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## ORGANIZATIONAL LEGITIMACY UNDER CONDITIONS OF COMPLEXITY: THE CASE OF THE MULTINATIONAL ENTERPRISE

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*We examine organizational legitimacy in the context of the multinational enterprise (MNE). After discussing three types of complexity (of the legitimating environment, the organization, and the process of legitimation) that MNEs typically face, we explore their effects on MNE legitimacy. In particular, we distinguish between the legitimacy of the MNE as a whole and that of its parts, and we develop propositions that include issues of internal versus external legitimacy and positive and negative legitimacy spillovers.*

It has become a growing industry to critique Nike globally (Phil Knight, NBC Today Show, May 11, 1998).

One of the critical issues faced by multinational enterprises (MNEs) involves the establishment and maintenance of legitimacy in their multiple host environments. Instances of legitimacy problems in MNEs abound, ranging from censure of MNEs in the global media, such as that faced by Nike for its labor practices in Asia (Maitland, 1997; Marshall, 1997), to direct attacks on MNE operations, such as the destruction of Cargill's facilities in India (Dewan, 1994). In an even more extreme example, Shell was accused of conspiring with the Nigerian government to execute Ken Saro-Wiwa, who had led a campaign against its environmental practices (Newbury & Gladwin, 1997).

An examination of the MNE case suggests that not only is legitimacy a critical issue for MNEs but that current research leaves several questions on organizational legitimacy unaddressed. For instance, what exactly is the legitimacy of a complex organization such as an MNE, and where does it reside: at the level of the MNE as

a whole or at its subunits? What constitutes the legitimating environment of an MNE operating in multiple institutional environments? What is the relationship between the overall legitimacy of the MNE and the legitimacy of its subunits? And, finally, why do MNEs find it so difficult to establish and maintain legitimacy and so often experience crises of legitimacy?

Research on organizational legitimacy (e.g., D'Aunno, Sutton, & Price, 1991; Dowling & Pfeffer, 1975; Meyer & Scott, 1983; Scott, 1987, 1995) provides us with a theoretical foundation on which to examine these questions. Scholars have defined organizational legitimacy as the acceptance of the organization by its environment and have proposed it to be vital for organizational survival and success (Dowling & Pfeffer, 1975; Hannan & Freeman, 1977; Meyer & Rowan, 1977). Institutional theorists have identified some of the determinants of organizational legitimacy and the characteristics of the legitimation process (Meyer & Rowan, 1977; Powell & DiMaggio, 1991; Scott, 1995; Selznick, 1957; Zucker, 1983), citing three sets of factors that shape organizational legitimacy: (1) the environment's institutional characteristics, (2) the organization's characteristics, and (3) the legitimation process by which the environment builds its perceptions of the organization (Hybels, 1995; Maurer, 1971).

In this article we suggest that examining the MNE case can potentially extend theories of organizational legitimacy since the MNE chal-

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lenges some of the underlying assumptions behind these theories. The MNE is an organization that operates in two or more countries with multiple subunits linked through shared policies or strategy.<sup>1</sup> As such, MNEs introduce an element of complexity in all three factors that influence organizational legitimacy—in the legitimating environment, the organization, and the process of legitimation. We suggest that these complexities have significant implications for theories of organizational legitimacy, since they affect the nature of legitimacy, and the process of legitimation. Therefore, the MNE case can both advance our understanding of organizational legitimacy in general and shed light on the specific legitimacy-related difficulties experienced by MNEs.

Traditionally, researchers have examined legitimacy at two levels: (1) at the level of classes of organizations (Carroll & Hannan, 1989; Hannan & Freeman, 1977; Meyer & Rowan, 1977; Singh, Tucker, & House, 1986) and (2) at the organizational level (Ashforth & Gibbs, 1990; Covalleski & Dirsmith, 1988; Deephouse, 1996; Dowling & Pfeffer, 1975; Neilsen & Rao, 1987; Ritti & Silver, 1986; Suchman, 1995). Here, we adopt the latter approach and examine legitimacy at the level of the organization, which we call *organizational legitimacy*.

