

**WHAT DRIVES CORPORATE SOCIAL PERFORMANCE?  
THE ROLE OF NATION-LEVEL INSTITUTIONS**

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July 4<sup>th</sup>, 2012

*Abstract*

Based on Whitley's "National Business Systems" (NBS) institutional framework (Whitley 1997; 1999), we theorize about and empirically investigate the impact of nation-level institutions on firms' corporate social performance (CSP). Using a sample of firms from 42 countries spanning seven years, we construct an annual composite CSP index for each firm based on social and environmental metrics. We find that the political system, followed by the labor and education system, and the cultural system are the most important NBS categories of institutions that impact CSP. Interestingly, the financial system appears to have a relatively less significant impact. We discuss implications for research, practice and policy-making.

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We thank ASSET4 (Thompson Reuters) for providing us with the data for this paper, and we are particularly grateful to Dr. Christopher Greenwald and Ms. Caroline Harrison at ASSET4 for their help and cooperation. We would like to thank Costas Markides, Donal Crilly, Sandra Waddock and Olga Hawn for valuable comments. We would also like to thank participants at the Cass International Strategy Workshop 2011. Ioannou acknowledges financial support from the Research and Materials Development Fund (RAMD) at the London Business School. Serafeim acknowledges financial support from the Division of Research and Faculty Development of Harvard Business School. All errors remain our own.

## INTRODUCTION

In recent years, growing attention has been paid on corporations' social responsibilities, termed as "corporate social responsibility" (CSR), both in the academic literature (e.g. McWilliams & Siegel, 2001; Margolis & Walsh, 2003; Orlitzky, Schmidt & Rynes, 2003) as well as in the business world. For example, in the 2010 UN Global Compact – Accenture CEO study ninety-three percent (93%) of the 766 participant CEOs worldwide declared sustainability as an "important" or "very important" factor for their organizations' future success. Moreover, eighty-one percent (81%) stated that sustainability issues are now fully embedded in the strategy and operations of their organization. The emphasis that firms have placed on their CSR activities has in many respects, fundamentally shifted the way we think about and understand the relationships between firms, the institutional environment in which they operate, and their various stakeholders, including local communities, employees, suppliers, governments and civil society.

Nowadays, business organizations adopt and implement a range of CSR activities, while a number of independent agencies, such as Kinder, Lydenberg and Domini (KLD), Bloomberg, and Thomson Reuters ASSET4 rate and rank order corporations based on their corporate social performance (CSP). Here, we follow Wood (1991) in defining CSP as "a business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm's societal relationships" (Wood, 1991:693). In other words, CSP constitutes the social performance outcome of a firm's undertaking of CSR activities. Recently, studies have found that independent company rating and ranking schemes (e.g. Consumer Reports, Moody's) can significantly influence the behavior of consumers (Sen & Bhattacharya, 2001), sell-side analysts (Ioannou & Serafeim, 2010) and investors (Becchetti, Ciceretti & Hasan, 2009; Rock, 2003) as well as the organizations that are being rated (Elsbach & Kramer, 1996; Espeland & Sauder, 2007; Chatterji & Toffel, 2010). Yet what such CSP ratings and rankings have also revealed is a significant variation in CSP not only across firms and industries but also across countries.

Institutional theory has long established that organizations are embedded within broader social structures, comprising of different types of institutions which exert significant influence on the corporations' decision making (e.g. Campbell, 2007; Campbell, Hollingsworth & Lindberg, 1991). Moreover, recent work in CSR has argued that CSR activities are framed vis-à-vis the social context and are thus influenced by the prevailing institutions in such contexts (Jackson & Apostolakou, 2010). In this paper, we build on both these literatures and argue that cross-sectional variation in CSP that results from the undertaking of CSR activities can be attributed to variation across nation-level institutions. Our focus on nation-level institutions is based on prior work within the varieties of capitalism theory (Hall & Soskice, 2001) which showed that nation level institutional heterogeneity can lead to comparative institutional advantages for those firms that operate within different countries (Jackson & Apostolakou, 2010).

To date however, only a limited number of studies have theoretically characterized the mechanisms through which variation in nation-level institutions and business systems may impact the variation in CSP across corporations (Jones, 1999; Stanwick & Stanwick, 1998; Jackson & Apostolakou, 2010) or have empirically documented their role across a broad set of countries (e.g. Habisch et al., 2004; Jamali et al., 2009; Jackson & Apostolakou, 2010). This has been primarily due to the lack of comparable CSP data across such a large number of countries. Accordingly, many scholars have argued that we are still far from being able to explain *social* performance heterogeneity across firms and have called for a comprehensive theoretical and empirical investigation into the reasons behind the observed variation; variation that may be due to the differences in nation-level institutions or national business systems (Whitely, 1997; Maignan & Ralston, 2002; Margolis & Walsh, 2003; Campbell, 2007). In this paper we answer this call and we explore whether and to what extent variation in CSP across firms may be explained by variation in nation-level institutions (Jones, 1999; Campbell, 2007; Matten & Moon, 2008); whereby we conceptualize such institutions as distinct “national business systems” (NBS), following the classification system proposed in Whitley (1997; 1999). We therefore focus on the following key question: *What are the mechanisms through which nation-level institutions within national business systems affect variation in corporate social performance?*

In answering this question, we structure the rest of the paper as follows. In the next section we briefly review prior literature that has investigated the relation between institutions and CSP and we highlight those insights that relate to our own research question. We then draw on institutional theory to outline theoretical mechanisms linking nation-level institutions, and NBS in particular, with variation in CSP. In the section that follows, we describe the Thomson Reuters ASSET4 dataset, the main data source used for constructing our final sample, and we provide details on the empirical estimation strategy that we use to test our hypotheses. The next section presents our results, followed by a section that discusses the implications of our findings for scholars and practitioners. After presenting caveats and limitations of our study, we conclude and sketch avenues for future research.

## **PRIOR LITERATURE**

Although the literature has not yet reached a consensus definition of CSP, we join an extensive stream of work (e.g. Wolfe and Aupperle, 1991; Waddock and Graves, 1997; Hillman and Keim, 2001; Waldman, Siegel and Javidan, 2006) in defining it as a composite multidimensional construct capturing “a business organization’s configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm’s social relationships” (Wood, 1991: p.693). Given this definition, we were able to locate a limited number of prior studies that have focused on factors that affect cross-country variation in CSP (e.g. Jones, 1999; Campbell, 2007; Aguilera et al., 2007; Chapple & Moon, 2005; McWilliams & Siegel, 2001) which we briefly review here.

First, a number of papers study CSP comparatively across a small number of countries (e.g. Maignan & Ralson, 2002; Ramasamy & Ting, 2004; Welford, 2004). For example, Maignan and Ralston (2002) study the extent to which firms in France, the Netherlands, the United Kingdom, and the United States had publicly committed to socially responsible behavior through postings on their corporate websites. Using a sample of 100 firms in each country, they find systematic and significant differences in managerial incentives and stakeholder pressure on the firm to act in socially responsible ways across these four countries. In another study, Chapple and Moon (2005) analyze website reporting of CSR activities by 50 firms in seven Asian countries (India, Indonesia, Malaysia, the

Philippines, South Korea, Singapore and Thailand) and find that cross-country CSP variation cannot be explained by the stage of the country's economic development as they hypothesize; rather, they suggest that "national factors" could explain such variation although they do not formally investigate such factors. They also find that multinational corporations adjust their CSR activities according to the specific national contexts in which they operate.

Theoretically, Aguilera et al. (2007) argue that "because business organizations are embedded in different national systems, they will experience divergent degrees of internal and external pressures to engage in social responsibility initiatives" (p. 836). They compare and contrast the Anglo-American model with the Continental European model and suggest that shareholders in the former would encourage CSR activities when they result in short-term benefits whereas in the latter model, shareholders would focus more on long-term strategies that generate benefits for a broader range of stakeholders. Their argument is effectively based on nation-level institutional differences between the two models (e.g. dispersed ownership focusing on short term returns within the Anglo-American model vs. long-term debt finance and ownership of large blockholders within the Continental model).

More recently, Jackson and Apostolakou (2010) empirically investigate the influence of the institutional environment on CSR activities of European firms and find that firms based in the more liberal market economies of the Anglo-Saxon countries achieve higher levels of CSP, compared to firms based in the more coordinated market economies (CMEs) of Continental Europe. They argue that these findings support the hypothesis that voluntary CSR activities in liberal economies act as a substitute for institutionalized forms of stakeholder participation whereas in CMEs CSP often takes on more implicit forms. In other words, the Jackson and Apostolakou (2010) study provides evidence of the influence of institutions on CSP across two broadly-defined NBS.

In a related study, Maignan (2001) investigates consumers' understanding of CSP in France, Germany, and the US and finds that their perceptions are significantly influenced by nation-level institutions. In particular, she finds that in France and Germany consumers are more likely to support socially responsible corporations, paying less attention to their economic responsibilities, whereas the reverse order applies for consumers in the US. She argues that her findings are based on differences in "national ideologies" (Lodge, 1990): individualistic (US) vs. communitarian (France, Germany). Her

study therefore suggests that nation-level institutions may affect the corporations' undertaking of CSR activities and resulting CSP via their impact on consumer perceptions.

In addition to cross-country variation in CSP, other studies focus on particular CSP activities (e.g. corporate philanthropy) and explore the link between such activities and government regulation. For example, one debate that has not yet been resolved in the literature is whether the ability to deduct charitable contributions from taxable income – an aspect of tax regulation – impacts in any way the total amount of corporate philanthropy that corporations are willing to provide (Campbell, 2007). Put differently, tax regulation – a property rights institution – can directly affect a frequently encountered component of the corporations' CSP activities (Campbell, 2007; Campbell, 2004: 131-132). Evidently then, these studies indirectly suggest that national institutions (in this case, the political and legal systems) may impact CSP in the form of corporate giving across organizations.

Recently, work in the field of international business (IB) has focused on the differences stemming from the variety of institutional contexts. More specifically attention has been paid to the role of global institutions (e.g. global standards) - such as the United Nation's Global Compact or the ISO standards - in exerting a harmonizing effect; particularly so for multinational enterprises (MNEs). For example, Christmann and Taylor (2006) explore this potentially harmonizing effect by focusing on ISO-certified firms in China. They find that such international certifiable management standards are effective only if certified firms strategically choose to substantially (rather than symbolically) comply with the requirements of the standards. Moreover, Crilly (2011) finds that in emerging markets, subsidiaries of large MNEs face substantial pressure for social engagement due to global pressures for legitimacy, which are stronger than isomorphic pressures from local norms and standards.

A related and extensive stream of literature, rather than focusing on CSP as the dependent variable, explores the impact of institutions on the adoption of codes of conduct or the adoption of voluntary reporting practices related to CSR. Without attempting a comprehensive review of this literature here, we indicatively note that Langlois & Schlegelmilch (1990) document the existence of a distinctly European (as opposed to American) approach to codifying ethics, van Tulder and Kolk (2001) provide evidence for the effect of institutions on the adoption of ethics codes in the sporting

industry and more recently, Haxhi & van Ees (2010) argue that particular dimensions of national culture affect the cross-national diversity in the worldwide diffusion of corporate governance best practices. Relatedly, with regards to voluntary reporting, Meek et al. (1995) find that the disclosure of strategic, financial as well as non-financial information reflects distinct national and regional influences across the U.S., the U.K. and Continental Europe. Furthermore, Smith et al. (2005) argue that the extent and quality of corporate social disclosure in annual reports is contingent on the distinct manner in which the role of a corporation and its stakeholders is defined within different societies. Given the importance of reporting practices in the data collection process of the ranking agencies, these studies as well as numerous others highlight the plurality of ways through which cross-national variation in institutions may affect CSR practices and by extension, CSP.

In summary, prior work has directly or indirectly explored how institutional variation may explain the differences in the adoption of specific CSR activities (e.g. ethics or governance codes) or differences in voluntary CSR reporting practices, typically across a limited number of national contexts. Therefore, the issue of how the diversity in cross-national institutional factors that contributes towards the variation in the entire CSP of companies has by and large remained unexplored. To fill this gap in our understanding, in the next section we provide a comprehensive theoretical model about how a country's institutional environment, conceptualized as a NBS and comprised of the a) the political system, b) the financial system, c) the education and labor system and d) the cultural system (Whitley, 1999) may explain variation in CSP.

