Organizational Legitimacy: Different Sources – Different Outcomes?

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Dissertation submitted in partial fulfillment of
the requirements for the degree of Doctor
of Philosophy in Business Administration
in the Graduate School
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ABSTRACT

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Abstract

An abstract of a dissertation that examines different dimensions of legitimacy stemming from different sources, and how they condition the effects of each other. The traditional literature studies organizational legitimacy as a uni-dimensional phenomenon, however, there are multiple audiences with different systems of values that evaluate organizations and based on the fit with their values grant or withdraw legitimacy from the firm. This dissertation examines three different dimensions of legitimacy (i.e. social, market, and home country) and shows that they may substitute each other in affecting organizational outcomes. This is shown in a financial event study of additions and deletions from the Dow Jones Sustainability Index, a qualitative study of the nature of corporate social responsibility (CSR) in the emerging market of Russia, and a large-scale quantitative analysis of M&A deals, where the acquirer comes from Brazil, Russia, India, China and South Africa (BRICS).
Dedication

To my family and friends.
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Acknowledgements

Special thanks to Will Mitchell, Nel Dutt, Elena Vidal, Andrew Spicer, Rich Burton, Steve Tallman, Aaron Chatterji, Sharon Belenzon, Elena Kulchina, and seminar participants at Duke, Ivey, Georgetown, NUS, HKUST, LBS, Wharton, USC Marshall, Minnesota, HEC Paris, BU and GWU; conference reviewers and participants at the 2010 Strategic Management Society, 2011 IABS, 2011 ARCS, 2011 and 2012 Academy of Management Meeting, 2012 Academy of International Business Meeting; Jorge Rivera and Robert Hoskisson at Bentley University’s ESG Workshop, Tima Bansal, David Deephouse, Jonathan Doh, Witold Henisz, Ioannis Ioannou, Andrew King, Matthew Kraatz, Michael Lenox, Gerry McNamara, Martin Ruef, Sandra Waddock, James Walsh, Bennet Zelner for their helpful comments and feedback on early drafts of parts of this dissertation. Also, thanks to my research assistants Svetlana Andrianova Fisher and June Reyes as well as to the administrative support at Duke University for sharing contact information of alumni in Russia.
1. Introduction

Organizational legitimacy has been a central tenet in the organizational theory and institutional literature since their founding. It is defined as ‘a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions’ (Suchman 1995: 574). Organizational legitimacy as a property of organizations is also important to the strategy field. The literature has shown that legitimacy helps firms to survive and grow (Dobrev & Gotsopoulos 2010; Ruef & Scott 1998), be more predictable (Bansal & Clelland 2004), and profitable (Dacin et al 2007), as well as succeed in many strategic activities, such as for instance international business (Kostova & Zaheer 1999).

Traditional literature has typically examined legitimacy as a uni-dimensional phenomenon; however, as the word ‘some’ in the definition above suggests, there might be several potential sources of legitimacy that operate at different levels and have varying ‘systems of norms, values, beliefs, and definitions’. In fact Ruef and Scott have called for a need to develop a multidimensional model of legitimacy which seeks to understand these varying sources of legitimacy, the levels at which they operate, the institutional elements that they target, and the environments that contextualize their effects (1998). This dissertation answers this call by examining three different dimensions of organizational legitimacy: social, market, and home country.
In addition to distinguishing between different dimensions of legitimacy by its sources (or audiences that judge organizational legitimacy), this dissertation evaluates how different dimensions of legitimacy interact in affecting organizational outcomes. This gap in the literature has emerged more recently (Kraatz & Block 2008) as the research is only beginning to distinguish between different types of legitimacy that reflect variation in the norms and values of different societal actors (Earle et al. 2010; Greenwood et al. 2002) and examining the order in which different sources and dimensions of legitimacy are conferred (cf., Greenwood et al. 2002). While organizations seek endorsement from various sources and are pleased when they receive it, certain sources may have a larger impact than others (Deephouse & Suchman 2008). Furthermore, what is legitimate for one group of social actors may not be legitimate for others (Earle et al. 2010).

Overall, this dissertation examines three sources of organizational legitimacy: 1) perceptions of firms based on the norms and values of nonmarket actors, 2) fit with the norms and values of market actors, and 3) perceptions of firms based on their origin (i.e. home country). I chose these based on existing literature as well as their understudied nature. I call them social, market, and home country legitimacy. Social legitimacy implies a generalized perception or assumption that the actions of a firm are desirable, proper, or appropriate within the societal system of norms, values, beliefs and definitions (Suchman 1995) – that of nonmarket actors. Market legitimacy indicates a generalized
perception or assumption that the actions of a firm are desirable, proper, or appropriate within the financial market’s system of norms, values, beliefs and definitions – that of market actors. The key difference between them (and between market and nonmarket actors) rests in the conflicting institutional logics as well as the nature of intermediaries and characteristics of firms’ interactions with the environment (Baron 1995). Market interactions are intermediated by markets or private agreements, typically voluntary in nature, such as economic transactions and the exchange of property, that create value by improving economic performance. Market actors include executives, investors, analysts, brokers, and others who actively assess and value an organization’s economic activity (Zuckerman 1999). Nonmarket interactions, on the other hand, are intermediated by government, media, public institutions, and other stakeholders, voluntary or involuntary in nature, that create value by improving social dimensions of performance (Baron, 1995). Nonmarket actors include regulators, employees, non-governmental organizations, and the local community who rely on a wider system of criteria when evaluating organizational legitimacy (Bonardi et al. 2005).

In addition, this dissertation considers home country as a source of organizational legitimacy. International business and organizational theory literatures have emphasized certain disadvantages as a result of liability of foreignness (Zaheer 1995), newness, and origin (Ramachandran & Pant 2010) in the host country; however, the role of nationality, or the liability of home (Stevens & Shenkar 2012) has been
overlooked in past research. This dissertation extends the literature by developing the concept of home country legitimacy, defined as a generalized perception that the actions of the firm’s home country fit with the norms and values of the host country. In this dissertation I will particularly focus on low home country legitimacy or the disadvantages borne by a firm investing in a foreign country due to friction caused by the attributes of its home country institutions (Stevens & Shenkar 2012).

In line with the proposed theory, the dissertation evaluates how other sources of legitimacy may help overcome the disadvantages stemming from the illegitimacy of the home country in the host country. In doing so, this dissertation answers the call for more attention to the intra-individual dynamics of legitimacy judgments, and in particular, to how these judgments form and change (Tost 2011). Also, it contributes to the neo-institutional theory by showing that foreign firms might gain legitimacy and acceptance not by shrinking institutional ‘distance’ and conforming to local norms and expectations but by exceeding these expectations, or conforming to a unique set of expectations local stakeholders have, based on the firms’ nationality (Stevens & Shenkar 2012). Since legitimacy judgments that evaluators render can determine success or failure for an organization – for example, a legitimacy judgment by a regulator (Bitektine 2011) – building theory on how different legitimacy judgments can substitute and/or complement each other is strategically important for organizations.
Overall, this dissertation examines legitimation judgments of all four main organizational constituents: the state, the public, the media, and the financial community. Each of these constituents influence the flow of resources crucial to the organizations’ establishment, growth, and survival, either through direct control or by the communication of good will (Hybels 1995). The main argument of this dissertation is that different dimensions of organizational legitimacy (stemming from different sources) may substitute each other in affecting organizational outcomes: when organizations lack one type of legitimacy but possess another, alternative base of legitimacy stemming from the later will substitute for the lack of the former in affecting performance. To achieve this, the dissertation 1) assesses the sources of social and market legitimacy as well as home country illegitimacy through a qualitative study in the emerging market of Russia, 2) shows that market legitimacy buffers the losses and gains from decreased and increased social legitimacy in a financial event study, and 3) demonstrates that social legitimacy helps firms overcome low home country legitimacy in cross-border acquisitions.

The main empirical focus as a source of social legitimacy is on corporate social responsibility (CSR). I examine CSR in developed and emerging markets, contributing to the longstanding debate about when CSR affects firm performance. In particular, in the developed market setting, I demonstrate that changes in a firm’s social legitimacy stemming from its CSR affect its stock market performance contingent on the firm’s
market legitimacy. In the emerging market setting, I both explore the currently ambiguous concept of CSR and demonstrate that CSR activities in the home country help firms from emerging markets overcome the challenges of low home country legitimacy in cross-border acquisitions.

This dissertation suggests strategic implications for firms as well as avenues for future research on CSR and organizational legitimacy: by developing one source of legitimacy, organizations can buffer themselves from the consequences of the potential losses of another. I will discuss these below, while the next section will review the existing literature.
2. Literature

An extensive literature review suggests that prior legitimacy literature has been highly theoretical, invoking legitimacy as an explanatory concept rather than examining it as an empirical property. Empirical accounts, to date, have focused on exploratory case studies of legitimacy being gained or lost, while only a handful of investigations employed legitimacy as a variable in hypothesis testing (Deephouse & Suchman 2008). This certainly provides a window of opportunity, particularly for strategy scholars who value legitimacy as a property of organizations and who are interested in its effects on performance and other strategic (organizational) outcomes.

Furthermore, the review suggests refining propositions involving legitimacy to recognize that there are different types and sources of legitimacy (Deephouse 1996). In particular, researchers might focus further on the workings of various sources of legitimacy. Subjects seek endorsement from various sources and are pleased when they receive it, but certain sources may have a larger impact than others (Deephouse & Suchman 2008). In addition, there is a greater need for research on the order in which these different sources of legitimacy and the different dimensions of legitimacy are conferred (cf., Greenwood, Suddaby & Hinings 2002). The issue of whose conception of legitimacy is operable at any particular point in time or place is also crucial to further research because what is legitimate for one group of stakeholders may not be legitimate for other social actors (Earle, Spicer & Peter 2010).
2.1 Different Sources of Legitimacy

Sources of organizational legitimacy comprise the internal and external audiences who observe organizations and make legitimacy assessments (Ruef & Scott 1998: 880). It is necessary to identify them because each critical actor, both internal and external, influences the flow of resources crucial to the organizations’ establishment, growth, and survival; this is accomplished either through direct control or by the communication of good will (note the paths of communication and resources each may have either a negative or positive impact on the legitimacy) (Hybels 1995).

To identify who has collective authority over legitimation in any given setting, it is useful to specify the focus of the research question: e.g. an examination of the legitimacy of the global energy industry after the Exxon Valdez oil spill would need to encompass popular opinion, state regulators, industry analysts, political activists, and experts throughout the world system (Deephouse & Suchman 2008). In addition, it is helpful to examine legitimacy agents – organizations that are specifically established to confer legitimacy on a certain set of subjects, such as accreditors and regulators, e.g. business school accreditation associations (Durand & McGuire 2005).

In a classical piece on legitimation, Hybels recognized four main groups of organizational constituents: the state, the public, the media, and the financial community (1995). The state is important because governmental bodies not only control critical resources directly through the awarding of contracts and grants, but also
indirectly influence the transfer of resources through regulation and legislation. The public is a critical actor because consumer groups and other ‘public interest’ groups affect legislation and regulation directly through lobbying and indirectly through influence on voters. The investment community legitimates both new and established organizations by determining the present values of firms based on rationalized appraisals intended to predict future returns on investment (collective assessments of future performance). Finally, the media not only reports illegitimate activities but also defines and evaluates grounds for the actions of entrepreneurs, managers, regulators, and investors (even though it has little direct control over the transfer of resources to organizations, it has considerable influence on the allocation decision of others).

While the state, the public and the media have somewhat overlapping norms and values by which they judge organizations, the financial community has separate evaluation criteria from them all. This is consistent with the literature where the state, the public and the media fall into the category of nonmarket actors, while the financial community represents market actors. Market and nonmarket actors have been juxtaposed in the literature for many decades, however, the conflict between them has been most pronounced in the “real” world with the recent financial and corporate crises. This led to calls for combining the interests of both market and nonmarket actors, and creating shared value (Porter & Kramer, 2011). This dissertation will juxtapose market
and nonmarket actors as different sources of organizational legitimacy, seeking to understand whether they may act as substitutes or complements.

The idea of substitution is conceptually plausible because legitimacy stemming from these major organizational constituencies takes on different values as norms and values by which market and nonmarket actors value the firm are dynamic and not necessarily coevolve. Moreover, they represent distinct institutional logics and the incompatible prescriptions from these multiple institutional logics raise the institutional complexity facing organizations. Given that organizations experience this complexity to varying degrees, they will differ in how they might respond, generating further variance in organizational legitimacy and thus an organization’s access to critical resources (Greenwood, Raynard, Kodeih, Micelotta & Lounsbury 2011).

Prior literature identified several dimensions by which legitimacy is evaluated. For example, a firm’s strategy is legitimate if it is acceptable to its organizational field, which consists of a network of competitors, suppliers, customers, regulators, trade associations etc. (Aldrich & Fiol 1994; Suchman 1995). However, it is cognitively legitimated if it is aligned with the cognitive consensus or industry recipe (Spender 1989) and it is normatively, sociopolitically, or regulatively legitimated if members of the organizational field endorse it (Deephouse 1999).

Furthermore, based on ‘pragmatic’, ‘moral’ and ‘cognitive’ legitimacy, two temporal textures (episodic and continual) and two substantive foci (organizational
actions versus organizational essences), Suchman distinguishes between twelve distinct types of legitimacy (1995), explicating the various dimensions for further research at both theoretical and empirical levels. Following his start, Bansal and Clelland (2004) introduced a contextually focused dimension, called corporate environmental legitimacy. This dissertation follows their lead and evaluates social legitimacy based on organizational actions and ‘moral’ legitimacy (i.e. CSR activities of the firm), market legitimacy based on ‘pragmatic’ legitimacy, and home country legitimacy based on ‘cognitive’ legitimacy with very specific sources of legitimacy for each dimension.

To conclude, previous legitimacy literature has discussed the need for and identified multiple dimensions of legitimacy; however, it has not discussed the sources of legitimacy as a differentiating factor, and is yet to understand how the different dimensions may condition the effects of each other. Thus, Kraatz and Block suggest that future research should give more attention to the possibility that organizational legitimacy can be additive or even multiplicative rather than zero-sum as Meyer and Scott propose (2008). The only existing study that came close to this realization is by Deephouse (1999) where he showed that firms face strategic choice for a balance between differentiating (and thus, reducing competition) and conforming (and thus, demonstrating legitimacy). While both improve performance, balancing the pressures of competition and legitimation is problematic because firms can only be as different as legitimately possible. This dissertation aims at expanding on these ideas and exploring
the interaction between the various dimensions of legitimacy. However, before I proceed any further, I need to address several shortcomings in the literature.

2.2 Legitimacy, status or reputation?

There is some confusion in the interdependent use of legitimacy, status and reputation. In particular, the use of legitimacy as a continuous variable obscures the main difference between legitimacy, and both status and reputation. Table 1 below demonstrates conceptual and empirical differences based on Deephouse and Suchman’s discussion (2008). I use legitimacy as an empirical property of organizations and therefore as a continuous variable for two reasons: (1) despite being fundamentally dichotomous, because legitimacy is always assessed by multiple audiences and with respect to multiple activities, an organization can become ‘more legitimate’ by becoming legitimate to more audiences in more of its activities; and (2) legitimacy can vary in its certainty and security: a firm may become ‘more legitimate’ by becoming more clearly legitimate, more firmly legitimate, or both (Deephouse & Suchman 2008). Thus, in this dissertation, I will refer to ‘more/less legitimate’ firms because I will assume that these firms are more/less clearly legitimate (i.e. there is a legitimacy signal involved) to more/fewer audiences in more/fewer of their activities.
Table 1: Comparison of legitimacy, status, and reputation

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Legitimacy</th>
<th>Status</th>
<th>Reputation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sources</td>
<td>Conformity to various social guidelines</td>
<td>Ascription and group mobility</td>
<td>Achievement and self-presentation</td>
</tr>
<tr>
<td>Levels</td>
<td>Population</td>
<td>Group</td>
<td>Individual firm</td>
</tr>
<tr>
<td>Dimensionality</td>
<td>Dichotomous: ‘legitimacy is known more readily when it is absent than when it is present’ (Pfeffer &amp; Salancik 1978: 194)</td>
<td>Ordinal or categorical</td>
<td>Multidimensional &amp; idiosyncratic, continuous (from best to worst)</td>
</tr>
<tr>
<td>Competition</td>
<td>Non-rival</td>
<td>Group-rival</td>
<td>Individual-rival (contingent on relative standing)</td>
</tr>
<tr>
<td>Effect within groups</td>
<td>Homogenizing</td>
<td>Segregating</td>
<td>Differentiating</td>
</tr>
<tr>
<td>Scope of effect</td>
<td>High (attaches to all entities that share a given form)</td>
<td>Medium (attaches to self-aware cliques or ‘status groups’)</td>
<td>Low (attaches to individual actors)</td>
</tr>
<tr>
<td>Main effect</td>
<td>Political (linked to authority)</td>
<td>Honorific (elicits deference and tribute)</td>
<td>Economic (becomes an input into potential partners’ expected utility functions)</td>
</tr>
<tr>
<td>Other effects</td>
<td>Produces a taken-for-granted right to act and command within a particular sphere of activity</td>
<td>Generates self-esteem and privileges; implies an ability to valorize by association</td>
<td>Favorable reputation is often a strategic resource that firms use for competitive advantages</td>
</tr>
<tr>
<td>Examples</td>
<td>Fortune 500 list or firm listings (IPO) on NYSE/NASDAQ represent organizational legitimacy by signaling that these companies conformed to some norms in a particular social arena, i.e. by meeting the</td>
<td>GM cars (Chevrolet, Pontiac, Oldsmobile, Buick and Cadillac) or Toyota cars (Yaris, Corolla, Matrix, Prius, Highlander, Tacoma, Tundra) represent the essence of the concept ‘status’ as</td>
<td>The following cars have reputation for certain aspects of their performance: Volvo (safest), BMW (“coolest”), Porsche (fastest), Tata NANO (The People’s Car, cheapest). All of them illustrate the reputation concept as</td>
</tr>
</tbody>
</table>
2.3 Dynamics of legitimacy

Legitimacy can be conceptualized as both a process and a state (Deephouse 1996), therefore, this raises certain confusion in the literature. As a process, legitimation comes from constituencies through conferral of resources and communication of good will (Hybels 1995). As a state (i.e., property), legitimacy results from legitimation and thus reflects changes in legitimation over time (Navis & Glynn 2010). While some constituencies may confer resources on the organization, others may withdraw or
reduce their support (i.e., the paths of communication and resources each may have either a negative or positive effect on legitimacy). Moreover, even though legitimacy is said to stem from institutionalized norms and values, social systems change over time and consist of multiple institutions (Hybels 1995). In addition, social values and expectations are often contradictory, evolving, and difficult to operationalize; their transmission is often full of ambiguities and inconsistencies while the diffuse constituents have frequently conflicting expectations and perceptions (Ashforth & Gibbs 1990). Therefore, it is useful to distinguish between the different arenas for legitimacy (i.e. the different sources of legitimacy) and examine high and low legitimacy organizations.

This dissertation examines emerging market multinationals as “low legitimacy organizations” because they are attempting to extend their legitimacy or defend it against a severe challenge (stemming from a poor reputation or stigma associated with their home country). In addition, it examines increases and decreases in social legitimacy along a continuum of market legitimacy, so we can distinguish between low and high legitimacy firms on these dimensions. I will start by conducting a qualitative study of CSR in Russia, seeking to understand the nuances of legitimacy sources, and continue extending the ideas mentioned in this chapter.
3. Qualitative Evidence

While most studies on corporate social responsibility (CSR) are conceptualized and conducted in the context of developed countries, there is little understanding of what CSR means both in terms of the nature and strategic impact on firms in emerging markets, where most of the current commercial activity takes place. In addition to various sources of legitimacy, this inductive chapter seeks to understand and explain the implications of CSR for Russian firms by asking what it means in that context, as well as how it affects their international expansion efforts and performance back at home (after the initial CSR-related changes are undertaken). The results suggest significant differences by the nature of the firm (i.e. big or small-and-medium sized) as well as by relations with the state (i.e. mutual benefit or barrier). The implications for scholars and managers are discussed as to the drivers of CSR heterogeneity, and the importance of CSR in overcoming liabilities in international expansion.

3.1 Literature

The classical definition of ‘the social responsibility of business encompasses the economic, legal, ethical and discretionary expectations that society has on organizations at a given point in time’ (Carroll 1979: 500). However, the majority of studies on corporate social responsibility (CSR) are conceptualized and conducted in the context of developed countries, where CSR is understood as going beyond “the narrow economic,
technical and legal requirements of the firm” or beyond compliance, and is usually voluntary (Davis 1973: 312). Nonetheless, extensive commercial activity now takes place in emerging markets (EM) as well as in traditionally developed markets, but relatively little is known about the nature and strategic impact of CSR in EM (Visser 2008), in particular whether it differs from voluntary ‘beyond compliance’ behavior.

This exploratory chapter seeks to understand and explain what CSR means in an emerging market of Russia, how it affects the international expansion of Russian firms and their performance back at home using qualitative methodology. The results of the study suggest that the context and the nature of the firm are important determinants of CSR activities; in particular, heterogeneous firm size and relations with the state explain heterogeneity in CSR in Russia. The state defines CSR activities for big firms with a wide circle of stakeholders and mandatory ‘beyond compliance’ behavior in the socio-economic partnership agreements, while small-and-medium-sized firms prefer to avoid the state by complying, limiting their main stakeholders to owners/management and employees, and engaging in CSR (mainly charity) voluntarily. Furthermore, the strategic impact of CSR is crucial for Russian firms that try to expand abroad by helping them overcome liabilities of newness, foreignness and origin. In particular, Russian firms can counteract these liabilities by providing better transparency and corporate governance, using environmental standards, and dealing with unions in the host country.
There are several reasons for emerging markets, defined as “low-income, rapid-growth countries using economic liberalization as their primary engine of growth” (Hoskisson, Eden, Lau & Wright 2000: 249), to be an intriguing and important context to study CSR. First, the shift in the economic power from the developed to the emerging world has accelerated, demonstrated by their larger world share of population and other socioeconomic indicators (see Figure 1); for example, emerging economies produce more than half of the world’s exports and consume more than half of the world’s imports (Woodall 2011); moreover, currently their growth rates exceed those of the “debt-ridden rich world” by four percentage points (The Economist 2011b), shifting managerial attention to the new opportunities in this part of the world. Second, as firms from emerging markets increasingly purchase firms in the developed world (The Economist 2011c), strategy scholars call for more research on firms in emerging markets, arguing that future inquiries could advance existing and/or develop new theories in this context (Wright, Filatotchev, Hoskisson & Peng 2005). Third, CSR is vastly understudied in emerging markets (Visser 2008); moreover, it may have a different meaning as governments in EM place CSR on their agendas, at times making it involuntary for firms. To conclude, with the increasingly important role that emerging markets play in

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1 In Russia, since 2003, then President and now Prime Minister Putin called on corporations to increase their effort in the field of CSR; in India corporate affairs ministry issued voluntary CSR guidelines urging companies to create a separate fund for their CSR activities and the minister even suggested issuing social credits, just like carbon credits, and said that if needed, the government will consider making CSR mandatory; in China the Ministry of Commerce says it is using CSR indicators, like environmental protection and employee welfare, to appraise exporters - including domestic- and overseas-funded
the current world economy, and the growing entry of emerging market firms into the
developed (and developing) world, there is a need to understand how these firms
operate in their country of origin in the area that is accepted as the norm of doing
business in the West – CSR (Waddock 2008a) – and how that practice affects their
international expansion and performance at home.

Figure 1: Emerging versus Developed Economies²

² Source: The Economist 2011b.
I chose Russia out of all emerging markets for two main reasons: 1) the lack of extant literature on CSR and other strategy topics in the region; and 2) weak institutional prerequisites for CSR, such as functioning market, civil society and state institutions (Campbell 2007; Matten & Moon 2008). The emergent status of Russia offers an opportunity to study CSR in a setting that is similar to other such volatile EM settings as China or India. Given the transitional and dynamic nature of Russia’s economic development and the dearth of literature, I utilized an inductive research design (Eisenhardt 1989b) for both questions and data collection methodology. One of the main objectives of the study was to understand the difficulties behind the international expansion of Russian firms as well as the nature of their socially responsible activities in order to develop an insight regarding potential advantages of CSR in overcoming the entry barriers into more developed international markets.

Strategy research in emerging economies offers four strategic options for research: (1) firms from developed economies enter emerging economies; (2) domestic firms compete within emerging economies; (3) firms from emerging economies enter other emerging economies; and (4) firms from emerging economies enter developed economies (Wright et al. 2005). While the first two options have been widely pursued by strategy scholars, the latter two have been largely neglected, calling for more research on the international expansion of Emerging Market Multinationals (EMMs). As any other firm going abroad, EMMs face liabilities of newness and foreignness; however, in
addition to these liabilities, such firms can also experience late entry and competitive disadvantages (Guillén & García-Canal 2009), EMMs have been less successful in their expansion due to their liability of foreignness turning into the liability of origin (Bartlett & Ghoshal 2000; Ramachandran & Pant 2010) or low home country legitimacy. This means that EMMs in host countries assume certain disadvantages as a consequence of where they are from (i.e. their specific nationality) as opposed to where they are not from (as in liability of foreignness).

The central tenet in the liability of origin argument is the lack of legitimacy of the focal firm (due to its origin, particularly in more developed countries). However, CSR literature suggests that by acting as a good ‘corporate citizen’ the firm can ensure its legitimacy (Carroll 1979). Moreover, CSR can help develop a particular type of intangible asset across institutional environments (Gardberg & Fombrun 2006). Drawing on this argument, I seek to understand how CSR can help firms overcome the liability of origin in international expansion, where proprietary intangible assets have been shown to enable EMMs to successfully compete even in the most advanced countries in the world (Guillén & García-Canal 2009). The motivation to examine the strategic impact of CSR (as a proprietary intangible asset and a way to gain legitimacy abroad) emerged in response to the gap in strategy and international business literature on international expansion of EMMs.
The motivation to examine the nature of CSR in emerging markets developed in response to the calls for more research in this empirical context as well as the need to advance theory regarding the different drivers of CSR. Current CSR literature argues that country-level institutional factors, including legal, political, capital, and labor markets, play an important role in explaining differences in the nature and scope of CSR (Campbell 2007; Chapple & Moon 2005; Ioannou & Serafeim 2010). These differences, however, have not been examined until recently, primarily due to the sole focus of CSR studies on the relatively homogenous institutional environments of developed countries. In emerging markets, where the above-mentioned institutions are weak, property rights are applied inconsistently, the enforcement of law is arbitrary, and tax evasion, corruption and fraud are commonplace, the definition of CSR (instead of going “beyond compliance” like in developed countries) may entail abiding by the law and codes of conduct (Jamali & Mirshak 2007) and therefore, should be particularly ‘contextualized’ to the setting (Dobers & Halme 2009). While one study of CSR activities in seven Asian countries demonstrates that there is cross-country variation that cannot be explained by the economic development of the country, but rather by the “national business systems” (Chapple & Moon 2005), examining CSR activities in several emerging markets at once may lead to overlooking other factors that drive this variation. Thus, a deep qualitative analysis of CSR issues in one emerging market can contextualize not only the role of the
institutional environment but also the nature of the firm and/or other factors that define CSR in emerging markets.

By choosing Russia as the empirical setting to examine these ideas, this study contributes to expanding the limited literature in this emerging market. Following a review of the literature, I identified only one current relevant qualitative study that used a contextualized approach to CSR; however, the goal of the study was to explore the type, nature and scope of CSR in Russia (Crotty 2011), rather than to understand the strategic impact of CSR for Russian firms. The study found that the historical legacy of the Soviet and transition periods influences the type and nature of CSR in that firms mainly support local communities and do not go beyond what is required by the state in their CSR activities; even though a few companies do follow the market logic for adopting CSR in that they certify with international environmental standards organizations (i.e. ISO 14001) in order to access foreign markets. Therefore, there is some evidence that CSR has a strategic impact on Russian firms, even though further research is needed to examine under what conditions environmental standards (or other CSR activities) help organizations achieve success abroad.

Another relevant, yet survey-based study of CSR in Russia found that local managers do not view CSR as a legitimate activity for business because going “beyond compliance” in the transition period was not the norm, in fact, non-compliance was commonplace (Kuznetsov, Kuznetsova & Warren 2009). This is consistent with other
studies of deviant behavior set in Russia (Earle, Spicer & Peter 2010), highlighting the need to contextualize western concepts in the Russian context. Regardless, the study found that only a few firms engage in CSR: they represent “a handful of super large corporations, operating in oil extraction and other lucrative industries, that occupy a strategic position in the national economy, enjoy special relations with the state and seek to attract financial resources from foreign and international markets to support their expansion” (Kuznetsov, Kuznetsova & Warren 2009: 43). This finding is consistent with the previous study in that some companies engage in CSR to gain access to international markets; however, little is known about the conditions under which the variation in CSR engagement arises within Russia, with some firms defining compliance as CSR, and others going beyond compliance for the above-mentioned strategic reasons.

Another gap in the literature is concerned with the legitimacy conundrum: while CSR helps generate legitimacy for the firm (Schlusberg 1969), in emerging markets CSR activities in many ways substitute for the state, hence, they may be perceived as illegitimate. Thus, even though the legitimacy advantage stemming from CSR may be useful in international expansion, CSR can also create problems with organizational legitimacy in the country of origin. Thus, three main conclusions can be drawn from the literature: 1) there is some evidence in favor of the strategic impact of CSR for Russian firms, however it is yet to be examined under what conditions the effect can be higher and how firms can achieve it; 2) there is a gap in understanding how CSR helps EMMs
achieve legitimacy and success in international expansion and what effect it has on these firms at home; and finally, 3) the definition of CSR within Russia may differ from the traditional framework and thus, to be able to define CSR in Russia, it is necessary to contextualize it. The next section discusses the empirical context and the issues most pertinent to CSR in Russia.

3.2 Empirical Context

According to the CSR literature, there are three main institutional drivers of CSR: functioning market, civil society and state institutions (Campbell 2007; Matten & Moon 2008); in the context of Russia the degree of functionality of these institutions is very low. First, the Russian market economy emerged as a result of the collapse of the Soviet Union, where subsequent market reforms turned a large proportion of the Russian economy informal. This made the business climate hostile for both foreign firms entering the country and businesses originally from Russia. Plagued by problems of organized crime, intractable bureaucracy and corruption (Fey & Denison 2003), Russia is still in its transition stage to the open market economy, where corporate governance, transparency and accountability become the main principles by which firms operate. To demonstrate how far Russia still has to go in its transition to ‘functioning market (and state) institutions’, I refer to the Transparency International Corruption Perception Index which rated Russia 154th out of 183 countries in 2010.
Second, as a result of the history of non-payment of taxes and wages in the transition period (Earle et al. 2010), Russian society became distrustful of each other, of business and state institutions. In addition to recent government regulation of non-governmental organizations (NGOs), this resulted in a weak civil society and ‘a vacuum of responsibility’ for environmental problems (Crotty & Hall 2011). While in developed countries the civil society and NGOs are the main drivers of CSR, in Russia they virtually have no influence on the government or business leaders³.

Finally, as a result of the remaining Soviet rules, state institutions are so inefficient and poorly functioning that Russian firms generally keep two systems of accounting—one for tax authorities and one for management, making official data on firm performance (even reported by Russian accounting standards) inaccurate (Levinsky 2002). This dual system of accounting and the resulting inaccuracies complicates strategy research in this context. Consequently, I ask interviewees about alternative ways of defining financial success in Russia. Consistent with previous research in EM that shows that because of local values and norms, western business concepts and their definitions take different shape, I expect to find some differences between commonly accepted definitions of financial success in the West and in Russia. For example, McCarthy and Puffer (2008) demonstrate that the values underpinning agency theory

³ “The Russian society is very inactive in terms of requests for business. There are certain political parties that say some things from time to time but as to our bank, the depositors only complained when their personal benefit was at stake but no requests about business being more transparent or helping the society more – it’s only the state that does this. Our society is very passive”. SME 4, Banking
based corporate governance systems are modified with respect to Russian values and norms. Moreover, there is additional uncertainty as to the meaning of the different concepts due to the dynamic and transitional nature of emerging markets. For instance, Russian managers are often uncertain about what constitutes ethical behavior as they are caught in a transition between two systems of ethics – socialist and capitalist (McCarthy & Puffer 2008). Due to these factors, I assume that just as the national culture, norms and values are critical to achieving success in Russia (Fey, Nordahl & Zätterström 1999), they will also be critical to defining CSR. Therefore, focusing on CSR heterogeneity across firms of different size, I expect to find differences between Western and Russian definitions of CSR.

3.3 Results

3.3.1 Methodology

This exploratory study took place in the fall of 2010; a detailed description of the methodology and validation of the techniques and strategies used in this research is available in Appendix A. In short, using alumni networks of several universities, I contacted around 350 people with a description of the study and a request for an interview. Given the Russian history and the Russian business culture, it is not surprising that this only led to 15% response rate and 10% of scheduled interviews. In total, I conducted 33 interviews with Russian executives of both large Russian
corporations and small-and-medium-sized enterprises (SMEs) as well as several foreign firms. A detailed description of interviews by firm characteristics is provided in Tables 2 and 3 below. The firms included a wide range of industries from highly diversified businesses to companies in natural resources (oil & gas, mining), services (financial, media/entertainment, IT, transportation, retail), manufacturing, and agriculture.

**Table 2: Interviews in International vs. Domestic Firms**

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<th>Big</th>
<th>SME</th>
<th>Foreign</th>
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<tr>
<td>International*</td>
<td>11</td>
<td>9</td>
<td>6</td>
<td>26</td>
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<tr>
<td>Domestic</td>
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<td><strong>Total</strong></td>
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* International if the firm either has operations abroad or is listed on a foreign stock exchange

**Table 3: Interviews in Private, Public vs. State-owned Firms**

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<td>State-owned*</td>
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<td><strong>Total</strong></td>
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<td>15</td>
<td>6</td>
<td>33</td>
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* State-owned if majority/all shares are held by the state

The list of interview questions can be found in Appendix B; it was mainly motivated by the purpose of the study to identify what CSR means in Russia, how legitimacy and success are accomplished locally and globally, what factors define
success and failure of Russian firms in international expansion, and what role the state plays in CSR engagement. The questions were categorized into five main areas for analysis due to the following considerations:

1) International expansion: as the main objective of the study is to examine the strategic impact of CSR on broadly defined international expansion (i.e. IPO, exports, cross-border M&A), inquiring about the factors that drive success and failure of international expansion had to be undertaken for empirical reasons.

2) CSR and business responsibilities in Russia: at the beginning of this research, there was no certainty as to the nature of CSR in this emerging market (the two relevant studies about CSR in Russia were published after I launched this study), thus it was critical to explain what is understood by CSR for both conceptual and empirical reasons.

