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Firms' Economic Reliance to National Markets and the Corporate Provision of Public Goods: Evidence from Corporate Disaster Philanthropy

Luis Ballesteros
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BIG Question:
"What determines the engagement of business organizations in the provision of public goods, i.e., pro-social behavior, and what are the conditions and mechanisms of performance benefits associated with such behavior and those of an economic surplus for external stakeholders?"

Introduction

"We are part of the same system. If the (Japanese) government cannot (orchestrate a reconstruction), we must rebuild. We need the market to recover," was the answer given by the VP from Coca Cola when I asked him about Coke's motives to donate in the aftermath of the 2011 earthquake and tsunami in Japan. At the time, I was working at the World Bank in disaster risk management and tasked with identifying potential sources of funding for relief and recovery. I would frequently encounter arguments that reflected this motive across my conversations with managers of multinational enterprises (MNEs) responding to the disaster. I had not started my Ph.D. program at Wharton, but these interviews had already provided me with the theoretical cornerstone for my dissertation: economic reliance on national markets (i.e., the share of corporate income explained by a given country) should affect the willingness of the firm to supply public goods (i.e., to behave pro-socially) and the degree that such behavior leads to performance benefits for the firm and an economic surplus for society at large. In the context of the disruption created by disasters, relief and recovery are public goods whose scarcity may reduce the expected profitability of firms that rely economically on the national market. The bigger the share of a firm's financial performance explained by a national market, the greater the strategic value for the firm of contributing to its relief and recovery.

Note that widespread arguments in the extant literature on non-market strategy, such as reputation and altruism, do not capture this simple causal intuition. Hence, I focus on economic reliance to contribute to the understanding of the determinants of non-market strategy by MNEs and its consequences for the firm and its stakeholders. In three chapters, I offer evidence that economic reliance facilitates the identification of (1) firms that are likely to engage in strategic philanthropy—i.e., the provision of cash and in-kind resources aimed at funding public goods that are key for firm performance, (2) firms that are prone to imitate the non-market behavior of rivals despite significant differences in size, performance, and market share, and be affected by stakeholders' perceived appropriateness of such behavior, and (3) firms comparatively capable to help countries increase or restore social welfare.

Dissertation Overview

In the first chapter, I formally develop the concept of economic reliance by building on the theory of clubs (Buchanan, 1965). I argue that national markets are economic systems that firms join through their operation. I derive a mathematical model that shows that the effect of economic reliance is not explained by traditional theories in strategic considerations such as reputational capital with internal and external stakeholders, a social license to operate, an agency cost, or institutional pressures (Dorobantu, Kaul, & Zelner, 2017). Likewise, it is not captured by the social-preferences theories of altruism and fairness (Andreoni & Miller, 2002; Camerer & Fehr, 2002) Overall,

this suggests that the effects of economic reliance on corporate pro-social behavior or CSR remains understudied.

My dissertation's main dataset is the product of a four-year collaborative project with researchers from the University of Pennsylvania Department of Computer and Information Science and the Wharton School, aimed at collecting and coding responses from firms, multilateral agencies, national governments, and non-profit organizations to every manmade and natural disaster that affected the world from 1990 to 2015.[1] It covers every monetary and in-kind donation reported in news media and 93,247 donations from 38,980 firms from 83 countries of origin.

In Chapter 2, I turn to the performance consequences of corporate pro-social behavior. Previous studies have documented that corporate pro-social behavior may be associated with performance benefits (Dorobantu et al., 2017). How firms realize such benefits is not trivial given the informational and time constraints under which some forms of non-market behavior, such as disaster philanthropy, takes place. For instance, about 84% of corporate donations to disasters come within three weeks of the disaster, hardly insufficient time for firms to conduct methodological due diligence on the damage to firm assets and the supply chain. Stakeholders also face great ambiguity in appraising the social value of a company's donations, given the fact that information on the human and material loss is not fully available for months or even years to come (Ballesteros, Useem, & Wry, 2017).

