

**INSTITUTIONAL PREDICTORS OF AND COMPLEMENTS TO INDUSTRY SELF-  
REGULATION WITH REGARD TO LABOR PRACTICES**

Harry J. Van Buren III  
University of New Mexico  
Anderson Schools of Management  
1 University of New Mexico  
MSC05 3090  
Albuquerque, NM 87131  
505.277.3909 telephone  
505.277.7108 facsimile  
vanburen@mgt.unm.edu

Karen D.W. Patterson  
University of New Mexico  
Anderson Schools of Management  
1 University of New Mexico  
MSC05 3090  
Albuquerque, NM 87131  
505.277.2807 telephone  
505.277.7108 facsimile  
patterson@mgt.unm.edu

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## **INSTITUTIONAL PREDICTORS OF AND COMPLEMENTS TO INDUSTRY SELF-REGULATION WITH REGARD TO LABOR PRACTICES**

ABSTRACT: In recent years there has been increasing managerial and academic attention given to a variety of mechanisms for companies to respond to stakeholder concerns about global business ethics. One area that merits further analysis is the role of *industry-level* cooperation regarding issues in global business ethics like labor practices. There are two main issues that we will take up in this paper: institutional pressures that predict when an industry will create a code of conduct and institutional complements for an industry-level code of conduct to be “successful” with regard to responding to stakeholder concerns about international business operations. We offer a number of propositions—drawing on a variety of literatures, including corporate social performance, business ethics, and institutional theory—with regard to both predictors and complements of industry self-regulation in reference to labor practices.

## **INSTITUTIONAL PREDICTORS OF AND COMPLEMENTS TO INDUSTRY SELF-REGULATION WITH REGARD TO LABOR PRACTICES**

In recent years there has been increasing managerial and academic attention given to a variety of mechanisms for companies to respond to stakeholder concerns about global business ethics. Many companies have adopted codes of conduct, engaged in social reporting (using standardized reporting regimes like the Global Reporting Initiative or their own reporting models), and monitored suppliers located outside of their home countries. It is reasonable to expect that more and more companies will engage in such activities in the future, and companies already engaged in such activities will refine what they do to respond better to current and emerging ethical issues in global business.

One area that merits further analysis is the role of *industry-level* cooperation regarding issues in global business ethics like labor practices. Industries as disparate as pharmaceuticals (Hemphill, 2006), oil (Watts, 2005), banking (Wright and Rwabizambuga, 2006), tobacco (Palazzo and Richter, 2005), accounting (Neill, Stovall, and Jinkerson, 2005) and architecture (Collier, 2005) have developed industry-level codes of conduct.<sup>1</sup> In this paper we intend to focus on industry-level codes of conduct that address labor and human rights issues in the context of international business operations. Table 1 provides examples of such industry-level codes of conduct across a variety of social issues.

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Insert Table 1 about here

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<sup>1</sup> Of course, accounting and architecture are professions, and professions have long had codes of conduct as a part of the expectations of their members.

Other industries—like the automotive industry—are working toward their own collective initiatives. Of course, an industry code of conduct requires competitors to cooperate with each other, which itself is fraught with difficulty.

An industry code of conduct can be useful. It can create an ethical floor for industry members. It can allow the industry to achieve economies of scale with regard to monitoring social performance, say for contract suppliers. It can help the industry better tell its story to its stakeholders<sup>2</sup> and perhaps avoid government regulation.

But industry codes of conduct also pose challenges. There is a need to convince a variety of stakeholders that the code and its implementation are rigorous. Developing the code—including taking up the issue of participation by non-members of the industry in the formulation and implementation processes—can be difficult. Ensuring compliance is complicated. Individual companies are putting part of their brand images at risk; if another company that is a signatory to the code behaves badly, all companies and the success of the industry’s initiative can be negatively affected. Industry members may need to create an institutional structure to administer the code, which may be costly and complicated.