3) Main stakeholders: the width of the circle of stakeholders (from narrow to wide) that companies consider to be key to their business defines the scope and nature of CSR (Devinney 2009; Scherer & Palazzo 2007), it was necessary to investigate whether the circle of stakeholders differs from firm to firm for conceptual reasons.

4) Role of state: by definition, CSR is ‘going beyond compliance’ and is not mandatory (Davis 1973), so asking how the government influences firm’s activities in the realm of CSR is central to advancing prior literature and describing the empirical context.
5) Legitimacy and success: institutional scholars have long argued that by gaining legitimacy, organizations also gain resources, stability, and enhanced survival prospects, and are thus more successful (Meyer & Rowan 1977). According to the Iron Law of Responsibility, firms are granted and withdrawn legitimacy based on their engagement in CSR (Davis 1973; Wood 1991); thus, examining the determinants of legitimacy in the context of Russia was necessary to develop existing literature as well as to bridge the gap in strategy and international business literature on overcoming the liability of origin or low home country legitimacy.

3.3.2 What CSR Means in Russia

As expected, I found that the definition of CSR in Russia in fact differs from the traditional western framework: “CSR in Russia is different from the West because in Russia it is a statement while in the West it is the rules of the game – a statement that regularly does not meet reality. Moreover, it is a channel to get the money out of the firm. In Russia there is a very low level of CSR – people are too busy with themselves” (Foreign Firm 5, Financial Services).

When asked to define CSR in the Russian context, interviewees noted that the term itself was poorly understood: “CSR is a difficult term that did not find a place in the Russian terminology – it did not land smoothly” (Big Russian Firm 4, Oil and Gas); “The term is not well accepted in Russia – not well understood” (Big Russian Firm 11, Media; SME 1, Banking); “When I hear of CSR, I grab a pistol” (SME 10, Retail Clothing);
“When I hear the term CSR, I think of the state that avoids meeting its function, transferring blame for misfortunes and awful state of education in the country on people who have nothing to do with it” (SME 2, Banking).

As expected, this reflects the context and culture of the country in its acceptance of western ideas. To address this issue, I designed several types of questions to ask the same question in a different way, i.e. ‘Who are your main stakeholders? What responsibilities to the society does business have?’ (see Q2a-d, Q3-4, Q8). Significant differences emerged immediately after several interviews, mainly in the views of representatives of big corporations as opposed to those of SMEs. This is consistent with prior literature as they represent two major Russian business communities – large, publicly traded or privately held companies, and small companies that are usually privately held (McCarthy & Puffer 2008). The results of the interviews are summarized in Table 4.

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4 Due to the space limitations, this table makes the following abbreviations: 1) in the left column, IPP stand for Industry, Private, International, Interviewee Position, the rest are the first syllabi from the headline of the section; 2) in the body of the table, fin – financial, mgt – management, yrs – years, repn – reputation, VP – Vice President, GD – General Director, Dir – Director, PD – Procurement Director, Advis – Advisor, Soc Invt – Social Investment, Corp Comms – Corporate Communications, Biz Devt – Business Development, Dept – Department, FinServ – Financial Services, Intl – International, X – Yes, Agricult/Agr – Agriculture, Manufg – Manufacturing, Conglom – Conglomerate, IT – Information Technology, ICT – Information and Communications Technology.

*In all cases in that row with X as the answer, there was also identification of socio-economic partnership agreements and regional development

* In all cases in that row with X as the answer, there was also identification of charity in 100% of cases and employees/employment in 73% of cases

* In all cases in that row with No as the answer, there was also identification of Implicit CSR, so read that No as ‘No, implicit CSR’

** In all cases in that row with No as the answer, there was also identification of higher taxes, so read that No as ‘No, more taxes’
Table 4: The Case Database

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<th>FOREIGN FIRMS (either through investment or parent company)</th>
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<th>International Expansion: Success and Failure (Q7a-c)</th>
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<th>CSR: Mandatory, Voluntary and Symbolic (Q1, Q2d, Q3)</th>
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<th>Key stakeholders: Wide and Narrow circle (Q4)</th>
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<th>Role of state: Barrier and Mutual Benefit (Q6, Q8)</th>
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Partners, exports, taxes. Profits, growth rate for the industry. 

**BIG RUSSIAN FIRMS**

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<td>Natural resources</td>
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<td>Transportation</td>
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<td>Director of Corpor. Communications</td>
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<td>Director of Corporate Communications</td>
<td>Former VP</td>
<td>Head of Biz Develop.</td>
<td>General Director</td>
<td>Founder, Former CEO</td>
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**International Expansion: Success and Failure (Q7a-c)**

- **S** Developed: established relations from Soviet times. Developing: “administrative resources” a.k.a. bribes.
  - Consultant: reputation, synergies, minimization of country and cultural risks, slow integration.
  - Intergovernmental agreements.
  - Ethical business, charismatic CEO (trust), consultants, dealing with unions, cash.
  - Good cash flow (for IPO) Strategic CSR in Russia, charity abroad.
  - Transparency, reputation, experience.
  - Developing: the market is emerging with more opportunities and many empty niches.
  - Established relations from Soviet times.
  - Consultant: different brands (from Russian), going to developing countries

- **F** Developed: image problems.
  - Pricing, politics, country, nationality, standards, large international.
  - Large institutional after the crisis, IPO in developed, go to Hong Kong instead.
  - Liability of origin.
  - Developed liability.
  - Political & personal reputation of origin.
Developing: no problems and culture wars distance, lack of experience of origin c on (oligarchs)

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### International Expansion: Success and Failure (Q7a-c)

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<th>If target has fin or social problems foreign consu lants &amp; auditors</th>
<th>Transpar ency, abiding by the host country law, hire locals, into developing</th>
<th>Cash or Asset Guarantees, good mgmt team</th>
<th>Export Resour ces</th>
<th>Diffe rent brand name (from Russian)</th>
<th>Compe titive advantage, local ties</th>
<th>Form er USSR, into Developing</th>
<th>Different brand name (from Russian)</th>
<th>Pricin g</th>
<th>Demand, CIS countries</th>
<th>Africa &amp; Asia, compet itive adv. (i.e. size)</th>
<th>Intl stand ards</th>
<th>Lear n lang uage, Inno vate, Adapt, Build ties, Try</th>
<th>Syner gy, Foreign Exper ts, Corp. gov., intl qualit y stand s, client ties</th>
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<tr>
<td>F</td>
<td>Devel oped: liability of origin</td>
<td>Lack of experienc e, liability of new-</td>
<td>Liabilit y of origin</td>
<td>Liabilit y of origin</td>
<td>Devel oped: liability of foreign-</td>
<td>Devel oped: compet itive</td>
<td>Liability of origin, visibility</td>
<td>Liability of new-ness</td>
<td>Indust ry with intern al</td>
<td>Small size of the firm</td>
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<td>Diffe rent techn ology, Devel oped: prote cti sm,</td>
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For big business, CSR was more coercive than voluntary: 67% of large firms described CSR as mandatory. Respondents indicated that whenever they expand their business, big companies have to sign a socioeconomic partnership agreement with the state: “Social partnership agreements assign certain obligations and responsibilities to invest in different social areas of a certain region. We only negotiate where the money will go, so that it is spent in the best way and the results of this social investment influence our image in the region. The agreement usually sets flexible deadlines for potential social projects but before we sign it, we also negotiate whether we will buy real estate and get an income tax deduction or other preferential treatment from the state” (Big Russian Firm 6, Conglomerate, Metal & Mining).

Therefore, such agreements provide a basis for a mutually beneficial exchange between the company and the state (as many interviewees highlighted, they follow the principle “Ты мне – я тебе” which translates as “Scratch my back, and I will scratch yours”). 83% of the firms described the role of the state in their CSR engagement as mutually beneficial. These partnerships, even though still informal (because they are not openly released on the company’s website) are very much institutionalized:

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5 “An example of a partnership with the government is Vladivostok or Petropavlovsk-Kamchatsky. It is strategically important for the state to supply gas in Vladivostok because the Far East and Eastern Siberia are rich in mineral resources but there are no people living there to develop them. So creating a gas infrastructure means that people would stay to live there. So we are creating good living conditions, and the state gives us some tax deductions”. Big Russian Firm 2, Natural Resources

6 Even for foreign MNCs who sign a “memorandum with the authorities – some document that guarantees the deal will be respected that includes some social packages or programs to help stabilize the economy/region; companies should promise that they will make an effort to improve the social situation in addition to the economic situation in the region they are entering. There is also some sort of an investment plan or
extensively sign agreements about socioeconomic partnership at a very high level: either the president of the company or the vice-president of regional development will sign it with governors of the regions where we operate. The agreement defines for a year a number of programs and measures that both sides shall take. They are essential to our operations, guaranteeing smooth processes. It is a formal agreement that we will help you and you will help us. They [such agreements] are omnipresent” (Big Russian Firm 3, Natural Resources).

In addition to the social responsibilities listed in these agreements, big business identifies a wider circle of stakeholders than SMEs: 50% of large firms see shareholders, employees, management, the population of Russia, the state and the local community as their main stakeholders; while 80% of SMEs define a much narrower circle of stakeholders, limited to shareholders/owners of the business, employees and management. Interestingly, there is more variation within large Russian firms than SMEs, and they seem to fit into multiple categories of answers. Half of large firms with a mutually beneficial relationship with the state define a wide circle of stakeholders and CSR as mandatory, while one third of large firms with a mutually beneficial relationship with the state and a wide circle of stakeholders views CSR as voluntary, another third with a narrow circle of stakeholders and voluntary CSR views the state as the barrier to targeting in numbers in terms of employment with deadlines to create social welfare”. Foreign firm 1, International Relations. However criticized they are: “Social partnership agreement are another form of bribery that gives foreign firms operating in Russia a civilized form of paying it” Big Russian Firm 6, Conglomerate
their operations. Therefore, evidence suggests that the role of state is important in defining CSR in the Russian context.

As for SMEs, respondents indicated that there is a significant difference from large firms: SMEs prefer minimum engagement with the state, define CSR as paying fair wages and taxes on time in addition to abiding by the law. These are not surprising given the context of Russia as well as the history of non-compliance and non-payments. As a type of CSR activity, SMEs commonly undertake voluntary charity (93% of firms); however, it is never advertised, making it “implicit” (60% of cases) as opposed to “explicit” CSR (50% of cases) attributed to big companies (Matten & Moon 2008). The latter seem to derive some value from producing social reports, raising brand awareness at the events they sponsor, or on other social occasions. SMEs, however, engage in charity for personal reasons (usually led by the owner or the management and employees who choose the recipient organization and the amount/type of donation). SMEs also contribute? Participate? substantively, over a number of years, supporting the same recipient organization. Big business, on the other hand, seems to engage in CSR mainly for symbolic reasons. Findings suggest that even though CSR seems to be important to success and expansion in regards to the state, symbolic engagement is prevalent: “CSR in Russia is a new show: company X needs money, i.e. cheap credit from the state; the state loves CSR, so companies do it to get what they want in return for providing fashionable and beautiful CSR – the rest is just words” (Big Russian Firm
1, Natural Resources); “CSR is a show, we do not know how to do this and what for…we are too small, we need to grow up and grow to the necessary size” (SME 3, Banking).

Majority of SMEs (85%) view the state as the barrier to their activity; that defines the width of their stakeholder circle: with narrow in majority (67%) and wide in rare cases (20%). Overall, 80% of SMEs define a narrow circle of stakeholders and 93% engage in voluntary charity, demonstrating more coherence within this group of firms.

Interviews suggest two explanations for the discrepancy between SMEs and big business. The first one proposed by SME representatives is the length of the term they use for the purposes of strategic planning: while big business (especially with links to the state) can plan 5-15 years ahead, SMEs cannot go beyond 2-3 years in their strategic planning. This is, again explained by the different relations with the state:

“Unfortunately, the long-term vision is absent in Russia – the highest term we evaluate is mid-term – on average 2-3 years, and what is coming next is totally uncertain. Only big business with state orders or shares can be sure of their future and plan in advance – small and medium-sized business cannot afford this luxury”

SME 15, Agriculture, Manufacturing
The short term in strategic planning can also be explained by the dynamic and corrupt nature of the Russian business environment. For example, one entrepreneur noted that due to corruption, it was cheaper to pay off the quality control staff than to actually follow the description of contents on the product; such bribery is called ‘phone activation fees’ (this can be around $5,000 – substantial savings when compared to following quality standards).

Due to the unpredictable role of the state, heterogeneous relations with the state can also impact big business. The above-mentioned interviewee added that the business he founded in the gambling industry – it had a very successful “road show” at London Stock Exchange and was ready for an IPO – became illegal overnight as the government introduced a law requiring all operating casinos to relocate to four distant underdeveloped regions of Russia, where they will have to start anew:

“When we calculated how much it would cost to build the infrastructure, including roads, airports, hotels, accommodation for employees in the middle of nowhere — not including the casinos themselves — the number was $6 billion, which is equivalent to the turnover of the whole casino industry in Russia, not just our company — where would the money for the infrastructure come from?! We realized we could not do this business anymore. Even in the «best» special zone of Krasnodar, there is only

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7 “Any social contract is impossible with such corrupt government. In any other environment, where the rules are clear and any rational person is following them, there are opportunities for social contract but not in Russia”. SME 2, Banking
one hotel 50 km away from the proposed area for casinos. The law must have been aimed at killing the industry, it is very badly thought out…”

Big Russian Firm 12, Entertainment

Even though this executive and other entrepreneurs in the gambling industry saw the need for regulation and tried to lobby the government with the law designed by their association, the government decided to adopt the US model of casino agglomeration without much research; thus, it disregarded the need for initial investment in the four dedicated areas, where the infrastructure conducive to gambling or tourism is severely lacking.

Another example of sporadic government actions related to unpredictable regulation concerns pharmacies: due to ever increasing prices on medicine (that is mainly imported from abroad) regulators decided to protect its citizens by fixing prices on the most critical drugs, in a sense, reverting to the command system of planned economy. However, this policy created unreasonable operating conditions for pharmacies since the import tariffs stayed unchanged. Because SMEs lack political power to lobby the government and cannot predict changes in regulation, leaders can only plan a short-term survival and thus, engage in limited CSR\(^8\). In contrast, for big

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\(^8\) “Big corporations effectively build new sports facilities for their employees in the middle of nowhere, e.g. Magnitogorsk. Of course, SMEs cannot afford this because they do not plan long term – the longest they plan is for 2-3 years. Big companies also not exclusively plan for long term but SMEs in particular – it depends on their family and friends whether they could finance expansion or whatever. So social obligations for SMEs are much lower – no one knows if they will survive tomorrow – as long as they provide a salary, that is already good: because medical insurance is so expensive, in SMEs it is the
business, higher social responsibility is the cost of higher predictability and stability on behalf of the state. In a sense, this is an additional tax:

“...There were and still are mandatory dialogues with business, that business should have a social responsibility. In Russia I think it means some amount of money paid to preserve the status of big business; it is an additional tax that no one can understand; moreover, it is based on the creativity of big business owners for PR reasons. It is bad for our society because in addition to tax for corruption, there is this social tax, so Russian products will never be competitive in the international market. It is basically money given to somebody else, more money paid by business to the state. But it is philanthropy, not strategic CSR…”

Foreign Firm 6, Conglomerate

The second explanation for higher rates of CSR for big corporations as compared to SMEs (proposed by representatives of big business) encompasses the historical legacy of enormous social obligations in the Soviet Union, as well as the “under-developed nature of SMEs that leaves no other alternative for the state but to rely on big enterprises to solve socioeconomic problems” (need citation, with page number, right?). SMEs claim that in the highly corrupt business environment, they simply cannot contribute more than employment and taxes (and philanthropic contributions if they so choose), even

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responsibility of the owner to protect or provide for the sick employees, while big business can get corporate discounts etc”. Big Russian Firm 10, Transportation
though both are necessary functions of the firm and thus do not fall within the traditional CSR framework.

Hence, when contextualizing CSR in Russia, it is important to differentiate by the size and nature of the firm. Given the context of tax evasion, corruption and wage non-payment, the two main responsibilities of paying wages and taxes and abiding by the law contextualize CSR for SMEs, while the historical roots of CSR in the social programs provided by Soviet enterprises contextualize it for big business. In conclusion, CSR heterogeneity in Russia is defined by different relations with the state and by firm size: CSR for large corporations is necessary ‘beyond compliance’ behavior, but for SMEs it is a voluntary activity that includes compliance, charity and supporting employees.

### 3.3.3 How Firms in Russia Can Use CSR to Facilitate International Expansion

Based upon the respondents in this study, Russian firms suffer from the liability of origin in their international expansion efforts: 83% of large corporations and 73% of SMEs mentioned liability of origin as the main reason for failure, with the rest of SMEs saying it is easier to expand into the developing world.

“There is definitely a stereotype against Russian companies as uncivilized… Shareholders from Russia are also not accepted abroad. There are examples of unsuccessful expansion in the energy sector, even though exports of resources are pretty easy abroad: they are highly needed everywhere, so the West will take it no matter what…The stereotype is omnipresent, however, I talked to many foreigners and foreign
companies and they all show a degree of distrust, sometimes even ungrounded, but stemming from this stereotype”

SME 4, Banking

“Problems arise due to the fact that foreigners are dealing with Russians for the first time in their life and share a stereotypical view of Russia: drinking vodka, mafia etc. Most problems come from the (financial) regulator: 1) the origin of capital, 2) the values of owners (USA and Germany are particularly vary of Russians); 3) managerial decision-making; 4) general cultural issues since Russian companies are isolated from the world business society. In countries of the third world, in emerging markets, however, Russia is a convenient partner because corruption is a natural habitat for Russian business, so it behaves like “fish in the sea”

SME 2, Banking

“For Russian companies to expand abroad they need to change the image not only of the company but also of the country – the two go together”

Foreign firm 1, International Relations

Conceptually, difficulties in international expansion arise due to the lack of legitimacy of the focal firm (Kostova & Zaheer 1999); consequently, it is important to understand how legitimacy is obtained in Russia, and which aspects of legitimacy are important for international markets. Organizational legitimacy stems from two main sources: market and nonmarket actors. By meeting the criteria of appropriateness with
their norms and values, organizations are subsequently granted market and social legitimacy (see Chapter 5). In order to contextualize and capture multiple dimensions of the concept of legitimacy, the interview protocol includes questions regarding the evaluation criteria for both market and social legitimacy domestically, as well as internationally.

Market legitimacy stems from the perception of the future financial viability of the firm, and thus is derived from the current objective (i.e. accounting) and subjective (i.e. market analyst) measures of financial performance, profitability and growth. However, in emerging markets, due to the nature of the business environment and the lack of publicly available reliable data on firm performance, market actors also follow other indicators that signal the future viability of the firm. In Russia, indicators include 1) the size of the company, measured by the number of clients or customers, and employees (as the financial crisis demonstrated, the larger the enterprise, the more it can ask from the state); 2) the price and quality of products and services; 3) the links to the government in terms of board members, ownership, or state orders (in the financial crisis, having state orders guaranteed survival); 4) international presence, such as exporting, or having international partners, including consultants, auditors and investors; professional management (especially those who are western or western-educated); ratings and media attention as well as word of mouth reputation; 5) salaries

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9 “Legitimacy of big business comes from the lack of desire of SMEs to overcome the $10 mn revenue barrier because that will require not only facing stiffer competition, but also higher social costs of doing business, higher responsibility, etc.” Big Russian Firm 3, Natural Resources, Metallurgy
and annual growth; the status of auditors (if a firm can afford hiring “the Big Four” to conduct their audit, that points to a certain financial success); and 6) the amount of taxes paid to the state and the availability of administrative resources (this includes Government Relations and/or Corporate Law Departments, as well as a designated lobbyist).

Social legitimacy, on the other hand, stems from the perception nonmarket actors hold of how well a firm’s actions fit with the norms and values of acceptable behavior in the larger social system. Interviews suggest that to achieve social legitimacy in Russia, it is important to engage in CSR (as defined differently by big companies and SMEs – see above). In addition, it is crucial to have a good personal and company reputation, relations / networks, trust, environmental certification, taxes, corporate governance and transparency (in particular, if minority shareholders are recognized and there are anti-bribery policies at the company level, as well as an established code of conduct). However, given a different system of norms and beliefs, these legitimacy determinants may differ from those valued by international actors, or they may be taken-for-granted, and thus, Russian firms that seek to expand abroad may choose to use different signals.

Overall, interviews indicate that to achieve success in international expansion and overcome the liability of Russian origin, firms can engage in targeted activities at various levels. First, at the individual level, in addition to a charismatic CEO, it is helpful to build trust and networks in the host country; this can be done, for instance, by using
foreign consultants, partners or auditors (by means of legitimacy spillovers). Second, at the firm level, it is useful to have a competitive advantage that according to the resource-based view of the firm should stem from a valuable, rare, inimitable and non-substitutable resource or capability (Barney 1991). Third, at the country level, in addition to expanding to countries with a similar institutional regime, firms could address the image or reputation problems (related to the liability of newness, foreignness and origin) by distancing themselves from Russia (i.e. by using a different company name). Fourth, at the target level (if Russian firms engage in M&A), companies could identify targets with lower levels of legitimacy (i.e. market and/or social) or offer cash in the transaction.

“Of course, it is particularly hard for Russian companies to go to developed countries unless they buy stressed assets. The attitude to them is less than positive: e.g. all of Evraz investments were into stressed assets with bad financial state, if not bought by Evraz they would go bankrupt (even though they were bought at the peak of the M&A market at very high prices). It is much easier to go to emerging markets since the levels of risk are much higher and developed country MNEs won’t go there for that reason”

Foreign firm 5, Financial Services

Finally, there are CSR-related activities, such as transparency\textsuperscript{10} and corporate governance (i.e. rights for minority shareholders, independent boards of directors),

\textsuperscript{10} “Of course, we had to become more transparent for the West” Big Russian Firm 8, Banking
environmental standards and fair dealing with unions in the host country, that provide positive signals for international expansion. It is worth noting that the first three activities (at the individual, firm, and country level) can be generated by means of CSR engagement as it results in greater trust, positive reputation and competitive advantage for the firm (Choi & Wang 2009; Godfrey 2005; McWilliams & Siegel 2001). Moreover, the existing literature suggests that to foreign governments, CSR can signal that the firm will play by the rules of the game. Thus, CSR-related activities may help achieve success, at least at the initial stages of the international expansion of EMMs, by signaling that the firm is prepared to work in a different institutional environment through its engagement in CSR, and, as a result, may overcome initial barriers to market entry.

The importance of signals for market actors is well-documented (Cohen & Dean 2005); however, signals for nonmarket actors have been largely unexamined (Spicer & Markoczy 2007). The interview results indicate that CSR can serve as a signaling mechanism for firms, demonstrating: a) better corporate governance (i.e. transparency); b) better product quality (i.e. international certifications); c) better reputation (with partners, customers and employees); d) better preparedness to operate in a foreign environment (particularly in more developed countries); and finally, e) better ability to overcome the liability of origin:
“Global Reporting Initiative (GRI) and Global Compact (GC) help reach another level of audience. They definitely help mitigate the Russian stereotypical image abroad, like mafia, corruption etc.”

SME 12, Oil and Gas

It is worth noting that these CSR signals may be helpful in international expansion, even when such attributes of the company as signing the UN GC or reporting on CSR by GRI standard are purely symbolic:

“We use GRI because it is popular and widespread, and OPEC is using it”

Big Russian Firm 4, Oil and Gas

“We signed GC but it was mainly stylistic”

Big Russian Firm 6, Conglomerate, Metal & Mining

“Signing Global Compact is a positive sign that people know about it and want to learn more; however, the devil is in the detail – in implementation. For it to have any power there should be a developed civil society in Russia and for now it is not. It is a question of culture, long term…”

Foreign firm 1, International Relations

Even though certain types of international expansion may require substantive implementation of CSR, e.g. receiving a foreign loan or investment:

“Loans from the World Bank and EBRR or any international banks are good for citizens of Russia because they require companies to invest in the community plus
ecological/environmental obligations are much higher than those in Russia (social investments don’t even exist in Russia). Foreign banks have written requirements about the community, sometimes even how much…”

SME 12, Oil and Gas

“To work with EBRR, we had to become more transparent and improve our management and investor relations. We even report by international accounting standards – not only financial but also social reports in preparation for IPO. The strategy around IPO is that we need foreign loans to grow and do M&As. So to get their [EBRR] attention, we need to open ourselves to audit, otherwise, we won’t get any loans. Once you get the loan, there are more requirements, so we need to continue being transparent etc. because if we do not meet these requirements, the banks can require the money back. So we issue reports every quarter to continue having loans, we even became public to avoid potential problems”

Big Russian Firm 10, Transportation

“To attract foreign investors, CSR is very important – psychology – the level of risks goes down if the company is more transparent and open than its competitors – so external consultants obviously prepare our firms to raise foreign capital by investing in CSR”

Foreign Firm 5, Financial Services
Preparing for international expansion, therefore, entails undergoing certain organizational changes related to CSR. Findings indicate that these changes may have different implications for big firms and SMEs. Overall,

“It is not beneficial for business to help the society! There are no tax breaks. On opposite, if the tax authorities see that you are giving money away, there will be more requests (even though they take income tax without deductions for charity) so business has to go around the state and help the society in what seems to be an illegal way....”

SME 7, IT; SME 8, IT

Therefore, the implications of organizational changes after adopting CSR in the short term may include costs (i.e. literally taxation on charitable donations and benefits to competitors as they learn more from higher transparency) but in the long term, adoption of CSR may result in certain benefits, such as a competitive advantage stemming from international certification, as it improves the quality of products and competitiveness in international markets.

“Obviously, those that already expanded abroad will win, since the standards’ war abroad will make them more competitive, and harmonization of standards (i.e. ISO) will make them adopt these standards before anybody else in Russia”

Big Russian Firm 12, Entertainment

Big business, however, may experience a competitive disadvantage due to greater pressures from the state and competitors as a result of increased transparency.
Business owners in Russia are aware of the disadvantages to firm size and to avoid this influence from the state, one respondent noted that “there is a tactic in medium-sized business to split assets into separate companies [when it is about to become large] as the scale of business defines the character of risks” (Big Russian Firm 3, Natural Resources). Therefore, it is important to consider both antecedents and consequences of CSR engagement when evaluating its strategic impact, even though big firms may have no other choice:

“Russian firms should use Korean experience in global expansion, e.g. Chaebols of Samsung or LG, because they also became global regardless of the state corporatism: they developed a track of transparency and were not scared of going abroad...Korean firms were also government-owned or had government assistance, personal networks and shares owned by the state, they also received huge benefits from the government and had no competition; however, with bigger size they started to expand abroad in the 80-90s. Thanks to the advice of professionals and consultants, they changed the way they conduct business: government stakes and control went away, foreign CEOs were hired etc. They could not afford doing business the old way (with the help of the state) and had to play by the market rules of the game”.

Foreign firm 1, International Relations
3.4 Discussion and Conclusions

Through qualitative inquiry, this exploratory study seeks to understand and explain what CSR means in the emerging market of Russia, how it affects international expansion of Russian firms and their performance back at home (after the initial CSR-related changes are undertaken) as well as the various sources of organizational legitimacy. The implications of the study for the CSR and strategy literature suggest that the context and the nature of the firm are important determinants of CSR activities.

In particular, in Russia, different relations with the state (i.e. mutual benefit or barrier) define CSR activities for big firms with a wide or narrow circle of stakeholders and mandatory or voluntary “beyond compliance” behavior. Small-and-medium-sized firms, on the other hand, view the state as the barrier to their activities, and thus, prefer to avoid the state, limit their main stakeholders to owners, management and employees, and engage in CSR voluntarily, mainly through charity or environmental certification, for strategic reasons. In addition, reflecting the mandatory versus voluntary nature of CSR activities, as well as the heterogeneous relations with the state, big business, typically engages in explicit CSR, while for SMEs it is generally implicit. These findings are important to advancing CSR literature by describing the forces behind CSR engagement as well as contextualizing CSR in Russia, a large emerging market.

Furthermore, this study advances the nonmarket strategy literature by demonstrating
that under certain conditions engagement in CSR may be mandatory and not a pre-emptive tactic to deal with the state, as some studies suggest (Hillman & Hitt 1999).

Results indicate that the strategic impact of CSR is particularly important for firms that try to expand abroad because such activities help them overcome the liabilities of newness, foreignness and origin (or low home country legitimacy as described below). In particular, Russian firms can counteract liabilities by improving transparency and corporate governance, using environmental standards and cooperating with unions in the host country. Such actions result in greater trust and networks, better reputation, and competitive advantage for the firm. Hence, consistent with prior literature, the interviews in this study demonstrate that CSR helps create intangible assets that help companies overcome nationalistic barriers and facilitate globalization (Gardberg & Fombrun 2006). However, domestically, the effect of CSR-related changes, which in the short term are certainly costly, in the long-term is two-fold: beneficial in terms of winning the standards’ war but detrimental to big business as it struggles to meet further requests by the state and deal with greater openness to its competitors. Future research could examine the double-edge of CSR domestically and internationally for firms from emerging markets (to date studies addressed this question only in developed countries).

As anticipated, findings indicate that the definition of CSR in Russia differs from the traditional western framework. This is not surprising given the context of non-
compliance—tax evasion, corruption and wage non-payment. Overall, in this chapter
the transformation of the concept of CSR depends upon heterogeneous relations with
the state and firm size: from mandatory for large corporations to voluntary for SMEs.
The main responsibilities of paying wages and taxes and abiding by the law
contextualize CSR for SMEs, while the historical roots of CSR in the social programs
provided by Soviet enterprises contextualize CSR for big business. In addition, large
corporations that see mutual benefit in their relationship with the state identify a wider
circle of stakeholders than SMEs, including shareholders, employees, management, the
population of Russia, the state and the local community; while SMEs that view the state
as the barrier to their operations limit their circle to shareholders/owners of the business,
employees and management. These results demonstrate how heterogeneous firm size
and relations with the state affect heterogeneity in CSR.

As for success in international expansion, findings indicate several key factors to
success that demonstrate cultural differences as well as similarities with other EMs (e.g.
Korea, China). First, the key factors include ties, such as the links to the government,
foreign partners, exports or presence abroad, as well as the high status (foreign) auditors
or consultants that are also symbols of success in the Russian business context. This is
consistent with prior literature that posits legitimacy spillovers from western actors have
a positive effect on international expansion: for instance, Russian banks that were
accredited by a World Bank-sponsored foreign aid program were more likely to receive foreign loans (Spicer & Markoczy 2007).

Second, consistent with prior literature, findings indicate that perceptions of poor corporate governance practices in emerging economies make international expansion harder for EMMs. Previous studies of IPO, for instance, demonstrate that even though firms from emerging economies can overcome negative country perceptions associated with lower levels of legitimacy, by increasing their international scope of operations prior to beginning the IPO process as well as by retaining acceptable levels of ownership in their respective firms, poor corporate governance increases the cost of capital in international capital markets (Bell, Moore & Al-Shammari 2008). Several interviewees noted that corporate governance is the first corporate activity to be improved if the firm is thinking about expanding abroad (whether it is for IPO or cross-border M&A – Russian standards of corporate governance are very low in comparison to global norms). Therefore, improving corporate governance practices and transparency can lead to greater success in international expansion.

Furthermore, consistent with prior literature, findings suggest that firms interested in attracting international investors, or becoming listed on major western stock exchanges, or doing business with western firms, understand the necessity of adopting western market-based norms to achieve their objectives (McCarthy & Puffer 2008). Foreigners are likely to use western-style signals to gather and evaluate
information on emerging markets, even if such signals have the opposite results to those desired – because in an effort to gain western legitimacy, domestic actors may choose to display western-style signals without the substantive content to support such appearances (Spicer & Markoczy 2007). I find that CSR activities provide one such signal that helps gain legitimacy and open doors to international markets for EMMs, particularly into more developed countries. While institutional similarity of EM makes it easier for EM expansion, moving into developed countries is still fraught with problems of legitimacy. Findings indicate that what is legitimate for social actors in one context (i.e. in EM) may not be legitimate for social actors in other context (i.e. in developed countries). Therefore, firms that want to achieve success in international expansion have to change their practices and customize them towards the norms and values behind western definitions of legitimacy, even if it is only symbolic. In particular, signing the Global Compact or reporting on CSR by GRI should help overcome the liability of origin by reaching the target audience and indicating greater transparency. Future research, however, shall examine whether such symbolic acts intended to improve legitimacy help not only at the initial but also at the later stages of international expansion of EMMs.

Future research could benefit from using converging methods of inquiry, as the main limitation (as well as the main advantage) of this study lies in the qualitative methodology. Given the transitional and dynamic nature of Russia’s economic development and the lack of extant literature in this context, I utilized an inductive
research design (Eisenhardt 1989b). This was important to achieving the goals of the study but certainly comes at a cost due to the limitations of qualitative research methods. Some pitfalls of these qualitative methods were addressed at the research design stage. In particular, to meet the four criteria for the quality of qualitative research (Gibbert, Ruigrok & Wicki 2008; Silverman 2010: 294; Yin 2009), I undertook the following procedures: 1) for construct validity, in addition to using multiple sources of evidence (any publicly available information as well as the data the participants wished to share), I also asked the informants to review the draft case study report; 2) for internal validity, I utilized pattern matching and explanation-building for each case as seen in Table 4; 3) for external validity, I used replication from case to case (this includes asking the same questions at interviews); 4) finally, for reliability, I developed a case study database (see Table 4 for a short version).

Another limitation concerning the choice of the emerging market provides direction for future research. As discussed above, I chose Russia due to the lack of extant literature on CSR and other strategy topics in the region, and due to the weak institutional prerequisites for CSR, such as functioning market, civil society and state institutions. However, other emerging markets are in need of further attention: thus, it would be interesting to examine the differences between Brazil, Russia, India, China, and South African, for instance, and also to go beyond them in the choice of the
empirical setting. Contextualizing CSR requires future research to study various countries in-depth; with Russia serving as a beginning for this stream of research.

Other issues to consider for future studies include the following. First, data from the interviews suggest that weak implementation of CSR, and thus, symbolic engagement in CSR activities, is due to the weak civil society that controls its implementation. Further research could examine other controlling mechanisms that can enhance more substantive CSR in the context of emerging markets (e.g. the state). Second, I find that the overall awareness of CSR, the code of ethics or conduct at the firm level is very low. Russian firms still conduct social accounting (e.g. keeping track of HR training expenses), this is presumably a leftover from the old Soviet managerial accounting system. Small-and-medium-sized businesses, in particular, do not believe in CSR due to high levels of corruption and an unfriendly business environment. Future research could examine other emerging markets, where these conditions are different from Russia and also identify the factors that can help raise awareness of CSR issues when traditional (western) mechanisms are not effective. Finally, further research could examine how CSR-related signals affect the target audience in the international markets, and whether these signals vary by country (i.e. developed or developing).

