of political embeddedness, business networks engage with the political system by shaping legislative changes through lobbying governments or influencing public opinion (Halinen and Törnroos, 1998; Welch and Wilkinson, 2004). Actors, as part of these business networks, may engage in political activities as individual firms, team up with other firms, or mobilize the network to act as a collective (Welch and Wilkinson, 2004).

Whichever approach a firm or business network applies to engage with the political system, shaping the formulation and implementation of legislative changes is “*an essential and distinguishable part that supplements the business activities*” (Hadjikhani and Ghauri, 2001, p.273) and resembles an opportunity for enhancing business performance (Salmi and Heikkilä, 2015).

In an attempt to overcome a common limitation of research on business-government relationships, namely capturing either the perspective of firms or the view of governments (Hadjikhani and Håkansson, 1996), we now draw our attention to the role of governments in business networks.

2.1 The role of governments in business networks

Understanding the role of governments in business networks when examining the concept of political embeddedness is fundamental. Governments are represented by political actors which include ministers, members of parliament, bureaucrats and members of opposing parties (Hadjikhani and Håkansson, 1996; Welch and Wilkinson, 2004). Government involvement in business networks, although wide-ranging, can broadly be divided into two areas: 1) governments providing a framework of rules and regulations (Salmi, 1995), and 2) governments acting as buyers (Håkansson and Snehota, 1995). Despite the obviously vital prior theoretical and practical research, which has focused on the commercial benefits involved when governments act as buyers, for example, the detailed nature of public contracts with business networks (Hadjikhani and Sharma, 1996), in this article we are more intrigued by governments’ role in furnishing a framework of rules and regulations.

Governments continuously formulate and implement legislative changes which can and do impact business networks in terms of 1) licensing and approval processes, 2) industry policy measures, 3) tax concessions and tariffs to promote technical areas or regional development, 4) requests for quotations for funding of research, or 5) initiatives to promote cooperation (Håkansson and Snehota, 1995; Hadjikhani and Sharma, 1996). Although a specific legislative change may or may not affect a business network, it is vital for business networks to stay informed about legislative developments to enable both proactive (e.g. to shape the formulation of government policy changes) and reactive political activities (e.g. to ensure compliance with government policy changes upon implementation) (Ritter et al., 2004; Hillman et al., 2004). Therefore, governments have the role of providing, updating and enforcing a framework of rules and regulation in business networks as well as to act as a source of information about the legislative developments.

2.2 The case of climate change

Before drawing our attention to the evidence of the structural and physical constraints of negotiations in climate change, we would like to suggest one thing: climate change is real and it is a direct outcome of the greenhouse gases emitted by human activity (IPCC, 2014). Indeed, it has been argued that anyone who denies this reality falls into entire disagreement with 97% of all published climate change science (Cook et al., 2013). Despite the broad consensus of climate scientists, the world continues to progress ever so slowly in reducing greenhouse gas emissions (IPCC, 2014). Meanwhile, and potentially more worrying, climate change is increasingly threatening our global natural, human and economic systems (IPCC, 2014). It has been over 11 years since Stern (2006) provided a detailed analysis of the costs and risks associated to contemporary inaction in the Stern Review on the Economics of Climate Change,

and yet progress towards successful negotiations in and between business and governments is still sluggish.

While climate change represents an unprecedented global challenge, it is still feasible to stabilize greenhouse gases in the atmosphere at acceptable levels (IPCC, 2014). However, Veal and Mouzas (2010) reiterate the complexity and urgency of responding to climate change by stating that it requires significant changes to economic thinking as well as the everyday life of people, and that the endeavor of alleviating greenhouse gases in the atmosphere is limited to a timeframe of 20 to 30 years as greenhouse gases are irreversibly embedded in the atmosphere for up to 40 years (IPCC, 2001, Stern, 2006).