There are two main issues that we will take up in this paper: institutional pressures that predict when an industry will create a code of conduct and institutional complements for an industry-level code of conduct to be “successful” with regard to responding to stakeholder concerns about international business operations. We offer a number of propositions—drawing on a variety of literatures, including corporate social performance, business ethics, and institutional theory—with regard to both predictors and complements of industry self-regulation

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<sup>2</sup> Stakeholders are any group or individual that can affect or is affected by the achievement of a firm’s (and by extension, industry’s) objectives (Freeman, 1984; Mitchell, Agle, and Wood, 1997).

in reference to labor practices. We will not focus on normative concerns about whether such industry-level initiatives are good or bad, particularly for workers.<sup>3</sup> Institutional theory may help explain, however, whether industry self-regulation focusing on labor practices (and more generally, on other social responsibility concerns like environmental responsibility) will occur and whether a particular initiative will or will not be successful in responding to stakeholder concerns with regard to labor practices.

### **GLOBAL LABOR ISSUES AND DEMANDS FOR CORPORATE SOCIAL RESPONSIBILITY**

One of the issues that has come to the forefront of stakeholder concerns about corporate behaviors relates to the treatment of workers in a global economy. It seems almost cliché to note that the world of business has become increasingly globalized (Friedman, 2005) and that organizations create value by linking workers from different countries together within the same value chain (Rivoli, 2005). Concurrent with such business trends are stakeholder concerns (whether employees, customers, communities, or governments) about the treatment of workers who manufacture products, especially when those workers live in countries in which wage rates are low and respect for human rights is lacking (Armbuster-Sandoval, 2005; Oxfam International, 2004). These workers can be classified in two ways: workers who work directly for a company headquartered in another country and contract supplier workers.

Many companies seek to employ labor wherever there is a competitive advantage—whether in terms of lower wages or superior skills. When a company directly employs workers in another country, it has direct control over wages and working conditions. In contrast, contract suppliers—the use of suppliers that either make products for another company under the latter’s

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<sup>3</sup> As interesting and indeed important as such questions may be from the perspective of business ethics, we restrict our attention here to more-instrumental concerns.

brand label or that provide services to another company (for example, janitorial services)—provide less direct control. These issues have often been discussed in the context of sweatshops (whether in the U.S. or in other countries; see Arnold and Hartman, 2003; Van Buren, 2005).

A number of groups, including human rights organizations and other non-governmental organizations (NGOs) have raised concerns about labor issues and corporate behaviors, especially when the countries involved are headquartered in developed countries (Diller, 1999; Kapstein, 2001; Spar and La Mure, 2003). Groups like Oxfam, Christian Aid, the Catholic Agency for Overseas Development,<sup>4</sup> and the Interfaith Center on Corporate Responsibility have all conducted research and engaged in activism focused on such concerns. The goal of such groups is to have an effect on stakeholder attitudes and beliefs about the social responsibilities of business; in short, to expect more of business than it is currently doing, creating a public issue that business must respond to (Wartick and Mahon, 1984).

There is considerable evidence that consumers and other stakeholders have increased their expectations of social performance with regard to labor issues (Connor, 2004; Harrison, Newholm, and Shaw, 2005). Indeed, one goal of NGOs is to have effects on perceptions of the legitimacy of corporate actions with regard to labor issues (Doh and Guay, 2006) that then lead to changes in stakeholder behaviors.<sup>5</sup> No company or industry wants to be the focus of a stakeholder campaign focused on irresponsible labor practices or indeed any other social responsibility issue.

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<sup>4</sup> In 2004, for example, the Catholic Agency for Overseas Development created a campaign, based on its own research focusing on labor and environmental issues in the electronics industry, called “Clean Up Your Computer.”

<sup>5</sup> A similar comment could be made with regard to other social responsibility issues, like environmental concerns.

The work of corporations with regard to social responsibility and global labor practices done in the 1990s was largely driven by individual company behavior and was highly idiosyncratic (Carroll, 1999; Clarkson, 1995; Spar and La Mure, 2003). Over time, more systematic approaches to social responsibility took hold. Groups like the Coalition for Environmentally Responsible Economies and the Global Reporting Initiative created standardized social reporting expectations for companies. Companies that created their own, non-standard, reporting regimes nevertheless began to report on a similar range of issues as did other companies in their industries. Activist groups similarly formalized their expectations for corporate social responsibility and began to adopt industry-level and cross-industry-level approaches to advocating improved business behaviors—often through activist group cooperation (Chapman and Fisher, 2004).

