Realities of Responsible Business: Institutional and Structural Conditions in MNE-Local Government Bargaining

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Abstract

We seek to identify circumstances in localities around the globe that contribute to responsible, or alternatively irresponsible, conduct by multinational enterprises (MNEs). We acknowledge the central role of the interactions and negotiations between MNEs and host local governments in setting the stage for the operations of MNEs locally. Those interactions are *institutionally* conditioned by conventions in MNEs' home and host economies which may or may not be conducive to ethical conduct. Additionally, they are *structurally* conditioned by resource dependences and the consequent power relations between MNEs and host localities. Variously combined, such conditions create distinct tendencies towards responsible or irresponsible corporate conduct. Especially interesting are the circumstances where either negotiating party is able to promote ethical and transparent practices in the other party, enhancing prospects for local institutional change, and beneficial local development.

Oinas, Päivi & Erja Kettunen (2018) Realities of responsible business: Institutional and structural conditions of MNE – local government bargaining, in Martina Fuchs, Martin Franz, Sebastian Henn and Ram Mudambi, eds. *Managing Culture and Interspace in Cross-border Investments: Building a Global Company*, London: Routledge, pp. 135-145.

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Introduction

How multinational enterprises (MNEs) behave in the localities they enter in different parts of the world has been keenly monitored by local agents as well as international audiences. Despite strong efforts to introduce corporate social responsibility (CSR) and the presumed widespread adoption of responsible practices in Western MNEs (Bondy, Moon and Matten 2012, 281), compliance with acceptable legal and moral standards is not a given around the globe. "[C]orporations operate in a broad variety of contexts where governments are not necessarily able or willing to regulate them effectively" (Crane et al 2014, 140). MNEs may succumb to unethical practices in such contexts, possibly regardless of explicitly subscribing to CSR, and following ethical codes of conduct elsewhere. The bulk of research on CSR concerns firms originating and operating in advanced Western economies. MNEs, however, increasingly also originate in countries with inadequate government regulation. Therefore, whether MNEs with different backgrounds engage in responsible or irresponsible conduct in different contexts of operation is worthy of analysis, given that they may face starkly divergent expectations regarding corporate conduct compared to their home environments.

There is no commonly agreed definition of CSR but, in its broadest sense, it concerns "the social obligations and impacts of business in society" (Crane and Matten 2007, vi). Responsibly or ethically (we will use these terms interchangeably) inclined corporations are interested in the consequences of their action, and therefore are willing to acknowledge and even tackle the "systemic social and environmental problems to which they are connected" (Crane et al. 2014, 140). Much research on CSR focuses on the national scale, but our analysis concerns the *local* scale. We ask, under what conditions are MNEs likely to engage in ethical vs. unethical conduct in the localities where they invest? We acknowledge the central role of the interactions and negotiations between MNEs and host local governments in setting the stage for the operation of MNEs locally.

We propose what we dub here "institutional and structural conditions" as essential – though not sole (cf. e.g. Campbell 2007, 948) – features influencing CSR on the local scale. *Institutional conditions* stem from the imprinting of features of the home vs. host economy's institutional environments in the operating principles of the variously interdependent parties involved in the local scale negotiations. Imprinting is not just the long-lasting influence on organisations of the environmental conditions at the *time* of their formation (cf. Stinchcombe 1965) but also of their geographical origin (cf. Guthey, Whiteman and Elmes 2014). Such imprinting concerns here ethical conduct on the part of the MNEs, and good governance practices on the part of the local governments. (A firm's ethical conduct may also be based on self- or market-induced responsibility, or industry standards, but we simplify here by delimiting our discussion to "home" and "host" institutional conditions.) Corporate actors face diverse institutional settings (cf. Meyer and Peng 2016), evidenced *inter alii* by the types and levels of corruption, i.e. "the abuse of entrusted power for private gain" (Transparency International 2016) around the globe. The *structural conditions* are created by MNE-locality resource interdependencies that are reflected in power relations in bargaining situations.

This chapter proposes that such conditions influence the interactions between MNEs and local governments, helping us formulate propositions as to the kinds of situations around the globe in which locally responsible vs. irresponsible corporate conduct is likely. In what follows, we discuss the bargaining relations between MNEs and local governments, and then introduce the two types of conditions affecting bargaining outcomes. We consider the tendencies towards ethical vs. unethical conduct in the contexts influenced by those conditions, and conclude by discussing implications for sustainable local development.