Overall, this chapter contributes to several literatures. First, it expands the CSR literature regarding the different drivers of CSR by providing a contextualized perspective. Second, it addresses the gap in the strategy and international business
literature by examining CSR as the mechanism to overcome the liability of origin in international expansion of EMMs. Third, it contributes to the neo-institutional literature on organizational legitimacy by understanding multiple dimensions domestically and internationally. Finally, by examining the understudied emerging market of Russia, the chapter advances our understanding of the strategic issues that drive performance heterogeneity in this country.

The managerial implications of this chapter can be summarized in two key takeaways: 1) managers of companies entering emerging markets should not underestimate the role of the state in market and nonmarket strategy; 2) managers of firms in emerging markets that seek to expand abroad should engage in strategic CSR by targeting their CSR activities at generating legitimate signals for host countries.
4. Strategic Role of Corporate Social Responsibility in International Expansion of Emerging Market Multinationals

Based on implications from previous chapter, this chapter studies the strategic impact of corporate social responsibility (CSR) in the international expansion of emerging market multinationals (EMMs). EMMs face challenges in cross-border M&As partly due to suspicions about their origin; I argue that they can overcome them by generating social legitimacy with critical actors in host countries from CSR activities in their home countries. The study uses a large-scale quantitative analysis of almost 5,000 cross-border M&A deals from 1990 to 2011, where the acquirers come from Brazil, Russia, India, China, and South Africa. The results show that positive CSR helps overcome home country disadvantages, leading to greater likelihood of and faster M&A deal completion (and vice versa for negative CSR). I contribute to the strategic CSR, international business and neo-institutional literature on legitimacy.

4.1 Literature review

Organizational legitimacy is helpful for firms in many strategic activities, including international expansion (Kostova et al. 1999; Li et al. 2007). The literature on organizational legitimacy to date has studied how firms acquire, maintain, and repair legitimacy (Ashforth et al. 1990; Barley et al. 1997), as well as benefits that arise from
legitimacy including survival, predictability, growth, and profitability (Bansal et al. 2004; Dacin et al. 2007; Dobrev et al. 2010; Ruef et al. 1998). However, research is only beginning to distinguish between different types of legitimacy that reflect variation in the norms and values of different societal actors (Earle et al. 2010; Greenwood et al. 2002) and, in particular, to consider how different dimensions of legitimacy may condition the effects of each other (Kraatz et al. 2008). This study argues that international expansion by a firm with low home country legitimacy (the perception that the actions of the firm’s home country meet the norms and values of the host country) is more likely to succeed when the firm possesses social legitimacy (the perception that the actions of the firm in the home country align with the norms and values of the general society in the host country).

The chapter focuses on the context of international expansion by emerging market multinationals (EMMs) from Brazil, Russia, India, China and South Africa (BRICS), answering the following question: Does firm-level social legitimacy based on CSR actions of EMMs from BRICS in their home countries help them succeed in cross-border acquisitions? This empirical context is critically important for strategy research: international expansion by EMMs, including cross-border acquisitions has increased strikingly in the past decade; not only does it signal organizational success and growth of the firm, but it may also lead to the development of new capabilities, and improvement or decline in firm performance. In addition, the context of international
expansion of EMMs is ideal for examining legitimacy issues arising from perceptions of home country as well as firm activities: many international actors are suspicious of firms from emerging markets, such as the BRICS, nonetheless, firms within the BRICS vary in terms of their social activities, such as labor, environment, political and other actions that may generate social legitimacy in the eyes of relevant actors outside their home countries.

The chapter uses the literature on organizational legitimacy as a framework from which to study this critically important phenomenon while at the same time offering an opportunity to extend the neo-institutional and strategic CSR literatures. The focus on two forms of organizational legitimacy – social and home country legitimacy – helps distinguish between various sources of legitimacy and different levels at which they operate, extending a multidimensional view of legitimacy (Ruef et al. 1998). I refer to social legitimacy, which is a firm-level concept, as the perception that the actions of the firm align with the norms and values of the general society (Suchman 1995). In particular, I consider social legitimacy that stems from engagement in CSR, firm activities that meet the norms and values of the general society (Carroll 1979; Dowling et al. 1975) by aligning social, environmental and corporate governance activities with societal expectations. Several studies have shown that engagement and reporting on various aspects of CSR, such as environmental (Cho et al. 2007; O'Donovan 2002) and social disclosures (Patten 1992) provide legitimacy. Moreover, strategic CSR literature
has established a small positive, yet significant effect of CSR on performance (Margolis et al. 2007) even though it mainly examined this effect in developed markets, and in terms of financial success, not that of international expansion.

In parallel, home country legitimacy refers to a home country-specific property of an organization as perceived by the actors in the host country; it is a host-country sentiment toward a firm’s home country: when it is sufficiently negative, the firm may be constrained or even precluded from entering the host country (Holburn et al. 2010). This study examines completion rates and time to completion of cross-border M&A deals by EMMs from BRICS. Comparative analysis shows that their cross-border deals have substantially lower completion rates and longer time to completion than those of firms based in developed markets. This discrepancy illustrates the illegitimacy discount (Zimmerman et al. 2002) that EMMs from BRICS pay when expanding abroad due to their low home country legitimacy; understanding how to minimize it is the main purpose of this study.

A multidimensional model of legitimacy seeks to understand the varying sources of legitimacy, the levels at which they operate, the institutional elements that they target, and the environments that contextualize their effects (Ruef et al. 1998). This chapter evaluates the role of two different sources of legitimacy, stemming from the perceptions of the home country of the firm, and social activities of the firm in the home country by the relevant actors in the host country. As noted above, I refer to home country
legitimacy as the perception that the actions of the firm’s country of origin fit with the norms and values of the host country, and social legitimacy as the perception that the actions of the focal firm in the home country are appropriate in the social context of the host country. These two sources of legitimacy operate at different levels: the perception of the home country in the host country is formed at a broader (population) level, while the judgments about social legitimacy are made at the firm level. Moreover, while home country legitimacy targets host countries in general, social legitimacy focuses more on the state, the public, and the media. Finally, it is the host country environment that contextualizes the effects of the two dimensions of legitimacy in this study.

To build a well-grounded theory of the legitimation of organizations, it is necessary above all to identify the critical actors, both internal and external, whose approval is necessary to the fulfillment of an organization’s functions (Hybels 1995). Each actor influences the flow of resources crucial to the organizations’ establishment, growth, and survival, either through direct control or by the communication of good will. In a classical piece on legitimation, Hybels (1995) recognized four groups of organizational constituents: the state, the public, the media, and the financial community. While these four constituents provide different sources of legitimacy, three – state, public, and media – have overlapping norms and values by which they judge

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1 From existing literature on various dimensions of legitimacy, social legitimacy refers more closely to sociopolitical legitimation – the process by which key stakeholders, the general public, key opinion leaders, or government officials accept a venture as appropriate and right, given existing norms and laws (Aldrich and Fiol, 1994).
organizations, whereas the financial community uses at least partially distinct
evaluation criteria (see Chapter 5). This distinction is consistent with the literature that
categorizes the state, the public, and the media as nonmarket actors or general
stakeholders, while defining the financial community as market actors or, more
narrowly, shareholders (Baron 1995). Because the norms and values by which market
and nonmarket actors value the firm are dynamic and do not necessarily co-evolve,
legitimacy stemming from these major organizational constituencies can take on
different values. This chapter will focus on legitimacy relevant to nonmarket actors.

Business responds to nonmarket forces by meeting societal expectations and
proactively meeting social needs; the adequacy of response to nonmarket forces is
viewed in terms of legitimacy, where the traditional economic and legal criteria are
necessary but not sufficient conditions (Sethi 1979). Corporate social responsibility as a
movement and organizational practice emerged in response to the demands by
nonmarket actors to place more emphasis on corporate responsibility, accountability,
transparency, and sustainability (Waddock 2008a). Thus, CSR engagement at the firm
level provides social legitimacy by symbolizing firm’s commitment to the norms, values,
and beliefs of nonmarket actors. CSR, sustainability, corporate citizenship and other
terms are used to describe a portfolio of socioeconomic activities that include
environmental, social, and corporate governance actions of the firm (Gardberg et al.
2006). By meeting the norms and values of the general society (such as environmentally

clean and efficient manufacturing facilities, high labor standards and fair remuneration, diversity on boards, philanthropy, and corporate volunteering), engagement in CSR results in greater social legitimacy for the firm. Hence, from this point onwards I will refer to social legitimacy and CSR interchangeably. In turn, in order to discuss home country legitimacy, it is helpful to describe the empirical context of this study.

To test the multidimensional theory of organizational legitimacy, I needed a context where all organizations would lack legitimacy of one type but have varying degrees of legitimacy of another. Therefore, I selected the setting of international expansion of firms from emerging markets: while there is sufficient variation among Emerging Market Multinationals (EMMs) on the social dimension of legitimacy (i.e., CSR), EMMs face the same challenge of low home country legitimacy in host countries. The international business literature refers to it as liability of origin (Bartlett et al. 2000; Ramachandran et al. 2010) or liability of home (Stevens et al. 2012): EMMs in host countries assume certain disadvantages as a consequence of where they are from (i.e., their specific nationality) as opposed to where they are not from (as in liability of foreignness); this is due to the friction caused by the attributes of their home country institutions (Holburn et al. 2010). Even though the level of home country legitimacy may differ among the BRICS’ firms because the perception of the country of origin lies in the eyes of the beholder, to a greater or lesser extent, all EMMs face low home country legitimacy when they expand abroad.
For example, as a result of Go Out Policy, the initiative of the Chinese government launched in 1999 to promote Chinese investment abroad, Chinese firms started their international expansion at the turn of the 21st century. Nonetheless, even today (in 2013) Chinese firms are still commonly perceived as illegitimate due to their origin; host country governments frequently scrutinize or even preclude M&A deals with Chinese firms because, citing a recent statement by a Canadian MP, China is not viewed as a “benevolent country”. As a result, when Chinese firms expand abroad, at a minimum, they raise suspicion and at a maximum, receive resistance by politicians, trade groups, environmentalists, and other stakeholders involved in cross-border M&A deals (as seen in multiple high-profile M&A cases, such as, for example, CNOOC, which after being blocked by the US regulator from buying Unocal in 2005, was bidding for a Canadian firm Nexen, generating the same resistance from politicians regardless of CNOOC’s efforts ‘to diffuse protectionist sentiment by describing the deal’s benefits for Canada and seeking to allay concerns in other countries, including USA and Britain’).

The lack of home country legitimacy is further reinforced by the recent nature of international expansion by EMMs: according to the data in this study and UNCTAD, while it started in 1990 and has been growing steadily since then – both in dollar terms

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and in the number of M&A deals – the majority of international expansion of EMMs has taken place after 2000 (see Figures 2-4).

Figure 2: Foreign Direct Investment from Developing Countries

Figure 3: Cross-border M&A from Developing Countries

\footnote{Figures 2 and 3 are from The Economist 2011c. Figure 4 is based on the data in this dissertation.}
Furthermore, the failure rate and delayed completion for EMMs (lack of completion and duration till completion of their cross-border M&A deals) has been at least twice that of the developed country MNEs (see Table 5). Of course, in addition to low home country legitimacy, EMMs may also face firm-specific competitive disadvantages (Guillén et al. 2009); however, the focus of this study is the interplay between home country and social dimensions of legitimacy.

Table 5: Sample distribution of cross-border M&A by home country

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<td>Total</td>
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<td>Cancel</td>
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<td>Brazil</td>
<td>333</td>
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Figure 4: Cross-border M&A from BRICS
4.2 Hypotheses

Because a key mode of international expansion for EMMs has been through mergers and acquisitions (M&As), and the importance of legitimacy is more directly observed at the initial stage of the M&A process, I focus on the public takeover process of a cross-border acquisition (see Figure 5). This period starts after signing a preliminary acquisition contract and making the initial public announcement of the deal till its resolution (either completing or canceling the deal). The public takeover period has extensive complexity and uncertainty as the initial judgment is made about the firm, and the outcome is highly vulnerable to judgments about organizational legitimacy by nonmarket actors. Furthermore, examining the outcome of this period as a measure of M&A success is important to strategy research.

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3 According to UNCTAD WIR 2009, in 2007, one year before the global financial crisis, roughly half of all outward FDI from developing and transition economies was through M&A.
Common indicators of M&A success include post-merger stock returns (short term indicators) and financial performance and market growth of the new firm (longer term factors). However, it is increasingly important to examine immediate term outcomes: in particular, whether and in what time a deal is completed. Deal completion and duration are important measures of success for two reasons: first, because over the past few decades approximately one in five takeover bids have ultimately been abandoned (Wong et al. 2001); second, deal abandonment and prolonged deal-making are associated with substantial costs such as upfront financial and termination fees, time, diversion of managerial attention (Dikova et al. 2010), and damage to the reputation and credibility of the firm (Luo 2005). Therefore, as the main outcomes of the public takeover process and measures of M&A success, I will examine the likelihood of completion of the deal, and conditional on completion, the length of time it takes from announcement to completion.

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6 When Rio Tinto broke a deal for Chinalco to purchase a larger stake in the company, it had to pay a US$195 million breaking fee. Even higher, after Getty Oil breached a merger agreement with Pennzoil, the court ordered a payment to Pennzoil of more than $10 billion for damages (Luo, 2005). Public companies can incur losses in the share price; e.g., Infosys’s share price fell more than 4% after Axon dropped its backing for the takeover bid in favor of a higher offer from HCL.
Situating this study in the context of the public takeover process allows examining the role of the nonmarket actors because owners/shareholders usually have agreed on primary details of the deal by the time it is announced (by signing a preliminary acquisition contract). The dealmakers may still decide to disengage as they discover more about each other. Nonetheless, a major influence on the success of this process emerges in the form of nonmarket gatekeepers in the host country: the state, employees, and community. I argue that the nonmarket gatekeepers will be more welcoming (hostile) towards socially (il)legitimate firms because such firms are more likely to continue CSR policies in the host country. Thus, CSR may help overcome the lack of legitimacy of EMM’s nationality or origin.

In particular, CSR as a source of social legitimacy may help gain access to the nonmarket gatekeepers and thus to international markets for several reasons. First, theoretically, CSR can help ensure organizational legitimacy (Carroll 1979; Dowling et al. 1975) by meeting the norms and values of social actors in host countries. Second, it can help develop a particular type of intangible asset that aids companies in overcoming nationalistic barriers and facilitating globalization (Gardberg et al. 2006); it has been previously shown that proprietary intangible assets enable EMMs to successfully compete even in the most advanced countries in the world (Guillén et al. 2009). Finally, CSR has been institutionalized and diffused globally as a global norm of doing business (Waddock 2008a) so by engaging in this organizational practice, EMMs are conforming
to a unique set of expectations that local stakeholders have in host countries. Moreover, given the origin of EMMs, by engaging in CSR, they are not only conforming but also exceeding the expectations derived from their nationality in host countries.

Now let us consider illustrative evidence for the evaluation process of nonmarket gatekeepers. I will discuss two examples: regulators and labor unions.

First, publicly announced deals typically are examined by public agencies such as anti-trust and international investment regulators, so the role of the state will be crucial for the completion and duration of the deal. Government regulation serves two general purposes – ensuring ‘utility’ (the economic benefit of enterprise) and ‘responsibility’ (the social obligations of industry) (Hurst, 1970); the regulator, faced with a hard choice the lower the legitimacy of the home country of the EMM, has the option of assessing the CSR of the acquiring firm to ensure that it will take ‘responsibility’ in the host country. For example, when Lenovo (China) offered to buy a laptop computer unit from IBM (USA) in 2005, the deal initially faced strong political opposition that led to an official review by the Committee on Foreign Investment (CFIUS), but the deal went ahead and the review was concluded in advance of the deadline partly due to “Lenovo’s commitment to being a great corporate citizen. Working cooperatively with CFIUS is an example of what you should expect of Lenovo, a company that is committed to customers, employees, and communities” (BusinessWire March 9, 2005).
Second, the outcome of completion versus cancellation of the M&A deal and the length of time that the process takes are also determined by other nonmarket actors, such as labor and trade unions, employees, and the local community. If they decide that the organization or its nationality is not appropriate for the local social context, their interference may lead to abandoning the deal or delaying its resolution while the involved parties negotiate potential social investments in the host country. For example, when a Brazilian steel company Companhia Siderúrgica Nacional (CSN) tried to merge with Wheeling-Pittsburgh Corporation in 2006, steelworkers feared the deal would decimate their ranks, so to fend off CSN, the United Steel Workers (USW) union helped create a hostile takeover bid by the Chicago-based steel distributor Esmark. The USW lobbied for the Esmark deal and, even though the shareholders were in favor of the deal with CSN, Wheeling-Pittsburgh Corporation was eventually sold to Esmark in 2007. Had CSN engaged with the union after announcing the deal, such as Tata did in a deal with Corus, an Anglo-Dutch steel company, the deal might have gone through rather than failing in the face of the competing bid.

The logic that the examples illustrate suggests that despite low home country legitimacy deals by EMMs with positive CSR will more likely result in a positive outcome. In particular, positive CSR of EMMs in their home country will generate a favorable perception about them in the host country. This positive perception is

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generated from publicly available sources of information as well as documents
distributed by the target and acquiring firms (i.e. offer letter, public announcement of
the M&A deal, acquiring company prospectus/reports). Positive information on EMM’s
CSR will help them overcome the two main hurdles in the public takeover process -
opposition from target employees and regulators. Receptivity from these nonmarket
actors will result in a positive outcome of the process (i.e. completion of the deal), and a
shorter amount of time for the public review of the deal (i.e. duration till completion).

In parallel, I will expect an opposite effect for deals by EMMs with indication of
socially irresponsible activities such as reports of negative labor practices, environmental
problems, bribery, and other issues. I will refer to such activities as “negative CSR”.
Prior literature suggests that perceptions of social irresponsibility are likely to generate
stronger observer reactions and ultimately loom much larger for the firm than
perceptions of social responsibility (Lange et al. 2012; Muller et al. 2011; Pfarrer et al.
2010). In this context, negative CSR in the home country can cause nonmarket actors in
the host country to form a negative perception of the firm; this negative perception will
have a negative impact on completion and duration till completion of M&A deals. In the
hypotheses I refer to CSR activities in the home country as the origin of social legitimacy
in the host country, or the perception that CSR at home generates in the minds of
nonmarket actors abroad. Based on the above logic, I suggest:
Hypothesis 1: Positive (negative) CSR will be associated with greater (lower) likelihood of completion of a cross-border deal by EMM.

Hypothesis 2: Positive (negative) CSR will be associated with lower (greater) duration to completion of the cross-border deal by EMM.

In addition, I will argue that the effect of home country CSR for EMMs will be higher in developed markets. This is due to two main reasons: even lower home country legitimacy in traditional developed markets, as reflected in their ‘liability of advantage’ (Pant et al. 2012), and the origins of formal views of CSR in developed countries.

As yet another challenge to legitimation that emerging market firms face abroad, the differential character of their ‘ownership’ advantages over those of developed market firms lower their home country legitimacy even more in developed countries. In particular, EMMs often have expertise in mass production and low cost value-creation processes; they own fast follower capabilities and develop routines of improvisation, and resilience in challenging institutional environments (Aulakh et al. 2009; Cuervo-Cazurra et al. 2008; Luo et al. 2007). However, the developed market actors often perceive these capabilities negatively: in their eyes they possess lower legitimacy. For example, low cost production by EMMs in their home countries is often interpreted and publicized by influential developed country actors as residing in exploitative practices (Khan et al. 2007), raising concerns about health and safety of such products (e.g.
Chinese drywall, toys, contaminated baby formula, food, and poisonous teas⁸). In addition, fast follower capabilities and resilience in challenging institutional environments raise suspicion in developed markets due to the concerns about intellectual property rights (e.g., debates about Indian pharmaceuticals) and transparency norms (e.g., corruption in the institutional environment and lack of corporate governance in Russian firms). Thus, the key constituents who are important for success of international expansion of EMMs in developed markets may threaten a deal by withholding legitimacy from such firms.

However, the legitimacy evaluation for EMMs with some information on CSR will be different because it counters some of the ‘ownership’ advantages – at least reducing (or igniting) them as perceived by the host country actors. In particular, positive CSR in the home country in the minds of developed country actors can signal higher product quality, fair labor practices, environmentally sound manufacturing processes, transparent relations with the government and contractors, reliable corporate governance structures, and general understanding of corporate responsibility. Negative CSR, on the other hand, may provoke further suspicion and negative sentiment towards EMMs by developed host country actors as it supports their initial judgments of the firm’s legitimacy based on the emerging market origin. Therefore, low home country

legitimacy will be at least partially overcome by an EMM’s home-country positive CSR engagement, and in opposite, will be further augmented by negative CSR engagement.

Moreover, because CSR requirements have originated and profoundly diffused in developed markets (Waddock 2008b), as a result of high profile CSR-related scandals of developed market multinationals’ operations in developing markets (e.g., Nike, Shell, BP, Wal-Mart), the effect of CSR for EMMs will be stronger when the host is a traditional developed market. This leads to the third hypothesis:

**Hypothesis 3: The effect of CSR will be greater for targets in developed markets.**

To summarize, the main argument is that firms from emerging markets gain legitimacy abroad by engaging in CSR in the home country and exceeding the expectations derived from their nationality. The main proposition is that legitimacy deriving from positive (negative) CSR helps (hurts) EMMs’ success in completing international M&As, particularly in developed host countries.
4.3 Results

4.3.1 Sample selection

In total, I examine 4,711 international M&A transactions from 1990 to 2011, where the acquirer comes from the largest emerging markets – the five BRICS countries. I choose this time period due to the availability of data and more importantly, the growth (in fact, emergence virtually from zero) of the number of the emerging markets’ cross-border M&A transactions and outward FDI at this time (see Figures 2-4 above). I choose BRICS not only due to the fact that they represent different regions of the world and provide variation in home country legitimacy but also because they comprise a large proportion of all M&A transactions by EMMs.

The sources of data include S&P Capital IQ, Compustat, Lexis-Nexis, and other databases. S&P Capital IQ is a financial information platform that was originally designed to address the needs of the investment banking community; it is now found in more than 4,200 firms, including JP Morgan, Piper Jaffray, and TIAA CREF, and more than 500 academic institutions (for a review of Capital IQ, see Phillips 2012). The advantages of S&P Capital IQ over other sources such as SDC Platinum is the user

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9 Initially the sample included open transactions as well as cancelled and closed (i.e. transactions that were announced in our time period but have not seen a resolution); however, since their number was very small (N=58) and to avoid right censoring, I decided to drop them from our final sample.

10 According to UNCTAD, in 2010 outward FDI from BRICS comprised 5.32% of the total world, 34.67% of the total for developing economies, 99.38% of the total for EMs (for comparison 93% in 2009, 75% in 2008 and 93.5% in 2007), even though developed economies still lead with 82.34% of the total world outward FDI. Source http://unctadstat.unctad.org
friendly platform and details on each company, particularly public companies (the data is linked to Compustat and stock exchange filings). Lexis-Nexis is a well-known database of media articles from around the world; it contains information in English and other languages, which helps deal with limited information about CSR of emerging market firms, as described below.

I recognize that there might be a selection bias in focusing on cross-border M&A deals (i.e., firms that choose M&A as a mode of international expansion). However, any selection issues will tend to be conservative in the context of this study. If firms in my sample are more capable of dealing with host country environments or have a greater (unobservable) propensity to complete cross-border deals due to the choices they make, this will result in underestimating the effect of CSR. M&A is the quickest and sometimes the only way for BRICS\(^{11}\) to gain foothold in the developed market (The Economist 2011); thus, the effect of CSR will be stronger in other modes of expansion, such as greenfield investment.

Furthermore, I conduct Heckman tests on the sample of 30,047 domestic and cross-border M&A deals by BRICS’ firms to determine if there are any selection factors in the decision to go abroad. The results are provided in Appendix C; they suggest little or no selection bias: while the coefficient for the Inverse Mill’s ratio is not significant, the hypotheses are still supported. This means that any unobserved factors that make

\(^{11}\) JBS FRIBOI from Brazil a big meat company, for instance, did not have any presence in the US until 2007 when it bought SWIFT, a struggling American rival. Tata’s purchase in 2000 of Tetley, British tea firm, gained it immediate access not only to the British but also to the North American markets.
participation in cross-border deals more likely tend not to be associated with completion or duration of the deals.

### 4.3.2 Measures

**Dependent variables.** The dependent variables are a) **Completion** - the likelihood that a cross-border acquisition deal will be completed (0, 1) and b) **Duration** – the logarithm of the time taken for its completion after the announcement. The sample for duration models is smaller because this variable is only calculated for completed deals; in addition, data on dates were missing in 16% of the cases, while in 10% of the duration sub-sample duration was less than zero days due to backdated public announcements (so I dropped these observations). Table 5 above shows the sample distribution of deals and key statistics for the main dependent variables by home country. I expect to find a positive (negative) relationship between positive (negative) CSR and **Completion**, and a negative (positive) relationship between positive (negative) CSR and **Duration**.

**Independent variables.** I measure social legitimacy (or CSR) with the Janis-Fadner index of media endorsement – with a larger number indicating greater legitimacy (Bansal *et al.* 2004; Carroll *et al.* 1989; Deephouse 1996). Although other measures of CSR on emerging market firms were not available\(^\text{12}\), the Janis-Fadner index has been

\(^{12}\) The KLD index started coverage of emerging market firms in 2011, while ASSET4 (Thomson Reuters, available from Datastream) has been covering a very small number of emerging market firms since 2008.
widely used in prior literature; moreover, it highlights the mechanism by which firms from emerging markets gain legitimacy abroad. In particular, host country actors refer to the media to make an informed judgment. For simplicity I call this measure CSR Index:

\[
\text{CSR Index} = \begin{cases} 
(e^2 - ec)/t^2 & \text{if } e > c, \\
(ec - c^2)/t^2 & \text{if } c > e, \\
0 & \text{if } e = c,
\end{cases}
\]

where \(e\) is the number of endorsing articles about CSR, \(c\) is the number of challenging articles, and \(t\) is their sum. I use Lexis-Nexis as the media source because of its international coverage and comprehensiveness. I searched for Major World Publications two and one years before the announcement of each deal. The reason for choosing Major World Publications is that they accumulate major news from other sources and present them in arguably the only international business language available to all - English. The rationale for not looking into news in other languages is that international stakeholders will not have the same access to them; moreover, if the news did not get published in Major World Publications, they will tend to receive less attention from international stakeholders. A potential criticism might be that Major

(13) Major World Publications group file, MWP, contains full-text news sources from around the world which are held in high esteem for their content reliability. This includes the world’s major newspapers, magazines and trade publications which are relied upon for the accuracy and integrity of their reporting. The list of sources is very comprehensive (i.e. 12 pages long)
World Publications only focus on public firms due to their visibility, but this is not true in our sample. After composing the CSR Index, I checked for the status of buyers and found that the split was 40-60 (private-public), which alleviates this concern.

Because I am interested in CSR as the source of social legitimacy, I extracted full length articles using company’s name and one or more of the following modifiers within 50 words from the company name: "responsib" or "sustainab" or "ethic" or "stakeholder" or "environment" or "polluti" or "social" or "governance" or "philanthrop" or "charit" or "law" or "tax" or "wage" or "employee" or "societ" or "compliance" or "code of conduct" or "transparen" or "corrupt" or "strike" or "sue" or "illegal" or "regulat" or "government" or "woman" or "women" or "black" or "labor union" or "labour union" or "politic"\textsuperscript{14}.

On average, this search generated 14 articles per firm (66,530 articles in total) with little to no information for majority of companies involved in about 3,000 deals. Following procedures from prior literature (Deephouse 1996) suggesting eight as the threshold for the number of articles to be evaluated (if the search returns more than eight articles, then, according to the rules, I randomly select a total of eight plus 25 percent of the remaining number of articles, a sampling fraction well above that used in most communication research) I content-analyze information from 2,850 articles. On average, this procedure results in 0.6 articles per firm; the majority of deals have no relevant information (in about 4,000 M&As), so I have CSR data for 734 deals by 383

\textsuperscript{14}Some of these terms came from the interviews with relevant actors, while others – from the existing literature.
I then conducted a content analysis of the articles, making sure they provide relevant information, coding them as either endorsing or challenging CSR activities of the focal firm.

By construction, CSR index varies from -1 to 1. Conceptually and based on anecdotal evidence, however, I have no reason to believe that its impact will be monotonic. Recent literature on CSR suggests that corporate social irresponsibility (CSiR) and the perceptions that it generates have been previously overlooked, and therefore it is useful to at least distinguish between CSR and CSiR in future research (Campbell 2007; Lange et al. 2012). CSR is a multi-dimensional phenomenon and so when the firm is socially responsible on some dimensions but not others, it may have to pay for consequences.

For example, a well-known Brazilian mining group Vale is very visible in its attempts to engage in CSR: in 2010, according to its social report, Vale spent $999 million on CSR projects ($829 mm for environmental conservation and protection, and $170 mm for social projects). However, this did not preclude South Africa’s National Union of Mineworkers (NUM) from successfully blocking it from acquiring South African mining company Metorex due to Vale’s anti-union behavior throughout the world, most notably

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15 The composition of home countries of these firms is the following: Brazil (5%), Russia (30%), India (20%), China (22%), South Africa (23%)
16 I also used the help of two research assistants in this process to achieve inter-rater reliability. Our convergence rate was high at 0.93.
against the United Steelworkers (USW) in Canada. In fact, NUM General Secretary Frans Baleni described Vale as “one of the world’s leading labor exploiters.”

Therefore, when CSR Index is based on some challenging articles (CSR Index < 0), excluding 0), this raises doubt about endorsing articles and whether CSR engagement is substantive or symbolic on the behalf of the focal firm (i.e. CSR is perceived as negative). Therefore, for the main analysis, just like in piece-wise regressions used in event history analysis, I split the index into four encompassing and mutually-exclusive components: All negative (CSR Index = -1), All positive (CSR Index = 1), Majority negative (-1 < CSR Index < 0), and Minority negative (0 < CSR Index < 1). Because the null hypothesis is that CSR does not matter, the comparative group of firms (CSR Index=0) has either zero information on CSR (3,977 observations) or an equal number of endorsing and challenging news (38 observations\(^\text{18}\)). In the matching analysis, due to small sample size, I combine Majority negative and Minority negative into Mixed negative category where the intuition is that in either of these categories there is concern over CSR activities of the firm, where the challenging articles cast doubt on the endorsing ones and thus the total CSR engagement of the firm. Table 6 below provides some examples of companies by home countries.

<table>
<thead>
<tr>
<th>Home country</th>
<th>All negative</th>
<th>All positive</th>
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</table>

\(^\text{17}\) Source: www.icem.org/en/78-ICEM-InBrief/4548-NUM-Succeeds-in-Blocking-Valea-s-Bid-for-Metorex-in-Southern-Africa

\(^\text{18}\) Including the dummy for this case (CSR Index = 0) did not change our results.
According to the hypotheses, I expect *All negative, Majority negative, Minority negative, and Mixed negative* categories to have a negative influence on the completion of the deal and positive effect on duration. I expect the opposite impact for *All positive*.

*Controls.* Based on previous research that uses the same dependent variables (Dikova *et al.* 2010; Muehlfeld *et al.* 2012) I use the following controls: cash payment; public status acquirer; public status target; percentage sought; and target subsidiary.

*Cash payment* indicates whether the deal was predominantly cash-financed (1) or stock-financed (0): Stock-financed transactions tend to be more complex, as there is more uncertainty about the value of the stock, and hence about the price paid for the transaction. If the deal is predominantly stock-financed, changes in the relative levels of stock prices of the partners may create pressure for renegotiation, leading to delays and sometimes derailment of the merger process (Weston *et al.* 1999). Cash-backed transactions (cases in which more than 50% of the payment was in cash) accounted for 78% of the deals.
Public status acquirer and Public status target, respectively, indicate whether the two partners in the transaction are publicly owned (coded as 1) or privately-held (0): Publicly owned companies, more so than privately owned ones, must comply with national and international regulations throughout all phases of trading activities. This feature of publicly owned companies may cause delays in the completion of an acquisition deal (Weston et al. 2004). In my sample, 47% of buyers and 27% of targets are public.

Percentage sought is the ownership stake in the target sought by the acquirer: the higher this percentage, the more is at stake for the acquirer’s and target’s shareholders, which may affect approval procedures.

Target subsidiary indicates whether the smaller partner in the transaction was, prior to the acquisition transaction announcement, a subsidiary (1) or not (0) of a larger enterprise. I expect subsidiary transactions to be more complex because the parent’s heritage in the governance structure of the subsidiary often persists for a considerable time period (Slovin et al. 1998). Targets were subsidiaries for 58% of the deals.

I add several controls to compare the five BRICS countries and thus their home country legitimacy. First, I add dummies Brazil, Russia, India, and South Africa to compare firms from these countries to Chinese firms (China had the largest number of M&A deals, lowest likelihood of completion, and longest average duration till completion). Second, I add a dummy Developed (host) to specify the location of the target
in the developed (1) or emerging (0) country. Third, I add Experience, which is the count number of M&As for the focus firm, assuming that with greater experience it will be easier to enter a foreign market. Fourth, I code a dummy variable First time that shows whether the company is entering the focus host country for the first time (0,1), assuming it will be more difficult to enter a foreign country for the first time. Finally, I include Year to control for macroeconomic conditions (using year dummies rather than a continuous measure of year did not change results). Table 7 provides descriptive statistics as well as correlations for dependent, independent, and control variables.

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9 I followed OECD categorization of developed countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom, and United States.
Table 7: Descriptive statistics and correlations

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Mean: 0.9 | 2.1 | .02 | .04 | .06 | .02 | .04 | 3.4 | .8 | .5 | .3 | .36 | .6 | .5 | .07 | .2 | .3 | .1 | .3 | 2.1 | .9 | .2 | 2007
St. dev.: 0.3 | 2.2 | .33 | .2 | .2 | .1 | .1 | .2 | .2 | .4 | .5 | .4 | .4 | .5 | .5 | .3 | .4 | .5 | .3 | .4 | .4 | .23 | .3 | .4 | .285
Min: 0 | 0 | -1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 1990
Max: 1 | 7.2 | 1 | 1 | 1 | 1 | 1 | 9.8 | 1 | 1 | 1 | 100 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 23 | 1 | 1 | 2011
The first dependent variable Completion has a mean 0.9 and a standard deviation of 0.3, showing that 10 percent of deals are not completed. The second dependent variable Duration has a mean of 2.13 and a standard deviation of 2.25 (this is a logged value). See Table 8 below for actual values of Duration in days: on average, it takes 58 days to complete a deal with a high standard deviation of 108 days, suggesting significant variation in Duration across deals, in addition to the relevance of logging this variable for our analyses. None of the correlations are significant; they are also low for independent variables. None of the controls have high correlations with variables other than those expected. The value of the deal is also logged and not available for all cases in the full sample; for observations that have deal size data, the mean is $260 million with a standard deviation of $1,071.39 million, demonstrating a wide variety of deals by size.