To the extent that a business changes its behaviors in response to social expectations and stakeholder pressures, it is involved in a form of self-regulation. When Nike, Hasbro, or the Gap engages in monitoring of working conditions in its contract supplier facilities, it is going over and above legal expectations. But companies within the same industry face similar stakeholder expectations and social pressures—whether for improved environmental performance or higher labor standards. To the extent that companies within the same industry face similar pressures for greater social responsibility, it might make sense for them to cooperate in an industry-level scheme for self-regulation. Industry-level cooperation can help present a unified message to the industry's stakeholders about what the industry is doing with regard to social responsibility challenges, share resources and expertise, and allow each individual company to be more effective with regard to its response strategies than would have been possible acting alone. Such

cooperation would also set an ethical floor for the industry and reduce the likelihood than any one company could achieve a competitive advantage by acting irresponsibly.

In a variety of areas—including global labor issues—stakeholders like NGOs have developed coherent and consistent expectations with regard to social performance. Many industries therefore would find cooperation in the form of self-regulation of labor practices to be useful in formulating responses to these expectations.

### **ANTECEDENTS OF SELF-REGULATION**

Self-regulation can be initiated by a number of industry actors. The extent and type of industry self-regulation is affected by the initiating party and other characteristics of the industry itself. In industries with numerous international participants, self-regulation may serve a distinct purpose in that it presents an opportunity for standardization that can level the playing field for all members (Clarkson, 1995; Wright and Rwabizambuga, 2006). This is not only important with regard to economic costs but also because of reputation effects and possible domestic or foreign government intervention. With regard to labor issues, self-regulation can create a consistent set of standards for members that reduces the likelihood that any one member thereof will act opportunistically by exploiting workers and sully the industry's image (Agre, 2002). Although members of any particular industry compete with each other, it is also the case that the fates of industry members are interdependent; reputational threats to one toy manufacturer, for example, can threaten the image of the entire toy industry. There are a variety of reasons that industries may initiate and conform to self-regulation.

Industry actors may be much more prone to self-regulate if the industry experiences large amounts of attention from other stakeholders, like NGOs concerned about labor or environmental issues. At the same time, the amount and type of attention perceived by the

industry may also determine the motivation for self-regulation. Industries that directly affect the well-being of populations or entities that require more care, such as industries that deal directly with children or the environment, may be exposed to much stronger pressures for self-regulation than industries with more complex or indirect stakeholder structures. While many industries may see the value in self-regulation, the standards and enforcement mechanisms for industries that are more strongly scrutinized by industry actors may be much more salient, making a stronger case for self-regulation. Because any attempt at self-regulation is costly to the industry's members, making an investment in industry self-regulation will make sense for some industries more than others; not every industry is equally situated with regard to stakeholder expectations or even awareness.

Many industries have dominant professional associations that set standards for professional ethics and behaviors. However, in industries that are fragmented, organizations may not be subject to the normative pressures provided by professional associations. Instead, organizations may experience pressures from other groups, such as consumer advocacy groups or international trade organizations (Rao, 1998; Agre, 2002). In industries where there are not strong professional norms of conformance, self-regulation may be a way of defining boundaries that are advantageous to actors in the field (Rao, 1994). In this way, self-regulation can be a way of achieving membership boundaries and standardization of practices (Lawrence, 1999).

There are multiple purposes to providing standardization and membership boundaries. Standardization can guard against irregular or unethical behavior and make those who do not conform to norms appear as deviants. Such deviant organizations would thus seem less legitimate members of the industry and less deserving of industry (and by extension, stakeholder) resources. Firms that actively participate in establishing mechanisms of self-regulation can

construct standards that are most advantageous to their positions (MacGuire, Hardy and Lawrence, 2004). While deviance can still occur, organizations that fail to conform to normative standards may be ostracized by competitors, customers, the media and even lawmakers. Thus the motivation to conform can be fairly strong depending on the level of cohesion within the field, the need for recognition from other actors in the field, and the level of attention to deviance. An industry that is able to engage in strong forms of regulation that are widely adhered to may be able to parry external threats (like stakeholder pressures and negative media attention) more effectively than industries that are more fragmented.