MNE – host local government interactions: bargaining relations

In the international business literature, an MNE's relation with the host state is established via negotiations, or bargaining, between the foreign firm and the host country government. The 'bargaining model' (Kobrin 1987) assumes that both the MNE and the host state possess resources that are wanted by the other party. The MNEs' resources include, for example, technology, managerial skills, capital and export potential; the host state possesses resources such as access to the domestic market, natural resources, labour and government incentives (ibid., 619-622). Originally, the MNE–host state relation was largely perceived as confrontational (e.g. Vernon 1977; Grosse and Behrman 1992), especially in developing countries, whereas nowadays the relation is widely considered cooperative because of perceived interdependence between firms and states under globalisation (Luo 2001; Ramamurti 2001; Wagner 2013).

Bargaining is a process, with iterative, recurrent negotiations taking place between the MNE and the host state over a range of issues (Eden, Lenway and Schuler 2005), such as business licenses, authorisation of construction plans and inspection of implementation, safety standards and certificates of origin. Formal government policy as well as informal practices typically influence the dealings.

While the literature on firm-state bargaining focuses on the national scale, we discuss bargaining relations at the *local scale* which is where concrete ongoing interactions take place, typically through personal contacts between MNEs and host local governments. The division of responsibilities between national and local governments varies between countries but the latter always have tasks of their own and they participate in enforcing national scale laws, rules and regulations. However, the local scale may show greater variance in their enforcement and reveal the power of informal practices (cf. Meyer and Peng 2016, 11). MNE representatives encounter local government officials when they seek advice or approvals regarding various application procedures and the related legislation, or when they inform policymakers about their business interests in face-to-face meetings, or other encounters such as local seminars or events.

Bargaining is affected not only by economic and political factors, but also by institutional factors (Eden, Lenway and Schuler 2005, 270). Moreover, we argue here that bargaining itself also becomes a locally institutionalised relation, and the nature and outcomes of local bargaining practices bear significant consequences on corporate conduct vis-à-vis economic, social, cultural, political and environmental development of the host localities. A key issue from a locality's perspective is whether or not local governments and MNEs as parties in the bargaining relation are committed to long term sustainable development of the locality, suggesting contributions to the advancement of activities as diverse as competent corporate management, fair wages, decent working conditions, employee training, use of natural resources, environmental protection, waste management, revitalising economic and community life, sustaining cultural heritage and supporting cultural events, etc. That, we argue, depends in part on the aforementioned institutional and structural conditions to which we turn below.

Institutional and structural conditions affecting local bargaining

Institutional conditions

Agents that operate in accordance with prevailing – formal and informal (e.g. North 1990), regulatory and normative (Meyer & Rowan 1977) – institutions are considered legitimate members of their societies and communities, that is, their action is perceived or assumed to be "desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman 1995, 574). Similar institutionalist tenets have also been adopted in the widely held institutional approach to CSR. The implication is that "firms within a given societal setting will tend to behave in a similar fashion in terms of CSR" (Young & Makhija 2014, 670). Some institutional environments create a stronger tendency towards responsible business conduct than others (Fransen 2013; Gjølberg 2009, 2010; Matten & Moon 2008). In the absence of such institutions, firms may have interests and incentives that may cause them to behave irresponsibly (Campbell 2007, 951).

Firms can be taken to act responsibly if they do "not knowingly do anything that could harm their stakeholders, notably, their investors, employees, customers, suppliers, or the local community within which they operate", and in the case that they "cause harm to their stakeholders, they must then rectify it whenever the harm is discovered and brought to their attention." (Campbell 2007, 951). However, legitimate corporate behaviour means different things in different contexts. Therefore, an MNE entering a foreign locality may perceive what is legitimate differently from its local stakeholders, facing an institutional mismatch. Formal regulation may be in place but enforcement by local authorities may be lacking, particularly in many developing economies (Su et al. 2016). We formulate the institutional conditions as follows (F for "firm"; L for "locality"; E+ for "ethical conduct"; E- for "non-ethical conduct"):

- An MNE's home-base institutions form a strong expectation for and enforce ethical conduct (**FE+**); alternatively they tolerate (even expect) unethical conduct (**FE-**).
- An MNE's host locality's institutions form a strong expectation for and enforce ethical conduct (**LE+**); alternatively they tolerate (even expect) unethical conduct (**LE-**).