On average, the percent of stake sought in the target is 36.36 with a standard deviation of 39.78, suggesting that majority of deals are for a majority stake in the company (when I cross-tabulate minority/majority stake dummy, 78% of the sample refers to deals with a majority stake). On average, firms in my sample engage in 2.09 deals with a standard deviation of 2.33, suggesting high variation in experience of firms. The majority of deals are conducted in the host country for the first time: the mean for First time is 0.88 with a standard deviation of 0.32. Finally, on average, the majority of deals take place in later years: the mean for Year is 2007 with a standard deviation of 2.9.
Table 8: Summary statistics for key variables by home country

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<td>Russia</td>
<td>7</td>
<td>93</td>
<td>45</td>
</tr>
<tr>
<td>India</td>
<td>7</td>
<td>93</td>
<td>43</td>
</tr>
<tr>
<td>China</td>
<td>15</td>
<td>85</td>
<td>78</td>
</tr>
<tr>
<td>South Africa</td>
<td>7</td>
<td>93</td>
<td>58</td>
</tr>
<tr>
<td>Full sample</td>
<td>10</td>
<td>90</td>
<td>58</td>
</tr>
</tbody>
</table>

I did not include control variables pertaining to the transaction such as termination fees, lock-up provisions, and solicitation clauses because, according to the Capital IQ data, fewer than 2% of our transactions specified termination conditions. For the remainder of the deals, either termination conditions were not in place or the information was not available. This is consistent with other studies (Dikova et al. 2010).

In addition, I did not control for the approach and the attitude in the deal: the majority (87.3%) of deals were unsolicited, implying that majority of targets did not actively seek potential buyers, and the majority (99.8%) of deals were friendly.

4.3.3 Data analysis method

I conduct logistic analysis on the probability of the deal being completed and linear regression on the duration of time it takes. The results are consistent when I limit the sample to M&A deals conducted for the first time abroad (Experience=1) and for the first time in the focus host country (First time=1). Therefore, I present Experience

---

20 Unfortunately, one of the main assumptions of the survival analysis is violated in our data, so I cannot use it in this chapter. See Appendix D for more details.
and First time as controls in the main analysis rather than as separate analyses. Given the structure of my data I have to deal with heteroskedasticity\textsuperscript{21}. Some firms in the sample conducted several M&As over the years but the data is not a balanced panel because this does not always happen every year; moreover, some firms had several deals in one year, so that the data cannot be set as a panel (and I cannot specify fixed effects). I deal with heteroskedasticity in two established ways\textsuperscript{22}: first, by logging duration, and second, by using robust standard errors in all of the analyses. In addition, I control for potential endogeneity in four ways: first, by lagging the independent variable (calculated 1 and 2 years before the year of announcement); second, by clustering means at the firm level; third, by using a matched sample of completed and cancelled deals (for the completion analyses); and fourth, using instrumental variables (for the duration analyses).

4.3.4 Hypothesis 1 (Completion)

The results of logistic analysis are presented in Table 9. Model 1 estimates the effect of controls: the likelihood of completion is higher if the target is a subsidiary, if the buyer is not from China, and the deal took place in earlier years. Model 2 adds our main independent variables: the coefficients from logistic regression are not directly intuitive, so I will interpret them through odds ratios: the odds for completion with

\textsuperscript{21} Breusch-Pagan test of heteroskedasticity after the regression model on duration shows the presence of heteroskedasticity: chi2(1)=7.48 Prob>chi2=0.0062

\textsuperscript{22} http://www.nd.edu/~rwilliam/stats2/l25.pdf
mixed negative news are 0.5 (any odds below 1 by construction are negative); if I split
the odds for this variable by the outcome, then for cancellation the odds are 11.5 versus
8.6 for completion. This supports the first hypothesis as mixed negative news imply
negative CSR and hence, lower likelihood of completion of the deal.

To address the issues of endogeneity arising from deal characteristics (i.e. some
deals may be inherently easier to complete than others), I complement this analysis
with a linear probability model on the matched sample of cancelled and completed
deals. In order to do matching, I follow the empirical methodology of Jaffe,
Trajtenberg, and Henderson (1993) and Belenzon and Shankerman (2012), comparing
the characteristics of deals that are completed and a control group that is not. The
control group is constructed as follows: for each completed deal, I randomly select a
cancelled deal that is in the same cohort with the same year of the announcement,
value of the deal, percent sought, public buyer (0, 1), payment mainly in cash (0, 1),
and the same characteristics of the target - public (0, 1), subsidiary (0, 1), and in a
strategic industry (0, 1).

<table>
<thead>
<tr>
<th></th>
<th>Full sample</th>
<th>Matched sample</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td></td>
<td>Completion</td>
<td>Completion</td>
</tr>
<tr>
<td>Mixed negative Completion</td>
<td>-2.169***</td>
<td>-0.613**</td>
</tr>
<tr>
<td></td>
<td>(0.811)</td>
<td>(0.308)</td>
</tr>
<tr>
<td>Majority negative</td>
<td>-0.613**</td>
<td>-0.569'</td>
</tr>
<tr>
<td>Minority negative</td>
<td>-0.569'</td>
<td></td>
</tr>
</tbody>
</table>

Table 9: Main results for completion (logistic regression - Hypothesis 1)
<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All negative</td>
<td>0.387</td>
<td>1.281</td>
<td></td>
</tr>
<tr>
<td>All positive</td>
<td>0.068</td>
<td></td>
<td>1.649**</td>
</tr>
<tr>
<td>Cash payment</td>
<td>0.056</td>
<td>0.052</td>
<td></td>
</tr>
<tr>
<td>Buyer public</td>
<td>0.037</td>
<td>0.048</td>
<td></td>
</tr>
<tr>
<td>Target public</td>
<td>0.129</td>
<td>0.133</td>
<td></td>
</tr>
<tr>
<td>Percent sought</td>
<td>0.0005</td>
<td>0.0005</td>
<td></td>
</tr>
<tr>
<td>Target subsidiary</td>
<td>1.205***</td>
<td>1.219***</td>
<td></td>
</tr>
<tr>
<td>Developed host</td>
<td>0.123</td>
<td>0.126</td>
<td></td>
</tr>
<tr>
<td>Experience</td>
<td>-0.006</td>
<td>0.003</td>
<td></td>
</tr>
<tr>
<td>First time</td>
<td>0.189</td>
<td>0.203</td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>0.505**</td>
<td>0.473*</td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>0.701***</td>
<td>0.732***</td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>0.628***</td>
<td>0.641***</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>0.561***</td>
<td>0.530***</td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>-0.068***</td>
<td>-0.069***</td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>136.7***</td>
<td>140.1***</td>
<td>0.916***</td>
</tr>
<tr>
<td>Observations</td>
<td>4,711</td>
<td>4,711</td>
<td>390</td>
</tr>
</tbody>
</table>

***p<0.01, **p<0.05, *p<0.1, 'p<0.1 at one-tail significance. Robust standard errors clustered at the firm level for Models 1-2.

*Strategic industry* is a dummy that refers to a number of industries that might be sensitive to national security concerns and thus are more likely to go through official
review by the government or other agencies that must approve the transaction. These include industries related to natural resources (gold, steel, aluminum, metals and mining, oil and gas, agricultural products), utilities (gas, water, electricity, energy), infrastructure (railroads, airports, marine), telecommunications (wireless telecommunication services, broadcasting, cable and satellite), and aerospace and defense23; 19% of deals involve a target company that is in a strategic industry (the mean for Strategic industry is 0.19 with a standard deviation of 0.39). The methodology involves comparing CSR of the firm involved in the deal, plus other deal characteristics, between completed and cancelled deals.

With 50% missing data on the value of the deal, I am left with 2,186 completed and 259 cancelled deals, of which I was able to match 282 completed deals with 108 cancelled deals using Coarsened Exact Matching in Stata24: multivariate L1 distance is 0.43 which is sufficiently high to indicate a reliable match. I use a linear probability model that relates a dummy variable for whether the deal is completed to a set of control variables. Since the control group of cancelled deals is matched on the year of the announcement and other characteristics, the methodology controls for these factors in the regressions. The empirical specification is

23 In their choice I rely on the UNCTAD definitions of “Sectoral measures motivated by essential security or public order” (see Table 3.A1.2 at http://www.oecd.org/industry/internationalinvestment/investmentpolicy/40476055.pdf) as well as recent public announcements of strategic sectors for foreign investment by a number of developing countries (For example, China http://news.xinhuanet.com/english/business/2012-07/21/c_131729537.htm).
24 Stata command CEM, for details see http://gking.harvard.edu/files/cem-stata.pdf
\[ C_{ikjt} = \text{All negative} + \text{All positive} + \text{Mixed negative} + X_{ik}, \]

where \( C_{ikjt} \) is a dummy variable equal to 1 if deal \( i \) in host country \( k \) by firm \( j \) in home country \( l \) is completed at time \( t \), and zero otherwise. The CSR Index is disaggregated into its components but due to smaller sample size (\( N = 390 \)) I merge \textit{Majority Negative} with \textit{Minority negative} news into \textit{Mixed negative}, assuming that the negative reports raise similar concerns for stakeholders. A set of controls \( X_{ik} \) includes logged deal value, year of announcement, percent sought, dummies for cash payment, public buyer, public target, target subsidiary, and target industry (strategic industry=1); these are the variables I match on.

The results of this analysis are presented in Model 3. For consistency with the main analysis, I estimate logit on deal completion. The results demonstrate support for the first hypothesis, indeed even more strongly than in Model 2, with significant impact of both “All positive” and “Mixed negative”: the odds of completing the deal with “All positive” CSR news are 5.2 while mixed negative news lower the odds to 0.11 (by way of construction, any odds below 1 have negative impact). If I split the odds by the outcome, then the odds for cancellation with positive news is 2.39 compared to 3 for mixed negative news, for completion – 13 versus 0.28 respectively, further providing evidence to the differences in the components of CSR Index as well as providing support for the first hypothesis.
4.3.5 Hypothesis 2 (Duration)

The results of linear regression analysis for duration are shown in Table 10 below. Model 4 shows the effect of controls on duration: it takes longer to complete the deal if the buyer and target companies are public, the target is a subsidiary, the buyer is from China, the deal takes place in the emerging market, or for the first time in the host country. Perhaps the most intriguing result among the controls is the effect of the developed host country on duration: the business press highlights problems for EMMs in developed host countries but, given more sophisticated development of national business systems and institutions, in retrospect it is reasonable that developed markets take shorter time to review deals. Model 5 shows the results for our main independent variables; coefficients on All negative (0.394, p<0.01), Majority negative (0.939, p<0.01) and Minority negative (0.549, p<0.05) are significant and positive, suggesting longer duration for firms with negative CSR. This supports the second hypothesis: all negative components of the CSR Index prolong deal-making.

Table 10: Main results for duration (GLS and IV - Hypothesis 2)

<table>
<thead>
<tr>
<th>GLS</th>
<th>Instrumental variables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full sample</td>
<td>1st stage</td>
</tr>
<tr>
<td>Duration</td>
<td>Duration</td>
</tr>
<tr>
<td>Majority negative</td>
<td>0.939***</td>
</tr>
<tr>
<td>Minority negative</td>
<td>0.549**</td>
</tr>
<tr>
<td>All negative</td>
<td>0.394**</td>
</tr>
<tr>
<td>----------------------</td>
<td>---------</td>
</tr>
<tr>
<td>All positive</td>
<td>0.185</td>
</tr>
<tr>
<td>CSR index</td>
<td></td>
</tr>
<tr>
<td>Visibility:</td>
<td>0.00749***</td>
</tr>
<tr>
<td>Headlines</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>-0.059</td>
</tr>
<tr>
<td>payment</td>
<td>(0.094)</td>
</tr>
<tr>
<td>Buyer public</td>
<td>0.379***</td>
</tr>
<tr>
<td>(0.099)</td>
<td>(0.093)</td>
</tr>
<tr>
<td>Target public</td>
<td>0.557***</td>
</tr>
<tr>
<td>(0.111)</td>
<td>(0.11)</td>
</tr>
<tr>
<td>Percent</td>
<td>0.001</td>
</tr>
<tr>
<td>sought</td>
<td>(0.001)</td>
</tr>
<tr>
<td>Target</td>
<td>0.641***</td>
</tr>
<tr>
<td>subsidiary</td>
<td>(0.0956)</td>
</tr>
<tr>
<td>Developed host</td>
<td>-0.268***</td>
</tr>
<tr>
<td>Experience</td>
<td>0.042</td>
</tr>
<tr>
<td>(0.033)</td>
<td>(0.031)</td>
</tr>
<tr>
<td>First time</td>
<td>0.296**</td>
</tr>
<tr>
<td>(0.139)</td>
<td>(0.134)</td>
</tr>
<tr>
<td>Brazil</td>
<td>-0.551***</td>
</tr>
<tr>
<td>(0.154)</td>
<td>(0.154)</td>
</tr>
<tr>
<td>Russia</td>
<td>-1.431***</td>
</tr>
<tr>
<td>(0.129)</td>
<td>(0.123)</td>
</tr>
<tr>
<td>South Africa</td>
<td>-0.666***</td>
</tr>
<tr>
<td>(0.142)</td>
<td>(0.144)</td>
</tr>
<tr>
<td>India</td>
<td>-1.106***</td>
</tr>
<tr>
<td>(0.111)</td>
<td>(0.111)</td>
</tr>
<tr>
<td>Year</td>
<td>-0.007</td>
</tr>
<tr>
<td>(0.01)</td>
<td>(0.01)</td>
</tr>
<tr>
<td>Constant</td>
<td>15.43</td>
</tr>
<tr>
<td>(29.99)</td>
<td>(29.29)</td>
</tr>
<tr>
<td>Observations</td>
<td>3,505</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.085</td>
</tr>
<tr>
<td>Kleibergen-Raap (KR) rk LM stat (under-identification)</td>
<td>4.618</td>
</tr>
<tr>
<td>KR rk Wald F (weak identification)</td>
<td>(p=0.032)</td>
</tr>
<tr>
<td>Hansen J stat (over-identification)</td>
<td>4.691</td>
</tr>
<tr>
<td>0 (e.e.i.)</td>
<td>0 (e.e.i.)</td>
</tr>
</tbody>
</table>

***p<0.01, **p<0.05, *p<0.1 Robust standard errors (4-8) clustered at the firm level (4-5); e.e.i. - equation exactly identified

To address concerns of endogeneity, I conducted instrumental variable analysis for deal duration. I investigated three potential instruments. First, firm visibility at home: the literature has argued that the higher the visibility of a given firm, the higher the pressure to engage in CSR (Chiu et al. 2011; Ioannou et al. 2010). To construct this measure, in Lexis-Nexis I searched for home country news articles that mention the company in the headlines; the logarithm of the total count of these articles is the measure of visibility (Headlines). Second, I examined a country-level variable in terms of the Reporting mandate as the adoption of mandatory sustainability reporting laws and regulations increases the social responsibility of business (Ioannou et al. 2011). This measure takes the value of one for country-year observations in the year following the enactment of a mandatory sustainability reporting law or regulation, zero otherwise. Third, I investigated another country-level variable in the form of the existence (or absence) of a socially responsible stock market index (SRI Index) in the focus home country (coded as 1 from the year it was
introduced, 0 otherwise) suggesting that its existence would encourage emerging market firms to engage in CSR (Ioannou et al., 2012).

I first ran the instrumental variable tests for both dependent variables (completion and duration) with the same specification as in the main models, using the same control variables. Instead of the disaggregated elements of the index, I was obliged to use the continuous measure of the CSR Index. This is due to the fact that instrumenting requires a continuous variable, or at least as many instruments as there are instrumented variables: I chose not to use the set of dummies for the components of the CSR index because I did not have four reliable instruments; furthermore, the discrete nature of dummy variables complicates the interpretation in the instrumental variable analysis, because one of the dependent variables is also a dummy.

I ran two analyses for completion and duration. For completion, I used Stata command ‘ivprobit’ with robust standard errors: I found that the Wald test of exogeneity did not reject the null that CSR Index can be treated as exogenous, so my key independent variable in this case did not need to be instrumented. Thus, I did not conduct further instrumental analysis for the dependent variable of deal completion.

For duration, on the other hand, using Stata command ivreg2 with robust standard errors, the post-estimation endogeneity test of endogenous regressors was significant: 13.245 Chisq(1) P-val = 0.0003 (using ‘endogtest’ command). That is, the test

\[ \text{Wald test of exogeneity for the three instruments together showed } \chi^2(1) = 2.27 \text{ with Prob } > \chi^2 = 0.1317. \]
\[ \text{Wald test of exogeneity for firm visibility and SRI Index resulted in } \chi^2(1) = 2.35 \text{ and Prob } > \chi^2 = 0.1256. \]
\[ \text{Finally, Wald test of exogeneity for firm visibility only calculated } \chi^2(1) = 0.07 \text{ with Prob } > \chi^2 = 0.7938. \]
rejected the null that the CSR Index can be treated as exogenous. Thus, it was appropriate to instrument the CSR Index for the dependent variable of duration.

To build a reliable model for instrumental variables, I undertook two procedures. First, using ‘redundant’ option in Stata, I examined the strength of the instruments – whether any of them did not provide useful information. The IV redundancy test (LM test of redundancy of specified instruments) was significant for SRI Index (8.954 Chi-sq(1) P-val = 0.0028) and Headlines (4.782 Chi-sq(1) P-val = 0.0288) but not for Reporting: 0.007 Chi-sq(1) P-val = 0.9340 so I dropped the Reporting instrument. Second, I compared Sargan statistic to see what instruments are appropriate: the Sargan test rejected the null that the SRI Index and Headlines instruments are appropriate together but it failed to reject its null (i.e., the statistic was equal to zero and the ‘equation was exactly identified’) when I took out SRI Index, leaving only Headlines as the instrument. Hence, based on these two procedures, I concluded that the appropriate and informative instrument is the measure of firm-level visibility, while omitting the two potential country-level instruments. The results of the analysis using Headlines as the instrument for CSR are presented in Models 6-8 in Table 10.

Models 6 and 7 present the results from the first and second stages of the instrumental variables regression; Model 8 shows results with GMM option. In the presence of heteroskedasticity or clustered errors, although the standard IV coefficient estimates remain consistent, their standard errors and the usual forms of the diagnostic
tests are not (Baum et al., 2003). To address this issue, I specify a GMM option in the implementation to provide more efficient estimation, valid inference, and diagnostic testing, allowing for clustering the errors at the firm level.

I report results for three post-estimation tests. First, the under-identification test is comparable to an LM test of whether my equation is identified. In the presence of heteroskedasticity, the traditional Anderson LM and Cragg-Donald Wald statistics are no longer relevant. Instead, I present the LM and Wald versions of the Kleibergen-Paap (2006) rk statistic, which is a generalization of the more traditional tests. For my data, the model is ‘always’ identified.

Second, the weak identification test estimates how relevant and how strong our instrument is. In the presence of heteroskedasticity, the traditional Cragg-Donald-based F-statistic is not relevant; instead I report the Kleibergen-Paap Walk rk F-statistic. For my sample, the F-statistic nears the critical value for 25% maximal IV size (4.691/4.593 versus 5.53), suggesting that my instrument is relevant.

Finally, I report the over-identification test. For this test, the null hypothesis is that the instrument is exogenous (uncorrelated with the error term), so if the statistic is significant and the p-value is small enough, this suggests that the instruments are not exogenous. Since the traditional Sagan test is no longer relevant, I report a Hansen’s J statistic (1982), which remains consistent when the error is heteroskedastic. For my specification, the test statistic is 0; therefore, the null hypothesis is not rejected. These
post-estimation tests as well as pre-estimation examination show that the firm-level Visibility instrument satisfies the conditions of exogeneity and relevance and as a result is valid.

The coefficient on the CSR Index is negative and significant in both Models 7 and 8 (-13.82, p-value<0.05 and -13.76, p-value<0.05), suggesting that the exogenous component of the CSR performance reduces duration. These results support the second hypothesis. They suggest that the higher a firm’s home country CSR, the shorter time it takes the firm to complete a deal.

4.3.6 Hypothesis 3 (Developed country host)

To test the third hypothesis, Table 11 splits the sample into deals in developed (Models 9-10, 13-14) and emerging markets (Models 11-12, 15-16). I first run the analysis for completion and then for duration. The coefficient on majority negative news is still significant for completion in developed host countries but not in emerging (Model 9): the odds for completion with majority negative news in developed markets are 0.43 (odds for cancellation are 12.6 versus for completion – 7.7). The coefficients for duration are also consistent with prior findings but only in the developed country context: firms with All negative (0.561, p<0.05) and Mixed negative news (0.981, p<0.05) take longer to complete the deal. These results provide moderate support for the third hypothesis. Moreover, it is reassuring that neither for completion nor for duration, the models in emerging markets show any significant results for CSR.
In addition, I examined mean differences for key independent variables between the two sub-samples (deals in emerging and developed host countries). I found that deals in emerging markets have significantly higher means for all four components of the CSR Index (All negative, All positive, Majority negative, Minority negative), suggesting that not only are they different between these institutional environments but also that despite the smaller number of observations with CSR and the higher number of deals in developed countries, the effect of CSR is higher in developed markets.

Table 11: Main results for the split samples (Hypothesis 3)

<table>
<thead>
<tr>
<th></th>
<th>In developed</th>
<th>In emerging</th>
<th>In developed</th>
<th>In emerging</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(9)</td>
<td>(10)</td>
<td>(11)</td>
<td>(12)</td>
</tr>
<tr>
<td>Completion</td>
<td>0.468</td>
<td>0.401</td>
<td>0.415</td>
<td>0.403</td>
</tr>
<tr>
<td>Duration</td>
<td>0.824*</td>
<td>-0.415</td>
<td>0.981**</td>
<td>0.777</td>
</tr>
<tr>
<td>Maj -</td>
<td></td>
<td>(0.468)</td>
<td>(0.401)</td>
<td>(0.41)</td>
</tr>
<tr>
<td>Min -</td>
<td>-0.632</td>
<td>-0.403</td>
<td>0.352</td>
<td>0.567</td>
</tr>
<tr>
<td>All -</td>
<td>0.248</td>
<td>0.505</td>
<td>0.561**</td>
<td>0.192</td>
</tr>
<tr>
<td>All +</td>
<td>(0.586)</td>
<td>(0.531)</td>
<td>(0.375)</td>
<td>(0.353)</td>
</tr>
<tr>
<td>Completion</td>
<td>0.054</td>
<td>0.095</td>
<td>0.311</td>
<td>0.008</td>
</tr>
<tr>
<td>Duration</td>
<td>(0.362)</td>
<td>(0.332)</td>
<td>(0.224)</td>
<td>(0.233)</td>
</tr>
<tr>
<td>Cash pay</td>
<td>0.194</td>
<td>0.213</td>
<td>0.017</td>
<td>0.017</td>
</tr>
<tr>
<td>Buyer public</td>
<td>0.276*</td>
<td>-0.257</td>
<td>0.012</td>
<td>0.012</td>
</tr>
<tr>
<td>Target public</td>
<td>0.186</td>
<td>0.186</td>
<td>0.623***</td>
<td>0.623***</td>
</tr>
<tr>
<td>% of stake</td>
<td>0.0008</td>
<td>-0.003</td>
<td>0.0002*</td>
<td>0.0002*</td>
</tr>
<tr>
<td>Target subsid</td>
<td>1.508***</td>
<td>1.52***</td>
<td>0.623***</td>
<td>0.623***</td>
</tr>
<tr>
<td>Experience</td>
<td>0.0002</td>
<td>0.018</td>
<td>0.106***</td>
<td>-0.001</td>
</tr>
</tbody>
</table>

108
Furthermore, I analyzed the effect of the interaction of the Developed host with the four indicators of CSR (All negative, All positive, Majority negative, Minority negative). The results were similar when I replaced the four indicators of CSR with their interactions, although with some effects only at 1-tail significance level when I added all terms in the models.

Overall, the results in Tables 9, 10, and 11 demonstrate support for the three hypotheses. I early noted robustness when using the Heckman test (Appendix C), which addressed potential selection bias in the firms’ choice to expand abroad. I now discuss additional sensitivity analyses.

### 4.3.7 Robustness checks

Several other sensitivity analyses assess other potential explanations. First, I considered the effect of state-ownership, although only 5% of my sample are deals by...
(109) state-owned firms. I found that they follow the same pattern in completion (about 10% of deals were cancelled) with somewhat longer duration. When I used state ownership dummy as a control in the main analysis, I found even stronger results, possibly due to potential legitimacy spillovers stemming from state ownership in some host countries.

Second, because 12% of deals in my sample involve more than one buyer, I explored any effects on deal completion and duration. I coded a dummy variable *Several* and included it in the main analysis: it did not affect the success of completion although it was significant and positive in the duration models, suggesting that it takes longer to complete a deal if more than one buyers are involved. The predicted results were consistent in both cases.

Third, an additional concern is that companies may strategically engage in CSR to be able to succeed in their international expansion, particularly in developed markets. Whether firms invested in CSR strategically to gain access to international markets or not does not affect the mechanism for the theoretical relationship between CSR and success of international expansion: CSR acts as a signal to host countries that the firm from emerging market is ready to play by the rules of the international community. I searched for information on when firms started CSR\(^{26}\) to compare the year of their initial

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\(^{26}\) To do this, in Lexis-Nexis I searched for home country news that mention the company in the body of the article and within those results for key terms such as "social responsibility or ethics or sustainability or corporate governance or environmental". Then I confirmed that the news and mention are relevant and recorded the year of the first mention as the year in which companies started CSR.
CSR engagement to the year of cross-border M&A. I found information for 24% of the cases in the sample; just as the cross-border M&As themselves, CSR is a relatively recent phenomenon for emerging market firms: the earliest year was 1991 but, on average, the firms in our sample started their CSR engagement in 2008. The correlation between non-missing years of initial CSR engagement and the year of announcement of the deal is low (r=0.05) and is even lower for first M&A deals or first-time M&As in the focus host country (r=0.04). This leads to a conclusion that since both M&As from emerging markets and CSR in emerging markets are recent phenomena, it is appropriate to assume that companies did not engage in CSR on purpose in order to expand abroad. However, even if they did, this does not affect the main theoretical mechanism, as both strategic and voluntary CSR are a signal to the host country that the BRICS firm will play by the rules of the international community and the host.

Fourth, I explored the reasons for deal cancellation. I conducted a wide search (using Google) for information on the reasons for cancellations, coding them into three categories: 1) regulator and other nonmarket stakeholders (including cancellations due to antitrust and national security concerns), 2) buyers (undisclosed reasons), and 3) shareholders (voting against the deal). Of 462 cancellations in my sample I found information for 322, with the following split among the three categories: 1) regulators=125; 2) buyers=94; and 3) shareholders=103. This shows that the direct impact of regulators and other nonmarket actors is a key factor for cancellations, indirectly,
nonmarket actors may also affect the buyers and seller categories; due to the unwillingness of the two sides in the transaction to disclose underlying reasons for cancellations, any such indirect effects are difficult to observe.

Fifth, to address potential concerns about the role of advisors in the transaction, I searched for the total number of advisors for the acquiring and target firms, assuming that the more advisors they have, the more likely they will complete the deal in shorter time due to the expertise of professionals. I found this information for the acquirers in 30% of deals in our sample and 14% for the targets. For the sub-sample with information on buyers’ advisors, I found that the deals that were cancelled (N=115) had a significantly higher number of advisors (on average, 2.83 with standard deviation of 2.63) than the deals that were completed (N=1293; mean=1.98, standard deviation=1.87) with the mean difference of 0.85*** (standard error=0.19, ***p<0.01). For the sub-sample with information for targets’ advisors, the deals that were cancelled (N=86) also had a significantly higher number of advisors (on average, 2.17 with standard deviation of 1.2) than the deals that were completed (N=582; mean=1.78, standard error=1.26) with the mean difference of 0.39*** (standard error=0.14, ***p<0.01). Furthermore, when I included the number of advisors for buyers and targets as controls in the duration models, the coefficient was positive and significant at the 1% to 5% levels, suggesting that it takes longer to complete a deal with more advisors (the main results did not change significantly).
Sixth, I examined whether the target company belonged to a strategic industry (see the description of this variable in the matching analysis above). The indicator variable for Strategic industry was not significant in either model, while the other results were materially equivalent. I continued to use the variable for the matching analysis and dropped it from the other models to preserve parsimony.

Seventh, the base comparison group for the CSR measures is the companies with no information on CSR and companies with an equal number of endorsing and challenging articles about CSR. In additional analysis I tried to split these groups into two and run the analysis, where the only base group for comparison is the companies with no information on CSR: the results hold and even gain more significance (e.g. for Minority negative).

Finally, even though this significantly decreased my sample size due to missing data, and such data was not available lagged, I checked whether my results are robust to introducing firm-level performance controls (i.e. size in terms of revenues, Return on Assets, and age) and whether firms with information on CSR (All positive, Mixed negative, All negative) are significantly ‘better’ than those without. The results withstood this test; moreover, firms with Mixed negative CSR (not All positive CSR, as that would be a concern about higher quality firms engaging in CSR and succeeding abroad) were of better ‘quality’ than others (see Appendix E for further details).
4.4 Discussion and conclusions

4.4.1 Discussion

Success in international expansion has generally been studied after the firm entered a host country. What has received less attention is the pre-entry stage that is crucial for the completion of the global expansion strategy and is vulnerable to legitimacy judgments by host country actors. This study evaluates M&As as the mode of international expansion, focusing on the completion of the deal and the duration till completion after the announcement of the deal as measures of success. Over the past few decades approximately one in five takeover bids have ultimately been abandoned (Wong et al. 2001); while deal abandonment and prolonged deal-making are associated with substantial costs, such as upfront financial and termination fees, time, diversion of managerial attention (Dikova et al. 2010), and damage to the reputation and credibility of the firm (Luo 2005).

I study cross-border acquisitions by EMMs from BRICS – firms that face low home country legitimacy abroad – in order to advance the multidimensional model of legitimacy. It is important to understand what factors can counter the illegitimacy discount that EMMs have to pay due to their origin when expanding abroad because BRICS’ share of world cross-border deals has risen above 20% in 2011\(^7\) and is set to grow further. Moreover, strategy studies show that this discount is significant, as EMMs

\(^7\) Source: http://www.economist.com/node/21548965
face substantial IPO underpricing in developed economies, particularly if they come from countries with lower levels of economic freedom (Bell et al. 2008). In part, this disadvantage becomes less of a constraint once firms expand the international scope of their operations (Bell et al. 2008). However, to achieve success in international expansion and overcome the potentially harmful sentiment toward their country of origin, EMMs may need initial legitimacy with relevant host country actors, particularly in the pre-entry stage of cross-border M&As.

I argue that to overcome low home country legitimacy when they expand abroad, EMMs may benefit from developing another dimension of legitimacy at home – in particular, social legitimacy that stems from their CSR engagement. By pursuing nonmarket strategy at home, firms meet the expectations of two main nonmarket actors in the host country that create hurdles leading to deal abandonment – opposition from target employees and regulators (Meyer et al. 2008). Social legitimacy can help fill the legitimacy vacuum (Dobrev et al. 2010) by persuading these two groups of nonmarket actors that the socially responsible actions of the acquiring firm will transfer to the host country. In particular, home-country CSR will ease barriers to foreign entry by making nonmarket actors believe that the acquiring firm will not send jobs abroad, build environmentally harmful facilities, avoid paying taxes, or engage in illegal practices in the host country.
I find support for these arguments using a robust set of analyses, including instrumental variables and matched sample of completed and cancelled deals. Overall, EMMs with some negative news about their CSR engagement at home are less likely to complete cross-border deals and take longer than firms with no information about CSR (or exclusively positive information). This is consistent with the CSR literature predicting that because negative events/news have a greater capacity to arouse the firm’s observers (Lange et al. 2012) the negative perceptions of social irresponsibility have a greater impact on nonmarket actors, and thus, the outcomes of their review of the deal. Matching of cancelled and completed deals also shows that deals by EMMs that have only positive information about their CSR at home are five times more likely to be completed than the same deals by EMMs with no such information. Interestingly, the coefficient on exclusively negative information is not significant for completion but it is significant and positive for duration, suggesting that when such firms complete deals, the fact that their CSR is viewed negatively will prolong deal making. One explanation for this result could be that these firms have other sources of legitimacy or competitive advantages that ensure success of their international expansion\textsuperscript{28}. Another intriguing result is that “all positive” news has a significant effect on completion (Model 3) but not on duration. This can be explained by the different reaction of nonmarket actors to uniformly positive CSR news about the EMM: nonmarket actors may not unanimously

\textsuperscript{28} A test of mean differences on financial performance indicators (excluded from regressions due to missing data) in fact shows significant differences by capitalization, profitability, and size
react to all positive news and may take longer to verify this exceeding any expectations signal, or react faster by trusting it. Either way, the firm with all positive news about CSR is more likely to complete the deal, as the result from Model 3 demonstrates, but the time to complete it is not significantly different from firms with no news about CSR. However, with ‘red flags’ (i.e. negative news about CSR) it takes significantly longer for review of the deal by nonmarket actors to be complete than for firms with no information about CSR. Overall, the evidence supports the main hypotheses.

In addition, I argue and find moderate support for the hypothesis that the benefit of CSR-based social legitimacy will be greatest in settings where home country legitimacy is lowest, that is, in EMMs’ expansion to traditional developed markets as opposed to other emerging markets. This finding suggests that the salience of home country and social dimensions of legitimacy can fluctuate across different institutional environments. Moreover, that the antecedents of legitimacy vary depending on the nature of the institutional environment – that of the developed versus emerging markets.

4.4.2 Conceptual contributions

The main theoretical contribution rests in the idea that different types of legitimacy may condition the effects of each other on performance. This contribution is relevant for three literatures.
First, I expand the neo-institutional literature by understanding the interaction between the different sources of organizational legitimacy, and examining the relevant criteria by which the legitimacy perception is formed by different audiences. Multiple authors have argued that different forms of organizational legitimacy can arise from different actors, with different impact on business activity and performance (Deephouse et al. 2008; Earle et al. 2010). To date, however, few studies have developed either the conceptual or empirical base of this argument. The approach to assessing the double edge of legitimacy (Ashforth et al. 1990) taken in this chapter addresses these gaps by raising important conceptual questions: How does organizational legitimacy stemming from different sources affect organizational outcomes? In particular, when do the different types of legitimacy substitute each other? The results of this study support the multidimensional view of legitimacy (Ruef et al. 1998), suggesting that despite low home country legitimacy developing a different dimension of legitimacy (in this case, by engaging in CSR) is beneficial to success. In addition, I demonstrate that the salience of different dimensions of legitimacy can vary across different institutional environments.