Organizational legitimacy can further be examined at the level of the MNE as a whole, as well as at the level of the subunit of the MNE in a particular country. The legitimacy of the MNE as a whole is the acceptance and/or approval of the MNE (not necessarily of any particular subunit) by its legitimating environment. For the MNE as a whole, the legitimating environment is the global "meta-environment" (Zaheer, 1995a), which consists of all of its home and host country institutional environments as well as supranational institutions, such as global me-

dia (e.g., *Financial Times* or CNN) and global activist groups (e.g., Greenpeace). The legitimacy of the MNE subunit is its acceptance by the specific host country institutional environment. In this article we examine both the legitimacy of the MNE as a whole and the legitimacy of the MNE subunit and discuss the relationships between them. We suggest that they are interrelated—that is, the legitimacy of the MNE as a whole is affected by the legitimacy of its subunits, and vice versa. However, MNE legitimacy may not be a simple average of the legitimacy of its subunits.

Several of our propositions are unique to the MNE because they are based on characteristics of the MNE that represent differences "in kind" from domestic organizations (Ghoshal & Westney, 1993). These propositions could be thought of as elements of a *theory of MNE legitimacy*. A few propositions, however, apply both to MNEs and to complex domestic organizations, for they are based on characteristics of the MNE that represent differences "in degree" (Ghoshal & Westney, 1993) from domestic organizations. These latter propositions are not unique to the MNE and serve, therefore, to expand our *theories of organizational legitimacy*.

We distinguish between the legitimacy of an MNE and two proximal concepts from the MNE literature: (1) overcoming entry barriers and (2) cultural adaptation. While a lack of legitimacy may act as a barrier to entry, legitimacy issues go beyond market entry and can become salient at any point in a company's history, as we have seen in such cases as Shell and Nike. Further, although cultural adaptation of an organization to a particular host country may contribute to its legitimacy, it is neither a necessary nor a sufficient condition for legitimacy because of the many other factors involved, including the nature of the product, and regulatory issues. In addition, legitimacy is socially constructed. Thus, there may not be a one-to-one correspondence between an organization's cultural adaptation and the way it is perceived by the environment. Therefore, it is possible for an MNE to be culturally adapted and still lack legitimacy in a particular environment.

In this article we also do not specifically examine the political processes or the negotiations between MNEs and host governments, as many scholars in international business have

<sup>1</sup> Currently, the most accepted definition of the MNE is that it is a specific organizational form that

comprises entities in two or more countries, regardless of legal form and fields of activity of those entities, which operates under a system of decision-making permitting coherent policies and a common strategy through one or more decision-making centers, in which the entities are so linked, by ownership or otherwise, that one or more of them may be able to exercise a significant influence over the activities of the others, and in particular, to share knowledge, resources, and responsibilities with others (Ghoshal & Westney, 1993: 4).



done (Behrman & Grosse, 1990; Doz, 1986; Doz & Prahalad, 1980; Dunning, 1993; Fagre & Wells, 1982; Kobrin, 1987; Lecraw, 1984; Murtha & Lenway, 1994; Vernon, 1971), which could affect the legitimacy of firms directly—in the regulatory domain—or indirectly—through the social construction engaged in by political interest groups. We focus, instead, on the background factors that could facilitate or hinder such firm-state negotiation processes.

In summary, we address the extent of the challenge encountered by MNEs in establishing and maintaining organizational legitimacy in the face of complexity in the environment, in the organization, and in the process of legitimation. As an illustration of the issues MNEs can face in their quest for legitimacy, we start with a brief description of Cargill's problems in India and use this case (and others) to discuss the criticality of legitimacy for MNEs, as well as the effects of complexity on legitimacy. We then develop propositions and conclude with a discussion of implications for theory and practice.

### CARGILL IN INDIA

Cargill, Inc.,<sup>2</sup> is perhaps the world's largest private agricultural company, with 65,000 employees and annual sales of over \$50 billion, as well as a presence in over 65 countries. Cargill entered the Indian market initially to create and distribute new high-quality hybrid seeds in Bangalore in South India, and subsequently to build a salt extraction and processing facility in western India. Its establishment in India has been marked by a series of crises that illustrate the critical importance of establishing and maintaining legitimacy for MNEs and their subunits.