The possible combinations of *institutional conditions* are the following:

LE+ FE+ The host local economy's and the MNE's home-base institutions enforce ethical conduct. Expectations regarding ethical conduct are shared by negotiating parties.

LE- FE+ The host local economy institutions tolerate unethical conduct, whereas the MNE's home-base institutions enforce ethical conduct, resulting in conflicting expectations in negotiations, or institutional mismatch.

LE+ FE- The host local economy institutions enforce ethical conduct, whereas the MNE's home-base institutions tolerate unethical conduct, resulting in conflicting expectations in negotiations, or institutional mismatch.

LE- FE- Both the host local economy and the MNE's home-base institutions tolerate unethical conduct. Negotiation results likely serve the negotiating parties' private interests and shirk the local common good.

Situation LE+FE+ could involve MNEs from the world's least-corrupt countries such as Denmark, New Zealand or Finland (Transparency International 2017) investing in localities in similar countries. In contrast, situation LE-FE- would involve both MNEs and localities from the other end of the corruptness spectrum. The cases in between would be created by investments across such institutional divides.

Structural conditions

Institutional theory posits that firms in a given institutional setting converge in their CSR strategies but does not highlight differences between firms (Young and Makhija 2014, 673). E.g. Gjølberg (2009) observes that the CSR literature has been unable to deal with various structural conditions, including power relations. In line with the bargaining model, the structural condition, as defined here, recognises the mutual dependencies between individual MNEs and their host localities. Dependence is taken to generate commitment and need for legitimacy.

In each locality where MNEs invest and operate, MNE–locality relations evolve that are shaped by how important the locality is to the firm in terms of significant resource provision, and how important the firm is from the point of view of the development of the local economy and community. The resource interdependencies are as follows (cf. Oinas 1995) (F for "firm"; L for "locality"; D+ for "dependent"; D- for "not dependent").

- An MNE is locally dependent if its operation is dependent on locality-specific resources (**FD+**); otherwise it is not locally dependent (**FD-**).
- A locality is dependent on an MNE if its development is dependent on resources controlled by the firm (**LD+**); otherwise the locality is not dependent (**LD-**).

For simplicity of presentation, the dependence relations are dichotomized, but obviously, *de facto* dependences are matters of degree. As "one's power resides implicitly in another's dependency" (Emerson 1962, 32), these relations of dependence are manifested in the power relations between the MNE units and their host localities. They give rise to the following *structural conditions* for the local bargaining relations:

LD+ FD+ Both the locality and the MNE are dependent on each other; the local government and the local MNE representatives are motivated and equal negotiators.

LD- FD+ The locality is not dependent on the MNE, but the MNE is dependent on the locality; the local government is the powerful negotiator.

LD+ FD- The locality is dependent on the MNE, but the MNE is not dependent on the locality; the local MNE representative is the powerful negotiator.

LD- FD- Both the locality and the firm are not dependent on each other; the local government and the local MNE representatives are indifferent equal negotiators.

LD+ is due to the MNE being an employer, tax payer, possibly an original innovator creating markets, connecting the region with external markets and technologies, building local networks and/or attracting other firms to the locality. The MNE's bargaining power increases when it possesses scarce and non-imitable resources helping to boost the local economy, e.g. sophisticated technological skills (Eden, Lenway and Schuler 2005). Similarly, the power of the local economy increases when it has rare and location-bound resources needed by the MNE, such as central location for efficient logistics, a large market, or valuable human or natural resources (cf. ibid.). In situation LD+FD+, both entities desire each other's resources, e.g. an MNE with a new technology investing in a locality where an industrial cluster has recently laid off employees with rare competences useful in the MNE's innovative activities. In situation LD-FD-, the firm could also find its resources elsewhere and the locality's development does not rely on a particular firm. The other situations can stem from various one-sided dependences.

Tendency towards corporate social responsibility

The institutional and structural conditions on local interactions and negotiations create tendencies towards ethical vs. non-ethical conduct in MNE units as outlined in Table 1. The columns present the institutional (LE+/-) and structural (LD+/-) conditions from the host locality's perspective. The rows present the institutional condition of the MNE's home-base, i.e. MNE imprinting (FE+/-) and the structural condition of the firm's dependence or non-dependence on the host locality (FD+/-). Combined, the table suggests 16 possible outcomes in terms of the tendency towards ethical conduct. Complex as it is, the table nevertheless provides just a simplified depiction of real-world circumstances. The systematic approach, however, provides an account of the diverse circumstances around the globe, where MNEs negotiate the conditions of their operations locally.