Second, the findings in this chapter are important for strategic CSR/nonmarket strategy literature. I indirectly test the argument that CSR creates intangible assets that help organizations overcome nationalistic barriers and facilitate globalization (Gardberg et al. 2006). More directly, I add access to international markets to the list of strategic benefits of CSR, augmenting prior work on the U-shaped relationship between CSR and
financial performance (Barnett et al. 2012), access to finance (Ioannou et al. 2013), and favorable analyst recommendations (Ioannou et al. 2010). In addition, the literature is only starting to examine CSR in the context of emerging markets (Dobers et al. 2009; Lim et al. 2012; Visser 2008). The empirical analysis in my study shows that CSR is context-specific in these markets (e.g., to identify socially responsible activities in South Africa, I had to use the search term “black” – for Black Economic Empowerment). Moreover, even among the BRICS countries, there is significant variation in how governments treat CSR: while engagement is still mainly voluntary in many settings, some countries start issuing mandatory policies for some sectors of their economy (e.g., the Chinese government issued a mandatory decree in 2008 called “CSR Guideline for State-Owned Enterprises”; meanwhile, Black Economic Empowerment laws apply to many firms in South Africa).

Finally, I contribute to the international business literature. I demonstrate the role of home country and social legitimacy in international expansion, developing insights on the criteria by which EMMs are judged abroad, understanding what CSR means in emerging markets, and how EMMs can overcome initial barriers to entry. There is a growing body of literature on the various liabilities that I call low home country legitimacy – i.e. liability of origin (Ramachandran et al. 2010), liability of home (Stevens et al. 2012) – that increase the costs of doing business abroad, particularly for EMMs (Pant et al. 2012). The contribution to this literature lies in the examination of pre-
entry conditions and processes that help deal with these liabilities, and in particular, help enhance the success of cross-border M&As.

4.4.3 Managerial Implications

The practical implications of this study are important for leaders of EMMs seeking to invest in developed and developing economies as well as for managers of developed country multinationals. I show that doing business within the principles of CSR at home helps EMMs avoid potential setbacks when expanding abroad into host countries. The results of this study are generalizable to firms in developed countries as well as in emerging markets for two reasons. First, because of the increasing role of sustainability not only in the viability but also in the ultimate value of the M&A deal – which has been recently demonstrated by deals in several industries, including energy and retailing, primarily thanks to the role of government regulation and tax incentives that increasingly become easy to monetize (Deloitte 2009). Second, because in the realm of international trade, CSR has emerged as a vital modus operandi on which failure and success often hinge: operating ethically and transparently is essential to earning a social license to trade, extract, procure, or sell29.

Moreover, the results of this study are important to managers and public policy-makers in emerging markets because of increasing globalization. Due to the institutionalization of patterns of accepted behavior and the ever-interconnected

multinational clients and regulatory bodies, the electronic and print media, educational institutions, professional accreditation, and international consulting firms, EMMs will find themselves operating in national environments that increasingly resemble each other (Rosenzweig et al. 1991). Because the challenges around CSR are progressively universal, the ability to adapt to, and successfully negotiate, the cultural references, standards, and practices of developed markets (such as CSR) is critical to EMMs’ success abroad; in addition, it may ultimately have spillover effects in the home country, leading, in the longer term, to harmonization of standards upwards (Sauvant et al. 2010: 16).

The results of this study suggest that being a good corporate citizen at home may at least partially substitute for low home country legitimacy abroad, particularly when expanding to developed markets. For managers of firms in emerging markets that in the next decade will be constantly evaluating various options for international expansion, such as listing shares on a foreign stock exchange, exporting, investing abroad through M&A or greenfield investment, or partnering with developed country firms (at home or abroad), the recommendation to invest in CSR will remain as cross-border M&As are one but easiest mode of expansion.

4.4.4 Limitations and future research

The study has limitations that suggest directions for future research. Further studies can evaluate other modes of international expansion such as greenfield and
alliance activity; could examine other measures of the success of international expansion such as financial performance, stock exchange returns on the M&A announcement, and the likelihood of survival; and could investigate other sources of organizational legitimacy, such as legitimacy spillovers from foreign or state investors, foreign partners, other organizational practices that meet the norms and expectations of some group of relevant actors in the host country.

For example, previous research showed that survival and profitability of foreign subsidiaries in host countries are enhanced by MNE’s intangible assets in the home country, and even though host country experience positively influenced survival likelihood, only its interaction with the firm’s ability to exploit intangible assets positively affected subsidiary performance (Delios et al. 2001). This suggests that even regardless of prior experience (which many EMMs lack in international expansion), intangible assets (such as home-country CSR-based legitimacy) can enhance survival and profitability of foreign subsidiaries. This provides further direction for research; obtaining data on financial performance, however (particularly at the subsidiary level) is difficult for EMMs. Due to missing data, as well as because I am interested in completion and duration till completion (rather than investigating the financial performance of M&As), I exclude financial information from the main analyses (I note that prior literature also typically does not control for the effect of financial performance on these outcomes, even though I provide a limited analysis in the appendix).
Nonetheless, future research could link financials with completion and duration outcomes or make them the sole focus of study.

Another limitation of this study is that I examine the concept of home country legitimacy empirically only through home country fixed effects; future research could draw from the literature on institutional or cultural distance to measure home country legitimacy along a continuum. Furthermore, future research could examine legitimacy and performance of target companies: if targets lack legitimacy in the host country, the review of cross-border M&A by an illegitimate EMM may be not as diligent or difficult to pass. Though I find that the rate of cancelation of M&A deals was significantly higher after the financial crisis, suggesting that the review has not become easier, even with so many struggling firms.
5. Two Coins in One Purse? The Interaction Between Social and Market Legitimacy in the Dow Jones Sustainability Index

This chapter considers the interplay between two dimensions of organizational legitimacy: financial market legitimacy arising from a firm’s alignment with the norms and values of financial market actors and social legitimacy stemming from the firm’s alignment with the norms and values of nonmarket actors. Using a large-scale financial event study of additions and deletions by Dow Jones Sustainability Index, we demonstrate that firms with higher financial market legitimacy benefit less from increased social legitimacy and lose less from decreased social legitimacy. We contribute to the neo-institutional literature by highlighting that different dimensions of legitimacy, stemming from different organizational audiences, can substitute for each other in influencing organizational outcomes.

5.1 Literature Review

5.1.1 Introduction

Institutional scholars have long argued that organizations can gain access to scarce resources by aligning their means and ends with societal values, thereby creating organizational legitimacy (Meyer & Rowan 1977; Meyer & Scott 1983; Parsons 1960; ...)

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1 This chapter was written as a research paper with Aaron Chatterji and William Mitchell
Stinchcombe 1965). The neo-institutional literature has studied how organizations acquire, maintain, and repair organizational legitimacy (Ashforth & Gibbs 1990; Barley & Tolbert 1997) and, in turn, the benefits that legitimacy bestows upon organizations, including survival, predictability, growth, and profitability (Bansal & Clelland 2004; Corbett et al. 2005; Dobrev & Gotsopoulos 2010; King et al. 2005; Ruef & Scott 1998). While neo-institutional researchers have recently started to distinguish between different dimensions of organizational legitimacy that arise from variation in norms and values across different social systems (Deephouse & Suchman 2008; Earle et al. 2010; Greenwood et al. 2002), a gap still remains in understanding when different dimensions of legitimacy are substitutes or complements. This gap in the literature precludes a comprehensive understanding of how organizations acquire, maintain, and repair legitimacy, because it is unclear how much organizations should invest in different dimensions of legitimacy and how much disparate audiences can influence firm performance (Ashforth & Gibbs 1990). We argue that legitimacy that arises from different types of actors will often substitute for one another in influencing organizational outcomes, such that organizations with high levels of legitimacy on one dimension will gain less and lose less following changes in another dimension.

We focus on two dimensions of organizational legitimacy – social legitimacy that stems from nonmarket actors and financial market legitimacy (for brevity, we will also refer to financial markets legitimacy as market legitimacy) that stems from market
actors. We argue that organizations with higher financial market legitimacy will gain or lose less from changes in social legitimacy, in comparison to organizations with lower market legitimacy. As we define in greater detail below, financial market legitimacy is market actors’ perception of how well a firm fits with norms and values of financial markets (Certo 2003; Rao et al. 2001), while social legitimacy is the perception that nonmarket actors hold of how a firm’s actions fit with the norms and values of acceptable behavior in the larger social system (Dowling & Pfeffer 1975; Bansal & Clelland 2004). The difference between market and nonmarket actors rests in the nature of intermediaries and characteristics of firms’ interactions with the environment (Baron 1995). Market interactions are intermediated by markets or private agreements, typically voluntary in nature such as economic transactions and the exchange of property, that create value by improving economic performance; market actors include executives, investors, analysts, brokers, and others who actively assess an organization’s economic activity (Zuckerman 1999). Nonmarket interactions are intermediated by government, media, public institutions, and other stakeholders, voluntary or involuntary in nature, that create value by improving multiple dimensions of performance (Baron 1995; Wood 1991); nonmarket actors include regulators, employees, non-governmental organizations, and the local community who rely on a wider system of criteria when evaluating organizational legitimacy (Bonardi et al. 2005).
In distinguishing between social and market legitimacy, we draw from and contribute to the neo-institutional literature, which suggests that the two types of legitimacy reflect potentially contradictory values and expectations (Ashforth & Gibbs 1990; Deephouse 1999; Dobrev & Gotsopoulos 2010) that arise from two non-overlapping organizational constituencies (Hybels 1995). Dowling and Pfeffer (1975: 122) argue that firms gain social legitimacy from “the congruence between the social values associated with or implied by [firms’] activities and the norms of acceptable behavior in the larger social system,” such as human capital development, health and safety, and environmental sustainability (Delmas & Toffel 2008; Terlaak & King 2006). In parallel, firms obtain market legitimacy when their actions are desirable, proper, and appropriate within the system of norms, values, beliefs, and definitions of market actors (Cohen & Dean 2005; Friedman 1970; Hirsch 1975; Pfeffer 1981; Westphal & Zajac 1998). As part of general society, market actors will care about social legitimacy, including the social impact of firms’ economic activity. Because market actors have particular interests in the future viability of a firm as an economic agent, however, they use different criteria from nonmarket actors when evaluating organizations (Hybels 1995; White 2001). This study addresses market legitimacy that arises from meeting the norms and values of financial markets, particularly market actors’ perceptions of a firm’s future financial viability.
We study social legitimacy that stems from evaluations of firms’ corporate social responsibility (CSR) activities in the form of addition or deletion by a social index. For over four decades, using multiple terms for this concept, scholars have argued that CSR activities confer legitimacy. Schlusberg (1969: 65) suggested that “corporations can strengthen their bases of legitimacy by accepting a judicial review of their public role,” for instance, while Sethi (1979) argued that economic and legal criteria are necessary but not sufficient conditions of corporate legitimacy. We regard CSR as a source of social legitimacy, and social indices that provide external validation and evaluation of a firm’s CSR activities as social legitimacy agents (Durand & McGuire 2005). Social indices, such as FTSE4Good, the Kinder, Lydenberg, Domini, and Company Inc. Index (KLD), and the Dow Jones Sustainability Index (DJSI), seek to verify that a firm’s goals and actions align with societal values such as environmental sustainability, labor and human rights, anti-corruption practices, and community engagement. In doing so, they provide meaningful signals of social legitimacy. Moreover, because the indices use these criteria to decide whether to add or drop firms from their lists, social indices serve as mechanisms that articulate changes in social legitimacy to the market.

We explore the interplay between social and market legitimacy in a natural experiment by considering the impact of being added and subsequently dropped from the DJSI. We argue that changes in social legitimacy, as reflected by addition or deletion from the DJSI, will have less impact on the economic value of firms with greater market
legitimacy, as reflected by stronger indicators of the future financial viability of the firm. We test this argument with a financial event study that addresses the potential endogeneity that arises in many CSR studies (Margolis et al. 2007). Although recent CSR studies test the impact of additions and deletions from a socially responsible index (Consolandi et al. 2009; Lackmann et al. 2011; Robinson et al. 2011), even in light of prior financial performance and CSR reputation (Doh et al. 2010), they find inconsistent results (Michlik & Rubash 2011) and do not clearly outline when and why CSR matters. We contribute to CSR literature by explaining this effect and finding consistent impact for both additions and deletions. We demonstrate that even though additions to social indices articulate increased social legitimacy and deletions indicate reduced social legitimacy, investors interpret the events differently for firms with different levels of financial market legitimacy. Firms with higher levels of market legitimacy gain little from increased social legitimacy and, in turn, pay lower economic penalties for reductions in their social legitimacy.

More generally, our study contributes to the neo-institutional literature by examining how two main organizational audiences that assess a firm’s legitimacy interact in affecting its value. Scholars have mainly studied legitimacy as a static uni-dimensional phenomenon, typically dichotomous in nature: whether a firm possesses it or not (Deephouse & Suchman 2008; Pfeffer & Salancik 1978). By moving away from this static uni-dimensional view toward a dynamic multi-dimensional model of legitimacy
(Ruef & Scott 1998) we show that legitimacy to one audience may not mean legitimacy to another (Deephouse 1996); moreover, legitimation by key organizational constituencies may have either a positive or negative impact on legitimacy at the same time (Hybels 1995). Therefore, one type of legitimacy may substitute for another in affecting organizational outcomes. This conclusion has strategic implications.

Organizations can gain legitimacy by conforming with institutional myths (Meyer & Rowan 1977) and/or by strategically manipulating environments (Deephouse 1996, 1999; Gimeno & Woo 1996). If one type of legitimacy substitutes for another, organizations can work to gain both types so that when they lose one, the other saves them from a crisis of legitimacy.

### 5.1.2 Different Sources, Outcomes and Dynamism of Organizational Legitimacy

Organizational legitimacy scholars have conceptualized legitimacy as both a process and a state (Deephouse 1996). As a process, legitimation comes from constituencies through conferral of resources and communication of good will (Hybels 1995). As a state (i.e., property), legitimacy results from legitimation and thus reflects changes in legitimation over time (Navis & Glynn 2010): while some constituencies may confer resources on the organization, others may withdraw or reduce their support (i.e., the paths of communication and resources each may have either a negative or positive effect on legitimacy). Moreover, even though legitimacy is said to stem from institutionalized norms and values, social systems change over time and consist of
multiple institutions (Hybels 1995). Therefore, we refer to greater and lower levels of legitimacy to identify these changes over time as well as the variance in certainty and security of legitimacy – in the sense that a firm may become “more legitimate” by becoming more clearly legitimate, more firmly legitimate, and/or more legitimate to more audiences in more of its activities (Deephouse & Suchman 2008).

Neo-institutional scholars generally view greater organizational legitimacy as a source of organizational success. As Meyer and Rowan (1977: 352) put it, “Organizational success depends on factors other than efficient coordination and control of productive activities: organizations that incorporate socially legitimated rationalized elements in their formal structures maximize their legitimacy and increase their resources and survival capabilities.” More recently, scholars have demonstrated that greater legitimacy can be a critical resource that helps organizations gain access to other resources, such as alliance partners (Dacin et al. 2007), new capital and market opportunities (Lounsbury & Glynn 2001), and human, financial, and intellectual resources (Zimmerman & Zeitz 2002). These resources, in turn, provide economic value for the firm, so that greater legitimacy provides a pathway to superior financial outcomes, such as increased sales, greater profits, and stronger market valuations.

Given the dynamism of organizational legitimacy (Deephouse & Suchman 2008), it is important to distinguish between its different sources (for the most recent overview see Bitektine 2011). The existing literature suggests two sets of key evaluators that
provide different sources of organizational legitimacy: general society and more focused financial markets (Baron 1995). The distinction between these sources of legitimacy reflects the long-standing debate in the literature rooted in the tension between business and society, whereby Friedman (1970) claims that the main responsibility of business lies in meeting shareholders’ financial expectations, while Freeman (1984) highlights a much broader set of relevant stakeholders (e.g., employees, customers, partners, and communities) and argues that, by meeting stakeholder demands, organizations can become more successful. While previous literature has generally considered these different sources of legitimacy independently, we will discuss how they can jointly affect organizations. First, we need to draw boundaries between the concepts; in doing so, we will distinguish between two key sources and evaluators of organizational legitimacy – nonmarket and market actors – and the basis and potential effects of their judgments.

5.1.3 Social legitimacy

One type of organizational legitimacy, which we refer to as social legitimacy, arises from activities that address broad social forces. Scholars have discussed these social forces in three related ways. First, in light of normative and moral legitimacy, broad social forces reflect suppositions of collectively valued purposes, means, and goals (Meyer & Rowan 1977). Second, as value challenges, broad social forces place the organization’s mission and legitimacy for existence at issue, regardless of how well it has fulfilled its own goals; e.g., some social forces view industries such as tobacco,
gambling, alcohol, and nuclear as immoral (Hirsch & Andrews 1984). Third, broad social forces affect organizations through socio-political legitimacy when stakeholders, the general public, key opinion leaders, and government officials accept a venture as appropriate given existing norms and laws (Aldrich & Fiol 1994: 648). Because broad social forces arise in multiple contexts, social legitimacy involves evaluation by multiple audiences, including media (Bansal & Clelland 2004), regulators (Singh et al. 1986), advocacy groups (Rao 1998), and organizational insiders (Kostova & Zaheer 1999).

However broad such social forces are, firms gain social legitimacy from two main sources (Suchman, 1995; Dacin et al. 2007): institutional and strategic. Institutional sources of social legitimacy include cultural factors beyond the control of any one firm and to which a firm simply needs to respond – for example, by tailoring environmental actions to conform to sustainability values. Strategic sources include more focused social engagements that firms can control, such as choosing which, if any, charity organizations to contribute to; such activities, in turn, can raise the social profile of the organization. Whether institutional or strategic, achieving consistency and credibility with these sources of social legitimacy contributes to a firm’s societal alignment. As a result, such firms are often able to attract social resources from a wide range of actors, including preferential tax treatment, highly motivated employees, subsidies, preferential contracts, regulatory support, loyal customers, volunteers, and other valuable resources.
5.1.4 Financial market legitimacy

The second type of organizational legitimacy, which we refer to as financial market legitimacy, arises from a narrower range of activities by which organizations align with the norms and values of financial markets. Market legitimacy is evaluated by financial market actors, such as analysts (Certo 2003) and investors (Rao et al. 2001). Previous literature has assessed market legitimacy through three lenses. First, as pragmatic legitimacy that results from demands for what Meyer and Rowan (1977) call rational effectiveness, whereby actors require tangible data for their decisions (Suchman 1995). Second, as performance challenges that occur when relevant actors believe that organizations have failed to execute the purposes for which they are chartered and claim support (Hirsch & Andrews 1984), including achieving expected economic performance. Third, as technical efficacy whereby tangible organizational outputs reflect a firm’s ability to fulfill an evaluating audience’s material needs (Love & Kraatz 2009), including producing superior products and delivering superior financial results (Shapiro 1982, 1983).

The sources of financial market legitimacy lie in frames of reference that arise from market actors’ (intendedly) rational cognitive maps, objective data, and empirical reality testing (Shrivastava 1987). The emphasis on rationality, objectivity, and empiricism enables management to understand and defend the organization’s performance, regardless of its underlying social values (Ashforth & Gibbs 1990).
Objective data provide market actors with a concrete basis for judgment of the company as an investment target, whereby market actors demonstrate their endorsement of an organization through investment, loans, and ongoing support by analyst recommendations and ratings. Market legitimacy arises from multiple sources of judgment that together form market perceptions of the future financial viability of the firm. Relevant indicators of future viability include historical track records and current performance measures, as well as credit quality and forecasts of future growth.

To be able to make judgments about market legitimacy, the economic environment expects objective financial outcomes, especially profitability (Hirsh 1975; Pfeffer 1981). Profitability reassures investors that the firm is markedly viable and worth supporting. In addition, market legitimacy can arise from more subjective indicators, such as innovativeness, cost effectiveness, expected growth, and technical efficiency, which shape expectations about future financial performance (Shapiro 1982; Love & Kraatz 2009). Such indicators influence investors’ and other market actors’ perception of a firm both directly and indirectly via market analysts’ ratings and recommendations (Westphal & Clement 2008). As a result of a proven record of success and expectations of future financial viability, firms gain market legitimacy - a form of endorsement from the market that helps them attract investment and financial support.

In sum, the neo-institutional literature suggests two types of organizational legitimacy, which we refer to as social and market legitimacy. By social legitimacy, we
mean generalized perceptions and assumptions that the actions of a firm are desirable, proper, and appropriate within societal systems of norms, values, beliefs, and definitions. By market legitimacy, we mean generalized perceptions and assumptions that the same is true within financial market actors’ systems of norms, values, beliefs, and definitions. The main difference between social and market legitimacy lies in the institutional environments in which they are embedded: Broader social arenas versus more specific economic contexts. In the social environment, legitimacy reflects responses to cultural pressures, potentially by engaging in socially and environmentally responsible activities. In the financial market environment, legitimacy arises from producing expectations of strong financial performance. As we discuss later, we use a multi-dimensional approach to measuring both types of legitimacy. A distinction between them lies in the fact that many of the measures of current and future financial performance that are the basic criteria by which market actors decide whether to support a firm in the future are not immediately obvious to nonmarket actors who are assessing social legitimacy, so perceptions of social legitimacy and market legitimacy can arise independently of each other.

\(^2\) Market and social legitimacy parallel the concept of reputation. Rindova, Pollock and Hayward (2006: Table 1) define reputation as “the perceived ability of the firm to create value for stakeholders” based on firms’ strategic choices and outcomes (signaling theory), which they contrast with legitimacy – a “fit with normative values and beliefs” based on external validation from multiple sources (institutional theory). Taking these definitions, one could view social and market legitimacy as perceptions by nonmarket and market actors that a firm’s actions and performance create a reputation for delivering the types of value that the actors care about. Even with such overlap in definitions, the legitimacy concepts help distinguish between different values and types of actors.
5.1.5 Relationship between Social and Market Legitimacy

Although independent as conceptual properties that audiences confer on an organization, social and market legitimacy may affect each other. Social legitimacy can help firms garner resources that lead to greater profitability, which in turn may generate market legitimacy. In turn, market legitimacy can create future social acceptance; for instance, technically innovative firms can help attract new social resources. Examples include Nokia’s ability to garner support from the Finnish government, Skoda’s ability to attract high-quality labor, and Apple’s ability to gather regulatory support for its expansion initiatives.

Despite the potential inter-relationships, firms may have different levels of social and market legitimacy at any point in time, for both strategic and environmental reasons. Strategically, firms may benefit from differences in their levels of social and market legitimacy. For instance, strategic balance theory suggests that firms should seek to be as different from each other as legitimately possible because, although they can benefit by conforming to social norms, firms need to differentiate from each other in order to achieve superior profitability (Deephouse 1999). Additionally, conformity with societal rules and norms may or may not be consistent with short-term profit maximization (Dacin et al. 2007). For instance, firms that provide superior employee benefits or closely adhere to or surpass environmental regulations may suffer at least short-term losses relative to less socially responsive competitors. In reverse, firms that
become perceived as being too successful financially may lose social legitimacy and come under increasing regulatory scrutiny and social challenges; examples include IBM in the 1970s, Microsoft in the 1990s, financial institutions during the global crisis in 2009, and potentially Google in the next decade. Zuboff and Maxmin (2002) argue that gaps in legitimacy that arise from the clash between social and economic environments have long existed; indeed, such conflicts may be inherent to corporate activity. Recent highly visible corporate crises, such as the economic recession and the Gulf oil spill, highlight this tension between the expectations about social actions and economic performance.

Beyond any strategic considerations, gaps between social and market legitimacy can arise from environmental dynamism. As focal organizations undertake activities and other groups shape the environments that determine relevant norms of legitimacy, both forms of legitimacy, as cultural constructs, may vary at different temporal rates. What is expected and accepted as norms in terms of labor and environmental practices today may vary over time, for instance, leading to changes in social legitimacy; expectations about unionization, pollution, and alcohol advertising in North America differ strikingly in the 2000s from the 1950s and 1960s. In parallel, different expectations about appropriate financial levels and/or views on the importance of innovativeness may stem from changing norms of market legitimacy. For instance, pharmaceutical companies achieved substantial financial market legitimacy in the 1980s if they reached financial targets of 8% to 10% return on sales; if a pharmaceutical executive announced that the
company was seeking profitability at that level today, she or he would be fired because expected levels of profitability now exceed 15% to 20% return on sales. Furthermore, a specific action may be considered legitimate at one time under one set of circumstances and illegitimate at another. During the past quarter of the century, for example, pig farms in eastern North Carolina have moved from being socially desirable businesses to being social outcasts. Table 12 illustrates examples in which social and market legitimacy may co-exist and/or conflict.

The core point is that each form of legitimacy is a dynamic concept that can vary independently. Whether due to strategic actions of a firm or changes in the legitimacy environment, legitimacy can increase or decrease at any time. Given this dynamic effect, the different types of organizational legitimacy may substitute for each other. For instance, if a firm already has a substantial level of market legitimacy, growth in social legitimacy may provide limited incremental value. If it loses social legitimacy, however, the market legitimacy may create a buffer for losses. Thus, the dichotomy of social and market legitimacy as two dimensions of organizational legitimacy may come together in affecting organizational outcomes. We now elaborate upon the mechanisms through which this effect takes place.
### Table 12: Examples of Social and Market Legitimacy

<table>
<thead>
<tr>
<th>MARKET LEGITIMACY</th>
<th>SOCIAL LEGITIMACY</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH</td>
<td>Wal-Mart: Socially, the environmentally conscious community has applauded Wal-Mart’s recent launch of the Sustainability Index to assess its suppliers, pushing them to become greener (e.g., adopting zero-waste policies). Markedly, the company achieved $14.3 billion in earnings in 2009. Starbucks: Socially, Starbucks provides benefits for its employees, supports small coffee farmers, and does business in an environmentally aware manner through actions such as reducing waste with recycled paper sleeves instead of double-cupping. Symbolically, Starbucks has been included in The CRO’s “100 Best Corporate Citizens” list for all nine years of the list’s existence. Despite the financial crisis, Starbucks has seen its profits triple in 2010 over 2009, and 2009 over 2008. Whole Foods Market: Whole Foods gains social legitimacy from a mission that supports employee needs (including caps on management compensation, an open-book policy on pay, and benefits that workers can vote on), green initiatives, and non-profit organizations such as the Animal Compassion Foundation and the Whole Planet Foundation. Markedly, in May 2010, Whole Foods reported that 2nd-quarter profit more than doubled from a year ago while its stock was up 83% since May 2009, compared with the 29% gain for the S&amp;P 500 Index.</td>
</tr>
<tr>
<td>LOW</td>
<td>Many social enterprises struggle to achieve market legitimacy: 71% of social enterprises lose money, even without factoring in indirect costs that their parent nonprofits cover (Casselman 2007). Examples include Girls on The Run in North America, FareStart in Seattle, Trosa in North Carolina, St. Patrick Center in St. Louis, Housing Works in New York, Rubicon Programs in California, and Kidslink in Ontario. Nonetheless, such organizations have strong social legitimacy that helps attract resources that allow them to survive. Fannie Mae and Freddie Mac had substantial losses during the recession ($72 and $21.6 billion in 2009), but were able to obtain $145 billion in government funding owing to the social stature. Many companies have lower social and market legitimacy. For instance, the social legitimacy of Fannie Mae and Freddie Mac has shrunk to the point that they were recently suspended from trading on the NYSE. AIG (with a loss of $10.9 billion in 2009) and GMAC (with a loss of $10.3 billion in 2009) have suffered public and regulatory discontent about their role in the recent financial crisis. Enron failed because it had a major decline in both social legitimacy (from publicity about illegal practices) and market legitimacy (from financial losses).</td>
</tr>
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5.2 Hypotheses

5.2.1 Hypotheses development

We start by considering how market legitimacy conditions the degree to which economic value changes with increases in social legitimacy. We focus on changes in economic value because firms and many stakeholders care deeply about financial performance and factors that shape it as it ensures growth and survival. Two mechanisms are relevant for our argument: (1) the incremental economic impact of increased social legitimacy for firms with greater or lesser market legitimacy, and (2) the relative clarity of the two forms of organizational legitimacy.

First, consider the incremental impact of increased social legitimacy for firms with greater or lower market legitimacy. Firms that possess higher market legitimacy, at least in countries with active financial markets, labor markets, and other elements of business infrastructure, have substantial competitive advantages. In addition to their ability to support their existing activities, such firms will be able to garner resources they need to reinforce their business or to expand into new activities. Hence, additions to social legitimacy provide only limited incremental value, because the firms can already gain access to most resources that they need. By contrast, firms with lower market legitimacy often struggle to gain access to new resources. In such cases, increases in social legitimacy provide an alternative route to attracting investment, personnel, regulatory support, and other resources in order to sustain existing operations or
develop new activities that they would otherwise struggle to obtain by relying solely on their market position. Therefore, investors will expect increased social legitimacy to provide greatest incremental economic benefits when firms have lower market legitimacy.

Second, consider the relative clarity of social and market legitimacy. The value of social legitimacy to the market will often be more ambiguous than that of market legitimacy, particularly when market legitimacy arises from financial performance, because social indicators often provide ambiguous forecasts of a firm's future viability (Power 1997). Ambiguity about the value of social legitimacy occurs for two reasons. First, investors may recognize the potential economic value of social legitimacy, but they are often uncertain about whether a firm will be able to use increased social legitimacy to gather new resources or whether the firm will struggle to sustain the benefits. Second, reliable social indicators often are difficult to produce and, even when they exist, are hard to interpret. A firm's own executives are often uncertain about the implications of social indicators. Interpreting the impact of environmental actions, for instance, is highly uncertain not only for executives but also for engineers who undertake them, let alone for investors. The examples in Table 12 demonstrate that social legitimacy is often ambiguous.

By contrast, market indicators provide clearer signals of a firm's value and opportunities (Pfeffer 1981), generating stronger indicators of Meyer and Rowan's (1977)
notion of the ceremonial criteria of worth. Of course, market legitimacy also can be ambiguous. Attempts to innovate often have uncertain implications for future performance, for instance, while measures of current profitability that rely on accounting judgments and profitability forecasts depend on the reliability of market trends and sustainability of a firm’s capabilities. Nonetheless, investors and analysts, as demonstrated in interviews that we conducted as part of this research, commonly find it easier to assess the value of a firm’s market legitimacy than that of its social legitimacy.

The ease of assessing market legitimacy reflects different uncertainties about the value of market and social legitimacy in the sense that the financial indicators that underlie market legitimacy reflect the financial dominant logic of the market (Bettis & Prahalad 1995; Grant 1988; Reay & Hinings 2009). Thus, for financial actors, market legitimacy commonly provides a clearer signal of firm value. Faced with indicators of firm value stemming from social and market legitimacy, investors will commonly follow the clearer signal (Spence 1974). If a firm has higher market legitimacy, investors will often rely on that signal and pay less heed to information from more ambiguous signals of increased social legitimacy.

When market legitimacy is low, by contrast, investors will be more likely to view increased social legitimacy as a meaningful signal of increased opportunities. In such cases, even ambiguous increases in social legitimacy will provide incremental value to stakeholders who have social resources that the firm may benefit from and will in turn
help the firm increase its financial performance. Hence, increases in social legitimacy will have greatest benefit for firms with low levels of market legitimacy.

**Hypothesis 1 (H1): The lower the level of market legitimacy that a firm possesses, the greater the gain in economic value from increased social legitimacy.**

In parallel, based on the logic of incremental value and signal clarity, firms that lose social legitimacy suffer most when they have lower levels of market legitimacy. The instrumental financial logic suggests that firms with strong market legitimacy will attract resources in any case. Investors will often be willing to support a firm that demonstrates strong market legitimacy, even if it visibly undertakes actions that do not align with social norms (Ruef & Scott 1998; Singh et al. 1986). Despite their increasing social disapproval, cigarette companies, for instance, long attracted investment – even from health professionals – because their higher levels of profitability and growth substituted for social legitimacy. Similarly, energy and pharmaceutical companies face regular criticisms of their pricing strategies, environmental practices, political lobbying, questionable engagements in developing markets, and other socially dubious activities. Indeed, energy and pharmaceutical firms consistently fall near the bottom of social reputation indices (e.g., in the tail of the annual Gallup poll of industry image from 2001 through 2011). Nonetheless, many energy and pharmaceutical sector firms have strong financial performance and, as a consequence, possess high levels of market legitimacy.
In turn, such companies easily attract investment and weather challenges to their social legitimacy that would severely damage firms with lesser levels of market legitimacy. In an extreme case, BP has recently suffered massive losses in social legitimacy as a result of the Gulf oil disaster. However, while it has also lost major economic value directly after the spill, the company continues to operate; in 2011 the company announced that it would pay its first dividend since the spill and planned to increase its total investment by $2 billion (Werdigier 2011, February 1). With this in mind, BP will almost certainly survive and attract new investment in the future. Similarly, the pharmaceutical firm Merck continues to prosper, despite major losses in social legitimacy following its withdrawal of the anti-pain drug Vioxx in 2004 due to cardiovascular problems. In contrast, companies with less market legitimacy would not have these survival and recovery chances. Hence, we expect reductions in social legitimacy to have the greatest impact on the economic value of firms with low levels of market legitimacy.

**Hypothesis 2 (H2):** The lower the level of market legitimacy that a firm possesses, the greater the loss in economic value from decreased social legitimacy.

In sum, the hypotheses argue that market legitimacy will condition how changes in social legitimacy affect changes in firms’ economic value. We do not predict a main effect for changes in social legitimacy for three reasons: the core logic highlights the importance of the conditioning effects; the organizational legitimacy literature suggests
positive (negative) returns to increases (decreases) in any types of legitimacy; and other empirical studies have tested the main effects in the context of additions and deletions from socially responsible indices (Cheung 2011; Doh et al. 2010). By contrast, the potential substitution effect between the two types of legitimacy is important to examine for strategic and theoretical reasons. If different sources of legitimacy interact in affecting organizational outcomes, the literature needs to examine the multiple dimensions of legitimacy, the mechanisms by which they are gained, and the ways in which they affect organizations, as well as their co-evolution. We now turn to a specific context of social and market legitimacy, focusing on market reaction to addition and deletion from indices of socially responsible corporate activity.