I focus on the apparent phenomenon of imitation: nearly two-thirds of disaster donations by firms are virtually the same as that of the first donor in the correspondent industry. If imitation momentarily drives a firm's pro-social behavior, it may well bring less financial advantage than in normal times. I draw upon the microfoundations of institutional theory to argue that firms concentrate on their rivals' financial standing while external stakeholders focus on firms' media reputation (Powell & Colyvas, 2008). Firms match the non-market behavior of high-revenue first movers because they believe that they are exemplary to identify and satisfy stakeholder expectations. On the other hand, stakeholders are especially likely to approve and reward companies with a pre-existing positive reputation because it signals that firms are selecting options whose means and ends are contextually appropriate. As a result, reputable first movers are prone to gain first-mover rents, but less reputable first movers are likely to suffer performance losses. This process generates imitation bandwagons that often result in aggregate losses because firms with high financial performance, but weak bad reputations often move first in the hopes of restoring their tarnished image.

My theoretical argumentation thus posits that organizational choices and its consequences on firm performance in a context of uncertainty and urgency are more a function of the legitimacy of the firm's social actions in the eyes of stakeholders than a function of the traditional metrics of financial performance. Moreover, corporate disaster giving is a non-market setting where firm choices are often disconnected from the social need, proxied by number of victims and the economic damage. Firms often gain performance benefits despite their donation being financially and socially suboptimal. I find that, 43% of the first movers and 51% of corporate donors obtained revenue losses not explained by their market operation.

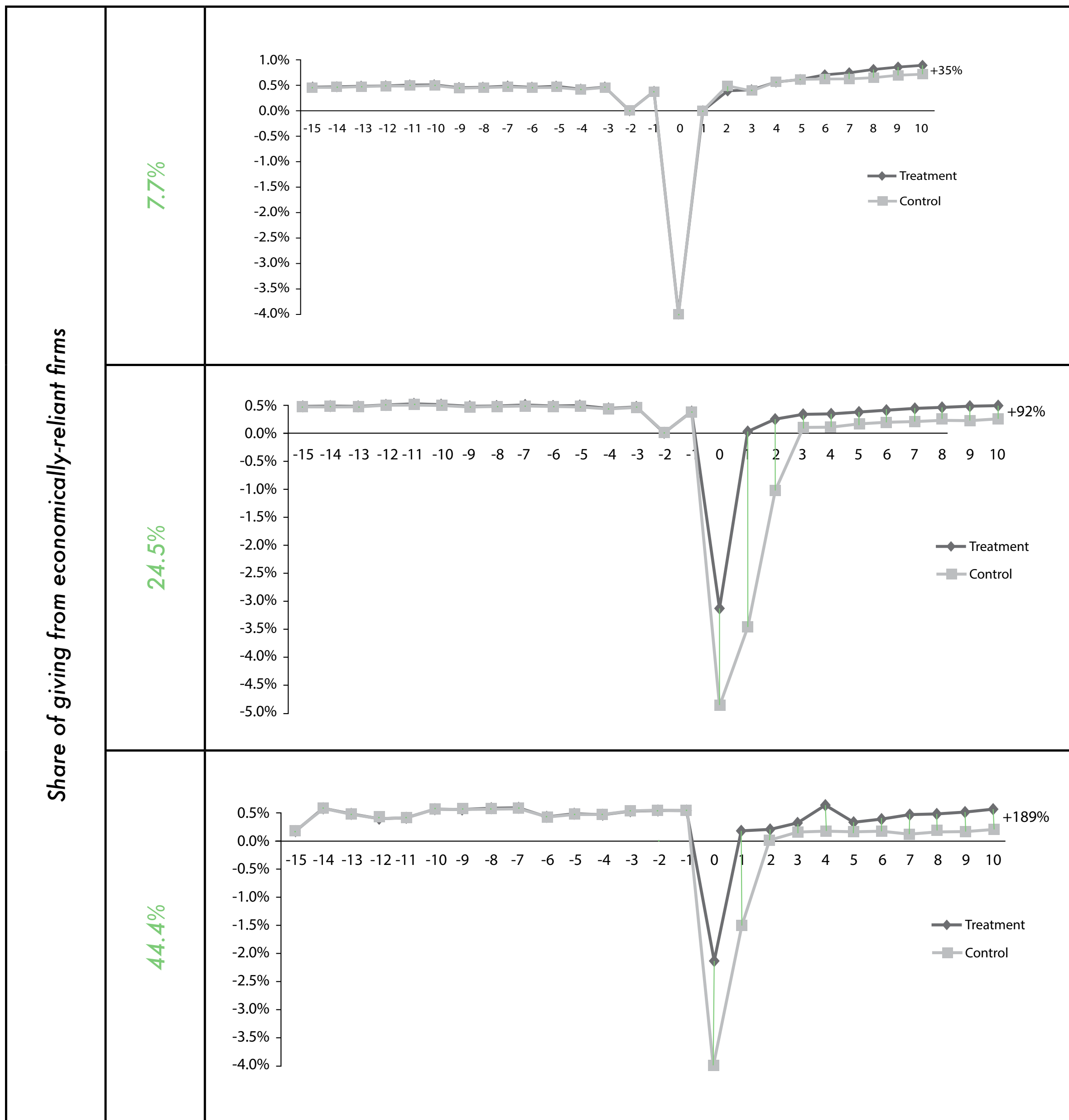
> *"Relief and recovery are public goods whose scarcity may reduce the expected profitability of firms that rely economically on the national market.*