Table 1. The institutional and structural conditions creating tendencies towards ethical vs. non-ethical conduct in MNE units

LOCALITY (L): / MNE (F):		ETHICAL CONDUCT ENFORCED IN HOST LOCALITY (LE+)		UNETHICAL CONDUCT TOLERATED IN HOST LOCALITY (LE-)	
		L DEPENDENT ON F (LD+)	L NON-DEPEND-ENT ON F (LD-)	L DEPENDENT ON F (LD+)	L NON-DEPENDENT ON F (LD-)
ETHICAL CONDUCT ENFORCED AT HOME (FE+)	F DEP. ON HOST L (FD+)	(1a) Ethical conduct highly likely	(1b) Ethical conduct likely	(2a) Firm may yield to unethical conduct, or promote ethical conduct locally	(2b) Firm may yield to unethical conduct
	F NON-DEP. ON HOST L	(1c) Ethical conduct likely	(1d) Ethical conduct likely	(2c) Firm may promote ethical conduct locally	(2d) Investment rare
UNETHICAL CONDUCT TOLERATED AT HOME (FE-)	F DEP. ON HOST L (FD+)	(3a) Firm likely obliged to ethical conduct	(3b) Firm may be compelled to ethical conduct	(4a) Unethical conduct highly likely	(4b) Unethical conduct highly likely
	F NON-DEP. ON HOST L (FD-)	(3c) Firm likely to push unethical solutions	(3d) Investment rare	(4c) Unethical conduct likely	(4d) Opportunistic unethical conduct likely

The different institutional and structural conditions brought together in Table 1 create tendencies towards MNE ethical or non-ethical conduct as follows.

(1) Both home and host institutional environments support a tendency towards ethical conduct (LE+ FE+)

(1a) Mutual dependence increases the likelihood of the MNE and the local government respecting each other's expectations as the stakes are high for both parties (LD+ FD+). These conditions create a strong tendency towards ethical conduct.

(1b) The MNE's dependence on the host locality strengthens the likelihood of the MNE respecting the expectations of the local government as it builds legitimacy in the non-dependent locality (LD- FD+), thus strengthening the MNE's tendency to act ethically beyond home turf.

(1c) The locality's dependence on the non-dependent MNE (LD+ FD-) makes the local government inclined to accept the MNE's requests in negotiations. They are likely not unethical but the MNE does not make long-term commitments.

(1d) Mutually weak dependence (LD- FD-) leaves the institutional condition decisive in creating a tendency towards ethical conduct, yet without long-term commitment.

(2) Mixed outcomes: MNE with an ethical institutional imprinting facing institutional mismatch (LE- FE+)

(2a) Mutual dependence makes the MNE and local government equal negotiators, and the stakes are high for both parties (LD+ FD+). Corporate strategy is decisive in bargaining as the MNE either adopts local practices, or alternatively, it manages to negotiate deals that promote ethical conduct locally.

(2b) The MNE's dependence on a non-dependent host locality (LD- FD+) raises its risk of yielding to corrupt local practices.

(2c) The locality's dependence on the non-dependent MNE (LD+ FD-) makes the local government inclined to accept the codes of conduct the MNE insists on. The firm may showcase the changing rules of the game in the global market, and thereby contribute to the spread of CSR amongst local stakeholders and to local institutional change.

(2d) Mutual non-dependence (LD- FD-) and an institutional mismatch make investment unlikely (but if it happens, it is for other reasons that short-term deals end up ethical vs. opportunistic).

(3) Mixed outcomes: MNE with an unethical institutional imprinting facing institutional mismatch (LE+ FE-)

(3a) Mutual dependence makes the MNE and local government equal negotiators, and the stakes are high for both parties (LD+ FD+), but the MNE may act against local rules. The local government's discretion in sanctioning unethical conduct is decisive. Tendency towards ethical outcome is strong.

(3b) MNE's dependence on non-dependent host locality (LD- FD+) increases the likelihood of negotiations leading to enforced ethical corporate conduct.