5.2.2 DJSI and Social legitimacy

5.2.2.1 The Dow Jones Sustainability Index (DJSI)

We examine the interchange between social and market legitimacy by studying how market investors interpret the news of addition to and deletion from a social index. Prior literature considered several mechanisms that confer legitimacy, including community directory listings (Ruef & Scott 1998), public and government endorsement in the media (Deephouse 1996), public approval based on a survey (Elsbach 1994), consistency with laws, filing articles of incorporation, registration with the Securities and Exchange Commission (SEC), and obtaining professional certification (Zimmerman & Zeitz 2002). Organizations lose legitimacy from negative assessments involving
questions, challenges, and rejections (Deephouse 1996; Hirsch & Andrews 1984; Meyer & Scott 1983). In order to gain legitimacy in restricted arenas, management must obtain explicit certification that typically conforms to detailed formal requirements (Suchman 1995). Social indices publicly outline these requirements in the area of CSR and, as social legitimacy agents, certify socially (ir)responsible companies by adding them to (or dropping them from) their lists.

We focus on the Dow Jones Sustainability Index, a key socially responsible index increasingly viewed by firms as a mechanism for generating social legitimacy. To date, however, academic studies have paid more attention to the KLD index: A meta-analysis of 167 CSR studies over 35 years (Margolis et al. 2007) identified no work that examined the DJSI, while we identified only three recent studies using the DJSI (Cheung 2011; López et al. 2007; Ziegler & Schroder 2010).

Despite limited academic attention, four factors make the DJSI a desirable mechanism for assessing social legitimacy. First, unlike KLD, DJSI provides international coverage in both developed and emerging markets; even though KLD has recently launched a new global index, the DJSI provides a more extensive database of international companies since 1999. Second, DJSI is more publicly visible; while KLD licenses their index for a fee and does not openly disclose its changes to the index, the DJSI publishes press releases and reveals the list, including additions and deletions, on its website and to its licensees. Third, as the primary worldwide sustainability
benchmark, a growing number of companies define inclusion in the DJSI as a corporate goal and use benchmarking reports from the DJSI to identify gaps and initiate improvements (SAM 2009). Fourth, many fund managers around the world recognize and value the DJSI. In 2010, DJSI licensees included 88 global institutions in 16 countries with more than $8 billion total investment in the financial products in the index (http://www.sustainability-index.com/07_htmle/other/faq.html); in comparison, KLD’s list included 11 licensees.

To further assess the DJSI as a meaningful mechanism for signaling social legitimacy, we undertook four procedures. First, we examined the media and academic attention to CSR, sustainability, and the DJSI. Second, we considered the criteria for the addition to DJSI and why it is a relevant signal of social legitimacy. Third, we conducted an archival review of reactions to the addition to DJSI by about twenty North American and European companies. Fourth, we interviewed analysts on the importance of social indices in their evaluation.

5.2.2.2 DJSI in Media and Academia

We began our study by calculating several measures that reflect the evolution of the attention that CSR, including its sustainability subcomponent, has received in the social institutional environment in which market and nonmarket actors operate. Following methodology from Bebchuk, Cohen, and Wang (2010), we examined attention both in the media and academic research. Media references and coverage of CSR are
relevant for two reasons: (1) greater attention by journalists may be a mechanism for information diffusion, influencing market and nonmarket actors and leading them to pay more attention to such issues; and (2) journalists talk with and write for market and nonmarket actors, so greater coverage of CSR may be a mechanism for generating greater interest in these issues. Academic research is relevant to market and nonmarket actors because it offers ideas and results that can affect their choices and which issues they pay attention to.

We obtained quantitative measures for the media and academic interest in CSR through searches in Lexis-Nexis and Business Source Complete. Figure 6A plots normalized percentage increase of the media and academic interest in each calendar year from 1998 to 2009, with 1998 being the base year for comparison. This figure plots two time series: (1) the percentage increase of unique newspaper articles, wires, and publications in major world publications with words “sustainability” and “Corporate Social Responsibility”; (2) the percentage increase of academic journal articles with these terms in the abstract of author-supplied keywords (all normalized by their 1998 values). We searched for these two terms because sustainability and CSR are often used interchangeably. All series demonstrate a gradual increase in the attention to sustainability and CSR during the decade. This trend exhibits growing institutional pressure and the potential for social legitimacy, provided by the social indices.
We then examined the attention that media and academics have paid to the DJSI itself. Figure 6B exhibits the same time series of the percentage increase in the number of unique newspaper articles, wires, and publications in major world news outlets that reference the Dow Jones Sustainability Index, and the percentage increase of academic journal articles that reference the index in the abstract of author-supplied keywords, normalized by the 1998 value of zero articles (since the index was founded in 1999). We found a significant escalation in media attention to the DJSI but virtually absent academic interest. This difference points to a persistent gap between practitioners and academics; nonetheless, because academic papers are often published with a significant time lag after research occurs, it is possible that there will be future overlapping interest in DJSI among the media and academia.
5.2.2.3 DJSI and Social Legitimacy

Social indices reflect two processes. First, they define standards for socially responsible practices\(^3\). Second, they provide a system through which organizations can communicate the best use of these standard practices. Thus, they both help set the rules of the game by identifying the criteria and create legitimacy for companies that best fit these rules by ceremonially adding them to the DJSI. While most previous studies have focused on the reasons why firms seek to engage in CSR and what effect it has on firm performance (Campbell 2007; Godfrey 2005; Godfrey et al. 2009; McWilliams & Siegel 2001), few have separated out the mechanisms of why and when CSR matters (Margolis et al. 2007; Orlitzky et al. 2003). We follow the argument that CSR can create intangible assets that help firms by establishing legitimacy and competitive advantage (Gardberg & Fombrun 2006). We also reflect the information literature argument that legitimacy denotes the persistence of quality and, due to economies of information search, commands a price (Stigler 1961). Hence, we argue that the legitimizing effects of the addition to the index will result in economic value.

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\(^3\) DJSI assessment criteria and weightings ([http://www.sustainability-index.com/07.html/assessment/criteria.html](http://www.sustainability-index.com/07.html/assessment/criteria.html)). (1) **Governance**: Codes of conduct/compliance/corruption and bribery (6%), corporate governance (6%), risk and crisis management (6%), industry-specific criteria (by industry); (2) **Environment**: Environmental reporting assessed based on publicly available information (3%), industry-specific criteria (by industry); (3) **Social**: Corporate citizenship/philanthropy (3%), labor practice indicators (5%), human capital development (5.5%), social reporting (3%), talent attraction and retention (5.5%), industry-specific criteria (by industry). The DJSI follows a best-in-class approach, ranking companies against their peers in 57 sectors, selecting the leading 10% from the investable stocks universe of the 2,500 largest capitalized companies in the Dow Jones Global Total Stock Market Index. The index is reviewed annually; listed companies are monitored throughout the year to verify involvement in critical areas. To minimize excessive turnover, the process applies a “buffer rule” in which DJSI members need only to qualify amongst the best 13% to be retained, while new members need to be ranked in the best 7% in their industries.
While being listed on a social index reflects the adoption of socially responsible practices, the opposite logic does not apply. Firms that a socially responsible index does not add to its list may still adopt some or even all of the practices. CSR engagement in practice is an internal organizational act that can go unrecognized; even if firms attempt to release the information, stakeholders may not trust the potentially biased source. Addition to the index, though, is a public act of CSR commitment because in addition to a voluntary action by the firm, it involves an independent and public audit; it is a signal to the market that the organization has fulfilled the ceremonial requirements of the institutionalized myths of inspection and evaluation (Espeland & Sauder 2007; Meyer & Rowan 1977; Sauder & Espeland 2009). Therefore, information about social legitimacy that comes from an independent third party such as the DJSI is credible in the market; moreover, by delineating a list of socially responsible firms, the index saves investors and analysts the costs associated with the search for information. Meyer and Rowan’s (1977) notion of a ceremonial criteria of worth applies to additions to the DJSI, demonstrating an organization’s social fitness and legitimating organizations with internal participants, stockholders, the public, the state, the IRS, and the SEC.

5.2.2.4 DJSI and Companies

Our archival review found that companies actively seek to be added to the DJSI for multiple reasons: to gain reputational and membership benefits, to seek insurance-like protection, to meet institutional pressures and stakeholder demands, to signal to
analysts and investors that they are creating long-term shareholder value, to signify product and company differentiation, and to increase the value and recognition of the company’s brand. Many executives believe that being listed on a socially responsible index will generate financial benefits from investors (who, in turn, expect the increased social legitimacy to attract support from major stakeholders such as customers and regulators). A meta-analysis of CSR studies found modest financial returns to CSR (Margolis et al. 2007); however, few studies examined the economic impact of addition and deletion from a socially responsible index. As we argued above, addition to the socially responsible index demonstrates that firms have satisfied the expectations of social, political, and environmental counterparts and, moreover, have accomplished this in a visible and effective manner. Even if many of a firm’s CSR activities might be known to market actors – and the current stock price might already reflect many of the expected benefits – validation by a credible third party such as the DJSI generates new information that has economic value.

5.2.2.5 DJSI and Analysts

In order to assess whether the DJSI generates meaningful information for investors, we conducted interviews with market analysts about the role of social indices in stock evaluation. We picked 16 additions to the DJSI, representing different industries. Using the One Source Database, we identified analyst reports that included stock valuation, company profile, recommendations, and analysis. We then contacted
analysts involved in preparing these reports in several institutions, including Wachovia Capital Markets, Credit Suisse, HSBC, Deutsche Bank, Société Générale, Cowen and Company, Macquarie Research, CIBC World Markets, RBC Capital Markets, and Oppenheimer. We contacted 3 to 4 institutions per company, approaching analysts based in the U.S. and Europe. During 2009, we sent out 116 interview requests and were able to obtain 12 interviews (we can provide the interview protocol and transcriptions). More than half of the respondents were aware of the social indices, such as the DJSI, and used them or considered using them in their evaluations, supporting the assumption that the DJSI is a meaningful source of social legitimacy.

In turn, many of the respondents recommended contacting equities analysts that focus exclusively on socially responsible investing (SRI). An interview with an SRI analyst in France indicated that at least one third of all socially responsible investors rely on sustainability indexes in their decision-making. The other sources include sustainability reports, annual reports, press, industry association memberships, NGOs, and rating agencies; institutional investors were particularly likely to pay attention to the indices.

For exploratory reasons, we also asked the analysts to comment on why the companies under their coverage would be added to a socially responsible index. The respondents identified four major factors. First, the nature of the product: in some industries, the product itself can be considered socially responsible. The managed care
company Humana, for instance, offered healthcare to minorities and disadvantaged people, which helped increase its share of Medicare business, thereby supporting the business case for CSR. Second, the nature of the industry: firms in the wireless equipment industry such as Motorola, for instance, can be considered “greener” than companies in other technology-related sector because radio waves do not affect human beings (according to current theories of science and physiology) and building wireless systems requires less physical infrastructure than any other type of construction. Third, company leadership: because CSR contributes to corporate reputation in the general merchandise industry (e.g., Wal-Mart, Target, and Carrefour), the former CEO of Wal-Mart, Lee Scott, reorganized the company’s supplier structure by introducing more stringent requirements with the launch of the Wal-Mart Supplier Index. Wal-Mart’s actions, in turn, initiated industry-wide change: for instance, Procter & Gamble redesigned their laundry detergent, making it more concentrated, so that consumers could save water, producers could save plastic and energy, and distributors and retailers could save space. Finally, the industry life cycle can matter; for instance, in the past analysts evaluated CSR issues in the utilities sector (e.g., firms such as EoN AG), but now they pay less attention to such issues because the practices are integrated within the utilities business and analysts pay attention to CSR news only when something goes wrong.
This multifaceted evaluation of the DJSI led us to conclude that the addition to
(deletion from) the index is a credible and observable signal of an element of otherwise
difficult-to-observe social legitimacy, in terms of accomplishments in the area of CSR.
Because many managers that believe in the financial benefits of CSR, the evaluation of
their social legitimacy by third parties provides a way to ascertain that a firm meets
social norms and values.

5.3 Results

5.3.1 Methods and Data

A recent meta-analysis on the link between corporate social and financial
performance (Margolis et al. 2007) recommended that future studies meet four criteria.
First, data about firms’ CSR should consist of reliable measures such as quantifiable
outputs or third-party audits, using assessment processes that are clear and open to
validation. DJSI meets this criterion because it uses an independent organization to
collect and verify company and non-company data, and also undertakes an annual audit
of each firm on the index. Second, studies must control for factors such as geographic
location, industry, risk, size, R&D spending, and advertising expenditures (McWilliams
& Siegel 2000). Our dependent variable, beta excess returns, inherently controls for risk
by representing a difference between the asset’s return and the return on a reference
asset that is assumed to be riskless (Campbell et al. 2007); we also include multiple controls. Third, the direction of causality needs to be theoretically articulated and empirically assessed at different time periods. The event study methodology addresses this concern. Finally, the mechanism by which CSR affects financial performance needs to be articulated. This chapter identifies information and legitimacy aspects of value creation along with mechanisms involving incremental impact and relative ambiguity that help develop a perspective on this relationship.

We use a financial event study with an original dataset of additions and deletions from the DJSI. The event study measures the effect of an unanticipated event on stock prices: The abnormal returns reflect the stock market's reaction to the arrival of new information, where the abnormal returns are calculated by subtracting the expected return for the stock from its actual return (McWilliams & Siegel 1997). If significant, the abnormal return will measure the average effect of the event on the value of the firm; that is, the presence of significant abnormal return allows the researcher to infer that the event had a significant impact on firm value. Inferring significance relies on three assumptions: markets are at least moderately efficient, events were unanticipated, and no confounding effects occurred during the event window. The method helps researchers avoid the use of accounting-based measures of profit, which are weak indicators of actual performance and connect only weakly to individual events.
For the event study method to be reliable, the DJSI must send a significant signal to the market. Fowler and Hope (2007) identify three criteria for such a signal. First, news about a company’s CSR activities must be announced through sources other than the company itself; the SAM Group publishes annual releases of the index changes in press and on their website. Second, the audit of corporate social, environmental, and corporate governance performance must be conducted by a third party; the SAM Group and Evalueserve examine all three performance indicators simultaneously. Third, the CSR engagement needs to be so substantial that it makes the company a leader in its industry; the DJSI selects companies based on a “best in class” approach that seeks to identify the best companies in each industry sector.

We used an event study because it isolates investors’ reaction as a mechanism for associating CSR and financial performance (Margolis et al. 2007). Given the specifics of DJSI World and our approach to the study, we did not face a single country bias or confounding events, for two reasons. First, our sample included companies from fourteen countries (Australia, Brazil, Canada, Chile, China, Germany, France, Japan, South Africa, South Korea, Spain, Taiwan, the U.S.A., and the U.K.). Second, we undertook a Lexis-Nexis search for potential events that may have affected investors’ decisions during the fourteen months before the announcement and one week before the announcement (the former period is when the DJSI is evaluating firms for addition or
deletion, while the latter targets a more narrow period of time in which confounding events to the immediate reaction of investors could have taken place).

We identified three prior empirical studies of performance that examined the DJSI. Two evaluated determinants of adding European firms from 1998–2004 (López et al. 2007; Ziegler & Schroder 2010), relying on accounting measures of performance; the third used U.S. stocks in 2002–2008, using an event study without controls for firm or industry characteristics (Cheung 2011), all finding inconclusive results. Our study, in addition to undertaking a more refined methodology with beta excess returns as a measure of financial performance, uses a more extensive timeframe (1999–2007) and encompasses a larger number of countries.

Overall, the DJSI as a source of data was appropriate for the event study due to its global reach, brand visibility, yearly review, continuous monitoring of companies, openness of information, consistent methodology, and availability for licensing. Between 1999 and 2007, the DJSI added about 500 firms and deleted about 300 firms. Due to data availability on CSRP (which provides data for firms listed on NYSE and AMEX), our final dataset includes 268 addition events that listed 216 companies (companies that were added twice were added in non-consecutive years) and 150 deletion events that delisted 133 companies, of which 58% were U.S.-based. This sample is substantially larger than previous studies. By checking the assumptions of event studies, we assured
the appropriate quality of the data and implementation of the study. Moreover, Appendix G addresses potential criticisms of drivers of additions and deletions.

5.3.2 Measures

Dependent variable. The dependent variable, Beta Excess Returns (BER), comes from the Daily Stock file of The Center for Research in Security Prices (CRSP). BER is the excess return of a stock issue less the average return of all issues in its beta-portfolio on each trading date, calculated using NYSE and AMEX data. We use BER as a dependent variable because it inherently controls for risk and compares the target company to all others in the market, solving two main limitations of previous studies. We aggregate beta excess returns on day one and two after the announcement of DJSI changes for clarity; we tested our models separately on days one and two, finding consistent results.

Changes in social legitimacy. As we noted above, we use addition to (deletion from) the DJSI to indicate increased (decreased) social legitimacy.

Market legitimacy. We reviewed the academic literature and interviewed analysts with experience in financial markets in New York, London, and Moscow (with Bloomberg, investment banks, and financial research firms) to determine indicators that market actors use when they assess firms’ market legitimacy. We gave the analysts Suchman’s definition of legitimacy contextualized for market actors and asked them what norms, beliefs, values, and definitions they hold of legitimate firms. Most generally, as we noted earlier, market legitimacy reflects perceptions of a firm’s future
financial viability. More specifically, the analysts identified two sources of market legitimacy, based on objective and subjective sources.

Objective sources of market legitimacy that the analysts rely on rest in measures of financial performance that help them form perceptions of future financial viability of the firm. Relevant measures include profitability, liquidity, and other ratios that assess profitability. The interviews highlighted multiple ways of constructing perceptions of future viability of the firm, so that there is no one best indicator for market legitimacy; instead, one needs to evaluate the impact of multiple inputs in the evaluation process. This conclusion reinforces Bitektine’s (2011) argument about the need for a deeper investigation into the evaluation criteria that different audiences use to assess legitimacy. We focused on identifying indicators that would be relevant to many analysts and investors but would not be immediately intuitive to the general public, so that we could separate broader social evaluations from more specific market assessments.

In our interviews, the analysts highlighted the importance of current measures of performance rather than more historical trends. Therefore, we assess the impact of objective market legitimacy through six indicators that measure current financial performance: (1) earnings before income and tax margin (EBIT margin), (2) earnings from continuous operations margin (ECO margin), (3) net income margin (return on sales, i.e., ROS), (4) return on assets (ROA), (5) return on equity (ROE), and (6) return on
capital (ROC). We then used a composite measure of standardized values (z-transformations, with mean=0 and s.d.=1) of the six ratios as our primary measure of objective market legitimacy. As we note below, we assessed other potential indicators of objective market legitimacy in sensitivity analysis. The data on financial performance comes from Capital IQ, a database that covers about 88,000 companies globally with over 5,000 financial data items. The six ratios are percentages, which makes it possible to compare across them and form a composite measure of objective market legitimacy.

Table 13 reports descriptive statistics for standardized values of the items. Appendix F shows that the six individual measures had consistent influence (with somewhat varying significance) on the impact of addition and deletion by the DJSI.

<table>
<thead>
<tr>
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<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
<th>(7)</th>
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<tr>
<td>(1) Objective ML</td>
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<td>(4) Net Income margin</td>
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<td>(5) ROA</td>
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<td>(6) ROE</td>
<td>0.56</td>
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<tr>
<td>(7) ROC</td>
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<td>0.5</td>
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<td>0.25</td>
<td>0.94</td>
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<tr>
<td>Mean</td>
<td>0.01</td>
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<td>0</td>
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<td>0</td>
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<tr>
<td>S.D.</td>
<td>0.71</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Min</td>
<td>-4.16</td>
<td>-5.23</td>
<td>-8.71</td>
<td>-13.46</td>
<td>-3.16</td>
<td>-5.73</td>
<td>-2.79</td>
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<tr>
<td>Max</td>
<td>2.67</td>
<td>4.17</td>
<td>4.5</td>
<td>3.18</td>
<td>5.43</td>
<td>13.97</td>
<td>6.42</td>
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<tr>
<td>N</td>
<td>418</td>
<td>379</td>
<td>417</td>
<td>417</td>
<td>413</td>
<td>412</td>
<td>375</td>
</tr>
</tbody>
</table>
The analysts also identified subjective sources of market legitimacy that rest in third-party assessments, recommendations, and company ratings, such as credit ratings by Moody’s, Standard & Poor’s, Fitch, and analyst recommendations to buy, hold, or sell a stock. Subjective sources generally include market research, industry reports, and industry rankings that demonstrate firms’ “ability to deliver future maintainable/sustainable earnings.” Our interviewees suggested that such subjective third-party sources primarily complement their own assessments, based on objective data – indeed, they commonly search for a rationale within the subjective data that will support their own assessments. Nonetheless, the analysts believed that subjective criteria were relevant indicators of market legitimacy. In our event study, we assess the impact of subjective market legitimacy by recording analyst recommendations to buy a firm’s stock during either of the two days prior to the event of addition or deletion by the DJSI.

The data on analyst recommendations comes from First Call Analyst Recommendations database, where the contributing analysts represent major international research firms, regional firms, and boutiques. The database provides broad coverage and local expertise to over 50,000 institutional investors and brokerage firms worldwide. We searched for analyst recommendations to buy (which should strengthen investor preferences) during a short event window – either one or two days before the DJSI announcement. If more than one analyst made recommendations on the same day, we calculated the average between them: analyst recommendations range from 1 (Strong
Buy) to 5 (Strong Sell); our measure of the recommendation to buy was coded as 1 when analysts’ recommendations were lower than 2.5 and 0 otherwise. Table 14 reports descriptive statistics and correlations for the variables.
Table 14: Descriptive statistics and Correlations (Dependent and Independent Variables)

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<tr>
<td>(2) Abnormal returns after deletion</td>
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<td>(3) Subjective Market Legitimacy</td>
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<tr>
<td>(4) Objective Market Legitimacy</td>
<td>0.12</td>
<td>0.16</td>
<td>0.02</td>
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<tr>
<td>(5) Size (log of employees)</td>
<td>0.18</td>
<td>-0.12</td>
<td>0.07</td>
<td>-0.09</td>
<td>1</td>
<td></td>
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<tr>
<td>(6) Sector: basic resources</td>
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<td>0.22</td>
<td>-0.12</td>
<td>-0.06</td>
<td>-0.02</td>
<td>1</td>
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<tr>
<td>(7) Sector: consumer</td>
<td>-0.11</td>
<td>-0.01</td>
<td>0.19</td>
<td>0.04</td>
<td>-0.16</td>
<td>-0.3</td>
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<td>(8) Sector: industrial</td>
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<td>-0.1</td>
<td>0.02</td>
<td>-0.02</td>
<td>0.02</td>
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<td>(9) Sector: services</td>
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<td>-0.06</td>
<td>-0.13</td>
<td>0.02</td>
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<td>-0.07</td>
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<td>(11) Geography: North America</td>
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<td>0.08</td>
<td>-0.15</td>
<td>0.08</td>
<td>0.05</td>
<td>-0.06</td>
<td>0.1</td>
<td>-0.03</td>
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<td>(12) Geography: Other</td>
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<td>0.02</td>
<td>0.04</td>
<td>-0.05</td>
<td>-0.02</td>
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<td>-0.06</td>
<td>0.09</td>
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<td>-0.17</td>
<td>-0.41</td>
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<tr>
<td>(13) Negative news 14 months before</td>
<td>-0.03</td>
<td>-0.06</td>
<td>0.22</td>
<td>-0.05</td>
<td>-0.01</td>
<td>0.11</td>
<td>-0.11</td>
<td>0.02</td>
<td>0.02</td>
<td>0.11</td>
<td>-0.08</td>
<td>-0.05</td>
<td>1</td>
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<tr>
<td>(14) Positive news 14 months before</td>
<td>-0.01</td>
<td>0.11</td>
<td>0.22</td>
<td>-0.02</td>
<td>-0.04</td>
<td>0.08</td>
<td>0.04</td>
<td>0</td>
<td>-0.1</td>
<td>0.06</td>
<td>-0.1</td>
<td>0.08</td>
<td>0.27</td>
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<tr>
<td>(15) Negative news 1 week before</td>
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<td>-0.35</td>
<td>0.1</td>
<td>-0.02</td>
<td>-0.14</td>
<td>-0.05</td>
<td>0.08</td>
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<td>-0.01</td>
<td>0.17</td>
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<tr>
<td>(16) Positive news 1 week before</td>
<td>0.01</td>
<td>0.02</td>
<td>0.14</td>
<td>0</td>
<td>0</td>
<td>0.05</td>
<td>-0.02</td>
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<td>-0.03</td>
<td>-0.04</td>
<td>0.11</td>
<td>0.02</td>
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<tr>
<td>Mean</td>
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<td>-0.004</td>
<td>0.02</td>
<td>0.01</td>
<td>10.42</td>
<td>0.13</td>
<td>0.38</td>
<td>0.14</td>
<td>0.35</td>
<td>0.26</td>
<td>0.67</td>
<td>0.08</td>
<td>1.5</td>
<td>0.31</td>
<td>0.11</td>
<td>0.09</td>
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<td>St. dev.</td>
<td>0.03</td>
<td>0.03</td>
<td>0.15</td>
<td>0.7</td>
<td>1.35</td>
<td>0.34</td>
<td>0.49</td>
<td>0.35</td>
<td>0.48</td>
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<td>-4.2</td>
<td>6.55</td>
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<td>0</td>
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</tr>
<tr>
<td>Max</td>
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<td>0.095</td>
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<td>2.67</td>
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</table>
The analysts’ discussion of objective and subjective sources of market legitimacy is consistent with academic studies. The organizational legitimacy literature suggests that higher levels of objective market legitimacy as indicated by stronger financial performance will result in greater attention and endorsement by market actors and thus generate greater levels of market legitimacy (Deephouse 1996; Dowling & Pfeffer 1975; Galaskiewicz 1985). In parallel, studies of social embeddedness of financial markets suggest that when investors are unsure about how to interpret the news from the market, subjective sources such as analyst recommendations can influence their interpretation and, in turn, change the market value (Westphal & Clement 2008; Westphal & Graebner 2010; Zuckerman 1999, 2004).

We considered other potential measures of objective and subjective market legitimacy, based on long-term indicators. For objective market legitimacy, we examined several measures of longer-term profitability and growth. For subjective market legitimacy, we considered Standard & Poor’s annual ranking of firm quality and credit rating in the year of the announcement, as well as average analyst recommendations over the year. The longer-term potential measures of objective and subjective market legitimacy were not significant when the models included other variables. The insignificant impact of the longer-term indicators was consistent with our interviews: The analysts said that their evaluations focus on information from the past two to three
months, so that the effect of annual ratings and longer-term financial performance will tend to have little influence in their evaluation of market legitimacy.

Control variables. We assessed several other factors. The final analysis included industry dummies based on DJSI classification (consumer, industrial, financial, and natural resources), dummy variables for headquarters location (North America, Europe, and Other), variables for negative and positive news during 14 months and 1 week before the DJSI announcement, and organizational size (log of the number of employees). Industry is relevant because the closer the product is to the end customer, such as the consumer industry, the stronger investor preferences might be for CSR and, thus, the higher the gains or losses from inclusion or exclusion from DJSI (Porter & Kramer 2006). Geographic location of a company might affect the economic value attached to CSR; in particular, the European Union has a longer history of corporate social engagement and stronger regulations in this area (Waddock 2008), so investors might particularly welcome the addition to the index for firms from these countries or, instead, might simply take CSR for granted.

The variables for prior positive and negative news reflect the need for the listing event to provide new information. The less prior longer- or short-term information there is about a firm’s CSR activities, the higher the impact that the event may have on the investors. We controlled for confounding events with a Lexis-Nexis search for potential events that may have affected investors’ decisions. Our search included major world
publications in two periods. For the period of fourteen months before the event, we sought headlines that referred to the company with the keywords “environment,” “fine,” “illegal,” and/or “sue” within 40 words from the company name. For the period of one week before the announcement, we sought headlines that included the company name, with the general words “good,” “bad,” “positive,” “negative,” or “outstanding” within 20 words from the name of the firm. After we conducted the Lexis-Nexis search, we coded the mentions in the press as four separate count variables: positive/negative press 14 months in advance and positive/negative press one week before the announcement.

We needed to apply judgment in how we used and interpreted the impact of organizational size. Organizational size could be a measure of market legitimacy, because it may provide power in market activities such as in obtaining a contract with a local supplier, but it may also be a source of vulnerability in nonmarket activities, such as the maintenance of social legitimacy, because larger and more visible organizations are more likely to be attacked by interest groups (Kostova & Zaheer 1999). Therefore, we use size as a control variable rather than a measure of legitimacy. Including or excluding size did not affect the predicted effects of objective or subjective market legitimacy in either the addition or deletion models. Size has a significant effect on its own in the case of additions to the DJSI (the negative sign is consistent with what we would expect for additions had we used size as a measure of market legitimacy). By contrast, size did not
affect market reaction to deletions when we include a constant term in the deletion models, where the constant reflects the main effect of deletion. We exclude the insignificant size variable from the deletion models because it tended to overlap with the negative main effect of the constant term; in addition, owing to missing values for the size variable, excluding the variable allowed us to analyze a larger deletion sample. The Appendix G reports sensitivity analyses with and without organizational size, as well as with and without the constant term. We will discuss these sensitivity analyses following the main results, along with other robustness checks.

5.3.3 Results

Table 15 reports the results. Model 1 and Model 5 report baseline models for addition (268 cases) and deletion (150 cases, including 11 for which we lacked data when the DJSI first added them to the list). In order to maintain focus, we report only the most important control variables. The main effect of addition is positive ($\beta = 0.0367$, p<0.05), while the main effect of deletion is negative ($\beta = 0.0103$, p<0.10). In the addition model, greater size confers less benefit ($\beta = 0.00341$, p<0.05), while the service sector gains more benefit relative to the other industries (most significantly in comparison to the consumer sector). In the deletion model, the resource sector suffers less ($\beta = 0.0194$, p<0.05), while firms with negative press during the week prior to the event suffer more ($\beta = 0.00918$, p<0.01).
Table 15: OLS Estimates of the Impact of Addition and Deletion from the DJSI on Firms’ Abnormal (Beta Excess) Stock Returns

<table>
<thead>
<tr>
<th></th>
<th>H1: Addition to DJSI (Increased Social Legitimacy)</th>
<th>H2: Deletion from DJSI (Decreased Social Legitimacy)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Constant</td>
<td>0.0367**</td>
<td>0.0366**</td>
</tr>
<tr>
<td></td>
<td>(0.0144)</td>
<td>(0.0143)</td>
</tr>
<tr>
<td>Objective</td>
<td>-0.006***</td>
<td>-0.0058**</td>
</tr>
<tr>
<td>ML (τ)</td>
<td>(0.0023)</td>
<td>(0.0023)</td>
</tr>
<tr>
<td>Subjective</td>
<td>-0.0279***</td>
<td>-0.0268***</td>
</tr>
<tr>
<td>ML (τ)</td>
<td>(0.0097)</td>
<td>(0.0097)</td>
</tr>
<tr>
<td>Size (log of employees)</td>
<td>-0.0034**</td>
<td>-0.0034**</td>
</tr>
<tr>
<td></td>
<td>(0.0014)</td>
<td>(0.0013)</td>
</tr>
<tr>
<td>Sector: Basic</td>
<td>-0.0056</td>
<td>-0.0064</td>
</tr>
<tr>
<td>Resource</td>
<td>(0.0054)</td>
<td>(0.0053)</td>
</tr>
<tr>
<td>Sector: Consumer</td>
<td>-0.0069*</td>
<td>-0.0083***</td>
</tr>
<tr>
<td></td>
<td>(0.004)</td>
<td>(0.004)</td>
</tr>
<tr>
<td>Sector: Other</td>
<td>-0.0018</td>
<td>-0.0023</td>
</tr>
<tr>
<td>Industrial</td>
<td>(0.0055)</td>
<td>(0.0055)</td>
</tr>
<tr>
<td>N America (v. EU)</td>
<td>0.0017</td>
<td>0.0028</td>
</tr>
<tr>
<td>Other (v. EU)</td>
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<td>(0.0038)</td>
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<tr>
<td>Negative press (14m)</td>
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<td>-0.0002</td>
</tr>
<tr>
<td>Positive press (14m)</td>
<td>0.0012</td>
<td>0.0015</td>
</tr>
<tr>
<td>Negative press (1w)</td>
<td>-0.0025</td>
<td>-0.003</td>
</tr>
<tr>
<td></td>
<td>(0.0041)</td>
<td>(0.004)</td>
</tr>
</tbody>
</table>
Notes: a) the core results were robust to including control variables for slack resources, firm age, horizontal and vertical diversification, R&D and advertising expenses; b) control for size was excluded from the deletion models due to its insignificance (see Appendix G); c) the “Paired” subsample (Models 4b and 8b) included only firms that were added and subsequently dropped by the DJSI.

(#) Market Legitimacy (ML): “Objective ML” is a formative measure with six measures of current profitability; “Subjective ML” reflects analysts’ “buy” recommendations during the two days before the DJSI listing event.
The results in Models 2 to 4 of Table 15 support Hypothesis 1. Model 2 tests Hypothesis 1 with the aggregate objective measure of market legitimacy, finding strong significance in the hypothesized effect ($\beta = -0.0061, p<0.01$). Model 3 uses subjective market legitimacy, also finding strong support ($\beta = -0.0279, p<0.01$). Model 4a includes the effects of both measures of market legitimacy, once again finding strong support to Hypothesis 1 with consistent results for objective and subjective market legitimacy ($\beta = -0.00581, p<0.05; \beta = -0.0268 p<0.01$). Model 4b limits the sample to firms that the DJSI subsequently dropped (we matched 139 cases, which we examine again in the deletion analysis), which ensures that we directly compare the benefits of addition to the costs of deletion; the paired subset has consistent results with the earlier analysis. Thus, the main effect of being added to the DJSI is positive but, as expected, companies with greater market legitimacy, whether objective or subjective, benefit less from the increased social legitimacy. We will depict the extent of the differences after discussing the deletion models.

The deletion results in Models 6 to 8 support Hypothesis 2. Model 6 tests Hypothesis 2 with the objective measure of market legitimacy, finding significance for the hypothesized effect ($\beta = 0.0066, p<0.10$). Model 7 uses the subjective measure of market legitimacy, also finding a significant effect ($\beta = 0.0333, p<0.10$). Model 8a includes both measures of market legitimacy, finding consistent results for both objective ($\beta = 0.00711, p<0.05$) and subjective market legitimacy ($\beta = 0.0366 p<0.10$). Model 8b focuses
on the subsample of firms with both addition and deletion events (139 cases); the results are consistent with Model 8a. Hence, these results suggest that, as expected, market legitimacy counter-balances losses of social legitimacy.

Figure 7 depicts the results for the matched sample of firms that were added and subsequently dropped in our sample (total of 139 firms; models 4b and 8b in Table 15). It allows for a more direct comparison of the net impact of additions and deletions at different levels of legitimacy (mean, plus/minus 1-2 standard deviations). It shows small net gain when firms had similar market legitimacy at addition and deletion, net gain with low market legitimacy when added and high market legitimacy when dropped, and net loss with high market legitimacy when added and low market legitimacy when dropped.