In the final chapter of my dissertation, I aim to address a weak spot in the non-market strategy literature where the social consequences of corporate pro-social behavior remain understudied (Dorobantu et al., 2017). We have lacked theory to predict when and why a firm's actions will create meaningful economic surplus, or the conditions under which businesses might be better able than other types of organizations to deliver such benefits. In the case of disaster philanthropy, while firms have the potential to contribute to social welfare based on their resources, this work may be best left to other entities that specialize in these activities and can be held accountable for their pursuit (Ballesteros et al., 2017).

Thus, I develop a theoretical model based on the dynamic capabilities literature. I argue that MNEs that are economically reliant to market systems, as compared to other types of entities that give disaster aid, have dynamic capabilities that enable them to sense areas of critical need more effectively following a disaster, mobilize resources hastily, and reconfigure assets for efficient responses. Hence, I predict that aid will arrive more quickly, and a nation will recover more fully, when economically-reliant firms account for a larger share of disaster aid. I further argue that these outcomes will be enhanced when disaster giving leverages firm-specific routines and resources.

[1] We covered newspapers, trade press, magazines, newswires, press releases, TV and radio transcripts, digital video and audio clips, corporate websites and reports, institutional websites and reports, and government websites and reports, among other sources.

Figure 1. The Effect of Relatedness in the Relationship between Disaster Giving from Locally Active Firms and Disaster Recovery



Note: The outcome variable is the annual growth rate of HDI. Treated are disaster countries with at least 42.4% of in-kind giving that is related to the donor's core operation coming from firms economically active in the affected country (as defined by the 7.7%, 24.5%, and 44.4% cutoff points). Each figure shows the difference between the annual growth rates of HDI for treated and control nations 15 years before the disaster and 10 years after the disaster. The total sample of country-year disasters in the period 2003-2013 is 464.

The findings of a quasi-experimental design confirm that economic reliance offers firms an advantageous position to help drive timely delivery of disaster aid. For instance, the level of recovery 10 years after the disaster is notably higher for countries that receive over 24.5% of disaster aid from locally active firms. On average, as seen in Figure 1, the growth rate of the Human Development Index for such nations is 92% higher than for their synthetic controls: this gap grows to 189% at the 44.4% of share of corporate giving.

Framework and Findings

I hope that my dissertation's integrative theoretical framework that centers on economic reliance helps guide similar studies exploring the determinants and consequences of non-market strategy. Across the three chapters, I offer evidence that studying national markets as systems where entities share the costs and benefits of public goods exclusive of the market system is a useful methodology to predict corporate behavior and the implications for firm performance and social welfare.