3. Methods

3.1 Data collection and analysis

The data collection process was driven by the lead author who spent three months researching in China. With the aim of developing in-depth case data, the lead author engaged with both business and governmental actors in three ways:

1. Attended the World Future Energy Forum (WFEF) 2016 and the Smart Grid China Summit 2016, both held in Beijing.
2. Conducted semi-structured interviews with the leadership team of an investment and consulting company, operating and specializing in the Chinese energy sector for over 25 years.
3. Collated, organized and analyzed documentation consisting of 668 announcements and reports (e.g. regulatory guidance, policy proposals, strategy documents) that were released by the Central Government (=State Council), Provincial Governments, Local Governments, National Development and Reform Commission (NDRC), National Energy Administration (NEA), Ministry of Finance (MOF), National Center for Climate Change Strategy and International Cooperation (NCSC), China Electricity Council (CEC), State-Owned Enterprises (SOEs), Private Chinese Companies, Energy Industry Alliances, Energy Industry Associations and News Agencies.

This form of triangulated data collection has enabled the development of a rich case database centered on the Chinese Electricity Industry Networks (CEIN) which spans from May 2014 until November 2016.

3.2 Towards a conceptual framework for analyzing the political embeddedness of business networks

The AAR model was originally developed to allow a more thorough analysis of business relationships by focusing on actor bonds, activity links and resource ties within business networks (Håkansson and Johanson 1992; Håkansson and Snehota, 1995). For this study, the most pertinent of the incremental versions of the original AAR model is that of a political form established by Welch and Wilkinson (2004). Indeed, it is their focus on three interconnected forms of network and how the interplay across these actors, activities and resources unfolds, which would seem pertinent as an anchor for our form of investigation and research in China.

1. Inter-business networks refer to traditional business networks as suggested in the original AAR model by Håkansson and Johanson (1992). Although dominated by business actors, this type of network might also involve governments acting as buyers (Håkansson and Snehota, 1995), suppliers or intermediaries (Welch and Wilkinson, 2004).
2. Policy-business networks describe business networks that possess both necessary and contingent relations between business and governmental actors. In this type of network, the interaction is mostly driven by formulating and implementing new legislation (Welch and Wilkinson, 2004). Moreover, it is common that business actors actively engage with their governmental counterparts to shape a current or emerging framework of rules and regulations (Salmi, 1995).
3. Inter- and intra-governmental networks relate to networks at the governmental level in which governmental actors interact both nationally and internationally. It frequently involves a wide array of relationships amongst governmental actors such as “ministries, departments, state and federal bodies and individuals within and across countries and multilateral agencies” (Welch and Wilkinson, 2004, p.227).

In addition to analyzing actor bonds, activity links and resource ties within each type of network described above it is vital to recognize their *interconnectedness*. This becomes particularly apparent when considering that a change in one relationship within any of these three types of networks may spread as a potential contagion effect across the entire business network (see Hadjikhani and Håkansson, 1996, for a study on how a change in one relationship is spread across a business network).

3.3 Decarbonizing the Chinese energy sector in response to climate change

This case study is based on an investigation of networks designed to enable ‘decarbonization’ of the Chinese energy sector through the formulation and implementation of a series of countermeasures for climate change. Within these networks, we focus on six governmental (G1 – G6) and six business actors (B1 – B6), and the interrelationships within and across.

According to the China National Environmental Protection Plan (Fan, 2006), the Chinese government has started and intends to continue the process of formulating and implementing a series of countermeasures for climate change. However, fossil fuels (e.g. coal, oil) continue to be the source for over 85% of the total primary energy consumed in China (EIA, 2015).

As a consequence of predominately deploying high-polluting coal-fired power plants to meet this demand, the Chinese power sector is “*the world’s leading energy-related CO₂ emitter, releasing 8,106 million metric tons of CO₂ in 2012*” (EIA, 2015, p. 3). To put this into perspective, France, Germany, Italy, the United States, the United Kingdom and Spain combined, were responsible for 7,826 million metric tons of CO₂ emissions from the consumption of energy in 2011 (EIA, 2011). As a result, international pressures have started to mount and have led to a gradual change in China’s thinking and positioning in international climate policy negotiations (Dröge and Wacker, 2014). Ultimately this change led to China ratifying the Paris Climate Change Agreement in 2016.