## **THEORETICAL DEVELOPMENT**

Our focus is on understanding why firms that are embedded in different nation-level institutions, but operate in the same industry, have significantly different CSP. For example, Japanese automakers Daihatsu and Kawasaki have considerably lower CSP than German automakers Daimler and BMW. Below we will argue that differences in the political, labor and education, financial and cultural institutions of Japan and Germany are likely to generate these differences in CSP. In terms of political institutions, laws and regulations that promote product market competition are more prevalent in Japan, a characteristic that limits the ability of companies to invest in CSR activities and generate high CSP. At the same time, Japan is characterized by relatively higher levels of corruption

further impeding the ability of companies to have high CSP. Regarding labor and educational institutions, Japan is characterized by a labor market where skilled capital is more readily available, and as a result supply of human capital is higher, decreasing the incentives of companies to use CSP as a recruitment differentiator. Moreover, employees are less likely to be organized in unions compared to Germany where union density is remarkably high providing unions with the power to force companies to improve their CSP. Although both countries have similar financial systems that are characterized by dominant banking groups, Germany was one of the first countries to have an SRI stock market index signaling investor pressure on companies to improve CSP. Finally, in Germany's more individualistic society firms are more likely to undertake explicit CSR activities in response to perceived expectations by a wider range of stakeholders, compared to societies in which CSR assumes an implicit form and is established as an institutional substitute (Jackson & Apostolakou, 2010).

For our theoretical model, we follow Huntington (1969) who defines institutions as “stable, valued, recurring patterns of behavior,” defined by their adaptability, complexity, autonomy, and coherence (1969: 12). More broadly, institutional theory focuses on the role of social beliefs, values, relations, constraints and expectations (Crossland & Hambrick, 2011) and argues that corporations are embedded in a nexus of formal and informal rules (North, 1990) which directly influence the activities they engage in and their subsequent outcomes. Accordingly, firms may develop strategic responses to institutions, with one possible response being the adoption and implementation of CSR initiatives (Jackson & Apostolakou, 2010) that could involve pro-active attempts to fill institutional voids (Oliver, 1991).

Importantly, subsequent work argues that institutions vary considerably across countries and they collectively constitute distinct “types” of national business systems (NBS) (Whitley, 1999) which are based on differing logics of economic activity (Whitley, 1999; Crouch, 2005; Deeg and Jackson, 2007; Matten & Moon, 2008). Thus, NBS are defined as “distinctive patterns of economic organization that vary in their degree and mode of authoritative coordination of economic activities, and in the organization of, and interconnections between, owners, managers, experts, and other employees” (Whitley, 1999, p.33). Our choice of Whitley's NBS framework as the foundation of our work is based on numerous empirical studies that have documented that a few key institutions are

critical for corporate behavior due to their impact on the relationships between the firm and its primary stakeholders: the political, the financial and the labor institutions (see Aguilera & Jackson, 2003 for a comprehensive review of these studies; Campbell, 2007). In this respect, Whitley's NBS model fully encompasses these three types of institutions and additionally, it accounts for the key role of the cultural system. In particular, Whitley (1999) argues that different institutional arrangements provide differential access to critical firm resources such as labor and capital. Whereas the access to capital is directly affected by the financial system and indirectly by the political system, labor is affected both by the labor market and also "the norms governing trust and authority relations are crucial because they structure exchange relationships [...] between employers and employees" (p.51).

In fact, some scholars argue that CSR is a typical "social construction": differences across NBS and national institutional environments generate differences in the roles of various stakeholders within them (Matten & Moon, 2008; Jackson & Apostolakou, 2010) and therefore, differences about how stakeholders' needs, expectations and interests are conceptualized. Moreover, they argue that "institutionalized rules and understandings help firms to frame, communicate and monitor these practices in socially accepted ways" (Jackson & Apostolakou, 2010, p.387). Since institutions shape the social and political processes of how stakeholders' interests are defined (Aguilera & Jackson, 2003) specific CSR practices are more likely to be adopted and to become effective when they are embedded within particular institutional structures as opposed to others.

In general, despite years of research on the antecedents of financial performance heterogeneity (e.g. McGahan and Porter, 1997, 2002), we are still far from being able to explain *social* performance heterogeneity across firms. Provided that in societies around the world, different systems of markets have emerged which reflect the societies' institutions, their ethics and values, and the range and types of social relations, we would *a priori* expect differences to arise in the ways firms socially perform across distinct societies (Matten and Moon, 2008 p.407). In fact, Whitley (2005) highlights different degrees of diversity in internal firm organization within NBS and argues that the character of the state not only determines the extent of institutional coherence but also affects the degree of homogeneity in firm behavior. In our work therefore we focus on the following question:

*What are the mechanisms through which nation-level institutions within national business systems affect variation in corporate social performance?*

To answer this question, we follow Matten and Moon (2008) in arguing that CSP variation may partially be explained “by historically grown institutional frameworks that shape national business systems (NBS) (Whitley, 1997)” (p.407). We recognize of course, that variation in nation-level institutions is not the only factor affecting CSP; firm- and industry-level determinants matter as well. In this paper however, our focus is on the variance in the nation-level institutions while empirically controlling in our specifications for these other factors. Therefore, our approach is consistent with Campbell (2007) who argues that “variation in socially responsible behavior is probably associated with variation in institutions and sticks and carrots they provide to constrain and enable such behavior” (p.952). We also acknowledge that by doing so we sacrifice some breadth in terms of investigating other factors that can explain CSP variation, but we believe we gain in terms of the theoretical depth of our argument regarding the role of nation-level institutions within the broader NBS.

### **Political system**

According to Whitley (1999), an essential feature of any political system is the power of the state: “the extent to which states dominate the economy and share risks such that businesses become dependent on state policies and actions” (p.48). Given significant diversity across countries in the power of the state, it follows that the extent to which states “directly or indirectly regulate market boundaries, entry and exit, as well as set constraints on the activities of economic actors” (p.48) through laws and regulations is also an important determinant of organizational outcomes in general, and social performance in particular. For example, de Oliveira (2006) argues that in Latin America, a political system characterized by poor governance results in CSR activities by corporations that are a substitute for the lack of state policies. Similarly, Adi et al. (2006) argue that due to widespread government failings, political unrest and corruption, Nigerian firms have focused on healthcare and education as the main areas of their CSR activities to compensate for the drawbacks of the Nigerian political system.

Broadly, laws and regulations play an important role in facilitating the corporation's engagement with the state as well as its key stakeholders (Campbell, 2007; Aguilera & Jackson, 2003; Roe, 2003). More particularly, several laws and regulations around the world aim at promoting competition between firms whereby competition is usually modeled as taking place in the market for outputs (i.e. products and services). Since they are typically based on the neo-classical economic view of the world, such laws and regulations are enacted because they arguably lead to higher levels of allocative efficiency, higher rates of innovation (Porter, 1985) and eventually, even to higher levels of social welfare. However, given high levels of competition, firms are faced with razor thin profit margins to the extent that their very survival may be put at risk. Therefore, social performance will be lower for two reasons: first, firms with minimal or zero profits have fewer, if any, resources to invest in activities that would increase CSP. Second, as Campbell (2007) notes, firms in highly competitive environments would be more likely to cut corners and attempt to save money whenever and however possible. It is no surprise then that indeed periods of very intense competition have been associated with lower levels of CSP taking the form of "compromised product quality and safety, sweating labor and cheating customers" (Kolko, 1963; McCraw, 1984; Schneiberg, 1999; Weinstein, 1968). Accordingly, we argue that in countries where laws and regulations promote high levels of competition, corporations are more likely to score low on the CSP index.

*Hypothesis 1: In countries where laws and regulations promote higher levels of competition, corporations will score lower on the CSP index.*

Moreover, countries around the world adopt legal rules and regulations to protect shareholders from corporate insiders investing in projects or activities that would benefit themselves or other stakeholders instead of the shareholders. For example, the undertaking of some CSR activities such as corporate philanthropic contributions may be primarily driven by managerial utility considerations (e.g. satisfaction of some personal or moral imperative of the manager) rather than the enhancement of shareholder wealth (e.g. Galaskiewicz, 1997; Clotfelter, 1985:190; Navarro, 1988). In addition, as prior literature has documented, social issue participation (e.g. not engaging with 'sin' industries, avoiding nuclear energy, etc) is negatively associated with shareholder value creation (Hillman & Keim, 2001). This finding is consistent with the neo-classical viewpoint (Friedman, 1970;

Jensen, 2002) which states that shareholder value maximization is the corporation's *raison d'être*. Any other initiatives, including CSR activities and social issue participation, that would address issues of stakeholders other than shareholders are essentially regarded as a waste of shareholder wealth. It follows then, that in countries where laws and regulations effectively protect shareholders' interests, thus reinforcing the neo-classical shareholder primacy model, the incentives for company insiders to address the interests of any other stakeholder are significantly lowered; the undertaking of CSR activities could be perceived as rent-seeking behaviour. Accordingly, CSP suffers.

*Hypothesis 2: In countries where laws and regulations promote higher levels of shareholder protection, corporations will score lower on the CSP index.*

In addition to these legal institutions, corporations often deal directly with states in a variety of ways (Rodriguez, Uhlenbruck, and Eden, 2005) and for reasons that include bargaining for public sector contracts, lobbying activities, negotiations about acceptable practices and antitrust cases, and other instances. As a result, state efficiency and bureaucracy as well as the overarching system of values and beliefs of the governmental officials – and the ruling party or coalition in particular – affect the level of CSP that corporations achieve.

Specifically, we expect that firms in countries where values and beliefs dictate lower levels of corruption will achieve higher levels of CSP for three reasons. First, in environments of high corruption some firms are more likely to engage in unethical practices to reduce their costs (e.g. child labor) or to increase their market share (e.g. through bribery). Such behavior will push other companies to also engage in unethical practices to remain competitive. Second, the resulting benefits to ethical firms may be lower in more corrupt countries since in such countries the state is less likely to provide incentives for them to be socially responsible in the form of tax exemptions, financial support and improved infrastructure. Third, ethical corporations themselves may have an effect on corruption in itself: firms that embed CSR activities within their core strategy – especially the formulation and adoption of ethical codes and corporate policies relating to procurement and project acquisition – are more likely to actively resist and oppose unethical activities more broadly. As a result, they contribute towards a lower overall level of corruption in the country overall (Luo, 2006).

*Hypothesis 3: In countries with higher levels of corruption, corporations will score lower on the CSP index.*

Finally, we argue that the ideological system of values and beliefs of state officials and of ruling parties or coalitions will also be a key factor affecting CSP variation. In countries where the predominant political ideology is tilted towards the left, collective social consciousness is more likely to encourage firms to attach greater importance to CSR (Davis & Thompson, 1994; Riley, 1983). As Matten & Moon (2008) argue, when CSR is motivated by a “societal consensus on the legitimate expectations of the roles and contributions of all major groups in society, including corporations” then by definition, CSR assumes an implicit - as opposed to an explicit - form. Accordingly, implicit CSR is more likely to materialize under leftist regimes (e.g. more coordinated economies) rather than rightist ones. Since implicit CSR consists of values, norms, and rules that together generate codified and mandatory requirements for corporations that are not conventionally described explicitly as CSR, implicit CSR materializes as an institutional substitute (Jackson & Apostolakou, 2010). In other words, in countries with a more leftist political ideology, CSR is more likely to be embedded within formal institutional structures rather than expressed through voluntary and explicit corporate initiatives. The stronger such institutional structures are, the more they crowd out explicit forms of CSR and the more they lessen the need for explicit CSR initiatives to be undertaken and communicated by corporations. To the extent that CSP measures the outcomes of such voluntary and explicit CSR initiatives as opposed to simply measuring compliance with formal laws and regulations, it will tend to be lower in leftist countries.

*Hypothesis 4: In countries with a more leftist political ideology, corporations will score lower on the CSP index.*

### **Education and Labor system**

In addition to the political system, Whitley (1999) also identifies the “system for developing and controlling skills” (p.50) that consists of two interrelated sets of institutions: “the system that develops and certifies competences and skills” (i.e. the education system) and “the institutions that control the terms on which the owners of those skills sell them in labor markets and how those markets are organized” (i.e. the labor system). A firm’s employees are also a “primary” stakeholder

(McWilliams & Siegel, 2001; Freeman, Harrison & Wicks, 2007) and therefore, changing strategic priorities, technologies and markets as well as the decisions relating to labor-management strategies are all contingent on the strength of trade unions, who can directly control the skills and capabilities in the economy (Whitley, 1999).