Briefly, Cargill's seeds project in Bangalore experienced difficulties from the very beginning. This project was a response to the Indian government's new Seed Policy, introduced in September 1988, which sought "to upgrade seeds and provide the Indian farmer with the best planting material in the world so as to optimize his output" (Pania, 1992: 82). The company, at its inception, encountered substantial resistance from local farmers, encouraged by influential local politicians and intellectuals

who opposed the project on the grounds that it was the first step toward a "new colonization" of India by the West (Dewan, 1994). The farmers claimed that the seeds project would take away their traditional self-sufficiency in seed production, leave them dependent on multinational firms, and lead to their financial distress and economic exploitation—apart from destroying their traditional way of life. The tension increased to the point that some of Cargill's offices and warehouses in India were vandalized and burned down by angry farmers.


Meanwhile, Cargill had launched a project in Kandla, in western India, to build a 1-million-ton export-oriented salt extraction and processing facility. This project also experienced legitimacy problems. Various local groups vociferously opposed the project, ranging from environmentalists to local salt producers, who felt threatened by multinational competition, to politicians, who categorized this project as another step toward a neocolonization of India. For their arguments, these groups drew from history and from the symbolism of Mahatma Gandhi's protest march against the salt tax imposed by the British in 1942. The politicians attempted to suggest that foreign colonizers, once again, were threatening the country's economic freedom. "Salt, once the symbol of our freedom movement, is today a pointer to our economic serfdom" (V. P. Singh, Member of Parliament, quoted in Setalvad, 1993: 85). Although Cargill took several steps to moderate the criticism—for example, by moving toward more labor-intensive technology that would protect employment—it finally withdrew from this project. We believe that the legitimacy problems faced in India were not unrelated to Cargill's withdrawal.

### THEORETICAL BACKGROUND AND PROPOSITIONS

Institutional theory suggests that organizational legitimacy is shaped by three sets of factors: (1) the characteristics of the institutional environment, (2) the organization's characteristics and actions, and (3) the legitimation process by which the environment builds its perceptions of the organization (e.g., Hybels, 1995, and Maurer, 1971). In this section we use the MNE to discuss how organizational legitimacy is affected when there is complexity in these three sets of factors. We suggest that a higher level of complexity in

<sup>2</sup> This section draws entirely on publicly available documentation and video material.

any of these factors—the institutional environment, the organization, and the process of legitimation—makes it more difficult for organizations to establish and maintain their legitimacy. We develop formal propositions on the relationship between complexity in these factors and the legitimacy challenges faced by MNEs and illustrate these propositions with examples from Cargill and other firms.



Organizational theorists long have recognized that *institutional environments* are complex and fragmented since they consist of multiple task environments (Galbraith, 1973; Lawrence & Lorsch, 1967; Thompson, 1967), multiple institutional “pillars” (Scott, 1995), multiple resource providers (Pfeffer & Salancik, 1978), and multiple stakeholders (Evan & Freeman, 1988). Drawing from this research and from the MNE case, we suggest that the complexity of the institutional environment is reflected in two major aspects. First, institutional environments are fragmented and composed of different *domains* reflecting different types of institutions: regulatory, cognitive, and normative (Scott, 1995). Second, MNEs conduct operations in *multiple countries* that may vary with respect to their institutional environments and, thus, are exposed to multiple sources of authority (Sundaram & Black, 1992).

Organizational researchers also have noted that *organizations* themselves can be complex and fragmented, for they may consist of multiple subunits with varying levels of interdependence and independence (Ghoshal & Bartlett, 1990; Lawrence & Lorsch, 1967). This type of complexity is particularly apparent in MNEs where the organization is fragmented not only by function or task but also by geographical region and location. As a result, each of the different subunits of the MNE faces its own host institutional environments, which vary across countries with respect to legitimacy requirements. In addition, organizations form their own internal institutional environments with their own legitimacy requirements over time (Selznick, 1957). Thus, each organizational subunit of the MNE is faced with the task of establishing and maintaining both *external* legitimacy in its host environment and *internal* legitimacy within the MNE (Rosenzweig & Singh, 1991; Westney, 1993).

Finally, research on the interaction between organizations and the environment from the social construction and symbolic interactionism

perspectives (Berger & Luckman, 1967; Stryker & Statham, 1985) suggests that this interaction is a complex social and cognitive process, subject to bounded rationality. Therefore, the process of *legitimation*, which involves the continuous testing and redefinition of the legitimacy of the organization through ongoing interaction with the environment (Baum & Oliver, 1991), is likely to be a boundedly rational process. The implications of the complexity of this process for organizational legitimacy become particularly apparent in the MNE, since in this case both the organization and the legitimating environment may lack the information and the cognitive structures required to understand, interpret, and evaluate each other. Table 1 presents a summary of the types of complexities that emerge in the three factors that influence legitimacy when one examines the MNE case, and it briefly summarizes the consequences of these complexities for organizational legitimacy.

