Reputational Dynamics of Private Regulation

Contribution to *Socio-Economic Review* discussion forum on the Grey Areas of Reputation

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Public regulation has undergone a gradual decline in the global economy. As public regulation has waned, many scholars, activists, and policy reformers posit that private regulation is an effective replacement. Rather than ask government to regulate firm behavior, private regulation implies that normal citizens, often in the form of activist groups or NGOs, incentivize or punish firms that fail to live up to socially responsible standards (Bartley, 2007; Vogel, 2008). In private regulation there are no legal means to enforce compliance; instead, reputation is a key mechanism in any push to influence firm behavior (Baron and Diermeier, 2007). Proponents realize that to make private regulation effective, firms must be motivated to care about their reputations.

Private regulation uses reputation as both a carrot and a stick. The carrot is (at least theoretically) that as firms adopt higher standards of socially responsible behavior (e.g., agreeing to stop using sweatshop labor to produce sneakers), those firms will be rewarded with a distinctive reputation. In turn, customers, investors, employees, and other stakeholders will be more likely to want to do business with them. The stick that private regulation offers is the threat of reputational damage for deviant firms. Firms that are identified as being particularly bad examples of socially responsible behavior can be singled out and publicly shamed. Reputational damage is likely to be most effective at curtailing bad behavior when firms have already publicly committed to higher standards of behavior.

Now that private regulation has proliferated, the question we should ask is, how effective is reputation as a mechanism for holding firms accountable to the public? The answer I believe is mixed and suggests that reputation's regulatory influence is much more complex than the proponents of private regulation theorized. The proliferation of mechanisms of private regulation plunges us into a grey area where reputations and values are not given but socially constructed, the ethicality or morality of practice is contested, and reputational consequences are not always straightforward.

Private Regulation and Reputational Incentives

A key mechanism underlying private regulation is a credible and legitimate signal of a firm's reputation in a particular area. As private regulation took hold in the 1970s, multistakeholder and nongovernmental initiatives began to create a system of institutional signals of a firm's willingness to abide by responsibility norms. These initiatives sought to replace traditional regulatory mechanisms with certification standards or voluntary compliance statements that firms could adopt to demonstrate their willingness to conform (for an overview see Utting, forthcoming). The first of these initiatives were established by quasi-governmental institutions, like the United Nations. The UN Global Compact, for example, represented an effort by a transnational body of state representatives to apply social responsibility standards to a global marketplace. Its stated goals were to raise awareness of corporate social responsibility and to serve as a hub for other voluntary partnerships between states and corporations. Ideally, the Global Compact would assist the corporate community in defining standards of a socially responsible corporate citizen, while also giving civil society groups a place at the table.

In addition to these quasi-governmental standards, civil regulation (or regulatory standard setting) established by third party associations, auditors, and consultants has proliferated since the early 1990s. Certification systems provide a set of regulatory policy guidelines for firms to follow and are usually linked to some type of accreditation that signals to others, including industry peers, that the firm uses best practices. Sometimes these standards are industry-specific or apply to a particular issue or topic. Certification systems have been set up across a diversity of topics, including forestry, human and employment rights, environmental performance, sustainable fishing or harvesting, or anti-corruption. One of the first such systems was the Forest Stewardship Council, created in 1993 to help identify retail and other operations that used sustainable forestry practices (Bartley 2007). Like most of the certification systems that followed, the Council was created following a number of scandals that put forestry industries under the watchful eye of activist groups and the public. Becoming a part of the Council allowed firms to signal their commitment to higher standards and avoid being stigmatized. Since that time the number of environmental certification systems has exploded. EcolabelIndex, a database that tracks all national and transnational environmental certifications, maintains there are currently 437 such certifications in 197 countries and 25 industry sectors.[1]

Although one might hold the explosion of certification systems as evidence that private regulation is working, it also means that standards of varying quality and thoroughness now compete as potential signals of firms' commitment to higher standards. Competition among certification systems may create a race-to-the-bottom, much in the same way that governmental deregulation does (Djelic and Sahlin-Andersson, 2006). The proliferation of certification systems has also made it difficult for organizations' audiences to determine the reliability of the reputational signal of any single system (Schneiberg and Bartley, 2008). Two issues compound

[1] http://www.ecolabelindex.com/ (last accessed, September 24, 2013)

the reliability problem: 1) certification systems with looser standards are more widely adopted and 2) many certification systems are now business-led rather than multistakeholder initiatives, about which many activists are skeptical. Given the heterogeneity in vast array of certification systems, it is clear that not every system promotes high standards and many appear to promote business interests more than they do the interests of the public they are meant to serve.

Thus, the very content of reputation signals is socially constructed and politically contested. Although certifications are meant to facilitate comparability and commensuration of reputation across very different types of markets (e.g., Espeland and Stevens 1998; Timmermans and Epstein 2010), in reality these certifications may only give the appearance of standardization and accountability. The proliferation of diverse standards creates strategic opportunities for firms that may prey on the ignorance of their consumer or regulatory audiences and use certification systems as impression management devices to establish a reputation for being socially or environmentally responsible without actually altering their behavior. Rather than acting as signals, these certifications seem, instead, to be serving as symbols that corporations use to decorate themselves with the appearance of social responsibility.