Consequently, the power of labor unions is a key factor affecting CSP, particularly at the national level. In fact, Matten and Moon (2008) argue that “higher levels of union membership in Europe resulted in labor-related issues being negotiated at a sectoral or national, rather than corporate level” (p.408) compared to the United States. We expect that in countries where labor unions are more prominent, firms will perform better on the CSP index since powerful unions may push for extended benefits for employees, focusing more on health and safety provisions, progressive labor relations policies, more workplace amenities, and may push for more engaged community involvement. The labor force may even increase overall awareness within society by acting as the firm’s ambassador for environmental and social policies. Prior literature also shows that labor unions can even influence social performance at non-union firms: McWilliams & Siegel (2001) note that this influence on non-union firms is analogous to the well-documented “threat effect” of unions on non-union wages (Freeman & Medoff, 1983; Mills, 1994): non-union corporations may voluntarily adopt progressive policies to actually avoid worker unionization (McWilliams & Siegel, 2001; Foulkes, 1980).

However, prior literature on the relationship between a corporation’s slack resources and social responsibility (e.g. Buchholtz et al., 1999; Seifert et al., 2004) offers a plausible alternative: in cases where labor power is higher, firms are left with relatively fewer resources to devote to environmental and social performance, and thus the relationship between labor power and CSP may become ambiguous. This argument is based on two assumptions: first, that CSP is the result of the utilization of the firm’s slack resources and not an integral part of the firm’s business model or its corporate culture as more recent empirical work seems to suggest (Eccles et. al., 2011). Second, it assumes an underlying trade-off in the utilization of resources for which evidence is limited, and an unrealistic independence among stakeholder interests: it is highly unlikely that labour unions would push for workplace amenities for example, while remaining indifferent to an adverse impact on the local community or the environment; typically employees originate from the local communities,

and/or may well reside in the firm's vicinity and be directly affected by its environmental impact. Accordingly, we predict a net positive relationship between strength of labor unions and CSP.

*Hypothesis 5: In countries where labor unions have more power, corporations will score higher on the CSP index.*

In addition to the labor system, the regulation and production of human resources (i.e. the education system) can also impact the variation in CSP. Prior work shows that firms with strong CSP attract and retain higher quality employees since CSP sends signals to prospective job applicants about what it would be like to work for the focal firm (Turban & Greening, 1997; Greening & Turban, 2000). This finding has implications for how firms compete in the market for skilled human capital: they will be more likely to recruit talent by improving their social performance since such skilled and talented employees increasingly choose to work for firms with high CSP. It follows then, that the more limited the skilled human capital availability is in a country, the more likely that firms will compete by enhancing their social performance in order to differentiate themselves as employers and become more attractive to prospective highly-skilled job applicants. Therefore, CSP is inversely related to skilled labor availability. In fact, existing evidence already shows that in industries with relatively limited skilled labor availability, firms are particularly proactive in their CSR activities (Siegel, 1999).

*Hypothesis 6: In countries with higher availability of trained and skilled human capital, corporations will score lower on the CSP index.*

## **Financial System**

Capital providers are important stakeholders for organizations since they finance business operations (Freeman, Harrison & Wicks, 2007). Yet significant diversity exists in the financing arrangements around the world: a critical feature that varies is the processes by which capital is made available and priced (Whitley, 1999). On the one end, some financial systems are market based (e.g. United States) where actors “mobilize and distribute capital largely through large and liquid markets which trade and price financial claims through the usual commodity-market processes” (Whitley, 1999, p.49). At the other end, credit-based financial systems (e.g. France, Germany) “typically have weak and fairly illiquid or thin capital markets, which play only a minor role in mobilizing and

pricing investment funds” (Whitley, 1999, p.49). In such financial systems, the dominant institutions are large banks and/or state agencies and ministries who, in times of capital shortages, make allocation decisions through administrative processes rather than open market operations.

In market based financial systems with well-developed equity markets, corporations strive to secure the most favorable financing terms. Typically, financing decisions by the markets are based on short-term profitability and therefore, within such systems, that is what firms focus on maximizing (Teoh, Welch & Wong, 1998a; Teoh, Welch & Wong, 1998b). This form of short-termism however, is likely to limit investments in CSR activities since the benefits from such activities usually materialize in the long-run (e.g. “reputation building”, Fomburn & Shanley, 1990; Weigelt & Camerer, 1988). Meanwhile, intense competition for financing may push firms towards behaving in socially *irresponsible* ways in order to survive. Thus, they may engage in actions such as misleading customers, abusing labor, miss-communicating corporate performance, and compromising product safety (Weinstein 1968; Schneiberg, 1999; McCraw, 1984; Jones, 1991; Kolko, 1963). For these two reasons, we expect that corporations located in countries that are closer to the market-based model, with deep and large stock markets, will fare worse on the CSP index.

On the other hand, market based financial systems are better structured to allocate capital resources more efficiently compared to credit-based financial systems which are based primarily on administrative processes of capital allocation. This may be true particularly during periods of high growth when shortages of available financing become more acute (Whitley, 1999). Since prior work has shown that more capital-constrained firms score lower along CSP dimensions (Hong, Kubik & Scheinkman, 2011), we would expect that corporations in credit-based financial systems will face relatively more capital constraints and therefore, will fare worse on the CSP index. In other words, corporations in market-based financial systems will face fewer capital constraints and therefore will fare better on the CSP index.

To date, a long literature has debated whether the markets are indeed myopic (i.e. short-term oriented) with empirical results being mixed, often even suggesting that the reverse is true; that markets are long-term oriented – at least for some firm activities. Importantly, some studies find significant positive stock returns associated with the announcement of research and development

(R&D) projects (Jarrell, Lehn, & Marr, 1985; Woolridge, 1988; Woolridge & Snow, 1990; Bizjak, Brickley, & Coles, 1993), thus suggesting a relatively efficient allocation of capital in that markets reward firm activities that are consistent with long-term value creation. Therefore, to the extent that CSR activities are similar to R&D projects in their long-term orientation, we expect that in countries with market-based financial systems, capital will be more efficiently allocated in general and to its potentially long-term value creating activities in particular. Thus, firms within such countries will face fewer capital constraints and will fare better on CSP. In sum, we expect the efficiency of the capital allocation process in market based systems to be a more salient mechanism than the potential short-termism of the market.

*Hypothesis 7: In countries with a more market-based financial system, corporations will score higher on the CSP index.*

In addition to the type of the financial system in place, we also argue that the total amount of available capital in the country that demands high CSP as an investment criterion will also affect CSP variation. Prior work shows that in fact, in the past ten years the amount of assets under management by socially responsible investment (SRI) funds has dramatically increased, reaching to more than \$4 trillion according to some estimates (Ioannou & Serafeim, 2010). Moreover, in a comprehensive review of the literature, Sparkes and Cowton (2004) suggest that SRI “has become an investment philosophy adopted by a growing proportion of large investment institutions”. We expect that in countries with larger amounts of such capital available, firms will fare better on the CSP index for two reasons. First, as Mackey, Mackey & Barney (2007) argue, the higher the demand for socially responsible investment opportunities, the higher is the likely increase in market value for a firm that improves its CSP; according to their theory, “the opportunity to invest in a firm engaging in socially responsible activities is a “product” firms sell to current and potential investors” (p.830).

Consequently, we argue that in countries where a socially responsible stock market index exists - indicating the presence of sufficient amounts of capital for SRI investments - firms will strive to improve their CSP as a means through which to attract this capital. This mechanism therefore, is similar to the one argued for the recruitment of high skilled capital. In the competitive markets for inputs (i.e. labor and capital), CSP may act as a critical point of differentiation. Second, the

development of a large enough SRI market could potentially reduce the cost of capital for firms with high CSP and thus provide additional market based incentives for firms to actually improve their CSP (Dhaliwal et al. 2011). Because of these two reasons, we expect a positive relation between the existence of a responsible stock market index and CSP.

*Hypothesis 8: In countries where a socially responsible stock market index exists, corporations will score higher on the CSP index.*

### **Cultural System**

Finally, Whitley (1999) argues that “the norms governing trust and authority relations are crucial because they structure exchange relationships between business partners and between employers and employees. They also affect the development of collective identities and prevalent modes of eliciting compliance and commitment within authority systems” (p.51). In what ways then, could the cultural system affect variation in CSP? As Matten & Moon (2008) argue, the cultural systems of the U.S. and Europe, “have generated very different broad assumptions about society, business and government.” Whereas in the U.S. an ethic for wealthy businessmen and for corporations to “give back” to society has emerged, in Europe a greater “cultural reliance on representative organizations, be they political parties, unions, employers’ associations, or churches, and the state” has been instituted instead (Lipset & Rokkan, 1967; Matten & Moon, 2008).

At a more micro level, work by Crossland & Hambrick (2011) shows that several cultural traits have a direct impact on managerial discretion, which they conceptualize as the “latitude of managerial action” (Hambrick & Finkelstein, 1987). Thus we expect that cultural traits will also impact managerial decision-making related to CSP. One such fundamental element of the cultural system that has been previously identified (e.g. Aguinis & Henle, 2003; Gelfand et al., 2004; Crossland & Hambrick, 2011; Triandis, 1994) is linked to the issue of autonomous vs. consensus-based actions. Societies characterized by high levels of individualism typically allow for a larger margin of individual initiative and are more willing to tolerate unilateral decision-making. In countries with low levels of individualism, the members of society form expectations that decision-making processes will be broader, more participatory and more consultative.

Transferring this finding in the CSP domain, Matten & Moon (2008) argue that in individualistic societies that provide discretion to private economic actors one would expect to encounter strong elements of explicit CSR; where explicit CSR is defined as “the result of a deliberate, voluntary, and often *strategic* (Porter & Kramer, 2006) decision of a corporation” (emphasis added, p.410). In other words, in more individualistic cultures managers are more likely to make their mark by choosing explicit decisions and actions, both in the CSP domain, but also more broadly. For example, in countries with a Roman Catholic heritage, which emphasizes the collective more than the Protestant heritage of following one’s individual faith, philanthropy is typically anonymous or low-key since attaching one’s name to a philanthropic act brings in an element of ‘selfish’ self-promotion; in Protestant countries this is much less of a concern.<sup>3</sup> Analogously, in individualistic societies firms are more likely to undertake explicit CSR activities in response to perceived expectations by a wider range of stakeholders. To the extent that CSP measures the outcomes of such voluntary and explicit CSR initiatives we therefore expect that it to be higher in individualistic societies compared to societies in which CSR assumes an implicit form and is established as an institutional substitute (Jackson & Apostolakou, 2010).

*Hypothesis 9: In countries that are characterized by higher levels of individualism, corporations will score higher on the CSP index.*

Another critical institution of any cultural system is the characterization of the relative status of leaders within civil society. Cultural research argues that in societies where such power distance (Hofstede, 2001; House et al., 2004) is lower, business leaders are seen as “mere facilitators or figureheads and less as empowered decision makers, [thus] experience greater normative constraint” (Crossland & Hambrick, 2011, p.801). Conversely, in societies with higher power distance, “stakeholders will be more likely to allow far-reaching executive actions, more likely to acquiesce in the face of executive actions, and less likely to question decision makers or the basis upon which actions are taken” (Crossland & Hambrick, 2011, p. 801).

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<sup>3</sup> We thank an anonymous reviewer for suggesting this point and this example to us.

On the one hand, high power distance can generate a sense of obligation on the part of executives or other high ranked officials to pay special attention to the expectations and needs of key stakeholders and society more broadly; it will urge them in other words, to act as society's nobility in pursuing CSR objectives with their actions (Waldman et al., 2006). Accordingly, we would expect the CSP index in high power distance societies to be higher.

On the other hand, as Waldman et al. (2006) have shown, high power distance may be negatively associated with CSP: managers in high power distance societies may be inclined to care more about their own interests rather than the interests of society. Therefore, they will be more likely to use their power for the pursuit of personal benefits (Carl et al., 2004) and may not particularly care about building long-term relationships with key stakeholders or feel responsible for the broader social welfare (Waldman et al., 2006). Moreover, Cohen et. al. (1996) find that in societies with a high power distance, actors are more likely to view questionable business practice as ethical compared to actors in low power distance societies. Therefore, under these conditions we would expect CSP to be lower. Taking into account prior empirical findings (e.g. Waldman et al., 2006; Ringov & Zollo, 2007) we expect this latter mechanism to be more salient in the CSP context and therefore we predict a net negative relationship between power distance and CSP.