In the rest of this section we develop propositions that address the ease or difficulty of establishing and maintaining legitimacy at two levels of analysis: (1) the MNE as a whole and (2) the MNE subunit. We consider the establishment of legitimacy as particularly relevant for the MNE subunit when it enters a new country. Maintaining legitimacy, however, is relevant both for the MNE as a whole and for the MNE subunit. We also discuss the extent to which each of the propositions is unique to the MNE or is applicable to all organizations. A summary of the propositions is graphically presented in Figure 1.

### Environmental Complexity and Legitimacy

The complexity of the MNE environment is reflected in the multiple domains of the institutional environment and in the multiplicity of institutional environments faced by MNEs.

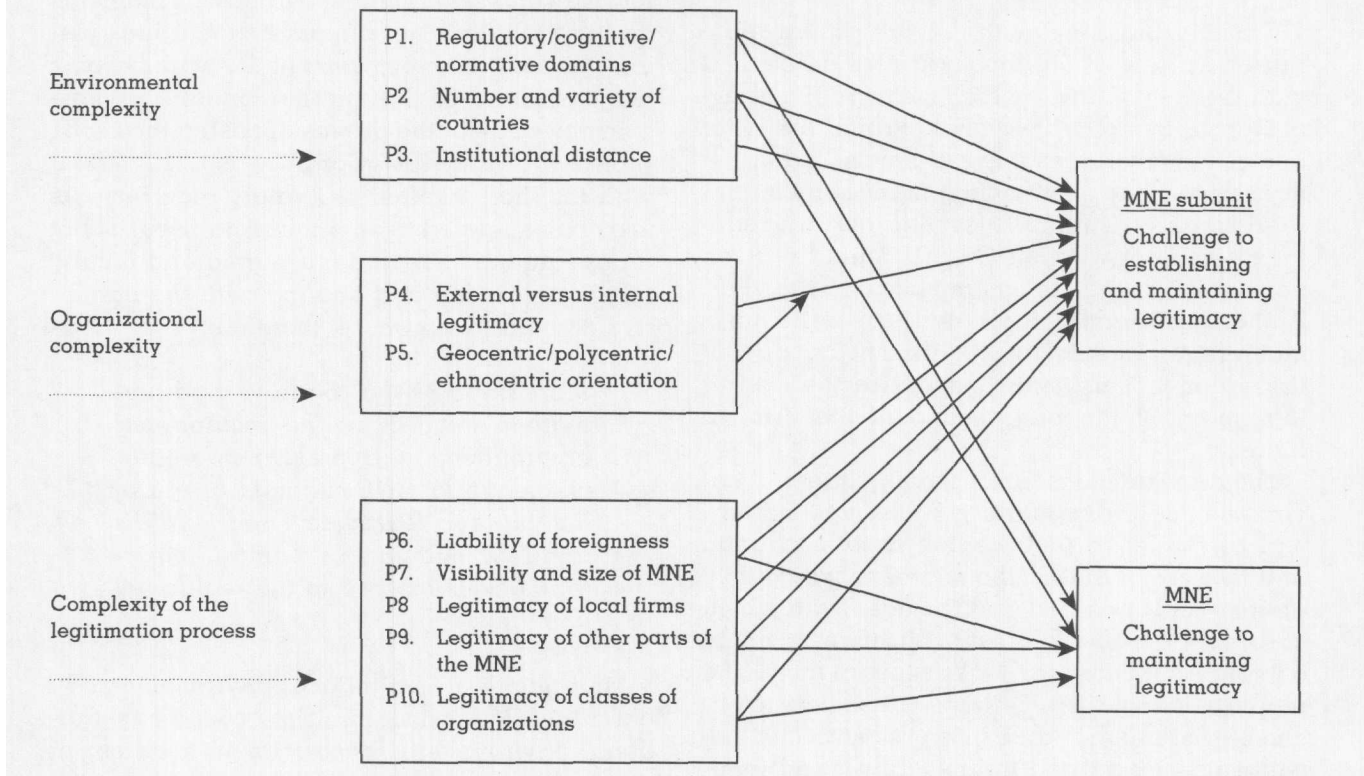
**Multiple domains of the institutional environment.** Organizational theorists have suggested that institutional environments consist of a variety of institutions, including regulations, cultural norms, educational systems, and so on. Researchers have suggested that there are different types of legitimacy that reflect the different types of institutions operating in the environment, such as sociopolitical, cognitive, and pragmatic legitimacy, among others (Aldrich & Fiol, 1994; Boddewyn, 1995; Hannan & Carroll, 1992; Suchman, 1995). Although we acknowledge