Membership standards can also be an important aspect of self-regulation. By constructing requirements for entry, industry participants can deter new entrants and thus appreciate a better competitive position themselves. Membership standards can also serve an important role in shaping the perception of the field as a whole (Lawrence, 1999). If perceptions of the industry are comparatively high, this might also deter entrance by new organizations that do not wish to comply with the existing standards. One barrier to entry might be learning about stakeholder expectations with regard to social performance and then responding appropriately to those expectations.

Another industry characteristic that may determine the level of self-regulation is the distance from the end consumer. Organizations that supply peripheral parts to manufacturers may not experience strong pressures to self-regulate because the relationship to end users is convoluted. A branded end product is by its very nature identifiable by stakeholders like NGOs and watch-dog organizations; the intermediate products that make up that end product are not. On the other hand, firms that contribute a large portion of the end products or sell directly to end users may be held responsible for any breach of ethics or social responsibilities, even defects or

recalls. One reason for the increased perception of responsibility is the propensity for social actors to attribute action to those organizations that they recognize. Organizations that are further removed from recognition may not be held responsible simply because they are not seen as a major component of the overall process. Early work on issues related to sweatshops and global labor practices, for example, focused on industries like apparel. Apparel is a product in which brand image is often important and consumers make frequent purchases of such products.

The importance of public attention is also apparent in industries where negative press has occurred in the past. Some areas never receive attention simply because the industry does not appreciate a large amount of cognitive legitimacy (Suchman, 1995). Some industries by their very nature or public visibility may receive more media attention than industries whose interactions with consumers and the general public are infrequent. Other industries may be given an inordinate amount of attention, specifically when significant negative events occur (Hoffman and Ocasio, 2001) such as a toy recall, an oil spill, a corporate scandal or a job-related death in a manufacturing firm. Press attention is a primary driver of stakeholder perceptions of firm- and industry-level irresponsibility (Frooman, 1997), which then affects how likely the industry is to bring about a coordinated response.

Finally, certain industries may appreciate stronger motives to self-regulate due to the strength of stakeholder coalitions. Some industries may have highly fragmented stakeholder interests, whereby different stakeholders have highly diverse sets of interests. Organizations in such industries may be able to stave off self-regulation because of the conflict among stakeholder groups, allowing for the justification that reasonable standards are unclear (Edelman, 1992). Other industries may appreciate strong cohesion among stakeholder groups. In such cases, organizations and industries may experience a much stronger impetus for self-regulation for

multiple reasons. First, strong stakeholder coalitions will be able to present a stronger voice to legislators. Organizations may see the possibility of imposed regulation. Government regulations, particularly in international settings, can be very costly and compliance with a less-stringent set of regulations may be preferable to dealing with imposed regulation. Secondly, strong stakeholder coalitions may be more effective in determining public support for an organization than in industries where stakeholder coalitions are fragmented. Organizations may be more willing to comply with stakeholder demands if doing so will affect their reputations (Rao, 1998).

It is also important to note that fragmentation is not only important with regard to the power of stakeholders but also the power of self-regulation. In industries where participating organizations are highly fragmented, self-regulation may not have a strong impact because peripheral firms will not feel obligated to comply with mainstream standards. On the other hand, firms that appreciate a large percentage of market share may not comply with standards if they do not feel it will affect their position in the industry (Suddaby and Greenwood, 2005; Greenwood, Suddaby and Hinings, 2002). However, in industries where there is strong concentration, there may be strong motivation to self-regulate because compliance is more likely from all organizations.