*Hypothesis 10: In countries with higher levels of power distance, corporations will score lower on the CSP index.*

## **SAMPLE, DATA AND METHODS**

### **Sample and Data Collection**

We construct our sample by combining a number of different databases (see Table 1). We obtained environmental, social and governance (ESG) metrics from Thomson Reuters ASSET4 that specializes in providing objective, relevant, auditable and systematic ESG information and investment analysis tools to professional investors. It is estimated that investors representing more than €2.5trillion assets under management use the ASSET4 data to build their portfolios by integrating ESG data into their traditional investment analysis. We collected stock market data from DataStream, analyst coverage data from I/B/E/S, and accounting data from WorldScope. The nation-level variables come from multiple sources including the IMD World Competitiveness report, the World Federation

of Exchanges, World Bank, the CIA Factbook, Botero et al. (2004), La Porta et al. (2006) and Hofstede (1997, 2001). The resulting sample includes in total 12,764 observations with available data for all variables for a total of 7 years: 2002 to 2008. The sample primarily comprises of firms from Japan, USA and the UK. However, a substantial number of observations come from Continental European countries, Australia, Hong Kong and Singapore. Our sample includes information from 42 countries and a large number of individual firms: 930 firms in 2002, 943 firms in 2003, 1,773 firms in 2004, 2,188 firms in 2005, 2,209 firms in 2006, 2,391 firms in 2007 and finally, 2,330 firms in 2008.

### **Dependent Variables: Measuring CSP and the ASSET4 Dataset**

In prior literature, constructing a truly representative measure of CSP has been rather challenging due to: a) the multi-dimensionality of the theoretical construct and b) because measurements of a single aspect of CSP (e.g. corporate philanthropy) provide a limited perspective of the firm's performance in the more general social and environmental sense (Lydenberg et al., 1986; Wolfe and Aupperle, 1991). In fact, Waddock and Graves (1997) highlighted the "need for a multidimensional measure applied across a wide range of industries and larger samples of companies" (p.304). Meanwhile, a wide variety of CSP measures have been used by researchers: forced-choice survey instruments (Aupperle, 1991; Aupperle et al., 1985), the Fortune reputational and social responsibility index or Moskowitz' reputational scales (Bowman and Haire, 1975; McGuire et al., 1988; Preston and O'Bannon, 1997), content analysis of corporate documents (Wolfe, 1991), behavioral and perceptual measures (Wokutch and McKinney, 1991), and measures from case study methodologies (Clarkson, 1991).

For this study, we utilize a global ESG dataset from Thomson Reuters ASSET4 who have collected data and scored firms on ESG dimensions since fiscal 2002. Specially trained research analysts collect 900 evaluation points per firm and according to guidelines all the primary data used must be objective and publically available. Typical data sources include stock exchange filings, CSR and annual reports, non-governmental organizations' websites, and various news sources. After gathering the ESG data the analysts transform it into consistent units to enable quantitative analysis of this qualitative data. Indicatively, we note that: a) for environmental factors the data would typically

include information on energy used, water recycled, CO2 emissions, waste recycled, and spills and pollution controversies and b) for social factors the data would typically include employee turnover, injury rate, accidents, training hours, women employees, donations, and health & safety controversies. According to Thomson Reuters ASSET4, every data point question goes through a multi-step verification and process control, which includes a series of data entry checks, automated quality rules and historical comparisons to ensure a high level of accuracy, timeliness and quality. Based on these data points, Thomson Reuters ASSET4 offers a comprehensive platform for establishing customizable benchmarks for the assessment of corporate performance. Subsequently, these 900 data points are used as inputs to a default equal-weighted framework to calculate 250 key performance indicators (KPIs) and further organize those in 18 categories within 4 pillars: a) environmental performance score, b) social performance score c) corporate governance score and d) economic performance score (see also Appendix 1). For every year, a firm receives a z-score for each of the pillars, benchmarking its performance with the rest of the firms.

In our work, we use the environmental and social metrics to construct a composite CSP index. When constructing such an index an aggregation issue arises: what weights should one assign to these two dimensions of CSP? The same issue was faced in the past by scholars that used the Kinder, Lydenberg and Domini (KLD) dataset. Some studies used differential category weights based on either (subjective) academic opinions about category importance (Graves and Waddock, 1994; 1997) or used the analytic hierarchy process to derive weights (Ruf, et al., 1993). The literature to date however, has not identified a theoretically derived ranking of importance for the various stakeholder groups as a guide for empirical work. Accordingly, we follow the convention established by Waddock and Graves (1997), Hillman and Keim (2001) and Waldman, Siegel and Javidan (2006) among others who used the KLD dataset, in constructing a composite CSP index by assigning equal importance (and thus equal weights) to each of the two pillars. In particular, the variable *CSP Index* is the equally weighted average of the social and environmental score for the focal firm for every year in our sample. For robustness, we also performed a principal components analysis (PCA) and in unreported results we used the first estimated component as our dependent variable with virtually no change in

our results. This is because the PCA analysis assigned approximately equal weights on the social and the environmental scores.

### **Independent Variables**

Nation-level variables are described in detail in Table 1. With regards to the choice of institutional variables, we rely extensively on a large literature from economics, sociology, and political science (see relevant references in Table 1) and we also remain as close as possible to the theoretical constructs suggested by Whitley (1999). Specifically, the political system variables cover laws and regulations that encourage competition in a country (*Competition and regulation*), laws that limit self-dealing of corporate insiders thus protecting shareholders (*Anti-self dealing index*), the level of corruption in each country (*Absence of corruption*), and the degree to which chief executives and the largest party in congress have left or center political orientation (*Left ideology*). Labor market and education variables cover the extent to which employee unions are powerful within society, measured as the extent to which employees are organized in unions (*Union density*), and whether skilled labor is readily available in the country (*Availability of skilled labor*). Financial system variables include the average leverage ratio (*Current Debt over Assets*) among firms in an economy, that captures the extent to which the financial system adheres to a credit- or equity-market based model (i.e. a higher leverage ratio signifies that firms depend more on debt for their financing rather than equity markets), and the existence (i.e. an indicator variable) of a socially responsible stock market index (*SRI Index*). We characterize the cultural system using two well established measures of cultural distance by Hofstede (1997, 2001): *Power Distance Index* and *Individualism*.

As additional controls in our specifications we include country variables that measure how globalized and competitive is the economy of each country (*Balance of Trade and Trade*), the quality of its infrastructure (*Basic infrastructure*) and the sheer size of its capital market (*Market Capitalization*). We include these variables to mitigate any correlated omitted variable bias arising from the influence of globalization, competitiveness and basic infrastructure of an economy on CSP. We also include a number of firm and industry level variables as potential factors affecting CSP. All firm and industry level variables are defined in Table 1. We expect CSP to increase in firm performance (*Return-on-Assets*) and to decrease in firm risk (stock return *Volatility*) (Campbell,

2007). Moreover, we expect CSP to increase for firms that compete through providing innovative and differentiated services and products (McWilliams & Siegel, 2001). We use as proxies for the product characteristics of a firm and the degree to which a firm competes on differentiation, the *Market-to-Book* ratio, and *Research and Development expenses over sales*. CSP will be higher for larger (*Firm size*), more diversified (*Number of segments*) (McWilliams & Siegel, 2001), and more visible (*Analyst coverage* and *American depository receipt*) firms (Ioannou & Serafeim, 2010). These last two measures have been used extensively in prior literature that has confirmed their validity as proxies for a firm's visibility (e.g. Lang, Lins, and Miller 2003; Baker, Nofsinger and Weaver 2002; Bhushan 1989; ). Finally, CSP will be lower in more competitive industries (*Herfindal Index*) (Campbell, 2007). All the specifications include industry fixed effects based on the Fama-French (1997) industry classification to account for systematic differences in CSP across industries as well as year fixed effects to capture potential time trends in CSP.

## **RESULTS**

### **Summary statistics**

Panel A of table 2 presents the average score and standard deviation for the social and environmental pillars and the CSP Index. We note that significant variation exists both within as well as across countries in CSP. Panel B of the same table presents the distribution of observations using the Fama-French (1997) industry classification across countries for all the years in our sample. Table 3 reports summary statistics for the variables used in the empirical specifications. The social and environmental scores as well as the composite CSP Index range between zero and one by construction, and have a mean that is close to 0.50. Furthermore, figure 1 graphs the average social and environmental scores and CPI Index across all countries over time revealing an upward trend in all scores between the year 2002 and 2008, albeit it is economically insignificant. Moreover, table 4 shows the annual mean and standard deviation of the independent variables of interest across countries over time. Finally, the two panels of table 5 present the complete correlation matrix where several of the variables capturing variation at the level of national institutions exhibit significant associations with the CSP Index.

To capture the relative importance of firm, industry, and nation-level factors in explaining variation in CSP across firms, we perform a variance of components analysis using a maximum likelihood methodology (VARCOMP in SAS). As a robustness check we used alternative methods which produced qualitatively similar results. We find that explainable variation in the CSP Index is attributed as follows: 70% firm, 11% industry, 2% year, and 17% nation-level effects, respectively. Since prior work has found that firm size may explain variation in CSP, we re-estimate the variance of components analysis on a subsample of the five largest firms in each country in every year between 2002 and 2008. We find that nation-level effects explain 35% of the explainable variation in the CSP index whereas, firm and industry effects account for 55% and 10% of the explainable variation, respectively. This finding suggests that the impact of nation-level institutions is *particularly* salient for this subset of firms which also happen to be the major influencers within the countries in our sample due to their dominant market presence in the specific country context.

These results suggest that nation-level factors are important in explaining total variation in CSP, particularly when they are compared to corresponding estimates by prior studies in the field of strategy. Such studies decomposed the variance of *financial* performance and found that the industry effects explained between 15% (Rumelt, 1991) to 19% (McGahan & Porter, 1997; 2002) of overall financial performance variation. They thus established empirically the importance of the strategic positioning school (Porter, 1980). Our findings here therefore, that are of similar magnitude, seem to suggest an equally important role of nation-level institutions in explain variation in CSP.

### **Regression results for full sample**

For all specifications, we estimate the coefficients using the ordinary least squares methodology with clustered (at the firm level) and robust standard errors and industry and year fixed effects. Moreover, we use lagged independent variables. For the firm and industry level controls all variables are calculated in  $t-1$  while the CSP construct is calculated in year  $t$ . Country level variables that are measured every year we also calculate in year  $t-1$ . Finally, country variables that do not vary over time are measured before our first year of CSP data and as a result they are lagged by construction. Column (0) of table 6 shows the results of the analysis using the CSP Index as dependent variable and omitting any nation-level variables. Column (1) of table 6 presents the main

regression results of our analysis based on the full sample and the CSP Index whereas columns (2) and (3) use the social and environmental scores as dependent variables. The results in columns (2) and (3) are qualitatively the same as column (1) and therefore we focus the rest of our discussion on column (1).

#### *Political System*

Consistent with hypothesis 1, our results confirm that laws and regulations that promote market competition (*Competition and Regulation*) are associated with a lower CSP index. This effect is economically large, suggesting that all else equal, a firm that is headquartered in a country in the 25<sup>th</sup> percentile of *Competition and Regulation*, relative to the 75<sup>th</sup> percentile, will have almost 20% higher CSP. Hypothesis 2 is also confirmed: we find evidence that when managers have the power to take decisions that might not be in the best interest of shareholders and potentially satisfy other stakeholders, CSP is higher. Moreover, we find that CSP is significantly higher for corporations in countries where corruption is less widespread, consistent with hypothesis 3. The economic effect is one of the largest at 0.13 for an interquartile change in *Absence of Corruption*. Finally, we find that firms in countries characterized politically by a *Left ideology* score lower on the CSP Index, supporting the view that CSP is an institutional substitute (Jackson & Apostolakou, 2010). The estimated coefficients suggest that an interquartile increase in *Left ideology* decreases the CSP index by 0.08.

#### *Education and Labor System*

As predicted by hypothesis 5, in countries with a higher *Union Labor Density* corporations fare better on the CSP index suggesting that unions put pressure on corporations to improve the social benefits provided to workers and can also increase corporate awareness of environmental consequences. The results also support the positive directionality of hypothesis 6, predicting that in countries with higher availability of skilled human capital (*Availability of Skilled Labor*) corporations will fare worse on the CSP Index since the abundance of highly skilled employees mitigates the need for higher CSP in order to attract and retain them.