**TABLE 1**  
**Legitimacy-Related Complexities Faced by MNEs**

Factors Influencing Legitimacy	Types of Complexity	Description	Effects on Legitimacy
Institutional environment	Multiple domains of the institutional environment	Institutional environments consist of three types of domains—the regulatory, the cognitive, and the normative—all of which influence legitimacy.	The tacitness of the cognitive and normative domains presents a particular challenge to MNEs as they seek legitimacy.
	Many and varied country institutional environments	MNEs face at least as many different institutional environments as the number of countries in which they operate, since institutions tend to be country specific. Their number and variety pose specific challenges to MNE legitimacy.	The larger the number of countries, the larger the variance in the legitimacy requirements that MNEs have to deal with. However, the larger the number of countries, the more likely that the organization has developed competence in dealing with different institutional environments.
	Institutional distance between home and host environments	This is the difference or similarity between the regulatory, cognitive, and normative institutional environments of the home and the host countries of an MNE.	The greater the institutional distance, the more difficult it will be for the MNE to understand the host environment and its legitimacy requirements. Further, the greater the institutional distance, the higher the need will be to adapt organizational practices to meet host country legitimacy requirements.
Organization	MNE subunits face two institutional environments: (1) the external host country environment and (2) the internal environment of the MNE.	Legitimacy is required in both institutional environments since the survival of the MNE subunit is contingent on support from the parent company and from the host country.	Tension between internal and external legitimacy requirements can make achieving external legitimacy difficult for a subunit.
Process of legitimation	Bounded rationality and the liability of foreignness	Owing to the social and cognitive nature of the legitimation process, the acceptance of an MNE subunit is affected by the host environment's perception of and attitude toward foreign firms.	Foreignness presents challenges to legitimacy because of (1) the lack of information about the MNE on behalf of the host environment, (2) the use of stereotypes and different standards in judging foreign firms, and (3) the use of MNEs as targets for attacks by interest groups in the host country.
	Legitimacy spillovers from outside and within the organization	Owing to the bounded rationality of the legitimation process, the legitimacy of a particular unit is not independent of all other units to which it is cognitively related.	Under conditions of bounded rationality, the environment makes sense of the legitimacy of a given unit based on the legitimacy of other similar units—for example, other units of the same organization or classes of organizations to which the focal unit belongs.



**FIGURE 1**  
Complexity and MNE Legitimacy: Summary of Propositions



the existence of multiple domains of the institutional environment, in this article we treat the legitimacy of an organization or of an organizational subunit as holistic in nature (i.e., there is one overall legitimacy of an organizational unit), even though it may be affected by the different domains of the institutional environment in which the organization functions.

We draw from institutional theory (Meyer & Rowan, 1977; Scott, 1995; Zucker, 1983) to suggest a set of institutional domains based on the three pillars of institutional environments suggested by Scott (1995): the regulatory, the cognitive, and the normative. The *regulatory* pillar is composed of regulatory institutions—that is, the rules and laws that exist to ensure stability and order in societies (North, 1990; Streek & Schmitter, 1985; Williamson, 1975, 1991). Organizations have to comply with the explicitly stated requirements of the regulatory system to be legitimate, although they do have the ability, particularly in the long run, to influence the regulatory domain through interest intermediation (Murtha & Lenway, 1994).

The *cognitive* pillar draws from social psychology (Berger & Luckman, 1967) and the cognitive school of institutional theory (Meyer & Rowan, 1977; Zucker, 1983). Organizations have to conform to or be consistent with established cognitive structures in society to be legitimate. In other words, what is legitimate is what has a “taken for granted” status (Aldrich & Fiol, 1994; Suchman, 1995) in society.

The *normative* pillar goes beyond regulatory rules and cognitive structures to the domain of social values (Selznick, 1957). Organizational legitimacy, in this view, accrues from congruence between the values pursued by the organization and wider societal values (Parsons, 1960). It is “the degree of cultural support for an organization,” which, presumably, will result from such congruence in values (Meyer & Scott, 1983: 201).