This integrative framework results in more precise predictions than approaches employed in the extant literature. For instance, I show that monopolistic firms engage in pro-social behavior more frequently and in a greater magnitude than firms operating in fragmented industries. This challenges empirical work in the institutional and strategic philanthropy literatures suggesting that the benefits of corporate pro-social behavior are comparatively large in competitive industries where the quest and returns to differentiation are relative big (Kaul & Luo, 2017; Marquis, Davis, & Glynn, 2013).

My findings suggest that the effect of institutional factors on non-market strategy is more complex than the extant literature has suggested (Dorobantu et al., 2017). On the one hand, firms react positively to rule of law and accountability on the use of resources. Hence, institutional development may enhance corporate pro-social behavior (Amaeshi, Adegbite, & Rajwani, 2016). At the same time, when firms perceive that the government is incapable of supplying public goods, they increase their average giving. Taken together, my dissertation provides a more nuanced understanding of the role of national institutions in disciplining firms into a certain non-market strategy than previous studies.

> *My findings offer guidance on when and how the firm is more likely to extract rents by donating to disasters.*

Chapter 2 suggests that one source of debate in the literature on timing strategy (e.g, first-mover advantage) is the little attention to the drivers of stakeholder responses (Fosfuri, Lanzolla, & Suarez, 2013). I suggest a structural mechanism behind the social construction of performance advantages: when corporate behavior is a relatively novel phenomenon, stakeholders cope with uncertainty by focusing on easy-to-collect signals. These cognitive referents replace formal institutions and objective mechanisms based on probability estimates (Ballesteros, Wry, & Useem, 2018).

Finally, the findings in chapter 3 suggest that drawing on dynamic capabilities may help address a longstanding debate in the literature on non-market strategy. By confirming that economically-reliant firms are in an advantageous position to help drive timely delivery of disaster aid, thereby lessening the adverse effects of disasters on social welfare, my dissertation sheds light on the mechanisms that explain firms' comparative advantage to supply collective goods (Ballesteros et al., 2017).

Implications

Regarding the managerial implications of my dissertation, the social impact of corporate social responsibility is a metric that is increasingly demanded by stakeholders and my dissertation offers a calculation method using measurable and unambiguous metrics. Given that corporate disaster philanthropy is increasing faster than other non-market strategies and such engagement is associated with performance benefits (Ballesteros, 2017)"abstract":"When firms decide to engage in the provision of collective goods that benefit social welfare (i.e., to behave pro-socially, understanding the conditions and mechanisms of such effects is of growing strategic value for managers. My findings offer guidance on when and how the firm is more likely to extract rents by donating to disasters. It identifies the firm-, industry-, and market-specific factors that managers need to consider when choosing the timing and magnitude of their philanthropy.

Regarding its social implications, responding effectively to natural disasters is a grand and growing challenge worldwide as the inflation-adjusted cost of disasters has sextupled in the last 40 years. At the same time, the level of aid from governments and aid agencies has been stagnant. Firms are increasingly called upon to address this gap, and have emerged in the past 25 years as a large contributor to humanitarian aid. Corporate philanthropy comprises a growing share of disaster relief, and for some disasters in the last seven years, it has exceeded the contributions of public aid and individual charity (Ballesteros, 2017; Ballesteros & Gatignon, n.d.)"abstract":"When firms decide to engage in the provision of collective goods that benefit social welfare (i.e., to behave pro-socially. The social value of corporate disaster philanthropy is thus likely to increase over time. My dissertation informs how such form of non-market strategy can be stimulated and disciplined to strengthen its positive benefits on business organizations and societies around the world.

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Luis Ballesteros (ballesteros@gwu.edu) is at the faculty of the GW Business School. He studies the individual and institutional drivers of organizational decision making under risk and uncertainty and the consequences of such choices for firm performance and economic development. Before receiving his PhD, Luis worked on industry development for the United Nations Development Program, disaster risk management for the World Bank, and in designing and trading market-based tools to hedge risk for JP Morgan.