#### *Financial System*

In testing hypothesis 7, we find a negative and significant coefficient on *Country Debt over Assets*, showing that in countries with a credit-based model corporations are more likely to fare worse on the CSP index. This finding is important because it confirms that the efficiency of the capital allocation process in capital-market-based financial systems relative to the credit-based systems outweighs any potential negative impact on CSP due to the short-term focus of corporations. In other words, the potentially longer-term horizon of debt-holders in a credit-based financial system is not enough to outweigh the inefficiencies caused by the allocation of capital by administrative processes rather than markets. Thus, firms in such systems are more likely to face significant capital constraints and subsequently fare worse in terms of CSP. Interestingly, the existence of a *Socially Responsible Index (SRI)* exhibits no relation with the CSP Index and therefore, hypothesis 8 is not supported by the empirical analysis. We think that this might be so because despite their significant growth in recent years, SRI funds remain a relatively small part of the total market. However, as SRI funds keep growing significantly over time and differentially across countries, future work may seek to understand their potential impact on CSP variation.

#### *Cultural System*

Finally, we find evidence that cultural traits play a significant role in explaining CSP variation across firms. Our results confirm hypothesis 9 according to which in countries that are characterized by higher levels of individualism (*Individualism*) corporations fare better on the CSP index. In individualistic societies that actively encourage broader discretion of economic actors, CSR materializes in a more explicit, proactive and strategic form and consequently, it enhances CSP. Surprisingly, hypothesis 10 is not confirmed. Instead, the positive and significant coefficient on the *Power Distance Index* indicates that a higher power distance generates a sense of noble obligation on the part of business executives to pay attention to the needs of their stakeholders and society more broadly.

In summary, our empirical findings confirm the majority of our hypotheses but also, the estimated economic effects provide an indication with regards to the relative importance of different elements of the NBS in driving CSP variation. In particular, the results show that the political system is the most significant factor affecting CSP variation: the economic effect of an interquartile change in

*Competition and Regulation* on CSP is 0.09 suggesting that a firm that is headquartered in a country in the 25<sup>th</sup> percentile of *Competition and Regulation*, relative country in the 75<sup>th</sup> percentile, will have almost 20% higher CSP. Similarly, for the *Anti-self Dealing Index*, *Absence of Corruption* and *Left Ideology* the estimated effects on CSP are 0.04, 0.13 and 0.08, respectively. Thus, we note that the estimated effect for *Absence of Corruption* is the largest economic effect across all of the independent variables. With regards to the Education and Labor system, we find that the economic effects are 0.05 and 0.04 for the *Availability of Skilled Labor* and *Union Density*, respectively. We also estimate the economic effects for the Cultural system to be 0.03 for *Individualism*, and 0.06 for *Power Distance*.

In contrast, for the financial system, only the coefficient on *Country debt over assets* obtains significance with an estimated economic effect of 0.03. This finding suggests that the structure of the financial system does not exert a significance influence on CSP. This may be due to the fact that the majority of actors within the financial system, such as investors and investment analysts, have only recently attempted to incorporate CSP in their assessments and capital-allocation decisions. More generally, based on the estimated economic effects, we find that apart from the political system the rest of the systems rank as follows: education and labor system, cultural system, and financial system. *Country, industry and firm control variables.*

Most of the control variables that we include at the country, the industry and the firm level obtain significance in the expected direction as theorized by prior literature. At the country level, we find that corporations in countries running on deficits (*Balance of Trade*) and with higher levels of international trade (*Trade*) fare better on the CSP Index. Moreover, the size of the equity market itself (*Market Capitalization*) does not appear to drive variation in the CSP Index. At the industry level, we find that higher concentration as measured by the *Herfindal Index* is positively related to CSP, confirming prior work by Koerber & Griffin (2011). The firm level controls reveal that CSP is related to the risk-return profile of a firm: better performing firms (higher *Return-on-Assets*) are more socially responsible, consistent with the argument set forth by Campbell (2007). Moreover, riskier firms (higher *Volatility*) fare worse on the CSP index. *Firm Size* as well as *R&D expenditure* exhibits significant positive association with the CSP Index whereas firm scope, as measured by the *Number of Segments* the firm competes in, does not seem to affect CSP. Visibility (*Analyst coverage*) of a firm

is significantly and positively related to CSP, consistent with prior findings showing that the returns of CSR activities are higher for more visible firms (Ioannou & Serafeim, 2010). Finally, we find that firms closely held by investors (*% of shares closely held*) fare worse on the CSP Index, indicating that wide dispersion of equity ownership is, on average, linked to better social performance. In general, these findings highlight the key role of firm and industry level factors in explaining CSP variation in addition to the institutional factors. Moreover, they raise important questions with regards to the institutional conditions under which some of the firm and industry level factors may become more salient than others. Future research may investigate how firm and industry level factors interact with institutional structures to affect CSP variation.

### **Regression results for domestic and multinational corporations**

A potential limitation of our analysis is that a number of corporations operate in multiple countries and as a result they are subject to the influence of multiple nation-level institutions. In our baseline specification we include national-level institutional variables of the country in which the firm is incorporated. To address this concern we perform a number of robustness checks.

First, we identify “domestic” firms by requiring that less than 10% of their assets are identified as foreign assets in their financial statements. 7,288 firm-year observations satisfy this criterion. Column (4) of table 6 shows the results for this subsample of firms. We find that our results hold virtually unchanged for this subsample of firms albeit with some minor differences in the magnitude of the effects (e.g. *Left Ideology*). We also identified “domestic” firms by imposing a more restrictive filter of 0% for foreign assets: again, the results remained qualitatively unchanged and therefore we do not report them here. Another method we employed to address the issue of multinational corporations was to identify all their operations across countries in terms of the level of sales, and empirically estimate the impact of home (incorporated) and host nation-level institutional factors concurrently. We used the geographic segment disclosures from WorldScope to identify the countries in which multinational corporations operated. Due to the very limited availability of such fine-grained information, our sample was drastically reduced to 857 observations (200 unique firms). Table 7 presents the results of this analysis. Since multinational corporations operated in more than one country beyond their home country (typically in 2-3 host countries), we calculated the values for

the host country institutional variables as the weighted average of the values in all host countries that the corporation operated in weighted by the fraction of overall sales. Generally, the results of table 7 confirm the importance of home country institutions even after we explicitly control for the impact of host country institutions. In two cases, *Country Debt over Assets* and *Individualism*, the coefficients of interest lose significance compared to the baseline specification of column (1) in table 6. This however, may be the result of the drastic drop in the number of observations and thus a potential inability of the model to efficiently estimate the coefficients.

Table 7 is also revealing in terms of identifying the impact of host country institutions. Clearly, this is a topic that remains open for future research but we note here that host country institutions appear to have a different impact on CSP compared to home country institutions. In particular, holding all home country effects constant, CSP is higher when a company is in a host country with laws that promote a more competitive environment and in a more corrupt country. Both results suggest that a corporation might improve its CSP when diversifying in countries with these characteristics in order to signal its quality and attract new business. For example, in countries with relatively high corruption, a good CSP might serve as a credible signal that the company is doing business in an ethical way and as a result it can attract non-corrupt business partners. Similar to home country effects, host *Country Debt over Assets* and *Individualism* have negative and positive coefficients respectively.

Finally, we re-run our baseline specification and excluded observations from the U.S., the U.K. and Japan to address any potential bias in our results due to the over-representation of these countries. In particular, we examined the robustness of the results to subsamples that excluded each country, two of the countries, or all three of them at the same time. We find qualitatively similar results (unreported) to the baseline specification of column (1) in Table 6, suggesting that our findings are not driven by anyone country alone.

## **DISCUSSION AND CONCLUSION**

A small number of prior studies have articulated how different factors affect CSP variation (e.g. Campbell, 2007; McWilliams & Siegel, 2001) yet no empirical studies have explored CSP heterogeneity across more than 40 countries worldwide. In this paper, we provide empirical evidence

of the profound role that nation-level institutions play in explaining this CSP variation as measured by our constructed CSP Index. In doing so, we utilize a global ESG dataset from Thomson Reuters ASSET4 covering more than 2,000 firms in 42 countries around the world for 7 years.

Drawing from institutional theory, our overarching hypothesis is that nation-level institutional variation significantly impacts the observed variation in CSP across corporations. For each country in our sample we classify institutions into four distinct systems following the classification scheme proposed by Whitley (1999): a) the political system b) the education and labor system c) the financial system and d) the cultural system. Within each system, we use established institutional metrics that have been previously identified in a long literature originating from economics, political science, cultural research and institutional theory, to provide a comprehensive theoretical model with regards to the mechanisms through which several nation-level institutions, constituting elements of distinct NBS, impact CSP variation. Although we provide preliminary empirical evidence about the impact of home versus host country institutions, we also suggest that in future work scholars should focus on providing a more nuanced understanding and a more comprehensive theoretical argument characterizing the relative impact of such institutions on CSP; a task that falls outside the scope of the current paper.

Institutional theory has long established that business organizations are embedded within broader social structures, comprising of different types of institutions, which exert significant influence on their behavior and consequently impact the corporations' strategic decision making and organizational outcomes (e.g. Campbell, 2007; Campbell, Hollingsworth & Lindberg, 1991). This is exactly the reason why in this paper we argue that CSP, a key performance outcome of a corporation's undertaking of CSR activities, will also be profoundly influenced by such institutional pressures. We find that within NBS, all four systems are significant factors affecting CSP variation with the political system being the most and the financial system being the least important in terms of estimated economic effects. Future work adopting a more dynamic approach could seek to understand how these distinct systems of institutions interact or co-evolve over time and how such processes affect CSP variation. More generally, future work may seek to understand the conditions under which some systems become more salient than others in driving variation in CSP.

By highlighting the role of institutions, our work also raises critical questions around multinational corporations and their social performance vis-a-vis the increasing pressures on countries to open up to globalization. Global trends towards increasing deregulation founded on the belief that institutional constraints hinder efficiency and profitability (Campbell, 2007) should be carefully re-evaluated: an increasing amount of evidence suggests that enhanced social performance is not contrary to but rather synergistic to economic performance (Eccles, Ioannou & Serafeim, 2011). To the extent that institutions contribute to enhanced social performance, extreme deregulation that significantly reduces the impact of institutions could, at the same time, reduce economic performance in a context of rapidly shifting social trends in regards to environmental and social issues.

This is not to imply however, that other factors, including institutional factors at the level of the firm or the industry, are not important. On the contrary, we believe that these factors are key and we include them as independent control variables in our empirical models. In fact, our results support the prominent role of firm and industry factors and generate questions around the interaction effects between these factors and institutions in affecting CSP variation. In this paper however, as a first step, we chose to focus on nation-level institutions due to the relative lack of empirical research on this issue and because nation-level institutions explain a significant portion of the total variation in the CSP Index. In fact, scholars have suggested that CSP is enhanced by convincing managers that CSR activities are the right thing to do ethically or that it is in some form in their self-interest (Campbell, 2007; Prahalad & Hammond, 2003). By providing a three level empirical model that accounts for these factors *in addition* to the institutional environment, our work shows that such pleas may indeed contribute positively to CSP but at the same time, we highlight that nation-level institutions are important, particularly if we consider the impact that multinational corporations globally have on mitigating acute social and environmental issues. Accordingly, future work should seek to understand further how the evolution of institutions affects not only economic as well as social performance at the firm level, but also what the impact of an enhanced social and economic performance is at the country level, in terms of competitiveness, social cohesion, and sustainability.

The finding that financial system characteristics have less influence on CSP relative to the political and the education and labor systems raises some interesting questions about the role of

capital markets in society. Investors have traditionally pursued solely financial performance disregarding the social performance of their portfolios. Given the increasing assets under management of SRI funds this is likely to change. Future research could examine the evolution of SRI funds and their impact on CSP in different institutional contexts.

With this paper we make contributions both to the theoretical as well as the empirical literature on CSP. First, we answer the call for more systematic research for understanding the broader spectrum of factors that affect CSP variation, as well as the call for investigating the influence of variation in nation-level institutions on CSP variation. The theoretical section of this paper draws extensively from but also integrates across strands of institutional theory, cultural research, economics, and political science to suggest specific causal mechanisms through which macro structures, such as institutions, contribute towards the observed CSP heterogeneity across firms. We also contribute to the growing literature within international business (IB) that seeks to understand the broader issue of institutional diversity and its implications for IB studies (e.g. Jackson and Deeg, 2008).