![Figure 7: Stock Market Reaction to Addition and Deletion by the DJSI](image)

**Figure 7: Stock Market Reaction to Addition and Deletion by the DJSI**
Table 16 reports sensitivity analyses. The results for objective and subjective market legitimacy remain significant in all models. Model 1a for additions and Model 2a for deletions add a control for slack resources based on the ratio of current liabilities to current assets; we did not include slack in other models because data availability limited our sample size. Models 1b and 2b add age, vertical and horizontal diversification, and R&D and advertising expenditures. Greater R&D expenditure has a negative impact with additions (Model 1b), while greater advertising expenditure has a negative impact with deletions, in fact substituting for the negative effect of deletion (Model 2b).

Prior studies suggest that greater visibility provides challenges to maintaining organizational legitimacy (Kostova & Zaheer 1999); firms with greater R&D and advertising expenditures are often highly visible. Models 3a and 3b add organizational size to the deletion models, with and without the constant term. Size has no significant impact when the analysis includes a constant (Model 3a), but exacerbates the negative impact of deletion when there is no constant (Model 3b: $\beta = 0.00134$, $p<0.05$). This result suggests that the negative impact of deletion is greatest for larger firms (similar to the negative effect of firms with high advertising), just as larger firms benefit less from addition.
Table 16: Robustness Tests

<table>
<thead>
<tr>
<th></th>
<th>H1: Add 1a</th>
<th>H1: Add 1b</th>
<th>H2: Delete 2a</th>
<th>H2: Delete 2b</th>
<th>H2: Delete 3a</th>
<th>H2: Delete 3b</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.0199</td>
<td>0.0286*</td>
<td>-0.00847</td>
<td>0.0838*</td>
<td>0.0102</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0171)</td>
<td>(0.0152)</td>
<td>(0.0110)</td>
<td>(0.0471)</td>
<td>(0.0205)</td>
<td></td>
</tr>
<tr>
<td>Objective Market</td>
<td>-0.0164*</td>
<td>-0.0247**</td>
<td>0.0378*</td>
<td>0.0561**</td>
<td>0.00659*</td>
<td>0.00688**</td>
</tr>
<tr>
<td>Legitimacy</td>
<td>(0.0106)</td>
<td>(0.00978)</td>
<td>(0.0217)</td>
<td>(0.0216)</td>
<td>(0.00351)</td>
<td>(0.00345)</td>
</tr>
<tr>
<td>Subjective Market</td>
<td>-0.00486*</td>
<td>-0.00532**</td>
<td>0.00723*</td>
<td>0.00621*</td>
<td>0.0396*</td>
<td>0.0387*</td>
</tr>
<tr>
<td>Legitimacy</td>
<td>(0.00252)</td>
<td>(0.00236)</td>
<td>(0.00458)</td>
<td>(0.00352)</td>
<td>(0.0205)</td>
<td>(0.0203)</td>
</tr>
<tr>
<td>Slack Resources (current liabilities /current assets)</td>
<td>0.00176</td>
<td>-0.00847</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.00500)</td>
<td>(0.00758)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age</td>
<td>2.74e-05</td>
<td>6.18e-06</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(3.54e-05)</td>
<td>(5.11e-05)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vertical Diversification</td>
<td>0.000213</td>
<td>0.000478</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.000297)</td>
<td>(0.000418)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Horizontal Diversification</td>
<td>0.000459</td>
<td>-0.00284</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.00234)</td>
<td>(0.00349)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R&amp;D</td>
<td>-0.000107***</td>
<td>9.22e-05</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(3.83e-05)</td>
<td>(5.59e-05)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>-6.75e-07</td>
<td>-1.37e-05**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(4.08e-06)</td>
<td>(6.12e-06)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size (log of employees)</td>
<td>-0.00189</td>
<td>-0.00354**</td>
<td>-0.00224</td>
<td>-0.00134**</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.00153)</td>
<td>(0.00141)</td>
<td>(0.00190)</td>
<td>(0.000581)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sector: Basic Resources</td>
<td>-0.0130**</td>
<td>-0.00341</td>
<td>0.0261**</td>
<td>-0.0719</td>
<td>0.0210**</td>
<td>0.0219***</td>
</tr>
<tr>
<td>(v. Services)</td>
<td>(0.00586)</td>
<td>(0.00785)</td>
<td>(0.0112)</td>
<td>(0.0456)</td>
<td>(0.00812)</td>
<td>(0.00792)</td>
</tr>
<tr>
<td>Sector: Consumer</td>
<td>-0.00830*</td>
<td>-0.0161***</td>
<td>0.00740</td>
<td>-0.0769*</td>
<td>0.00646</td>
<td>0.00648</td>
</tr>
<tr>
<td>(v. Services)</td>
<td>(0.00450)</td>
<td>(0.00529)</td>
<td>(0.00734)</td>
<td>(0.0420)</td>
<td>(0.00589)</td>
<td>(0.00588)</td>
</tr>
</tbody>
</table>
Note: Control variables for other measures of slack resources (e.g., total liabilities/total assets), for membership in highly regulated industries (Cho & Patten 2007) were insignificant.
5.4 Discussion and Conclusions

Ruef and Scott (1998) proposed a multi-dimensional model of organizational legitimacy more than ten years ago, but the literature has only started to understand different sources, mechanisms, and processes behind social construction of legitimacy (Bitektine 2011; Deephouse & Suchman 2008). We study how different dimensions of legitimacy affect organizations in a new light – through their interaction. By considering two sets of organizational constituents – market and nonmarket – that have different values and norms in assessing organizational legitimacy, we theorize, measure, and test how different sources of organizational legitimacy affect organizational outcomes. In particular, we examine how financial market legitimacy that arises from market actors conditions the effect of changes in social legitimacy that arises from nonmarket actors. We find that firms with higher market legitimacy benefit less from increased social legitimacy and lose less from decreased social legitimacy. The results suggest a countervailing effect whereby market legitimacy substitutes for social legitimacy in generating economic value.

This study contributes to the neo-institutional and CSR literatures. First, we extend organizational legitimacy theory by moving away from the dichotomous understanding of legitimacy, which has been common in many studies (Zimmerman & Zeitz 2002) and considering interactions among different sources of legitimacy and their
effect on performance (Bansal & Clelland 2004; Dehphouse 1999; Earle et al. 2010; Kostova & Zaheer 1999). In doing so, we assess two sources of organizational legitimacy, examine how they affect firm value, and argue that market legitimacy, subjective or objective, conditions the benefits and costs of gaining and losing social legitimacy. The core argument that market legitimacy conditions and substitutes for social legitimacy in terms of market assessment reinforces the point that organizational legitimacy is a multi-dimensional concept (Dacin et al. 2007; Dehphouse & Suchman 2008; Kraatz & Block 2008; Ruef & Scott 1998). Moreover, by making a clear distinction between subjective and objective sources of market legitimacy and testing their effect separately and simultaneously, we demonstrate how different sources of one dimension of organizational legitimacy complement each other. Thus, while different dimensions of organizational legitimacy may substitute for each other, different sources of one of the dimensions in turn can reinforce each other.

Second, we extend the literature on CSR. By applying organizational legitimacy theory to study firms’ engagement in CSR and its effects on performance, we enhance our understanding of the mechanisms behind CSR value construction: Investors approve of CSR less when the firm has developed an alternative base of organizational legitimacy, consistent with the values and norms of the market. Empirically, corporations face increasing social, political, and economic institutional pressures to undertake actions within the realm of CSR. Many firms view indices that list companies
based on various dimensions of social and environmental performance as a valuable way of gaining organizational legitimacy (Schuler & Cording 2006). In addition, with increasing funds available in the market for socially responsible investment, managers commonly believe that joining such indices will generate financial benefits. While the literature on the relationship between corporate social performance and corporate financial performance often finds modest returns to CSR (Margolis & Elfenbein 2008), previous studies have not considered how the effect of CSR on firm value may vary with market legitimacy, and whether and under what conditions the costs outweigh the benefits of CSR. We demonstrate that the costs of the deletion may outweigh the benefits of the addition for firms that lack market legitimacy, possibly reflecting demands of the financial market that firms focus first on financial performance before taking on social activities. This comparison is intriguing for the academic literature and with implications for firm strategy.

Third, empirically, we contribute to both literatures by answering a recent call from neo-institutional scholars to examine the role of private decentralized institutions (King et al. 2005) and using a robust methodology to examine CSP-CFP link. Akin to norms, codes of conduct, and industry standards, participation in DJSI evaluation is voluntary, and diffuse actors rather than centralized power brokers provide rewards and sanctions (Ingram & Silverman 2002). The work is one of the first to examine the DJSI – a more general index than the KLD – using a robust methodology and
triangulating the event study analysis with qualitative data from interviews and archival search, previously called for (Margolis & Walsh 2003). In addition, the chapter examines the data-generating process and the opinions of the parties most interested in the links between social and financial performance, including corporations, analysts, and investors. By understanding under what conditions the market values social legitimacy signals, we address a gap in our understanding of perceptions of CSR by key stakeholders in the capital markets.

Our study has practical implications. Social indices are not only a meaningful source of social legitimacy but also an important investment tool in the market. Currently, about 11% of the $25 trillion in total assets under professional management in the United States involves socially responsible investing (SIF 2007), whereby investors seek to attain both financial returns and social good. Globally, this number is even higher, according to Carbon Disclosure Project’s 534 institutional investors representing more than $64 trillion of assets (PWC 2010) and UN Principles for Responsible Investment’s 784 signatories with $22 trillion of assets under management (PRI 2010). Evaluating the impact of additions and deletions at DJSI is important to both market and nonmarket actors seeking to understand the role of social indices. Furthermore, our discussion of conditions under which different sources of organizational legitimacy interact in affecting organizational outcomes provides the basis for active management of organizational legitimacy. In particular, managers can seek to ensure that their firms
establish several bases of organizational legitimacy, so that when they lose one, they can draw on another in defending their organization.

The study has limits that provide direction to future research. First, studies could examine more firms, including those for which CRSP or Capital IQ lack data. Second, further work could examine other elements of social legitimacy beyond social indices, as well as market legitimacy beyond analyst recommendations and profitability. Third, studies could examine the joint evolution of social and market legitimacy. Fourth, research could examine other mechanisms for market interpretation of the social legitimacy signals. Finally, future research could study periods that experience major shocks to social and market legitimacy, such as the recent financial recession and the Gulf Oil spill. More generally, while recent studies demonstrate how market legitimacy conditions the likelihood of social illegitimacy (Mishina et al. 2010) and how social legitimacy conditions the changes in market legitimacy (Handelman & Arnold 1999), future work could consider other dimensions of organizational legitimacy, including how they condition each other and affect various organizational outcomes.

In sum, this chapter advances our understanding of CSR and organizational legitimacy. The core finding that market legitimacy conditions how changes in social legitimacy affect firms’ economic value is robust and important to the extant literature.
6. Discussion

This dissertation seeks to understand the different sources and outcomes of organizational legitimacy by studying the interplay between its different dimensions. Thus, the previous chapter studies the interplay between two dimensions: social legitimacy and financial market legitimacy, stemming from the perception that the actions of the firm fit with the norms and values of market actors. I argue that the impact of changes in social legitimacy will be conditioned by a firm’s existing level of market legitimacy. I use a quasi-experimental setting to test this idea based on additions and deletions from the Dow Jones Sustainability Index (DJSI) from 1998-2007; I also conduct multiple interviews to ensure that this was a relevant setting to study CSR. I measure market legitimacy based on both objective and subjective measures, reflecting criteria that arose during interviews that I conducted with market analysts.

The analysis uses a financial event study of several hundred additions and deletions by the DJSI for firms from North America, Western Europe, and other regions, including extensive controls for alternative explanations. This study shows that firms with greater market legitimacy suffer/gain less in terms of abnormal stock returns from decreased/increased social legitimacy as reflected in additions and deletions by the DJSI. This suggests strategic implications for firms as well as avenues for future research on CSR and organizational legitimacy: by developing one source of legitimacy, organizations can buffer themselves from the consequences of the potential losses of
another. Furthermore, previous literature on the effect of CSR on performance has underemphasized this interplay between social and market legitimacy.

In the remainder of the dissertation I turn to considering CSR in emerging markets as it provides a source of legitimacy for these firms abroad. I start with a qualitative study of the nature of CSR in one emerging market, Russia. I then turn to a large sample quantitative study involving several thousand firms based in the five BRICS (Brazil, Russia, India, China and South Africa) emerging markets over 1990-2011.

The third chapter conducts a qualitative study of the nature and strategic impact of CSR in the emerging market of Russia. Based on interviews in over 30 companies, this study develops a contextualized perspective of CSR. This setting provides an opportunity for rich and deep understanding of the concept of CSR in an emerging market setting, where we are only beginning to grasp this phenomenon. The results suggest that how emerging market firms engage in CSR depends substantially on their size as well as relations with the state and other social actors. At the same time, interviews found that firms of any size that consider international expansion view investment in CSR at home as a potential facilitator for their international expansion.

Large firms in Russia, similar to those in developed markets, sometimes define their social responsibility broadly to encompass multiple stakeholders, such as the local community, the country, employees, shareholders, and the media. Broad-based CSR, i.e., going beyond compliance, is most likely if these firms have a close relationship with the
state in which CSR provides mutual benefits to the firms and state actors. For instance, the company and governors, mayors, or other state representatives may sign a socio-economic partnership agreement in which they describe social obligations and benefits to the company and the region in which it operates (e.g., improving infrastructure in exchange for tax breaks). In addition, large firms tend to view CSR as beneficial to their international expansion; e.g., improved governance and transparency, compliance with international environmental standards and labor regulations may facilitate international expansion. At the same time firms commonly identify domestic tradeoffs, particularly in terms of governance: the same transparency that facilitates international expansion may make them more susceptible to political rent extraction and to competitive challenges due to weak legal standards and limited capital and labor markets at home.

Small firms, meanwhile, tend to focus their CSR activities more narrowly, primarily emphasizing the needs of employees and owners. They often lack resources for broader CSR, have valid concerns that visible CSR activities will encourage political authorities to tax them more intensely, and often view such investments as the responsibility of the state. When small firms do engage in community investments, they often reflect social relationships of the owners, such as contributions to local orphanages or the church. One intriguing exception arises with small firms that are considering international expansion: in some interviews, executives discussed potential investments
in international quality or environmental standard certification in their attempts to gain access to international markets.

Thus, the third chapter demonstrates that CSR in this particular emerging market setting varies in terms of firm size, engagement with local political and social organizations, and concerns about competitive challenges and rent extraction. In addition and of particular importance for the remainder of this dissertation, firms with plans for international expansion often view CSR as a facilitator.

The fourth chapter considers international expansion of firms from emerging markets and evaluates how social legitimacy, as reflected in home country CSR, helps overcome the challenges in cross-border acquisitions. The main argument in this chapter is that firms from emerging markets gain legitimacy (and thus access to international markets) by engaging in CSR and exceeding expectations that actors in host countries hold about the emerging market home country. The key point here is that many international actors, particularly those based in developed markets, are suspicious of firms from emerging markets due to doubts about labor practices, contractual compliance, environmental responsibility, political relationships, and other factors in these countries; international actors that may affect the outcome of international expansion include regulators, politicians, analysts, executives, employees and others. As a result, firms that expand from emerging markets frequently find it difficult to find resources and gain the support that they need to succeed in the host countries.
This chapter explores the idea that investment in CSR activities at home can help overcome this suspicion from international actors in the host country and, in turn, contribute to the success of international expansion. From the neo-institutional standpoint, they are overcoming the expectations that local stakeholders in the host country have formed of firms in the emerging market home country, whereby using CSR as a form of social legitimacy that facilitates doing business globally.

I undertake a large-scale quantitative analysis of cross-border and domestic M&A deals. The acquirers come from the five BRICS countries. I examine the success of international expansion based on the completion and duration until completion of M&A deals. I measure firms’ home country CSR based on a count of media articles that mention CSR terms such as environmental, social, corporate governance practices, lawsuits, and other factors. I expect firms with higher number of positive CSR articles to be more likely to complete deals and do so more quickly (and vice versa). I compare the success of domestic deals by firms in the BRICS, as well as their cross-border deals in developed and emerging markets. To address endogeneity that could arise from differences in underlying firm capabilities, I match deals by relevant characteristics such as deal size, strategic industry of the target, public status of the buyer and the target firms, percentage of stake sought in the deal, year of announcement, and others. In addition, I find instrumental variables for CSR in firm visibility and compare differences in means of all company characteristics that may signify firm quality.
The results of these analyses demonstrate that home country CSR affects the success of international expansion by firms based in emerging markets. In particular, negative CSR makes it even more difficult to overcome low home country legitimacy as seen in lower completion rates and longer duration from announcement to completion of cross-border M&A deals, while positive CSR makes the odds of success five times higher in the matched sample of cancelled and completed deals. The key implication of this chapter is that social legitimacy as reflected in home-country CSR helps firms from emerging markets overcome limits to perceived lack of legitimacy that international actors hold about business activities in the emerging market firm home country.

Most generally, my dissertation shows that CSR is important for achieving legitimacy, better performance, and even success in international expansion. I also find confounding conditions under which engagement in and effect of CSR is limited. The major conceptual implication is that since legitimacy judgments that evaluators render can be a matter of life and death for an organization (e.g., a legitimacy judgment by a regulator) building theory on how different legitimacy judgments can substitute and/or complement each other is strategically important for organizations and the societies in which they operate. This work provides direction for future studies concerning what drives organizations to engage in CSR and under what conditions CSR affects organizational behavior and firm performance.
7. Future Research

As I note in chapters 3-5, each one of them has several limitations that provide direction for future research. First, obviously, future studies could examine other samples of firms or use other sources of data. Second, further work could examine other sources of legitimacy, or other elements of social legitimacy beyond social indices and media articles, as well as market legitimacy beyond analyst recommendations and profitability. Third, future research could examine the joint evolution of social, market, home country and other types of legitimacy, and the dynamics that demonstrate any changes in any of them. Fourth, scholars could study periods that experience major shocks to different types of legitimacy, such as the recent financial recession and the Gulf Oil spill, because such empirical settings may provide more clear signals of changes in some type of legitimacy and thus offer opportunities for a natural experiment.

Furthermore, future research could study other more clear and obvious signals of CSR or legitimacy for critical actors that evaluate organizational legitimacy, in particular for nonmarket actors. The importance of signals for market actors is well documented (Cohen & Dean 2005); however, signals for nonmarket actors have been largely unexamined (Spicer & Markoczy 2007). I argue and show that CSR activities provide one such signal that helps gain legitimacy and for instance, open doors to international markets for EMMs, particularly into more developed countries. In addition, signals like additions and deletions from the DJSI are more direct, and as we show in the fifth
chapter, may have a significant effect on the economic value of the firm. In addition, the results of the interviews in chapter three show that as a signaling mechanism, CSR demonstrates a) better corporate governance (i.e. transparency); b) better product quality (i.e. international certifications); c) better reputation (with partners, customers and employees); d) better preparedness to operate in a foreign environment (particularly in more developed countries); and finally, e) better ability to overcome the liability of origin. However, what remains poorly understood is under what conditions such signals are purely symbolic or substantive (see below); this distinction is of particular interest in the international context. For instance, a recent study using the UN Global Compact and Global Reporting Initiative as signals of CSR demonstrates that global institutional pressure through nongovernmental linkages encourages CSR adoption, but this pressure leads to ceremonial commitment in developed countries and to substantive commitment in developing countries (Lim & Tsutsui 2011). Understanding why and what effect this kind of commitment has on organizational outcomes can provide a fruitful area for future research.

Another interesting area for future research comes out of the conclusions from the third and fourth chapters – that CSR may in fact be mandatory under certain conditions and not a pre-emptive tactic to deal with the state as some studies suggest (Hillman & Hitt 1999). Understanding these conditions and the role of state in
mandating CSR may offer future avenues for research even though that goes against traditional definitions of CSR as a voluntary organizational practice/strategy.

This also opens an avenue for future research on the double edge of legitimacy (and CSR to this effect). Understanding when do benefits outweigh the costs, and how firms can minimize legitimacy advantages and disadvantages can serve as another direction for future research. For instance, the third chapter shows that even though investment in CSR is certainly costly in the short-term and domestically may hurt Russian firms (because by increasing their transparency they also increase further requests by the state and the vulnerability to their competitors), in the long-term it is beneficial for these firms because they can win the standards’ war abroad and improve the quality of their products and relations with customers, suppliers, employees, and other market and nonmarket actors at home and abroad. Future research could examine the double-edge of CSR domestically and internationally for firms from emerging markets (to date studies addressed this question only in developed countries).

International business scholars have several opportunities to build on the research in this dissertation. First, they can evaluate other modes of international expansion, such as greenfield and alliance activity. Second, future studies can use other measures of the success of international expansion, such as financial performance, M&A premiums, stock exchange returns on the M&A announcement, and the likelihood of survival. Third, they can rely on legitimacy spillovers from other sources, such as
foreign or state investors, foreign partners, or other organizational practices that meet
the norms and expectations of some group of relevant actors in the host country. Fourth,
future research could draw from the literature on institutional or cultural distance to
measure home country legitimacy along a continuum (versus using home country fixed
effects). Furthermore, future research could examine legitimacy and performance of
target companies: if targets lack legitimacy in the host country, the review of cross-
border M&A by an illegitimate EMM may be not as diligent or difficult to pass.

In addition, what has been overlooked in the fourth chapter is an opportunity to
match firms from developed countries to those from emerging markets and examine the
effect of CSR on the success of their international expansion, so that holding firm
characteristics constant, we can more directly observe the effect of CSR and home
country legitimacy on success.

Finally, it is important for the strategy literature to understand what happens
after completing the M&A deal: do EMMs get better returns on their investment in
emerging or developed economies? Matching analysis could help tease out these
differences, and understand how institutional environments in these settings can affect
the economic outcomes of foreign investment by firms with low home country
legitimacy.

Several other issues remain as to understanding how symbolic versus
substantive engagement in CSR can affect organizational outcomes. From my interviews
it follows that weak implementation of CSR and thus, symbolic engagement in CSR activities is due to the weak civil society that controls its implementation. Further research could examine other controlling mechanisms that can enhance more substantive CSR in the context of emerging markets (e.g. the state). Additionally, I find that the overall awareness of CSR, the code of ethics or conduct at the firm level is very low and even though, as a leftover from the old Soviet managerial accounting system, Russian firms still conduct social accounting (e.g. keeping track of HR training expenses), small-and-medium-sized businesses in particular do not believe in CSR due to high levels of corruption and unfriendly business environment. Future research could examine other emerging markets, where these conditions are different from Russia and also identify the factors that can help raise awareness of CSR issues when traditional (western) mechanisms are not effective.

Finally, further research could examine how CSR-related signals affect the target audience in the international markets, and whether these signals vary by country (i.e. developed or developing). I find that what is legitimate for social actors in one context may not be legitimate for social actors in other context and therefore, firms that want to achieve success in international expansion have to change their practices and customize them towards the norms and values behind western definitions of legitimacy, even if it is only symbolic. In particular, signing the Global Compact or reporting on CSR by GRI should help EMMs overcome low home country legitimacy by reaching the target
audience. Future research, however, shall examine whether this helps not only at the initial but also at the later stages of international expansion.

Overall, the most promising avenues for future research evolve around three main areas: 1) legitimacy spillovers and legitimacy agents giving more clear (and credible) legitimacy signals to critical actors evaluating organizations; 2) threats to legitimacy through exogenous shocks to organizations or organizational populations (so that research could distinguish between different dimensions of legitimacy and their effects more directly); and 3) the double edge of legitimacy with the effect of symbolic and substantive actions on the balance between the positive and negative consequences of high/low legitimacy. Below I created a table with the mechanisms that this dissertation suggests and potential future studies that could test them more directly; this shall also provide some direction for future research (see Table 17 below).
### Table 17: Future research

<table>
<thead>
<tr>
<th>Mechanisms</th>
<th>Theories</th>
<th>Research design</th>
<th>Boundary conditions</th>
</tr>
</thead>
</table>
| There are different types of legitimacy depending on who is evaluating organizations (i.e. sources) and there are different levels at which they operate (firm-level and country-level) | Legitimacy (judgment) | Existing study: add industry level to the analysis by creating industry-country pairs in my data (e.g. Chinese semi-conductors versus pharmaceuticals)  
Quantitative study: match EMMs to firms from developed countries and examine the same dimensions of legitimacy and the same outcomes. Show that social legitimacy is important in some contexts but not others (i.e. in developed countries) and for some firms but not others (i.e. EMMs) | Many large firms in emerging markets are highly diversified and cross multiple industries (i.e. conglomerates) so there may be legitimacy spillovers across industries |
| Stakeholder receptivity (i.e. with regulators and labor unions in particular) | Stakeholder | Qualitative analysis: interview regulators and heads of labor unions in emerging markets on the criteria by which they judge multinational firms in the public takeover process.  
Content analysis: examine media articles that report on the M&A and give it some evaluation in the local media. | Individual biases, generalizability |
| CSR sends a signal of legitimacy in developed countries | Legitimacy | Survey: identify regulators, key representatives of the public in developed countries and ask them about the perception that CSR activities of EMMs generate in their minds.  
Quantitative analysis: since my Russian study shows that CSR in Russia is not perceived as a legitimate activity (but viewed as a western idea) I could split my sample into deals involving Russian | Individual biases, generalizability |
<table>
<thead>
<tr>
<th>Two-step evaluation process of EMMs: 1) country level; 2) firm level</th>
<th>Categorization</th>
<th>Lab experiment: provide participants with a role description (i.e. regulator, target company board member, target company shareholder based on their background coming from developed or emerging markets) and ask them to evaluate a hypothetical M&amp;A offer from EMMs (i.e. give them a hypothetical name of the firm, its origin and several characteristics based on their social and market activities – ask them to agree or disagree to the deal at every stage of adding details about the company whether they are about its market or social performance, vary the order in which these details arrive)</th>
<th>Individual biases that might also help understand how these judgments are generated (so could provide an advantage in the study)</th>
</tr>
</thead>
<tbody>
<tr>
<td>The origin of the firm generates (il)legitimacy</td>
<td>IB: liability of origin/home</td>
<td>Content analysis: follow the sentiment in the media articles towards China over time Lab experiment: measure (brain) reactions (on a scale from negative to positive) to naming different origins of firms</td>
<td>Individual biases (towards communism)</td>
</tr>
</tbody>
</table>
8. Conclusion

The main theoretical contribution rests in the idea that different types of legitimacy may condition the effects of each other on performance. The core point is that each form of legitimacy is a dynamic concept that can vary independently. Whether due to strategic actions of a firm or changes in the legitimacy environment, legitimacy can increase or decrease at any time. Given this dynamic effect, the different types of organizational legitimacy may substitute for each other. For instance, if a firm already has a substantial level of market legitimacy, growth in social legitimacy may provide limited incremental value. If it loses social legitimacy, however, the market legitimacy may create a buffer for losses. This contribution is relevant for three literatures.

First, by understanding the interaction between the different sources of organizational legitimacy, and examining the relevant criteria by which the legitimacy perception is formed by different audiences, I expand the neo-institutional literature. Multiple authors have argued that different forms of organizational legitimacy can arise from different actors, with different impact on business activity and performance (Deephouse et al. 2008; Earle et al. 2010). To date, however, few studies have developed either the conceptual or empirical base of this argument. The approach to assessing the double edge of legitimacy (Ashforth et al. 1990) taken in this dissertation addresses these gaps by raising important conceptual questions: How does organizational legitimacy
stemming from different sources affect organizational outcomes? In particular, when do the different types of legitimacy substitute each other?

In addition, I extend organizational legitimacy theory by moving away from the dichotomous understanding of legitimacy, which has been common in many prior studies (Zimmerman and Zeitz 2002). The results of this dissertation support the multidimensional view of legitimacy (Ruef et al. 1998), suggesting that market legitimacy may buffer the gains (losses) from increased (decreased) social legitimacy, and high (low) social legitimacy may help overcome (augment the effects of) low home country legitimacy. Moreover, by making a clear distinction between subjective and objective sources of market legitimacy and testing their effect separately and simultaneously, I demonstrate how different sources of one dimension of organizational legitimacy complement each other. Thus, while different dimensions of organizational legitimacy may substitute for each other, different sources of one of the dimensions in turn can reinforce each other. Finally, I demonstrate that the salience of different dimensions of legitimacy can vary across different institutional environments.

Second, the findings in this dissertation are important for strategic CSR/nonmarket strategy literature. By applying organizational legitimacy theory to study firms’ engagement in CSR and its effects on performance, I enhance our understanding of the mechanisms behind CSR value construction: Investors approve of CSR less when the firm has developed an alternative base of organizational legitimacy,
consistent with the values and norms of the market. Empirically, corporations face increasing social, political, and economic institutional pressures to undertake actions within the realm of CSR. Many firms view indices that list companies based on various dimensions of social and environmental performance as a valuable way of gaining organizational legitimacy (Schuler and Cording 2006). In addition, with increasing funds available in the market for socially responsible investment, managers commonly believe that joining such indices will generate financial benefits. While the literature on the relationship between corporate social performance and corporate financial performance often finds modest returns to CSR (Margolis and Elfenbein 2008), previous studies have not considered how the effect of CSR on firm value may vary with market legitimacy, and whether and under what conditions the costs outweigh the benefits of CSR. I demonstrate that the costs of the deletion may outweigh the benefits of the addition for firms that lack market legitimacy, possibly reflecting demands of the financial market that firms focus on financial performance before taking on social activities.

In addition, I indirectly test the argument that CSR creates intangible assets that help organizations overcome nationalistic barriers and facilitate globalization (Gardberg et al. 2006). More directly, I add access to international markets to the list of strategic benefits of CSR, augmenting prior work on the U-shaped relationship between CSR and financial performance (Barnett et al. 2012), access to finance (Ioannou et al. 2013), and favorable analyst recommendations (Ioannou et al. 2010). Moreover, the literature is
only starting to examine CSR in the context of emerging markets (Dobers et al. 2009; Lim et al. 2012; Visser 2008). The empirical analysis in chapters three and four does this in the context of BRICS and shows that CSR is context-specific in these markets (e.g., to identify socially responsible activities in South Africa, I had to use the search term “black” – for Black Economic Empowerment). Moreover, even among the BRICS countries, there is significant variation in how governments treat CSR: while engagement is still mainly voluntary in many settings, some countries start issuing mandatory policies for some sectors of their economy (e.g., the Chinese government issued a mandatory decree in 2008 called “CSR Guideline for State-Owned Enterprises”; meanwhile, Black Economic Empowerment laws apply to many firms in South Africa).

Finally, I contribute to the international business literature. I demonstrate the role of home country and social legitimacy in international expansion, developing insights on the criteria by which EMMs are judged abroad, understanding what CSR means in emerging markets, and how EMMs can overcome initial barriers to entry. There is a growing body of literature on the various liabilities that I call low home country legitimacy – i.e. liability of origin (Ramachandran et al. 2010), liability of home (Stevens et al. 2012) – that increase the costs of doing business abroad, particularly for EMMs (Pant et al. 2012). The contribution to this literature lies in the examination of pre-entry conditions and processes that help deal with these liabilities, and in particular, help enhance the success of cross-border M&As.
Appendix A: Description and Justification of the Methodology

Research philosophy (philosophical assumptions): exploratory, interpretive

Since the main objective of this study was to understand the nature of CSR in Russia, first and foremost, the researcher had to immerse herself in the context; once the context of Russia was analyzed, due to the dynamic (and still transitionary) nature of this emerging market and the types of research questions that evolved, the researcher decided to pursue an exploratory qualitative research. Such research requires constant monitoring of the role of the researcher in interpreting what she observes and a detailed description of the researcher background and personality that may constitute potential biases in how information from this research is assessed and communicated.

My background includes growing up in Russia (in a town of Kolomna, 60 miles south-east from Moscow), getting undergraduate and master’s degrees at the Plekhanov Russian Academy of Economics in Moscow, studying and working abroad on exchange programs (Copenhagen, Denmark and Dresden, Germany) as well as undertaking a Master’s degree from Oxford University in the UK and PhD studies at Duke University in the US. These experiences define my identity and form the base for my research methods as well as the angles from which I approach research problems: Oxford and Duke taught me qualitative and quantitative research methods, while Russian background helped with deeper understanding of the context. Therefore, the decision to
pursue an inductive study was weighted against other options with knowledge and experience in both types of methodology as well as the empirical context.

**Qualitative research method: grounded theory/ interpretive case study**

Due to the importance of the context in this study, the two qualitative research methods I used were grounded theory and case study research. Grounded theory is very useful in developing context-based, process-oriented descriptions and explanations of organizational phenomena; its main attraction for researchers in business and management is the promise that it will help to develop new concepts and theories of business-related phenomena, that are firmly grounded in empirical phenomena (Myers 2009: 107). Hence, I followed the prescriptions of this method in designing and conducting research in Russia.

A case study approach, on the other hand, was useful because as an empirical inquiry, it investigates a contemporary phenomenon within its real-life context, when the boundaries between phenomenon and context are not clearly evident (Yin 2009). Once again due to the dynamic nature of the emerging market of Russia, as well as the Soviet effect on organizations in this context, the boundaries between CSR phenomenon and the Russian context were not clear in the beginning of this research. I adopted the case study inquiry as it also helps with the technically distinctive situation in which there may be many more variables of interest than data points, and as one result it relies
on multiple sources of evidence, with data needing to converge in a triangulating fashion, and as another result, it benefits from the prior development of theoretical propositions to guide data collection and analysis (Myers 2009: 76). Before developing interview schedule and a research proposal for the study, I did an extensive literature review with certain theoretical guidelines emerging from the exercise. However, with the help of colleagues and non-academic advisors, I went beyond theory and focused more on the phenomenon in designing further stages of this research. To summarize, case study and grounded theory methodology guided this study in understanding the phenomenon in the context, inseparable from each other.

**Research design: a multiple case, inductive study**

In order to be able to generalize about the phenomenon, I conducted interviews with representatives of multiple companies. Initially, a ‘wish list’ of companies was compiled using two criteria: CSR and international activities. The former was based on companies that signed the UN Global Compact or Social Charter (Russian-based initiative that restates the core principles from the Global Compact) or reported on CSR by Global Reporting Initiative. The latter was derived from Columbia University Emerging Market Global Players project (http://www.vcc.columbia.edu/content/emerging-market-global-players-project-0) that produces annual reports identifying the top multinationals in various markets. I particularly wanted to get variance on the following company
dimensions: 1) CSR-multinational, 2) CSR-domestic, 3) no-CSR-multinational, and 4) no-CSR-domestic. However, as research progressed, I went beyond this initial list of companies (retaining some of them that were responsive to the interview requests) including smaller (and medium-sized) firms that the respondents were representing.