Dynamics exist that may prevent these standards from losing their appeal as private regulatory devices. One of these dynamics is that competition between firms incentivizes some firms to differentiate their reputation in a positive way by becoming known for its social responsibility. Because some firms are serious about distinguishing themselves as responsible citizens, they will flock to those standards that raise the bar (Sabel et al., 2000). These firms may seek to associate only with certification systems that promote the highest standards and that exclude firms that do not allow for regular monitoring and compliance tests. Another dynamic that helps prevent shirking are the presence of activist groups that seek to hold firms accountable

to the standards for which they are certified. This bottom-up pressure to behave according to their commitments to the certifiers potentially inhibits some firms from using certifications merely for symbolic purposes (e.g., Overdevest, 2010). However, for this pressure to be effective, activists must be capable of identifying and targeting corporate shirkers and threaten their reputation.

Private Regulation and Reputational Threats

Another mechanism through which private regulation works is through potential reputation threats created by activist groups. Research on social movements and corporate social responsibility has emphasized that stakeholder attempts to influence firm behavior are rarely uncoordinated and diffuse; rather, in order for private regulation to be effective, private citizens often join forces and mobilize their resources in organized campaigns against corporate targets (e.g., King 2008; Soule 2009). Activists' main weapon against corporations is their ability to threaten corporate reputations by exposing malfeasance, lack of ethical decision-making, or the use of normatively questionable practices. These negative claims present an image of the firm that runs contrary to the positively distinguishing image claims the firm makes about itself. Impression management, the skills and tactics that actors use to manipulate the shared perceptions that others have of them, underlies many of these contentious interactions. In particular, skilled activists seek to create negative perceptions of misbehaving firms and question their fundamental character, while those same firms seek to avoid the potential reputational costs this might impose by making positive claims about their character.

Punishing firms is only effective inasmuch as the media pay attention to the activists' claims. If nobody knows about the claims other than the activists, then the activists' actions will

not alter public perceptions. However, inasmuch as activists grab media headlines, they are able to draw the public's attention to the targeted firm and its irresponsible behaviors and policies, which can subsequently affect the firm's reputation. Research shows that activist protests and boycotts that draw more media attention lead to larger declines in the target firm's stock price, in part due to the reputational damage such attention inflicts (King and Soule, 2007; King, 2011). Thus, activists are highly dependent on media attention to inflict their punishment.

The quest to drum up media attention, however, means that activists are most likely to target firms that make attractive subjects of journalist inquiries. Large firms that have positive reputations make better candidates for media coverage than small, less prestigious firms. Not surprisingly, activists tend to target large, high reputation firms the most, irrespective of the egregiousness of their irresponsible behavior (Bartley and Child, forthcoming; King and McDonnell, forthcoming). In fact, one study showed that firms that have engaged in more socially responsible actions are more, not less, likely to be targets of boycotts than other firms (King and McDonnell, forthcoming). The lesson seems to be that the worst offenders can often escape the notice of activists' protests if they are not highly visible or prestigious.

The adverse consequences of this selection process is that those firms that are the most frequent targets of activist actions are not necessarily the firms that most need to be regulated. Instead, it seems to be the same firms (the Nikes and Apples of the corporate world), year after year, that receive the majority of activists' outrage. These firms learn that responding directly to activists may only legitimate their claims further, and instead they choose to use impression management strategies that divert attention from the negative claims made by activists. For instance, after a firm is boycotted, they are much more likely to make claims about an unrelated prosocial behavior, but rarely are these prosocial claims in direct response to the activists'

original critiques (McDonnell and King, 2013). Thus, the actual source of the problem is rarely resolved. Reputation threats, then, seem to lead to ongoing impression management efforts, in which both activists and the corporate targets are equally engaged in using tactics to alter public perceptions, sometimes losing focus on the real goal of making substantive changes to business practices.

Finally, another critique made about the stick approach is that activists are not fully engaged in monitoring, perhaps in part because they are more concerned with creating media attention than they are with the more costly process of ensuring implementation (Seidman, 2007). The lack of weight behind monitoring makes it even easier for firms to respond to activist pressures through decoupled impression management. If this is the case, then firms should feel little pressure to actually implement their promised changes.

Conclusion

Unlike public regulation, where "bad" behavior is defined by legal dictum, private regulation leaves open the possibility for multiple interpretations of the same practice. Relying on incentives and sanctions to influence firms to be socially responsible opens up the possibility for questioning the very definition of responsibility and manipulating the symbols by which firms demonstrate conformity to social responsibility norms. The ambiguity of rules and reputations leaves open the possibility that both stakeholders and firms will engage in impression management to shape the public's perceptions of their behavior and its consequences for society. Firms may dedicate more effort to managing the impressions that their key audiences have of them than dedicating resources to conforming to the emerging standards. These entrepreneurial efforts to define and redefine standards and to engage in impression management have the

potential to undermine private regulation and make it an ineffective mechanism to hold business responsible for the public good.

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