Empirically, our paper is the first one to provide evidence for the impact of nation-level institutions on CSP covering such a large number of countries, industries and firms. Our models investigate a complete multi-level impact model (firm, industry and national levels) and as such they are able to explain 47% of the variance in the CSP Index with observable characteristics. Throughout this paper, we regard institutions as being exogenous with respect to specific organizational outcomes of corporations (i.e. CSP), in order to attribute causality to the established relationships. In fact, Whitley (1998) argues that NBSs are deeply embedded into the national economies and are fundamentally contingent on their specific histories, such that they are unlikely to be restructured over a short period of time, or simply due to internationalization. While we believe this is a valid assumption for our sample that covers 7 years of data, it is certainly a valid assumption for developed economies in particular, where institutional characteristics are well established and to a large extent determined by colonization and the historical origins of their laws (La Porta et al. 1998). It might be less valid however, for emerging economies where the institutional architecture is evolving to accommodate the changing social, political and economic landscape. Future research therefore, may

consider longer time horizons, and employing a more dynamic approach may investigate how the evolution of institutions in emerging markets affects firms' CSP; it may even consider how the corporations' social responsibilities potentially impact the evolution of institutions in such countries.

We note additional caveats of our analysis. To reach any level of CSP, firms need to first adopt a range of CSR practices and strategies. Whereas in our work we focus on the impact of nation-level institutions on CSP - rather than the impact on adoption and implementation of CSR practices and strategies - future work may seek to understand this latter relationship better and deeper. Yet, to the extent that a gap exists between our operationalization of CSP and the firms' CSR practices and strategies, our analysis essentially suggests and empirically establishes a lower bound for the overall impact of nation-level institutions; future research could focus on understanding which institutions are more likely to affect certain types of CSR actions and strategies more so than others, and the resulting effect on CSP.

Since both environmental and social performance scores are constructed by Thomson Reuters ASSET4 by examining only publicly available information for publicly-traded firms, our theoretical and empirical findings will likely be more relevant for publicly traded firms rather than privately-owned ones. Such firms may respond to institutional incentives (if at all) in significantly different ways than public firms do, and therefore it is likely that our results do not apply directly to that context. To the extent that data exists about CSP of privately-held firms, future research could seek to understand whether and how such firms respond to institutional structures in terms of their CSP.

Similar to all CSP measures and metrics used in past literature, it is possible that the scores that we obtained from Thomson Reuters ASSET4, although reflecting accurately and summarizing effectively all the available information about a focal corporation's social performance, they might not fully reflect the actual social impact of the firms' CSR activities. In other words, to the extent that available public information does not fully reflect the real social impact of CSR activities, our measures will tend to be noisy and incomplete. Future research therefore, could focus on developing direct measures of the real social impact that CSR activities have on various stakeholder groups, rather than use measures based solely on public disclosures of various forms.

Finally, we note that firms may be in a position to game their CSP scores so as to generate favorable organizational outcomes (e.g. legitimacy or reputation). Prior research has shown that CSR is inherently prone to decoupling (Weaver et al. 1996) where decoupling is defined as the low extent of implementation of a focal initiative (Westphal et al. 1994). For example, adoption of a code of ethics may or may not trigger substantial changes in the corporation's day to day operations, depending on the degree of implementation; in other words, some corporations may only symbolically adopt the code to "tick the box" of the rating agency. We consider this to be unlikely but possible for our context. Company self-reported data is all but one of the many sources that are being used by Thomson Reuters ASSET4 to gather information. The list of sources would also include NGOs, stock exchange filings, and independent news sources. As much as the company could 'game' their own reporting, it is unlikely that it would be able to influence to the same degree all of these third-party sources. However, future research could explore the propensity of organizations to decouple their CSR activities under different institutional regimes and the subsequent CSP implications.

### **Implications**

Given the growing attention that managers and top executives worldwide pay to the adoption and implementation of CSR activities and the resulting CSP, it is crucial that they understand the key factors affecting their organizations' social performance, especially those factors outside the boundaries of their own firms and thus, those factors beyond their direct control. In this study, we identify and quantify such factors, both at the firm and industry level but more importantly, at the level of NBS that oversee the external environments in which corporations exist and operate.

At the same time, our work has important policy implications by presenting evidence of the profound impact that institutions have in influencing the social performance of the corporations in the ecosystem that these institutions are meant to oversee. Therefore, our work is particularly relevant for emerging and less developed countries in which the political, the education and labor, and the financial systems, are currently being built and/or their roles are being redefined. Policy makers should design or redesign institutions by being fully aware of the power that such institutions have in determining the social and environmental performance of corporations and thus, in defining their net contribution towards the resolution of the world's most acute problems.

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Table 1: Variable definitions, measures and data sources

<i>Category</i>	<i>Measure</i>	<i>Measurement</i>	<i>Source</i>
<i>Political System</i>	Competition and regulation	Laws encourage competition in the country (Measured each year)	IMD World competitiveness report
	Anti-self dealing index	Laws limit self-dealing of insiders (Measured as of 2001)	La Porta et al. (2006)
	Absence of corruption	Inverse of average corruption score over the period 1996 through 2000	World Bank
	Left/centre ideology	Chief executive and largest party in congress have left/centre political orientation (Measured as the percentage of years between 1928 and 1995 during which both the party of the chief executive and the largest party in congress had left or centre orientation)	Botero et al. (2004)
<i>Education and Labour System</i>	Union density	Employees are densely organized in unions (Measured as of 1997)	Botero et al. (2004)
	Availability of skilled labour	Skilled labour is readily available in a country (Measured each year)	IMD World competitiveness report
<i>Financial System</i>	Country Debt over Assets	The average debt over assets ratio for all firms within a country-year pair (Measured each year)	Worldscope
	SRI Index	Indicator variable for country-years where a socially responsible stock market index exists (Measured each year)	World Federation of Exchanges
<i>Cultural System</i>	Power Distance Index	"The extent to which the less powerful members of organizations and institutions accept and expect that power is distributed unequally" (Measured as of 1973)	Hofstede (1997, 2001)
	Individualism	"The degree to which individuals are integrated into groups" (Measured as of 1973)	Hofstede (1997, 2001)
<i>Country Controls</i>	Basic infrastructure	Quality of basic infrastructure in a country (Measured each year)	IMD World competitiveness report
	Balance of trade	(Exports-Imports)/GDP (Measured each year)	IMD World competitiveness report
	Trade	(Exports+Imports)/GDP (Measured each year)	IMD World competitiveness report
	Market Capitalizaion	Log of total market capitalization	IMD World competitiveness report
<i>Industry controls</i>	Herfindal index	Log of sum of squared ratios of firm sales over industry sales (Measured each year)	Worldscope
<i>Firm Controls</i>	Return on Assets (ROA)	Industry-adjusted net income over total assets (Measured each year)	Worldscope
	Volatility	Daily stock return volatility over the fiscal year (Measured each year)	Worldscope
	Market to Book Ratio (MTB)	Market value of equity over book value of equity calculated at fiscal year end (Measured each year)	Worldscope

	R&D Expenses	Research and development expenses over sales (Measured each year)	Worldscope
	Firm size	Logarithm of total assets (Measured each year)	Worldscope
	Number of segments	Logarithm of number of four digit SIC codes the company operates in (Measured each year)	Worldscope
	Analyst coverage	Number of analysts issuing earnings forecasts for the firm (Measured each year)	IBES
	ADR	Company trades an American Depositary Receipt (Measured each year)	Worldscope
	Percentage of shares closely held	Percentage of shares held by investors owing more than 5% (Measured each year)	Worldscope
	Leverage	One minus the ratio of shareholder's equity over total assets (Measured each year)	Worldscope

Table 2 – Panel A: Average and standard deviation of social and environmental scores and CSP index across years, by country (N = 12,764)

Country	Firms	Obs	Environmental		Social		CSP Index	
			Mean	St.Dev.	Mean	St.Dev.	Mean	St.Dev.
Australia (AUS)	93	414	0.48	0.30	0.48	0.29	0.48	0.27
Austria (AUT)	21	104	0.46	0.31	0.43	0.31	0.44	0.29
Belgium (BEL)	26	142	0.50	0.32	0.46	0.31	0.48	0.30
Brazil (BRA)	18	29	0.67	0.28	0.80	0.27	0.73	0.27
Canada (CAN)	247	712	0.37	0.28	0.39	0.29	0.38	0.27
Switzerland (CHE)	60	324	0.60	0.31	0.58	0.32	0.59	0.29
Chile (CHL)	5	5	0.34	0.24	0.58	0.27	0.46	0.25
China Mainland (CHN)	23	37	0.40	0.25	0.40	0.27	0.40	0.24
Czech Republic (CZE)	2	2	0.73	0.20	0.76	0.07	0.74	0.06
Germany (DEU)	79	391	0.63	0.31	0.63	0.28	0.63	0.27
Denmark (DNK)	24	136	0.47	0.29	0.44	0.30	0.46	0.28
Spain (ESP)	53	277	0.64	0.29	0.69	0.31	0.67	0.29
Finland (FIN)	24	142	0.70	0.26	0.64	0.25	0.67	0.23
France (FRA)	91	487	0.72	0.26	0.73	0.26	0.73	0.23
United Kingdom (GBR)	341	1,703	0.57	0.28	0.62	0.26	0.59	0.25
Greece (GRC)	25	131	0.46	0.29	0.48	0.32	0.47	0.29
Hong Kong (HKG)	69	273	0.33	0.26	0.36	0.26	0.34	0.24
Hungary (HUN)	1	1	0.89		0.91		0.90	
Indonesia (IDN)	4	4	0.24	0.06	0.63	0.22	0.44	0.12
India (IND)	21	26	0.47	0.28	0.60	0.27	0.53	0.26
Ireland (IRL)	17	86	0.40	0.25	0.39	0.23	0.40	0.22
Israel (ISR)	2	8	0.20	0.08	0.19	0.10	0.19	0.06
Italy (ITA)	53	262	0.47	0.35	0.60	0.33	0.53	0.32
Jordan (JOR)	1	1	0.20		0.36		0.28	
Japan (JPN)	407	1,837	0.59	0.33	0.41	0.32	0.50	0.30
Korea (KOR)	20	35	0.70	0.32	0.58	0.33	0.64	0.31
Mexico (MEX)	13	21	0.52	0.37	0.51	0.40	0.51	0.38
Malaysia (MYS)	9	9	0.37	0.22	0.51	0.14	0.44	0.15
Netherlands (NLD)	38	197	0.64	0.30	0.74	0.25	0.69	0.25
Norway (NOR)	24	136	0.52	0.31	0.55	0.32	0.53	0.29
New Zealand (NZL)	10	46	0.43	0.24	0.43	0.21	0.43	0.19
Philippines (PHL)	1	1	0.39		0.15		0.27	
Poland (POL)	4	4	0.34	0.34	0.42	0.18	0.38	0.17
Portugal (PRT)	12	62	0.60	0.29	0.68	0.27	0.64	0.24
Russia (RUS)	12	20	0.60	0.29	0.50	0.30	0.55	0.25
Singapore (SGP)	42	178	0.31	0.24	0.31	0.23	0.31	0.21
Sweden (SWE)	53	305	0.59	0.31	0.60	0.27	0.59	0.26
Thailand (THA)	3	4	0.43	0.37	0.40	0.34	0.42	0.34
Turkey (TUR)	6	6	0.18	0.08	0.42	0.14	0.30	0.10
Taiwan (TWN)	11	17	0.55	0.24	0.39	0.33	0.47	0.25
United States (USA)	809	4,202	0.37	0.29	0.43	0.29	0.40	0.26
South Africa (ZAF)	13	13	0.61	0.24	0.76	0.21	0.68	0.22

N is the number of observations. All scores range between zero and one. Hong Kong is not a separate country but part of the People's Republic of China as a specially administered region (SAR).