In order to meet the four criteria for the quality of qualitative research (Gibbert et al. 2008; Silverman 2010: 294; Yin 2009: 36), I undertook the following procedures: 1) for construct validity I used multiple sources of evidence (company websites or any publicly available information as well as whatever sources of data the participants wished to share, e.g. social reports for Sakhalin Energy and Gazprom), I also asked the informants to review the draft case study report; 2) for internal validity I did pattern matching and explanation-building for each case; 3) for external validity I used replication from case to case (this includes asking the same questions at interviews); 4) finally, for reliability I developed a case study database (available in Excel spreadsheet upon request).

Qualitative data collection technique: semi-structured interviews

Since interviews are particularly useful when investigators are interested in understanding the perceptions of participants and learning how participants come to attach certain meaning to phenomena (Berg 2007: 97), I had to rely on interviews as the primary means to achieve the objectives of the study. The interview schedule was
developed with the five types of questions in mind: causal-research, noncausal-research, noncausal-policy, noncausal-evaluation and noncausal-management (Miles & Huberman 1994: 24). They helped understand both the depth and breadth of the phenomenon (noncausal research questions) and the potential causal relationships between our core concepts (CSR and international expansion). These questions were pretested with a group of experts for the content and Russian colleagues for the translation. The research proposal with the interview schedule was then submitted for IRB approval; it was received on September 9th, 2010 (a copy is available upon request).

The study took place in mid-September-November of 2010. The trip to Russia began with a conference “Corporate Responsibility in Emerging Markets” held in Saint Petersburg, at which I had an opportunity to get acknowledged with the work of the CSR Research Center at Saint Petersburg Graduate School of Management, and meet colleagues interested in this topic. Right before and during the conference, a summary of the research proposal was sent out in the interview request email to all Duke University’s Fuqua School of Business alumni. In total, 33 interviews were conducted over the period of two months. The interviews were 60-90 minutes long, tape recorded and transcribed. They were semi-structured due to the exploratory nature of this research.

Sample: convenience + purposive + snowball
After evaluating the options in the context of Russia (i.e. very low trust in people and business-related research, especially regarding the sensitive topic of CSR), for pragmatic reasons I decided to combine several sampling techniques. In order to achieve a higher response rate, I relied on convenience sample (often referred to as availability sample), purposive sample (that includes the number of companies that I wanted to interview due to their social or international activities) and finally, snowball sampling or chain referral sampling, as it was the best way to locate subjects with certain attributes necessary for the study (Berg 2007: 43). When I sent out the proposal for review by experts who have done research in Russia, they agreed that this would be the best way to approach the context (in fact, most argued that snowballing technique would work best in this research setting).

I kept track of the participants when they were first contacted, responded and were interviewed. I used five main pools of potential respondents: 1) recent Duke University’s Fuqua School of Business alumni that are Russian speakers (native or non-native) – 67 in total, of which I interviewed twenty three; 2) participants in the Duke University’s Fuqua School of Business capitalist economy training for Soviet managers in the 1990s – 417 in total, contact information available only for half, I interviewed only two; 3) Oxford and Cambridge-University-wide alumni that are members of the Oxford-Cambridge society in Russia – 230 members in total, of which I interviewed three; 4) National CSR Forum contacts – 21 in total, of which I interviewed three; 5) Plekhanov
Academy of Economics alumni and their contacts that I was referred to – twelve in total, of which I interviewed two.

In total I managed to get 33 interviews (I had more lined up but due to the established patterns in the data, time constraints and background of potential respondents that did not work in business per se, I decided not to pursue them; moreover, they would have taken place by phone after leaving Russia). The low rate of response for the interview request is not surprising, given that some contact information was outdated or did not exist per se (e.g. for Duke alumni number 2 in most cases I only had information on their place of work many years ago so I had to manually search for any references to these individuals in the Internet using their name and the name of the company, however, in most cases, once again due to the dynamic nature of this emerging market, they have changed jobs, retired or moved). Some contacts left Russia (e.g. out of 67 Fuqua School of Business alumni number 1, only 60 were still based in Russia). The low levels of trust in people and research in general also partly explain the low response rate: even though I mentioned links to Duke University and Saint Petersburg Graduate School of Management (or relied on Oxford University or Plekhanov Academy connection), some respondents later confirmed that they did not identify or recognize either of these educational institutions. The main reason for non-response or low response for most people in Russia is, of course, lack of time (several interviewees preferred to meet after work and told us that if they were not in a transition
from one job to another, they would have never responded to the request in the first place).

In preparation for each interview, as I knew the company of employment for most of the respondents (even though some of them changed the workplace as I learnt during the interview) I did substantial research about their firms from all publicly available sources of information, identifying the firm’s international and social activities. In the case study database that I developed in this process, I highlighted the companies that were either on the CSR or EMM lists. If the interviewees were not working for these particular companies anymore, I asked them to answer the questions retrospectively (only in a few cases).

**Qualitative data analysis approach: cross-case analysis, deconstructionist, open and axial coding**

Ethnomethodologists look for processes by which people make sense of their interactions and the institutions through which they live (assuming that people make sense of the phenomena and their sense-making is the basis of their future actions and interpretations); a semiotician looks for surface manifestations and the underlying structure that gives meaning to these manifestations; finally, a deconstructionist looks for the multiple meanings implicit in a text, conversation or even pointing out both the dominant ideology (taken-for-grantedness) and some of the alternative frames
(disruptions) that could be used to interpret the text, conversations, or event (Feldman 1995: 4-5). Given the purpose of this research, I adopted a deconstructionist approach, seeking to understand all possible meanings of CSR in the Russian context as well as the various factors that might affect firm’s engagement in CSR (such as the role of state).

In order to enhance generalizability and deepen understanding and explanation of the phenomenon, I conducted a cross-case analysis. Using multiple comparison groups helps not only to find out “under what sets of structural conditions [the] hypotheses are minimized and maximized” (Glaser & Strauss 1967) but also helps form the more general categories of how those conditions may be related (Miles & Huberman 1994: 173). Thus, I used a mixed strategy of cross-case analysis, starting with variable-oriented strategy by looking for themes that cut across cases, in which case key variables emerged just like in previous qualitative research where pattern clarification helped find evidence for a key construct (Eisenhardt 1989a); then using these key variables, I used a strategy that Miles and Huberman call ‘stacking comparable cases’ - examples of this technique can also be found in previous case studies (Eisenhardt 1989b). Basically, I “stacked” the case-level displays in a “meta-matrix”, further condensed it, permitting systematic comparison and synthesis that provided evidence for making conclusions.

The cross-case analysis began after all cases were finished. Using standard cross-case analysis techniques, similar constructs and relationships between cases were sought for. After major themes in the interviews were identified, a systematic indexing process
began: due to the open nature of interview questions, it was easy to code them under the main categories of interview questions. Then some tentative propositions were developed by grouping firms according to the potential variables of interest: as the patterns emerged from the data, the size of the firm was one key variable; others include ownership and international focus of the firm. The case pairs were then compared to identify similarities and differences. Short answers from interviews were added to the Excel, which formed the case database, then color coding started as to the important quotes for later use in the chapter. I started with open coding (related to conceptual categories) and moved to axial coding (grouping the codes according to conceptual categories that reflect commonalities among codes).

The analysis process was iterative and lasted several months, in many ways similar to previous qualitative studies (Graebner & Eisenhardt, 2004); however, I have not systematically gathered information from multiple people within the firms in the sample (primarily due to the number of firms, time constraints and the nature of research questions). From this process a framework emerged describing what CSR means in Russia, in particular what defines it and what differences exist by the nature of the firm. Output tables were then constructed using the directions from classic Miles and Huberman book. The findings are presented in the chapter with pseudonyms adopted for the firms in question in order to maintain confidentiality promised to the respondents.
Appendix B: Full List of Questions for Interviews

1) **Questions about the individual:** Please describe your role in the company. Which stakeholder do you most often interact with? How? What policies exist in the company guiding your behavior? Have you ever had any conflicts? How were they resolved?

2) **Questions about legitimacy, CSR and the role of the state:** Please answer the following questions from three viewpoints: as a member of the society, as a representative of business, and as a representative of this company, and note when the difference of viewpoints get particularly acute:

a) What are the expectations or the main responsibilities of business in Russia? Any? I refer to the responsibilities to the population, the state, and the business community. Are the any differences between them? What about the expectations form the international community?

b) What do you understand by CSR? What comes to mind when you hear this term?

c) How is your company engaged in/helping the community? What is the role of state in your contributions to the society? Do you collaborate with federal or local branches of the state? At which level? Please provide examples (question about “Implicit” CSR)

d) How are social investments selected? Conducted? Communicated? Are the company employees involved in the process?
e) What are the determinants of success(ful business) in Russia? Under what conditions will your company be respected (i.e. legitimate) in Russia/abroad? By the society? By the state? Business and international community? How is success measured/perceived in Russia?

f) How to achieve a good reputation and is it important to success?

3) Questions about “explicit” CSR: Are you aware of social reporting of your company? Are you familiar with the Global Compact? GRI? The recent President of Russia’ decree on social reporting? Why is your company (not) using that or that international guideline? What would international CSR standards like GRI/Global Compact give to/signal about your firm? Is your company a member of the Russian community of CSR-oriented firms i.e. has it signed the RUIE Social Compact? What does that signal about your firm (in comparison to signing the UN Global Compact)?

Who reads social reports? Why are they written?

4) Questions about stakeholders: Who is the main stakeholder in your firm? What does your answer depend on?

5) Questions about legitimacy: How does your company select future partners/suppliers? What do you look for in trying to figure out who a reliable partner might be? Do you rely on third-party ratings? Reputation? Analyst recommendations?

Do you ask friends? Colleagues from other firms? Partners?

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1 Russian Union of Industrialists and Entrepreneurs – the most influential business lobby and business network in Russia with direct links to the government.
6) **Questions about the role of state:** How does the state influence your business? How do you manage/fight these influences? In what ways does your management of the state take place through informal channels and conversations, and how much of it occurs through formal ones, such as lobbying the Duma or another formal parliamentary or regulatory body? How much takes place in formal courts?

7) **Questions about international expansion:** Have your company ever attempted at going abroad? Including M&A, exports, IPO, foreign credit etc.

   a) If yes, how and who assisted you? Where? Was it a success or failure? How long did it take? How was the company perceived by regulators of the foreign country? By the society? Employees and management of the company you acquired? Were there any problems regarding the image of Russia abroad? If so, how did you address it?

   b) How does the organization plan to deal with different legal and ethical environments when expanding abroad; do you have an internal code of conduct; do you do training on these issues; if so, what do you do? Do you have external advisors in the international expansion? How do they choose where to expand? Do you actively think about foreign listing?

   c) If no, imagine a situation when your company is deciding between expanding into developed vs. developing country. Where would it be easier to go? Why? Would expect any bias against Russian firms?
8) Provoking questions about the state imposing more and more responsibilities on business: is it fair to ask big business to help fight the consequences of the recent fires? What about hints from the state “to buy local”, i.e. Aeroflot, or not to raise prices, i.e. Mechel? Help with infrastructure projects like Skolkovo Innograd etc.? What is the role of state in achieving success in business?
Appendix C: Heckman selection bias models

In this analysis, I address a potential selection bias: choosing to expand abroad versus staying at home. I am interested in completion of cross-border and domestic deals: if companies chose to expand abroad because they have a greater (unobservable) propensity to complete deals, then the effect of cross-border deals may be overstated; the propensity to complete deals is in the error term of the completion regression and is correlated with the cross-border nature of the deal.

I expand the sample of M&A deals to include domestic and cross-border deals by BRICS’ firms: in total, this includes 30,047 deals, with 87% completed and 16% cross-border: the variable Cross-border equals 1 if the deal is cross-border and 0 otherwise. To determine whether selection is relevant, first I estimate the probability of being treated as a function of original control variables plus an additional identifying variable - (logged) revenue of buyers (it is missing in 43% of the cases but its significance shows its appropriateness). Revenue is assumed to affect the probability of choosing to expand abroad (positively) but is assumed to not influence completion (results of the analysis support this assumption – revenue is not significant in full models). A probit estimate of the probability of being treated gives an Inverse Mill’s ratio (lambda) that I later use in the original models. Hypotheses 1 and 2 continue to be supported but the coefficient on lambda is negative and not significant, suggesting no correlation between the error terms in the selection and primary equations. This suggests that the (unobserved) factors that
make participation in cross-border deals more likely tend to not be associated with cancellation or duration of the deal.

**Table 18: Results of Heckman selection bias models**

<table>
<thead>
<tr>
<th>Interpretation</th>
<th>Probit Cross-border</th>
<th>Probit Cross-border</th>
<th>H1 Completion</th>
<th>H2 Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Majority negative</td>
<td>-0.740** (0.366)</td>
<td>0.704** (0.300)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minority negative</td>
<td>-0.620** (0.391)</td>
<td>0.405* (0.233)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All negative</td>
<td>0.276** (0.356)</td>
<td>0.382* (0.214)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All positive</td>
<td>0.167 (0.298)</td>
<td>0.0758 (0.184)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash payment</td>
<td>-0.0134 (0.0280)</td>
<td>-0.00342 (0.00715)</td>
<td>-0.0558 (0.161)</td>
<td>-0.0621 (0.124)</td>
</tr>
<tr>
<td>Buyer public</td>
<td>0.00831 (0.0243)</td>
<td>0.00210 (0.00615)</td>
<td>-0.0496 (0.146)</td>
<td>0.153 (0.112)</td>
</tr>
<tr>
<td>Target public</td>
<td>0.152*** (0.0335)</td>
<td>0.0402*** (0.00917)</td>
<td>0.278 (0.321)</td>
<td>0.228 (0.260)</td>
</tr>
<tr>
<td>Percent sought</td>
<td>0.00174*** (0.000314)</td>
<td>0.000441*** (7.97e-05)</td>
<td>-0.00105 (0.00327)</td>
<td>-0.000270 (0.00273)</td>
</tr>
<tr>
<td>Target subsidiary</td>
<td>0.0698** (0.0292)</td>
<td>0.0176** (0.00727)</td>
<td>1.352*** (0.211)</td>
<td>0.495*** (0.158)</td>
</tr>
<tr>
<td>Developed host</td>
<td>0.217 (0.146)</td>
<td>-0.229** (0.109)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Experience</td>
<td>0.000842 (0.00136)</td>
<td>0.000214 (0.000346)</td>
<td>0.00444 (0.0283)</td>
<td>0.0386 (0.0253)</td>
</tr>
<tr>
<td>First time</td>
<td>0.0918 (0.211)</td>
<td>0.236 (0.153)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>0.134 (0.284)</td>
<td>-0.569*** (0.184)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>0.851*** (0.228)</td>
<td>-1.544*** (0.165)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>0.746*** (0.278)</td>
<td>-0.729*** (0.180)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>0.398** (0.298)</td>
<td>-1.150*** (0.184)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Coefficient 1</td>
<td>Coefficient 2</td>
<td>Standard Error 1</td>
<td>Standard Error 2</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>---------------</td>
<td>---------------</td>
<td>------------------</td>
<td>------------------</td>
</tr>
<tr>
<td>Year</td>
<td>-0.0591***</td>
<td>-0.0150***</td>
<td>(0.00459)</td>
<td>(0.00116)</td>
</tr>
<tr>
<td>Inverse Mill’s ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>1.24e-06***</td>
<td>3.14e-07***</td>
<td>(3.71e-07)</td>
<td>(9.40e-08)</td>
</tr>
<tr>
<td>Constant</td>
<td>117.7***</td>
<td></td>
<td>(9.213)</td>
<td>(193.4)</td>
</tr>
<tr>
<td>Observations</td>
<td>17,012</td>
<td>17,012</td>
<td>2,959</td>
<td>2,207</td>
</tr>
<tr>
<td>R-squared</td>
<td></td>
<td></td>
<td></td>
<td>0.083</td>
</tr>
</tbody>
</table>
Appendix D: Survival analysis

In this analysis, I try an alternative estimation method for the duration and completion of cross-border deals – survival analysis of multiple failure-time data. These data arise when either of two or more events (failures) occur for the same subject, or in our sample, from identical completions (cancellations) of the deal for the same company. Thus, failure times are correlated within cluster (i.e. the firm), violating the independence of failure times assumption, required in traditional survival analysis. In my data I have unordered failure events of the same type, where the same event of deal cancellation can occur to the same firm multiple times. The cumulative hazard curve looks like the following (duration in days on x-axis and hazard estimates on y-axis):

![Cumulative hazard curve](image)

Figure 8: Cumulative hazard curve

When our data is set for survival analysis with failure (or event) being the completion of the deal, time of entry – the date of the announcement, and time of exit – the date of the completion or cancellation of the deal, the sample size becomes smaller N.
= 2,251 (1,795 completions by 1,595 firms). This is due to missing dates for some of the observations as well as backdating and announcing deals on the same day as their completion or cancellation (previously dropped from our analysis). Average duration from announcement to completion in this sample is 147 days, with a minimum of 1 day and a maximum of 2,463 days.

To explore the data first I conducted univariate analyses – the tests of equality across strata to explore whether or not to include the predictor from main models in the final (survival) model. For the categorical variables I use a non-parametric test - the log-rank test of equality across strata. For the continuous variables I use a semi-parametric model – a univariate Cox proportional hazard regression. I consider including the predictor if the test has a p-value of 0.2 - 0.25 or less. If the predictor has a p-value greater than 0.25 in a univariate analysis it is highly unlikely that it will contribute anything to a model which includes other predictors.

The results of the univariate analysis show that CSR Index and its two sub-components (All positive and All negative) lie within the cut-off point of 0.2 and so can be included in the model. Out of all controls, only the following can be included in the model: Buyer public, Target public, Percent sought, Target subsidiary, Developed host, Experience, Brazil, South Africa, India, China, and Year (as well as Employees, Revenue, and ROA from other robustness tests). Before testing the full model, in survival analysis it is highly recommended to look at the Kaplan-Meier curves for all the categorical
predictors. This provides insight into the shape of the survival function for each group and gives an idea of whether or not the groups are proportional (i.e. the survival functions are approximately parallel). Below I show the Kaplan-Meier curves for All positive and All negative variables: it clearly takes longer to complete deals without any information on CSR (y-axis shows the proportion of completed deals, x-axis shows the completion duration in days).

Figure 9: Kaplan-Meier survival estimates for firms with/out All positive CSR

Figure 10: Kaplan-Meier survival estimates for firms with/out All negative CSR
It is clear from the graphs that the curves are not parallel (curves with All Positive and All negative =I end earlier than those with zeroes). This may be an indicator that one of the main assumptions for survival analysis is violated. Using stphtest command in Stata I run a test for violation of proportional hazards assumption. The output from stphtest is significant, indicating evidence contradictory to the proportionality assumption: \( \text{chi2}=56.83, \text{df}=13, \text{Prob}>\text{chi2}=0.00 \). This is the second key assumption in the Cox model, which in a regression type setting means that the survival curves for two strata (determined by the particular choices of values for the x-variables) must have hazard functions that are proportional over time (i.e. constant relative hazard). We have seen how this can be evaluated graphically (for All pos and All neg – see above) but Stata test adds more evidence that one of the two assumptions for the Cox model is violated. Therefore, I do not pursue the survival analysis to test our hypotheses in the fourth chapter of this dissertation.
Appendix E: Robustness checks using firm performance characteristics

In this analysis, I address potential endogeneity biases due to unobserved heterogeneity among BRICS firms stemming from their performance. We are interested in whether the effect of CSR remains in the presence of firm performance characteristics, and whether firms with highly positive CSR are also of higher ‘quality’. To answer these questions, I conduct two tests: one including performance data as controls in the main regressions, and one comparing the mean differences of firms with and without information on CSR.

The neo-institutional literature argues that legitimacy stems from greater age, size, and profitability – so I will use these measures to control for firm characteristics. If companies with better performance are more likely to complete deals, and in shorter time, then the effect of CSR might be overstated. Unfortunately, company data is limited and is only available for the year of the announcement of the M&A, so the sample size is smaller and the results shall not be fully trusted (although such measures of performance as size and profitability usually highly correlate with values from previous years). Age is measured as the logarithm of the difference between current year and the year of founding; size is a logarithm of revenues, and profitability is Return on Assets (ROA). I also included Return on Sales (ROS) as a measure of performance, and the
logarithm of the number of employees as a measure of size but they did not bear any significance, and so are not reported here.

Including size, age, and profitability does not seem to drastically change our results; moreover, the effect of these controls on the likelihood of completion is insignificant, while duration is longer for bigger firms and shorter for more profitable companies with no effect of company age. Therefore, this test provides an additional robustness check and support for our hypotheses: even in the presence of greater profitability and size, negative CSR hurts international expansion plans by BRICS firms.

In addition to this analysis, I compared firms with information on CSR (All positive, Mixed negative, and All negative) to those that do not have any such information on a number of ‘firm quality’ metrics (for those observations that I had data). I found that firms with mixed negative information on CSR are significantly better than firms with no information on CSR. Moreover, the comparison of means suggests that firms with negative CSR are better than firms with positive CSR.

<table>
<thead>
<tr>
<th></th>
<th>H1 Completion</th>
<th>H2 Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Majority negative</td>
<td>-1.113**</td>
<td>0.744**</td>
</tr>
<tr>
<td>Minority negative</td>
<td>-0.371</td>
<td>0.419</td>
</tr>
<tr>
<td>All negative</td>
<td>-0.0218</td>
<td>0.129</td>
</tr>
<tr>
<td>All positive</td>
<td>-0.457</td>
<td>-0.101</td>
</tr>
<tr>
<td></td>
<td>Estimate 1</td>
<td>T-Value 1</td>
</tr>
<tr>
<td>---------------------</td>
<td>------------</td>
<td>-----------</td>
</tr>
<tr>
<td>ROA</td>
<td>0.00302</td>
<td>-1.627***</td>
</tr>
<tr>
<td>Size</td>
<td>0.0134</td>
<td>0.113***</td>
</tr>
<tr>
<td>Age</td>
<td>-0.00152</td>
<td>-0.00285</td>
</tr>
<tr>
<td>Cash payment</td>
<td>-0.427</td>
<td>-0.303</td>
</tr>
<tr>
<td>Buyer public</td>
<td>-0.712</td>
<td>0.132</td>
</tr>
<tr>
<td>Target public</td>
<td>0.827***</td>
<td>0.332</td>
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<tr>
<td>Percent sought</td>
<td>0.000406</td>
<td>1.90e-05</td>
</tr>
<tr>
<td>Target subsidiary</td>
<td>1.536***</td>
<td>0.695***</td>
</tr>
<tr>
<td>Developed host</td>
<td>0.461*</td>
<td>0.0486</td>
</tr>
<tr>
<td>Experience</td>
<td>-0.0113</td>
<td>-0.0255</td>
</tr>
<tr>
<td>First time</td>
<td>-0.318</td>
<td>0.133</td>
</tr>
<tr>
<td>Brazil</td>
<td>0.430</td>
<td>0.0928</td>
</tr>
<tr>
<td>Russia</td>
<td>1.134***</td>
<td>-1.316***</td>
</tr>
<tr>
<td>South Africa</td>
<td>1.119**</td>
<td>-0.547**</td>
</tr>
<tr>
<td>India</td>
<td>0.402</td>
<td>-0.855***</td>
</tr>
<tr>
<td>Year</td>
<td>-0.106**</td>
<td>0.00576</td>
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<tr>
<td>Constant</td>
<td>215.7**</td>
<td>-10.26</td>
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<tr>
<td>Observations</td>
<td>1,136</td>
<td>827</td>
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</table>
Table 20: Test of mean differences of additional firm characteristics by CSR

<table>
<thead>
<tr>
<th></th>
<th>All positive</th>
<th>Mixed negative</th>
<th>All negative</th>
<th>No CSR</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>0.08</td>
<td>0.09</td>
<td>0.09</td>
<td>-3.1</td>
</tr>
<tr>
<td>Employees</td>
<td>8.8***</td>
<td>10.4***</td>
<td>9.6***</td>
<td>7.4</td>
</tr>
<tr>
<td>Revenues</td>
<td>7.5***</td>
<td>9.5***</td>
<td>8.3***</td>
<td>5.9</td>
</tr>
<tr>
<td>Assets</td>
<td>8,885</td>
<td>137,427***</td>
<td>47,280***</td>
<td>6,935</td>
</tr>
<tr>
<td>Market cap</td>
<td>5,112**</td>
<td>44,445***</td>
<td>34,373***</td>
<td>3,328</td>
</tr>
<tr>
<td>Age</td>
<td>37***</td>
<td>30</td>
<td>36***</td>
<td>29.5</td>
</tr>
<tr>
<td>Visibility</td>
<td>74***</td>
<td>542***</td>
<td>433***</td>
<td>44</td>
</tr>
</tbody>
</table>
### Appendix F: Splitting Objective Market Legitimacy Components

Table 21: OLS Estimates of the Impact of Addition and Deletion Moderated by the Six Items of Objective Market Legitimacy

<table>
<thead>
<tr>
<th></th>
<th>H1: Addition to DJSI (Social Legitimacy Increase)</th>
<th>H2: Deletion from DJSI (Social Legitimacy Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A.1a</td>
<td>A.1b</td>
</tr>
<tr>
<td>Constant</td>
<td>0.0456***</td>
<td>0.0386***</td>
</tr>
<tr>
<td></td>
<td>(0.0151)</td>
<td>(0.0142)</td>
</tr>
<tr>
<td>EBIT margin</td>
<td>-0.0298*</td>
<td>0.0333</td>
</tr>
<tr>
<td></td>
<td>(0.0165)</td>
<td></td>
</tr>
<tr>
<td>ECO margin</td>
<td>-0.0104</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0126)</td>
<td></td>
</tr>
<tr>
<td>Net income margin (ROS)</td>
<td>-0.00845</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.00813)</td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROC</td>
<td>-0.0458**</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.0213)</td>
<td></td>
</tr>
<tr>
<td>ROE</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size (log of employees)</td>
<td>-0.0037***</td>
<td>-0.0035***</td>
</tr>
<tr>
<td></td>
<td>(0.0014)</td>
<td>(0.0013)</td>
</tr>
<tr>
<td>Sector: Basic Res</td>
<td>-0.0076</td>
<td>-0.005</td>
</tr>
<tr>
<td>(v. Services)</td>
<td>(0.0056)</td>
<td>(0.0053)</td>
</tr>
<tr>
<td>Sector: Consum</td>
<td>-0.0089**</td>
<td>-0.006</td>
</tr>
<tr>
<td>(v. Services)</td>
<td>(0.0044)</td>
<td>(0.004)</td>
</tr>
<tr>
<td>Sector: Industrial</td>
<td>-0.0042</td>
<td>-0.001</td>
</tr>
<tr>
<td>(v. Services)</td>
<td>(0.0058)</td>
<td>(0.005)</td>
</tr>
<tr>
<td>North America</td>
<td>0.0006</td>
<td>0.0012</td>
</tr>
<tr>
<td>(v. EU)</td>
<td>(0.004)</td>
<td>(0.004)</td>
</tr>
<tr>
<td></td>
<td>Other Countries</td>
<td>(v. EU)</td>
</tr>
<tr>
<td>------------------------</td>
<td>-----------------</td>
<td>---------</td>
</tr>
<tr>
<td>Other Countries</td>
<td>-0.0102</td>
<td>-0.0109</td>
</tr>
<tr>
<td>(v. EU)</td>
<td>(0.0076)</td>
<td>(0.007)</td>
</tr>
<tr>
<td>Negative press</td>
<td>0.00010</td>
<td>-0.88e-05</td>
</tr>
<tr>
<td>past 14 months</td>
<td>(0.0007)</td>
<td>(0.0006)</td>
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<tr>
<td>Positive press</td>
<td>0.00110</td>
<td>0.0012</td>
</tr>
<tr>
<td>past 14 months</td>
<td>(0.002)</td>
<td>(0.002)</td>
</tr>
<tr>
<td>Negative press</td>
<td>-0.00160</td>
<td>-0.0025</td>
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<tr>
<td>1 week before</td>
<td>(0.0042)</td>
<td>(0.004)</td>
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<tr>
<td>Positive press</td>
<td>0.0040</td>
<td>0.0046</td>
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<tr>
<td>1 week before</td>
<td>(0.006)</td>
<td>(0.006)</td>
</tr>
<tr>
<td>Observations</td>
<td>241</td>
<td>266</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.078</td>
<td>0.065</td>
</tr>
</tbody>
</table>
Appendix G. Robustness Check for the Selection into the DJSI

An additional robustness check verified that the DJSI adds and deletes companies based on their social – not financial – performance. We constructed a new sample from several sources: 1) CSR performance from Thomson Reuters/Datastream (ASSET4, a Swiss-based company that specializes in providing objective, relevant, auditable, and systematic CSR information); 2) analyst coverage from I/B/E/S; and 3) accounting data from WorldScope.

Our sample includes 10,584 observations based on 2,290 unique firms across 7 years (2002 to 2008) around the world; some specifications lose data due to the lag in some of our variables. The analysis investigates whether a firm’s ROA or CSR drives DJSI addition or deletion. We ran two analyses (lagged and non-lagged variables) for two samples: 1) “Add-Full” and “Delete-Full” include all 2,290 firms; 2) “Add” and “Del” use the firms from DJSI merged with the new dataset. CSR is the weighted average of social, environmental, and governance scores for the focal firm for each year in our sample. ROA is the ratio of net income to total assets. Controls include: 1) Analyst Coverage measured as the number of analysts that cover a firm each year, to assess firm visibility; 2) Firm size measured as log of assets; 3) R&D Intensity measured as ratio of R&D expenses / sales; 4) Diversification measured as log of the number of four-digit SIC codes that a firm operates in each year; 5) SRI Index, an indicator of the existence or lack
of a socially responsible market index in a given country to control for institutional
country-level factors; 6) GDP per capita also addresses country factors; 7) Herfindahl
index measured as the logged sum of squared ratios of firm sales over total industry
sales in each year assesses industry dynamics. The regressions include year, country,
and industry fixed effects. Standard errors (in parentheses) are robust to arbitrary
heteroskedasticity and allow for serial correlation through firm-level clustering.

The results show a strong relationship between CSR and addition/deletion from
DJSI. For ROA, by contrast, we find a negative relationship between ROA and deletions
only in one case for deletions in the full sample (C.1b).
Table 22: Results of the robustness test for the selection into the DJSI

<table>
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<tr>
<th></th>
<th>Add-Full</th>
<th>Del-Full</th>
<th>Add-Full</th>
<th>Del-Full</th>
<th>Add</th>
<th>Del</th>
<th>Add</th>
<th>Del</th>
</tr>
</thead>
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<td>Constant</td>
<td>-0.027</td>
<td>-0.016</td>
<td>0.161</td>
<td>-0.033</td>
<td>1.25***</td>
<td>-0.266</td>
<td>1.211**</td>
<td>-0.211</td>
</tr>
<tr>
<td>(0.017)</td>
<td>(0.014)</td>
<td>(0.193)</td>
<td>(0.021)</td>
<td>(0.446)</td>
<td>(0.446)</td>
<td>(0.505)</td>
<td>(0.507)</td>
<td></td>
</tr>
<tr>
<td>CSR</td>
<td>0.06***</td>
<td>0.027***</td>
<td>0.491**</td>
<td>-0.501**</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(0.008)</td>
<td>(0.007)</td>
<td>(0.202)</td>
<td>(0.203)</td>
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<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>ROA</td>
<td>-0.0003</td>
<td>-0.0004**</td>
<td>0.0002</td>
<td>0.0001</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(0.0002)</td>
<td>(0.0002)</td>
<td>(0.005)</td>
<td>(0.005)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Analyst</td>
<td>0.0002</td>
<td>0.0003</td>
<td>-0.003</td>
<td>0.003</td>
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<td></td>
<td></td>
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<tr>
<td>(0.0002)</td>
<td>(0.0002)</td>
<td>(0.004)</td>
<td>(0.004)</td>
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<tr>
<td>Coverage</td>
<td>0.003**</td>
<td>0.002*</td>
<td>0.017</td>
<td>-0.017</td>
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<tr>
<td>(0.001)</td>
<td>(0.001)</td>
<td>(0.032)</td>
<td>(0.032)</td>
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</tr>
<tr>
<td>Size</td>
<td>0.0007</td>
<td>-0.003</td>
<td>0.008</td>
<td>-0.007</td>
<td></td>
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<tr>
<td>(0.003)</td>
<td>(0.003)</td>
<td>(0.075)</td>
<td>(0.075)</td>
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<td>R&amp;D Intensity</td>
<td>3.87E-07</td>
<td>-0.0001</td>
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<td>(0.0003)</td>
<td>(0.0003)</td>
<td>(0.013)</td>
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<td>Diversification</td>
<td>-0.0007</td>
<td>-0.003</td>
<td>0.008</td>
<td>-0.007</td>
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<tr>
<td>(0.003)</td>
<td>(0.003)</td>
<td>(0.075)</td>
<td>(0.075)</td>
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<tr>
<td>SRI Index</td>
<td>-0.003</td>
<td>-0.005</td>
<td>0.006</td>
<td>-0.005</td>
<td>0.071</td>
<td>0.083</td>
<td>0.047</td>
<td>-0.047</td>
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<tr>
<td>(0.011)</td>
<td>(0.01)</td>
<td>(0.014)</td>
<td>(0.014)</td>
<td>(0.193)</td>
<td>(0.193)</td>
<td>(0.29)</td>
<td>(0.29)</td>
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<td>Herfindahl</td>
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<td>0.003</td>
<td>-0.01</td>
<td>0.011</td>
<td>0.0004</td>
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<td>(0.003)</td>
<td>(0.002)</td>
<td>(0.003)</td>
<td>(0.003)</td>
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<td>(0.057)</td>
<td>(0.067)</td>
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<tr>
<td>GDP per capita</td>
<td>-6.75E-07***</td>
<td>-2.53E-07</td>
<td>-5.85E-06</td>
<td>-1.66E-07</td>
<td>-3e-05***</td>
<td>3e-05***</td>
<td>3e-05***</td>
<td>3e-05***</td>
</tr>
<tr>
<td>(2.20E-07)</td>
<td>(2.08E-07)</td>
<td>(5.26E-06)</td>
<td>(4.54E-07)</td>
<td>(7.59E-06)</td>
<td>(7.60E-06)</td>
<td>(9.64E-06)</td>
<td>(9.67E-06)</td>
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<tr>
<td>Lagged CSR</td>
<td>0.065***</td>
<td>0.039***</td>
<td></td>
<td></td>
<td>0.243</td>
<td>-0.243</td>
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<td>(0.009)</td>
<td>(0.008)</td>
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<td></td>
<td>(0.272)</td>
<td>(0.273)</td>
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<tr>
<td>Lagged ROA</td>
<td>0.0001</td>
<td>-6.79E-05</td>
<td>0.005</td>
<td>-0.005</td>
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<td>(0.0002)</td>
<td>(0.0002)</td>
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<td>(0.007)</td>
<td>(0.006)</td>
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Biography