Decarbonizing the Chinese energy sector plays a pivotal role in achieving the commitments under the Paris Agreement. As such, the Chinese government is currently making use of its capability to act as a business network change agent by formulating and implementing a set of policy changes and activities in order to attempt to facilitate these commitments in view of a global audience. It is these governmental activities that we now turn our attention to, and in doing so, attempt to determine whether these governmental activities facilitate or actually disrupt organizational behaviors focused on successful decarbonization. We do this by analyzing the specific challenges that the selected organizations faced when the framework of rules and regulations, they were working under, was altered.

4. Analysis and discussion of findings

4.1 Eight mechanisms of how a change at one point in the network affects the inter-business networks, policy-business networks as well as inter- and intra-governmental networks

As outlined in the conceptual framework above, we attempt to shed light on *how* the formulation and implementation of government policy changes affect the business network itself. As such, we focus on three interconnected forms of networks, namely, 1) inter-business networks, 2) policy-business networks, and 3) inter- and intra-governmental networks (see Figure 1), and examine how the interplay across these actors, activities and resources unfolds.

A key finding stemming from our study suggests that the way in which governmental actors furnish a framework of rules and regulations may lead to a string of intended and unintended consequences. These consequences may spread across the three interconnected forms of networks and may affect actors, activities and resources in ways that either enable or hinder firms’ responses to climate change. Indeed, if we analyze the case data we see that a governmental intervention (e.g. forecasting the national electricity demand) in the policy-business network affected actors, activities and resources throughout the three interconnected forms of networks that construct the CEIN.

We illustrate this finding by describing eight mechanisms of *how* a government intervention affects the interplay of actors, activities and resources across the three interconnected forms of networks. Figure 1 illustrates this *interconnectedness* of inter-business networks, policy-business networks as well as inter- and intra-governmental networks when attempting to decarbonize the CEIN in response to climate change. Each number in Figure 1 highlights the actors involved in each of the eight mechanisms.

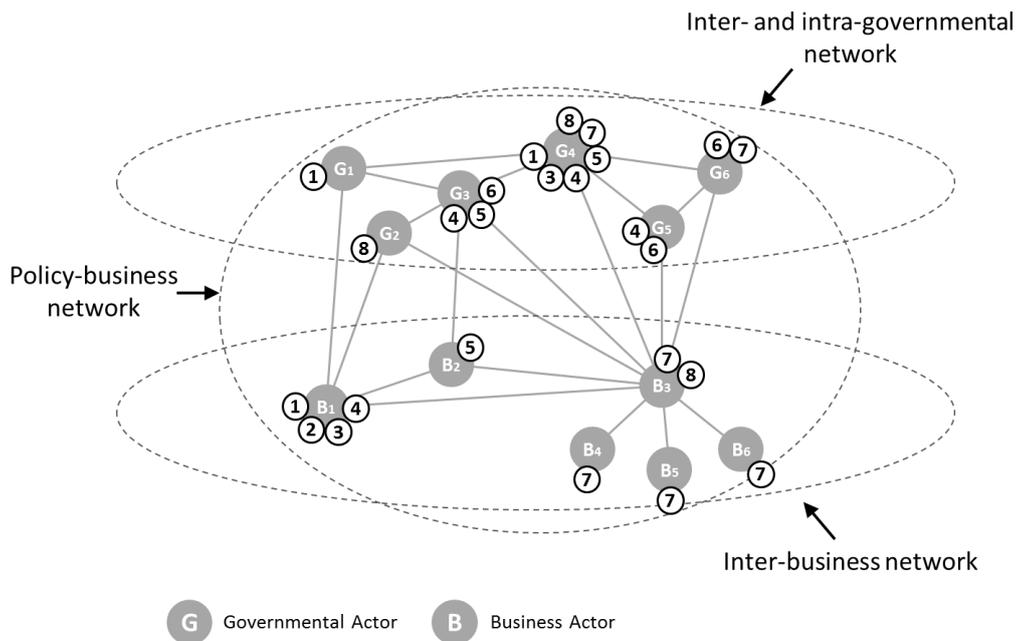


Figure 1: The interconnectedness of the Chinese Electricity Industry Networks (CEIN)

We seek to exemplify how a governmental intervention at any point in the network may spread across the three interconnected forms of networks by outlining *how* inaccurate electricity demand forecasting for the year 2014 published by the China Electricity Council (G1) led to a string of consequence for all actors, activities and resources embedded in the CEIN. Here, we show that governmental intervention in business networks may act as *both* barrier and enabler of organizational responses to climate change. We do acknowledge that the nature of these findings may indeed not be popular with some of those Chinese governmental actors, but this is countered by the renewed calls across social, political and intellectual domains for potential solutions to address climate change to be found and implemented as well as potential barriers to be identified.