(3c) Locality's dependence on the non-dependent MNE (LD+ FD-) may lead to outcomes where the local government yields to some of the MNE's unethical requests and the MNE may try to push unethical business practices amongst local stakeholders.

(3d) Mutual non-dependence (LD- FD-) and an institutional mismatch render investment unlikely (but offers an opportunity for the MNE to push unethical solutions).

(4) Tendency towards unethical conduct as both home and host institutional environments tolerate or even expect unethical conduct (LE- FE-)

(4a) Mutual dependence and the high stakes of both parties (LD+ FD+) make negotiating parties tend to put effort into ascertaining each other's mutual interests. Broader local development does not weigh heavily on the agenda; institutional change is not aspired to.

(4b) The MNE's dependence on a non-dependent host locality (LD- FD+) strengthens the tendency towards unethical conduct.

(4c) The locality's dependence on the non-dependent MNE (LD+ FD-) makes the local government inclined to accept the MNE's requests, strengthening tendencies towards unethical conduct.

(4d) Mutual non-dependence (LD- FD-) turns negotiations into games of opportunistic gains.

Thus, the diverging tendencies in corporate responsible action emerge as MNEs negotiate the terms of their operation locally under given circumstance. Situations 1a-d are rather clear-cut, with a strong tendency towards predominantly ethical outcomes. Also situations 4a-d suggest opportunistic solutions emerging from negotiations in a rather clear-cut fashion. Cases in the other two groups are variable – and interesting – because of the inherent institutional mismatch and unequal power relations. For example, in (2b), a principally ethically operating unit of a Nordic corporation can face strong attempts at coercion to locally prevailing corrupt practices by local stakeholders in, say, the former Soviet states. In contrast, e.g. in (3b), an emerging economy MNE attempting to get established in a Nordic city could learn contemporary corporate transparency.

Arguably, situations 1a-d and 2a-d are the more prevalent in the world because the majority of global investments originate in and target the more advanced economies of the global North where CSR strategies are believed to be more prevalent. Situations 3a-d are less typical as investments from countries where institutions do not strongly support law enforcement and ethical practices are still less common on the world scale although, as is well known, their numbers are increasing. We still know rather little about situations 4a-d as MNEs originating in less developed countries and targeting localities in other less developed countries remain considerably fewer on the world scale compared to those originating in developed economies. Their numbers are growing, however, so we should get interested.

Conclusion: Negotiating sustainable development?

Our aim was to contribute to the systematic study of the diverse circumstances in which MNEs invest and negotiate the terms of their operations in interaction with local stakeholders, centrally local governments, and to understand the conditions in which they are likely to engage in ethical vs. unethical conduct in their host localities. To this effect, we made stark delimitations which enabled us to focus on the institutional and structural conditions that we reckon are fundamental to understanding the realities of responsible business practices in localities around the world. This kept us from touching upon additional factors that are likely to influence the tendency towards corporate responsibility. These relate to corporate strategy, governance and relative independence of foreign units, corporate and locality's brand image, developments in major markets, international stakeholder relations, political systems including the role of i.a. labour unions, activities of international organisations, behaviour of other MNEs in the locality and in the MNE's global organisational field. The economic situation in host localities also plays a role: large investment hubs are distinct from smaller towns. The local government in the former has experience with potentially powerful MNEs whereas the latter might be receiving its first ever FDI.

That said, our analysis offers pointers to understanding the formation of locally institutionalised bargaining relations and their role in facilitating or hindering local development. Particularly interesting are the cases where either party is in the position to take action towards promoting ethical and transparent practices in the other party, giving rise to prospects for local institutional change. The consequence for local firms can be the opening up of opportunities to reach new markets. Initial success and the need to build legitimacy in highly competitive and institutionally robust segments in the global markets is likely to help MNEs from weak institutional backgrounds to internalise the benefits of transparency, both from the point of view of profit and from the point of view of collaborative potential arising in corporate networks and societally legitimate public-private partnerships. In localities, institutional change may facilitate the build-up of a more lucrative local institutional environment for ethical inward investment and thereby better prospects for local economic development in the long run. Most difficult are the situations where both parties are stuck with unethical practices and short-term gains. In these cases, fraudulent institutions are likely to change slowly, which tends to be reflected in local development prospects.

Acknowledgements. We thank Lucía Gómez for comments on an earlier version. Erja Kettunen is grateful for the Foundation for Economic Education for financial support.

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