Table 2 – Panel B: Number of observations by sector over years

Industry	2002	2003	2004	2005	2006	2007	2008	Total
Airlines	11	11	12	14	15	15	12	90
Agriculture	0	0	1	1	1	2	1	6
Automobiles	24	24	39	53	53	54	50	297
Banks	80	85	135	166	162	173	168	969
Alcohol Bever	9	9	15	18	18	18	15	102
Building Mat	18	18	32	44	43	45	45	245
Shipping Cont	15	16	26	30	30	29	29	175
Boxes	4	4	8	8	8	9	7	48
Business Serv	39	40	101	122	123	138	128	691
Chemicals	37	37	58	71	70	75	67	415
Electronic Equip	45	45	68	91	94	98	93	534
Clothes	6	6	9	17	18	19	14	89
Construction	23	23	51	61	61	66	65	350
Coal	0	0	6	6	6	8	8	34
Computer Hard	11	11	19	28	27	27	23	146
Computer Soft	24	24	45	57	58	55	55	318
Pharmaceuticals	37	38	60	69	70	71	61	406
Electrical Equip	4	4	11	17	18	19	17	90
Energy	38	38	90	104	107	132	152	661
Fabricated Prod	1	1	4	4	4	5	4	23
Finance	36	36	95	113	115	133	135	663
Food Products	16	17	30	45	46	50	46	250
Entertainment	7	7	15	24	24	25	25	127
Gold	0	0	8	10	11	12	26	67
Defence	1	1	1	1	1	1	1	7
Healthcare	9	9	15	16	13	15	15	92
Household	19	19	36	43	43	45	40	245
Insurance	45	46	88	104	105	112	101	601
Measuring Equip	7	7	16	18	18	18	18	102
Machinery	28	28	64	77	77	78	73	425
Restaurants Hotel	16	17	26	28	29	28	25	169
Medical Equip	21	21	31	34	34	34	34	209
Mining	5	5	27	30	30	44	51	192
Paper	11	11	17	22	22	24	24	131
Personal Serv	3	3	9	11	13	13	13	65
Real Estate	23	23	56	68	72	79	81	402
Retail	48	48	85	113	116	125	122	657
Rubber Plastic	3	3	6	7	7	7	7	40
Shipping	0	0	3	4	4	4	3	18
Tobacco Prod	7	7	7	7	6	8	7	49
Soda Candy	7	7	13	17	18	18	16	96
Steel	15	15	35	47	46	50	53	261
Telecom	46	47	71	86	89	99	106	544
Recreational Pr	11	11	14	19	19	18	16	108
Transportation	36	36	68	84	84	92	84	484
Textiles	0	0	2	2	2	2	2	10
Utilities	52	53	90	108	109	116	115	643
Wholesale	32	32	55	69	70	83	77	418
<b>Total</b>	<b>930</b>	<b>943</b>	<b>1,773</b>	<b>2,188</b>	<b>2,209</b>	<b>2,391</b>	<b>2,330</b>	<b>12,764</b>

Table 3: Summary statistics

Variable	Mean	Std. Dev.	Min	Max
CSP Index	0.49	0.29	0.06	0.98
Environmental Performance Score	0.49	0.32	0.09	0.97
Social Performance Score	0.50	0.31	0.00	0.99
Competition and Regulation	3.60	0.23	2.36	3.99
Anti-self Dealing Index	0.61	0.21	0.16	1.00
Absence of Corruption	1.74	0.45	-0.84	2.39
Left Ideology	0.45	0.27	0.00	1.00
Union Density	0.26	0.18	0.01	0.90
Availability of Skilled Labour	3.62	0.42	0.69	4.04
Country debt over assets	0.54	0.10	0.23	0.77
SRI Index	0.85	0.36	0.00	1.00
Power Distance Index	43.62	11.90	11.00	104.00
Individualism	74.01	20.52	14.00	91.00
Basic Infrastructure	3.75	0.39	0.69	4.01
Balance of Trade	3.07	0.52	0.00	4.03
Trade	2.51	0.80	0.00	4.04
Market Capitalization	1.22	0.57	0.16	3.63
Herfindal Index	-2.32	0.90	-4.59	0.00
Return on Assets (ROA)	0.00	6.04	-59.27	34.87
Volatility	27.61	8.98	11.69	63.08
Market-to-Book Ratio (MTB)	3.02	3.18	-5.42	30.18
R&D expenses	2.07	4.81	0.00	34.36
Firm Size	8.94	1.64	1.52	15.14
Number of Segments	0.38	0.46	0.00	1.39
Analyst Coverage	13.13	8.80	1.00	53.00
ADR	0.18	0.39	0.00	1.00
Percentage of Shares Closely Held	25.66	22.46	0.00	100.00
Leverage	61.67	21.71	9.04	108.44

All variables are described in Table 1. CSP index is the average environmental and social score for a firm-year.

Table 4: Average and standard deviation of nation-level institutional variables for each year

Year	Competition and Regulation		Anti-self Dealing Index		Absence of Corruption		Left Ideology		Union Density	
	<i>Mean</i>	<i>St.Dev.</i>	<i>Mean</i>	<i>St.Dev.</i>	<i>Mean</i>	<i>St.Dev.</i>	<i>Mean</i>	<i>St.Dev.</i>	<i>Mean</i>	<i>St.Dev.</i>
2002	3.718	0.253	0.575	0.200	1.785	0.391	0.535	0.237	0.267	0.207
2003	3.620	0.212	0.575	0.201	1.782	0.395	0.532	0.238	0.268	0.207
2004	3.619	0.210	0.617	0.209	1.779	0.395	0.456	0.265	0.262	0.174
2005	3.620	0.220	0.609	0.207	1.751	0.401	0.424	0.277	0.265	0.172
2006	3.641	0.214	0.610	0.207	1.750	0.404	0.423	0.277	0.264	0.170
2007	3.567	0.216	0.607	0.206	1.728	0.475	0.435	0.278	0.263	0.166
2008	3.514	0.237	0.615	0.202	1.690	0.566	0.444	0.283	0.261	0.166
Year	Availability of Skilled Labour		Country debt over assets		SRI Index		Power Distance Index		Individualism	
	<i>Mean</i>	<i>St.Dev.</i>	<i>Mean</i>	<i>St.Dev.</i>	<i>Mean</i>	<i>St.Dev.</i>	<i>Mean</i>	<i>St.Dev.</i>	<i>Mean</i>	<i>St.Dev.</i>
2002	3.694	0.400	0.599	0.073	0.798	0.401	41.429	10.703	79.803	15.689
2003	3.644	0.413	0.594	0.068	0.828	0.378	41.427	10.714	79.688	15.715
2004	3.554	0.473	0.544	0.091	0.809	0.394	42.985	11.368	75.447	19.976
2005	3.626	0.368	0.537	0.092	0.856	0.351	43.664	11.549	73.339	20.676
2006	3.630	0.380	0.526	0.091	0.856	0.351	43.697	11.565	73.304	20.724
2007	3.636	0.418	0.520	0.098	0.844	0.363	44.227	12.127	72.416	21.286
2008	3.624	0.453	0.528	0.106	0.881	0.324	45.153	13.260	71.258	22.223

Table 5: Correlation matrix – Panel A

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
CSP Index (1)	1													
Environmental Performance Score (2)	0.93	1												
Social Performance Score (3)	0.92	0.71	1											
Competition and Regulation (4)	-0.23	-0.22	-0.20	1										
Anti-self Dealing Index (5)	-0.12	-0.15	-0.08	0.37	1									
Absence of Corruption (6)	-0.01	-0.04	0.03	0.51	0.32	1								
Left Ideology (7)	-0.15	-0.22	-0.05	0.37	0.04	0.41	1							
Union Density (8)	0.10	0.11	0.07	-0.13	-0.22	0.28	-0.02	1						
Availability of Skilled Labour (9)	-0.16	-0.12	-0.18	0.34	-0.36	-0.06	0.28	-0.20	1					
Country debt over assets (10)	0.00	-0.01	0.02	-0.24	-0.54	-0.37	0.22	-0.18	0.44	1				
SRI Index (11)	-0.01	-0.01	-0.01	0.09	0.06	0.05	0.01	-0.44	0.11	0.05	1			
Power Distance Index (12)	0.02	0.06	-0.02	-0.30	-0.13	-0.68	-0.43	-0.34	0.10	0.12	-0.18	1		
Individualism (13)	-0.05	-0.13	0.04	0.28	0.33	0.50	0.60	-0.16	-0.08	0.03	0.50	-0.66	1	
Basic Infrastructure (14)	-0.14	-0.12	-0.13	0.63	0.17	0.45	0.34	-0.27	0.46	-0.03	0.18	-0.18	0.26	1
Balance of Trade (15)	0.07	0.14	-0.01	-0.05	-0.42	0.07	-0.28	0.51	0.20	-0.18	-0.10	0.10	-0.46	-0.06
Trade (16)	0.16	0.14	0.15	-0.19	-0.07	0.26	-0.20	0.51	-0.29	-0.36	-0.37	-0.01	-0.33	-0.27
Market Capitalization (17)	-0.08	-0.13	-0.02	0.46	0.55	0.47	0.39	-0.28	0.04	-0.21	0.10	0.38	-0.13	0.36
Herfindal Index (18)	0.19	0.17	0.18	-0.21	-0.16	0.09	-0.15	0.36	-0.29	-0.15	-0.34	0.01	-0.20	-0.23
Return on Assets (ROA) (19)	0.00	0.00	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Volatility (20)	-0.17	-0.16	-0.15	0.01	0.04	-0.01	0.02	0.05	0.00	0.05	-0.03	-0.02	-0.01	0.00
Market-to-Book Ratio (MTB) (21)	-0.05	-0.08	0.00	0.06	0.07	0.04	0.10	-0.05	-0.02	0.00	-0.01	-0.07	0.10	0.04
R&D expenses (22)	0.05	0.05	0.04	0.06	-0.05	0.01	0.08	-0.07	0.15	0.14	0.08	-0.04	0.07	0.10
Firm Size (23)	0.39	0.33	0.38	-0.10	-0.17	-0.19	0.00	-0.13	0.12	0.20	0.06	0.14	-0.04	-0.03
Number of Segments (24)	0.16	0.17	0.12	-0.05	-0.05	-0.09	-0.18	0.03	0.01	0.00	-0.09	0.14	-0.20	-0.04
Analyst Coverage (25)	0.32	0.25	0.35	-0.13	-0.17	-0.13	0.06	-0.10	0.08	0.30	-0.02	0.09	0.01	0.00
ADR (26)	0.31	0.28	0.30	-0.16	-0.06	-0.06	-0.25	0.15	-0.17	-0.09	-0.17	0.11	-0.23	-0.17
Percentage of Shares Closely Held (27)	-0.08	-0.06	-0.10	-0.20	-0.16	-0.23	-0.25	0.09	-0.06	-0.05	-0.28	0.32	-0.42	-0.18
Leverage (28)	0.14	0.10	0.16	-0.15	-0.07	-0.05	-0.04	0.01	-0.08	0.10	0.02	-0.01	0.04	-0.11

Table 5: Correlation matrix – Panel B

Variable	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)	(28)	
Balance of Trade	(15)	1													
Trade	(16)	0.47	1												
Market Capitalization	(17)	-0.43	-0.09	1											
Herfindal Index	(18)	0.25	0.46	-0.19	1										
Return on Assets (ROA)	(19)	0.00	0.00	0.00	0.00	1									
Volatility	(20)	0.01	0.02	0.04	0.01	-0.11	1								
Market-to-Book Ratio (MTB)	(21)	-0.14	-0.05	0.08	0.03	0.22	0.06	1							
R&D expenses	(22)	-0.03	-0.12	0.05	0.00	-0.06	0.26	0.11	1						
Firm Size	(23)	0.01	-0.09	-0.08	-0.05	-0.09	-0.26	-0.22	-0.14	1					
Number of Segments	(24)	0.11	0.05	-0.08	0.07	-0.02	-0.07	-0.05	-0.09	0.11	1				
Analyst Coverage	(25)	-0.07	-0.02	0.01	0.06	0.06	0.02	0.06	0.19	0.39	-0.01	1			
ADR	(26)	0.18	0.26	-0.11	0.20	-0.01	0.00	-0.05	0.02	0.25	0.10	0.26	1		
Percentage of Shares Closely Held	(27)	0.21	0.23	-0.23	0.23	0.01	0.03	0.02	-0.07	-0.09	0.03	-0.04	0.07	1	
Leverage	(28)	-0.04	0.02	-0.09	-0.01	-0.16	-0.10	0.00	-0.31	0.48	0.10	0.03	0.06	-0.06	1