1. **Demand forecasting:** In January 2015, the National Energy Administration (G4) released the annual power statistics for 2014. The data indicated that “*electricity consumption grew only 3.8%, compared to a 6.5-7.5% forecast*” which has been forecasted earlier by the China Electricity Council (G1) [Policy, Announcement 222, line 1-3]. This issue continued throughout 2015 and was reiterated by the Q1 2015 electricity consumption statistics released by the National Energy Administration (G4). Here, the China Electricity Council (G1) had “*forecasted consumption growth of 4-5% in 2015*” [Policy, Announcement 326, line 4-5]. However, the actual electricity consumption “*only grew 0.8% during the first three months of 2015*” [Policy, Announcement 326, line 1-2]. Electricity demand forecasting does not come without its challenges, particularly as “*typical growth is not typical in China – there have been consecutive growth years in the 10%+ range, followed by either a single-digit contraction or flat growth*” [Policy, Announcement 623, line 18-20]. Although the 2015 yearly consumption forecast was revised down to 1%, the generation capacity had already been put in place by the Electricity Generators (B1) [Policy, Announcement 344, line 1-4].
2. **Oversupply:** As a direct and unintended consequence of the mismatch between forecasted and actual electricity demand growth, China found itself in a situation of having “*the lowest generation utilization since 1978 and [...] more than 50 GW of excess capacity.*” [Policy, Announcement 326, line 6-9]. Therefore, electricity generators (B1) had idle generation capacity which led to new governmental measures to limit “*new generation builds to match demand growth*” [Policy, Announcement 326, line 11-13], as well as reduced profitability of renewables projects as the sufficiency of subsidy fund, is based on electricity consumption growth [Policy, Announcement 315, line 16-20].
3. **Policy changes:** In an attempt to match the generation capacity with the lower than expected demand growth, the National Energy Administration (G4) has announced to “*halt new project development in regions with high levels of curtailment*” [Policy, Announcement 361, line 12-13]. One may conclude that these policy changes strengthen the position of existing electricity

generation projects of Electricity Generators (B1), but it also hampers their ability to provide new renewable electricity projects as developers are forced to “*abandon some of their wind project development pipeline*” [Policy, Announcement 361, line 12-14]. Hereby, the policy changes ultimately act as a barrier to decarbonizing the CEIN.