As can be seen from this discussion, the motivation for self-regulation with regard to human rights and ethical standards encompasses a variety of issues. With regard to international contexts, these factors may be pronounced due to the lack of a strong state influence and the need to appear legitimate to a variety of stakeholder groups beyond any national boundaries. From the preceding discussion we offer the following propositions:

*Proposition 1: Industries that face greater expectations with regard to social responsibility will face greater pressures for self-regulation than industries that face fewer expectations with regard to social responsibility.*

*Proposition 2: Industries that produce products closer to final end products will face greater pressures for self-regulation than industries that produce products further from final end products.*

*Proposition 3: Industries that have been the subject of recent negative press attention will face greater pressures for self-regulation than industries that produce products that have not been the subject of recent negative press attention.*

*Proposition 4: Industries that face demands from unified stakeholder coalitions will face greater pressures for self-regulation than industries that produce products that do not face demands from unified stakeholder coalitions.*

*Proposition 5: Industries that are highly concentrated are more likely to bring about self-regulation than industries that are highly fragmented.*

The previous discussion addressed some of the factors that might precede industry-level self-regulation. The successful implementation of these regulations, however, may be affected by additional factors. While the predictors and complements of self-regulation may very well be

correlated, there is additional concern with regard to the actual success of self-regulation with regard to meeting stakeholder needs.

### **COMPLEMENTS TO SUCCESSFUL SELF-REGULATION**

While the predictors of industry self-regulation are highly varied, the factors that contribute to successful compliance to such standards are equally as complex. The diverse sets of contexts found in today's business environment do not allow for a formulaic approach to self-regulation. However, certain conditions can exist that will drive adherence to industry standards in most contexts. The following discussion allows for insight into the types of situations that might present high levels of adherence to industry self-regulation.

Many industries appreciate the 'big 3' principle whereby there are three major organizations that account for the majority of the industry market share. In international contexts these implications may be less severe but can still set strong precedents. These organizations can appreciate significant power in defining accepted industry practices. Even practices that may present a conflict of interest will be more successful when implemented by large, powerful firms (Suddaby and Greenwood, 2005). The same can be said of the opposite situation, whereby key actors in the industry may adhere to standards, thereby forcing other industry participants to adhere to the same standards if they want to be considered players in the game. Further, studies of social networks suggest that greater efficiencies within a social system (like an industry) accrue when there are one or two dominant members of the network that coordinate the activities of other members (Milward and Provan, 1998). In cases where large firms do not adhere to the standards, if the majority of firms follow the regulations, even large organizations will feel more pressure to conform. Moreover, large organizations that do not conform may experience increased negative attention for failure to do so while firms with fewer resources comply.

The composition of regulatory organizations may also contribute to the success and the legitimacy of self-regulation. In cases where control over self-regulation comes from within, stakeholders may not assign legitimacy to the organization or the regulations because of a (perceived) conflict of interest. For example, accrediting organizations for educational organizations are controlled by all participants in the educational process rather than just those from certain organizations. While the accrediting process still leaves much to be desired, the overall legitimacy of accreditation is noteworthy, specifically with regard to institutions of higher education.

Stakeholder concerns may also be more appropriately represented when various stakeholders have access to public reports on a regular basis. Regular updates on the amount of compliance to self-imposed standards may drive organizations to comply for fear of retribution by stakeholders should they receive a negative report. Even in industries where reports are not commonly attended to, firms may still comply for fear of negative publicity if they fail to meet industry standards. For example, in the auto industry, compliance to industry standards is published on a regular basis and thus the adherence to these standards has as a positive rather than neutral effect on those organizations that are recognized. By the same token, those that do not comply are more closely scrutinized than those that don't comply in industries where compliance is sporadically reported.

Finally, we can address the importance of industry-wide legitimacy as it affects self-regulation as a whole. Obviously certain industries appreciate more legitimacy than others. While all industries may benefit from self-regulation, industries that are viewed as illegitimate or inherently unethical – such as gambling or pornography – may not have the incentives to self-regulate that other industries do because their standards will not be as readily accepted. Even in

areas not related to the illegitimate portions of the industry such as employee rights or manufacturing standards, these types of organizations may still be deemed illegitimate by stakeholders because the core business activity lacks moral legitimacy (Suchman, 1995; Agre, 2002).