Table 6: Main regression analysis

	DV: CSP Index		DV: CSP Index		DV: Environ. Score		DV: Social Score		DV: CSP Index	
	<i>Full Sample</i>	<i>Std.Err.</i>	<i>Domestic</i>	<i>Std.Err.</i>						
	(0)		(1)		(2)		(3)		(4)	
<b><i>Political System</i></b>										
Competition and Regulation (H1)			-0.151***	-0.019	-0.177***	(0.022)	-0.125***	(0.022)	-0.181***	(0.026)
Anti-self Dealing Index (H2)			-0.169***	-0.031	-0.181***	(0.034)	-0.156***	(0.033)	-0.112***	(0.039)
Absence of Corruption (H3)			0.135***	-0.018	0.138***	(0.020)	0.133***	(0.019)	0.141***	(0.022)
Left Ideology (H4)			-0.171***	-0.022	-0.242***	(0.024)	-0.100***	(0.024)	-0.142***	(0.027)
<b><i>Education and Labor System</i></b>										
Union Density (H5)			0.191***	-0.038	0.233***	(0.042)	0.148***	(0.041)	0.143***	(0.055)
Availability of Skilled Labour (H6)			-0.080***	-0.011	-0.073***	(0.013)	-0.086***	(0.012)	-0.074***	(0.015)
<b><i>Financial System</i></b>										
Country debt over assets (H7)			-0.242***	-0.062	-0.317***	(0.068)	-0.167**	(0.068)	-0.297***	(0.077)
SRI Index (H8)			-0.001	-0.014	0.012	(0.015)	-0.014	(0.016)	0.002	(0.020)
<b><i>Cultural System</i></b>										
Individualism (H9)			0.001***	0.000	0.000	(0.000)	0.002***	(0.000)	0.002***	(0.001)
Power Distance Index (H10)			0.002***	-0.001	0.002***	(0.001)	0.003***	(0.001)	0.002***	(0.001)
<b><i>Country Controls</i></b>										
Basic Infrastructure			-0.004	-0.013	0.015	(0.014)	-0.023*	(0.014)	-0.022	(0.016)
Balance of Trade			-0.070***	-0.014	-0.058***	(0.014)	-0.083***	(0.015)	-0.066***	(0.017)
Trade			0.019***	-0.005	0.005	(0.006)	0.034***	(0.006)	0.024***	(0.008)
Market Capitalization			0.006	-0.014	0.005	(0.015)	0.007	(0.014)	0.008	(0.018)
<b><i>Industry Controls</i></b>										
Herfindal Index	0.071***	-0.005	0.014**	-0.006	0.006	(0.007)	0.021***	(0.007)	0.026***	(0.008)
Industry fixed effects	Yes		Yes		Yes		Yes		Yes	

<i>Firm Controls</i>										
Return on Assets (ROA)	0.001***	0.000	0.001***	0.000	0.001**	(0.000)	0.002***	(0.000)	0.001***	(0.000)
Volatility	-0.003***	0.000	-0.003***	0.000	-0.003***	(0.000)	-0.003***	(0.000)	-0.002***	(0.000)
Market-to-Book Ratio (MTB)	0.002**	-0.001	0.005***	-0.001	0.004***	(0.001)	0.005***	(0.001)	0.006***	(0.001)
R&D expenses	0.004***	-0.001	0.005***	-0.001	0.005***	(0.001)	0.004***	(0.001)	0.004***	(0.001)
Firm Size	0.072***	-0.004	0.092***	-0.003	0.094***	(0.004)	0.090***	(0.004)	0.090***	(0.004)
Number of Segments	0.010	-0.009	0.012	-0.009	0.006	(0.010)	0.018*	(0.009)	0.007	(0.010)
Analyst Coverage	0.004***	-0.001	0.004***	0.000	0.003***	(0.001)	0.005***	(0.001)	0.005***	(0.001)
ADR	0.102***	-0.011	0.045***	-0.010	0.026**	(0.012)	0.064***	(0.011)	0.047***	(0.015)
Percentage of Shares Closely Held	-0.001***	0.000	-0.001***	0.000	-0.001***	(0.000)	-0.001***	(0.000)	-0.000*	(0.000)
Leverage	0.001**	0.000	0.000	0.000	-0.000	(0.000)	-0.000	(0.000)	-0.000	(0.000)
Constant	-0.069	-0.101	0.443***	-0.113	0.593***	(0.122)	0.293**	(0.122)	0.556***	(0.141)
Year fixed effects	Yes		Yes		Yes		Yes		Yes	
Observations	12764		12764		12764		12764		7288	
R-squared	0.395		0.469		0.457		0.405		0.463	

\*\*\*, \*\*, \*: significant at the 1%, 5%, 10% level for a two-tailed test.

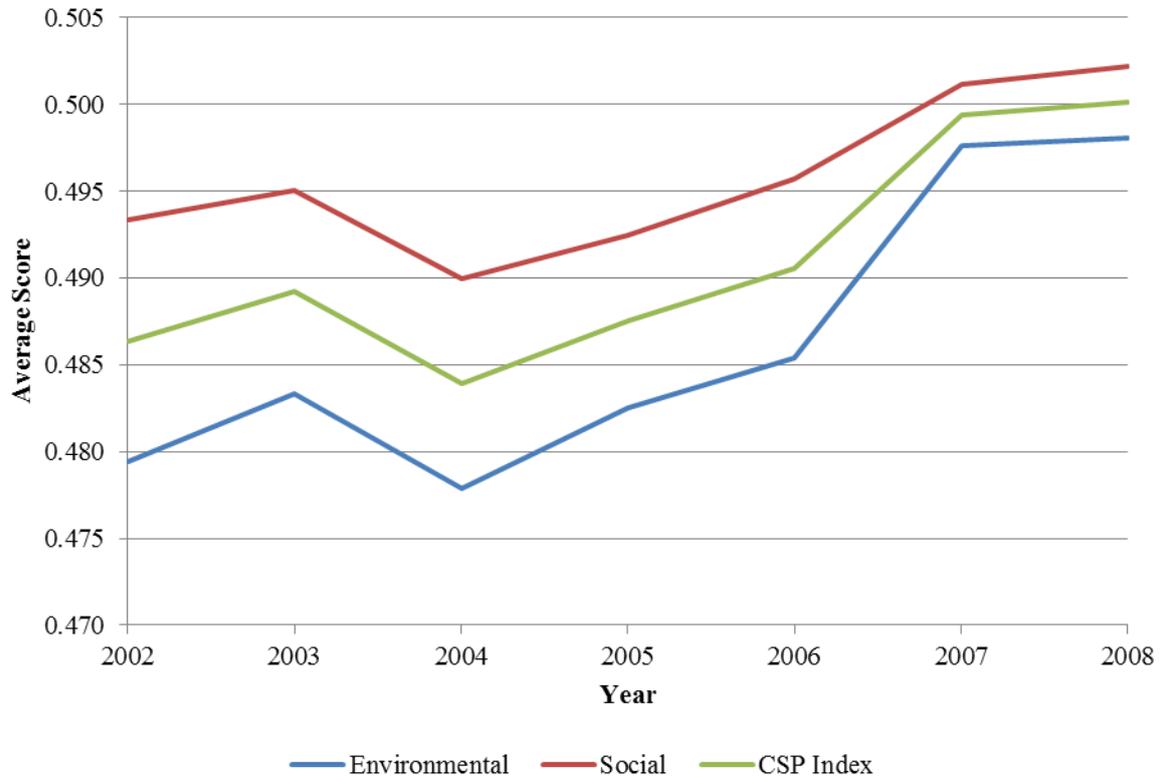
All variables are described in Table 1. The first three columns include all observations. The fourth column includes only domestic firms. The estimates coefficients are derived from OLS estimation with clustered at the firm level and robust standard errors.

Table 7: Regression results: Home vs. Host country institutions for multinational corporations

	<b>CSP Index</b>	
<b><i>Political System - Home</i></b>		
Competition and Regulation	-0.140*	(0.075)
Anti-self Dealing Index	-0.344***	(0.104)
Absence of Corruption	0.215***	(0.065)
Left Ideology	-0.280***	(0.076)
<b><i>Political System - Host</i></b>		
Competition and Regulation	0.160*	(0.082)
Anti-self Dealing Index	-0.196	(0.144)
Absence of Corruption	-0.184**	(0.073)
Left Ideology	-0.105	(0.087)
<b><i>Education and Labour System - Home</i></b>		
Union Density	0.347***	(0.115)
Availability of Skilled Labour	0.026	(0.037)
<b><i>Education and Labour System - Host</i></b>		
Union Density	0.250	(0.216)
Availability of Skilled Labour	0.041	(0.040)
<b><i>Financial System - Home</i></b>		
Country debt over assets	-0.199	(0.218)
SRI Index	-0.010	(0.050)
<b><i>Financial System - Host</i></b>		
Country debt over assets	-0.415***	(0.140)
SRI Index	0.019	(0.052)
<b><i>Cultural System - Home</i></b>		
Power Distance Index	0.004*	(0.002)
Individualism	0.001	(0.001)
<b><i>Cultural System - Host</i></b>		
Individualism	0.005**	(0.002)
Power Distance Index	-0.003	(0.002)
Constant	0.640	(0.395)
Industry, firm controls	Yes	
Country controls – Home and Host	Yes	
Observations	857	
R-squared	0.599	

All variables are described in Table 1. All firm, industry, and country level variables from Table 6 are included in the model but the estimated coefficients are not presented. The estimates coefficients are derived from OLS estimation with clustered at the firm level and robust standard errors. The sample includes 200 unique multinational firms.

Figure 1: Average environmental, social and CSP Index over time, across countries



## Appendix 1

### Description of ASSET4 pillars and categories

<b>Overview of ASSET4 Data 2002 - 2008</b>	
<i>Pillars</i>	<i>Categories</i>
Environmental Performance	Resource Reduction Emission Reduction Product Innovation
Social Performance	Employment Quality Health & Safety Training & Development Diversity Human Rights Community Customer / Product Responsibility

### Description of ASSET4 Categories (from ASSET4 documents)

<b>Environmental Performance Pillar</b>	<p><i>Resource Reduction</i></p> <p>The resource reduction category measures a company's management commitment and effectiveness towards achieving an efficient use of natural resources in the production process. It reflects a company's capacity to reduce the use of materials, energy or water, and to find more eco-efficient solutions by improving supply chain management.</p>
	<p><i>Emission Reduction</i></p> <p>The emission reduction category measures a company's management commitment and effectiveness towards reducing environmental emission in the production and operational processes. It reflects a company's capacity to reduce air emissions (greenhouse gases, F-gases, ozone-depleting substances, NOx and SOx, etc.), waste, hazardous waste, water discharges, spills or its impacts on biodiversity and to partner with environmental organizations to reduce the environmental impact of the company in the local or broader community.</p>
	<p><i>Product Innovation</i></p> <p>The product innovation category measures a company's management commitment and effectiveness towards supporting the research and development of eco-efficient products or services. It reflects a company's capacity to reduce the environmental costs and burdens for its customers, and thereby creating new market opportunities through new environmental technologies and processes or eco-designed, dematerialized products with extended durability.</p>
<b>Social Performance</b>	<p><i>Employment Quality</i></p> <p>The workforce / employment quality category measures a company's management commitment and effectiveness towards providing high-quality employment benefits and job conditions. It reflects a company's capacity to increase its workforce loyalty and productivity by distributing rewarding and fair employment benefits, and by focusing on long-term employment growth and stability by promoting from within, avoiding lay-offs and maintaining relations with trade unions.</p>
	<p><i>Health and Safety</i></p> <p>The workforce / health &amp; safety category measures a company's management commitment and effectiveness towards providing a healthy and safe workplace. It reflects a company's capacity to increase its workforce loyalty and productivity by integrating into its day-to-day operations a concern for the physical and mental health, well being and stress level of all employees.</p>
	<p><i>Training and Development</i></p> <p>The workforce / training and development category measures a company's management commitment and effectiveness towards providing training and development (education) for its workforce. It reflects a</p>

<p>company's capacity to increase its intellectual capital, workforce loyalty and productivity by developing the workforce's skills, competences, employability and careers in an entrepreneurial environment.</p>
<p><i>Diversity and Opportunity</i>  The workforce / diversity and opportunity category measures a company's management commitment and effectiveness towards maintaining diversity and equal opportunities in its workforce. It reflects a company's capacity to increase its workforce loyalty and productivity by promoting an effective life-work balance, a family friendly environment and equal opportunities regardless of gender, age, ethnicity, religion or sexual orientation.</p>
<p><i>Human Rights</i>  The society / human rights category measures a company's management commitment and effectiveness towards respecting the fundamental human rights conventions. It reflects a company's capacity to maintain its license to operate by guaranteeing the freedom of association and excluding child, forced or compulsory labor.</p>
<p><i>Community</i>  The society / community category measures a company's management commitment and effectiveness towards maintaining the company's reputation within the general community (local, national and global). It reflects a company's capacity to maintain its license to operate by being a good citizen (donations of cash, goods or staff time, etc.), protecting public health (avoidance of industrial accidents, etc.) and respecting business ethics (avoiding bribery and corruption, etc.).</p>
<p><i>Customer / Product Responsibility</i>  The customer / product responsibility category measures a company's management commitment and effectiveness towards creating value-added products and services upholding the customer's security. It reflects a company's capacity to maintain its license to operate by producing quality goods and services integrating the customer's health and safety, and preserving its integrity and privacy also through accurate product information and labeling.</p>