4. Subsidy payments: Simultaneously the slower than expected growth in electricity consumption threatens the liquidity of the renewables subsidy fund [Policy, Announcement 315, line 16-20]. This has led to Electricity Generators (B1) being “*owed over RMB 6 billion in renewable energy subsidies*” [Policy, Announcement 133, line 1-2]. This issue is amplified by “*disagreements over responsibility*” between the Ministry of Finance (G5) and the National Development and Reform Commission (G3) [Policy, Announcement 133, line 6-10]. In order to overcome this issue, the National Energy Administration (G4) has “*requested that companies submit documentation showing owed subsidy payments*” [Policy, Announcement 315, line 1-8] and coordinates the responsibility for subsidy collection and redistribution system with the Ministry of Finance (G5).
5. Financing: The delays in subsidy payments [Policy, Announcement 133, line 1-10] combined with the low utilization hours of renewable electricity sources as well as the resulting renewables curtailment [Policy, Announcement 231, line 1-6] hamper the profitability of renewable electricity generation [Policy, Announcement 191, line 6-12]. Ultimately renewable electricity projects are becoming less credit-worthy for Financial Institutions (B2) and therefore the National Energy Administration (G4) introduced a new policy that encourages “*regional governments to set up financing vehicles to guarantee solar bank loans, and encourages banks to offer attractive rates and longer-term financing for solar*” [Policy, Announcement 44, line 8-10]. Moreover, in June 2016, the National Development and Reform Commission (G3) announced an insurance on renewable energy utilization hours by offering a “*financial guarantee to wind and solar power plants who fail to meet minimum utilization hours in the year due to manmade events (curtailment)*.” [Policy, Announcement 587, line 1-2].
6. New management guidelines: In an attempt to reassure the profitability of renewable energy generation, the Ministry of Finance (G5) released new management guidelines for the renewable energy subsidy fund which places “*greater pressure on provincial level Ministry of Finance offices to supervise and report misappropriation of funds*.” [Policy, Announcement 348, line 3-5]. This may be interpreted as a measure to overcome the previously described “*disagreements over responsibility*” between the Ministry of Finance (G5) and the National Development and Reform Commission (G3) [Policy, Announcement 133, line 6-10].
7. Independent review: An additional consequence of the concerns about subsidy payments, the National Energy Administration (G4) initiated an independent review of Grid Operators (B3). Hereby, the National Energy Administration (G4) pushes Grid Operators (B3) to “*reform its distributed PV grid interconnection practices*” [Policy, Announcement 184, line 1-3]. The announcement encourages Subsidiaries Grid Operators (B4, B5 & B6) to “*strictly obey regulations related to metering, accounting and payment of subsidies*” [Policy, Announcement 184, line 7-10].
8. Transmission: Due to the oversupply of electricity in some regions and “*very little transparency into the operational costs and profits*” of Grid Operators (B3), the National Energy Administration (G4) initiated a transmission and distribution pricing reform [Policy, Announcement 211, line 5-8]. Under the reform, Local Government Offices (G6) control the revenues of Grid Operators (B3) on a “*cost + permissible profit basis, similar to the way distribution pricing is regulated in the U.S. and many other countries around the world*.” [Policy, Announcement 211, line 2-4]. Hereby, the policy change “*opens up a range of new business cases including direct sales between generator and consumer*”. [Policy, Announcement 211, line 12-14]. Furthermore, the State Council (G2) eliminated approval processes related to inter-provincial transmission pricing. [Policy, Announcement 140, line 3-7].

5. Conclusion and implications

This study was conducted to understand the political embeddedness of business networks by examining the evidence of firms' responses to climate change. We find that a governmental intervention at any point in the network may lead to an array of intended and unintended consequences that may spread across the three interconnected forms of networks, and affect actors, activities and resources in ways that can act as enabler or barrier to firms' responses to climate change. We extend Hadjikhani and Håkansson's (1996) argument that a change in one relationship may spread across the entire business network by using a 'politicalized' version of the AAR model (Welch and Wilkinson, 2004) that allows focusing on three interconnected forms of networks. It was the re-working of the original AAR model (Håkansson and Johanson, 1992; Håkansson and Snehota, 1995) that aided unveiling the interconnectedness of inter-business networks, policy-business networks as well as inter- and intra-governmental networks. Moreover, the 'politicalized' AAR model allowed to specify how the interplay across actors, activities and resources unfolds and may act as enabler or barrier to firms' responses to climate change.

Furthermore, the study provides empirical evidence on the heterogeneous nature of governmental actors embedded in the business network. In this case, falsely assuming that governments are homogenous entities and therefore analyzed as being a single actor (e.g. Boddewyn, 2003), would have hindered unveiling the eight mechanisms of *how* a change at one point in the network affects the inter-business networks, policy-business networks as well as inter- and intra-governmental networks. The findings may help firms to better predict the widespread of changes that may occur throughout the business network when one relationship is altered. This would require that we move beyond 'developing network insight' (e.g. Mouzas et al., 2008) and consider the political embeddedness of business networks seriously. Business managers need to extend their networking and engage with governmental actors on a recurrent basis across inter-business networks, policy-business networks as well as inter- and intra-governmental networks. However, predicting the final outcome of a governmental strategy is a paramount challenge due to the multiplicity of potential adjustments. Hence, governmental interventions in business networks always come with the risk of unintentional outcomes (Forsgren et al., 1995; Hadjikhani and Håkansson, 1996) that may spread across the three interconnected forms of networks.

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