The preceding discussion leads us to recognize that the overall influence of self-regulation is highly varied. While the acceptance of self-regulation is not guaranteed in any industry, certain situations can help to drive the successful implementation of self-imposed regulations. These contexts are specified in the following propositions:

*Proposition 6: Industry self-regulation is more likely to be successful at responding to stakeholder concerns about the industry's behavior if one or two large firms play a central role.*

*Proposition 7: Industry self-regulation is more likely to be successful at responding to stakeholder concerns about the industry's behavior if an institution separate from the control of any one firm is created to administer the self-regulatory scheme.*

*Proposition 8: Industry self-regulation is more likely to be successful at responding to stakeholder concerns about the industry's behavior if it encompasses a large portion of the industry's output and membership.*

*Proposition 9: Industry self-regulation is more likely to be successful at responding to stakeholder concerns about the industry's behavior if regular public reports are issued.*

*Proposition 10: Industry self-regulation is more likely to be accepted by stakeholders if the industry itself is viewed as legitimate.*

## **DISCUSSION AND IMPLICATIONS**

The success of self-regulation can be examined from multiple perspectives. Some might view success as adherence by the majority of firms. Others may view success as the adoption of standards that are advantageous to industry participants. Still others might see success as the extent to which self-regulation goes above and beyond imposed regulation in concern for industry stakeholders. In this paper, we have addressed success in terms of acceptance by stakeholders, most prominently those affected by labor policies and human rights issues in international settings.

With regard to the particular issue of labor practices in a globalized economy, stakeholders have a variety of concerns. They do not want to profit from the misery of another human being. They want to feel better about the products that they buy. They may even be concerned about their own jobs and worry that someone else in another country might be taking theirs unless there are better labor standards. Motivations for concerns about labor issues are complex, but firms and industries need to take account of what their stakeholders are expecting from them.

While the initiative to provide boundaries for one's own actions may seem counterintuitive, several factors contribute to the drive toward self-regulation. Self-regulation may be a response to outside parties or professional organizations that require control mechanisms for ethical and legal reasons. Many industries have constructed laws and rules of conduct but many of these are enforced by outside participants, most commonly, the state or federal government. Sometimes the drivers of these self-adopted rules and regulations stem from outside forces, at other times they are adopted by major players in the field as a way of defining the actions and boundaries of more peripheral actors. In settings where government forces are contradictory or outdated, self-regulation can preclude or at least postpone involvement by government actors that may lead to further constraints to the industry. More generally, self-regulation may allow an industry and its members to receive increased support from stakeholders. These situations are very applicable in today's environment due to the fast-paced rate of change in most industries and the especially high level of technological advancements that take place over short periods of time. Self-regulation by entire industries may lead to faster and more-effective responses to stakeholder concerns than experimentation and dissemination of knowledge from individual firms.

Industry-level self-regulation with regard to purely social concerns (in contrast to licensing requirements or other self-regulatory rationales) like labor practices is relatively new. We anticipate that more industries will seek to engage in such self-regulation, encompassing a variety of social and ethical concerns, in the future. Future research might proceed along a number of tracks. The propositions developed in this paper might be subjected to empirical testing. A more-qualitative approach might be to look at particular industries that have engaged

in self-regulation with regard to social and ethical issues and examine whether the historical development of that industry's approach is consistent with our framework.

We think that industry-level self-regulation that addresses stakeholder concerns about social and ethical issues like labor practices will become more significant as individual firms perceive that there is advantage in pursuing collective action in this regard. A better understanding of the predictors and complements of self-regulation might help academics and managers understand when collective approaches to social-issue responses will be more or less likely to occur and more or less effective.

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**TABLE 1**

Examples of industry-level codes of conduct focused on labor, human rights, and environmental issues

<u>Name</u>	<u>Focus</u>
American Petroleum Institute Environmental Principles	Air, water, and soil pollution
Electronic Industry Code of Conduct	Factory safety, worker protections, environmental responsibility
Equator Principles	Environmental and social impact of lending
International Council of Toy Industries	Factory safety, worker protections
The Code (Tourism industry)	Prevention of child sex tourism