The three domains are not necessarily independent. Values, for instance, may drive cognitive categorization and, in turn, influence and be influenced by regulation. The cognitive and normative domains emerge through processes of education and socialization, and the regulatory

domain, in particular, is influenced by governments and the interest intermediation process (Murtha & Lenway, 1994).

Cargill's problems with the salt project illustrate a variety of legitimacy issues associated with these domains, such as the cognitive issue of Cargill being a privately held multinational and the symbolic meaning of salt in India, the normative issue of protecting manual labor and traditional agricultural lifestyles, and the regulatory issue of whether Cargill could be given permission to operate on land owned by the Port Authority of Kandla. Inability to meet the minimum requirements for legitimacy on any of these dimensions could jeopardize the overall legitimacy of the project, and of the firm, in India.

The three domains of country institutional environments—the regulatory, cognitive, and normative—differ in their degree of formalization and tacitness—that is, the degree to which they are explicitly codified and the ease with which observers (especially outside observers such as a foreign company) can make sense of them. The regulatory domain is perhaps the easiest to observe, understand, and interpret correctly because it is formalized in laws, rules, and regulations. Compared to the regulatory domain, the normative domain is more tacit and part of the "deep structures" of a country (Gersick, 1990). It is, therefore, more difficult to sense and to interpret, particularly for an outsider. The cognitive domain perhaps lies between the regulatory and the normative domains, as to the degree to which it can be observed and interpreted correctly.

This suggests that legitimacy in the normative and cognitive domains, rather than in the regulatory domain, might pose a more difficult challenge for MNEs. After an MNE subunit has conducted operations in a host environment for some time, it may become easier for it to make sense of local cognitive and normative institutions. So will the hiring of "locals" to manage the operation (rather than posting expatriates), or working with a local partner. However, we believe that the cognitive and normative domains will always be relatively more challenging than the regulatory domain to MNE subunits trying to establish or maintain their legitimacy.

In both of Cargill's projects in India, for instance, there were many deeply embedded social values that played a role in the legitimating

process, which may not have been that transparent to an MNE coming into the country. These hidden values were reflected in such comments as "agriculture is not a market, it is a lifestyle" and "a self-sufficient community will become wage-laborers of the multinationals"—expressions by some of the groups opposing the seeds project (Dewan, 1994). Cargill was able to deal with the more explicit regulatory requirements (e.g., those related to environmental issues), but it appeared to have had much greater difficulty in understanding and dealing with the normative domain. We propose, therefore:

*Proposition 1: The cognitive and normative domains of the institutional environment will present a greater challenge to MNE subunits in establishing their legitimacy, and to MNEs and MNE subunits in maintaining legitimacy, compared to the regulatory domain.*



**Multiplicity of institutional environments.** By definition, MNEs face multiple country institutional environments, each with its own set of regulatory, cognitive, and normative domains (Westney, 1993). The structure and the composition of these institutions, and their legitimacy requirements, typically vary across national environments (Kogut, 1991; Kostova, 1996). For example, most rules and regulations tend to be country specific, since they are created by governments and are often the outcome of local political processes. So are the cognitive and normative institutions (the shared social knowledge and the values, beliefs, and social norms), which are shaped through the educational system and through processes of social interaction, typically within national borders. Cargill, with operations in 65 countries, has faced 65 unique sets of regulatory, cognitive, and normative institutions that it has had to get to know, understand, and take into account in its operations. Such multiplicity and variety in the environments in which they operate clearly differentiate MNEs from domestic firms (Sundaram & Black, 1992).

In addition to the number of countries in which an MNE operates, its legitimacy is also likely to be affected by the extent of variety across these environments. The more similar the

institutional profiles<sup>3</sup> (Kostova, 1997) of the multiple countries in which it operates, the easier it will be for the MNE to make sense of all of its environments and to respond appropriately to their legitimacy requirements. For example, MNEs operating in a set of countries in Asia alone will find it easier to establish their legitimacy in all of those countries than will MNEs operating in countries with different institutional profiles—say, in a set that includes Asian and European countries. In brief, the legitimacy of a given organization is “negatively affected by the number of different authorities sovereign over it and by the diversity or inconsistency of their accounts of how it is to function” (Meyer & Scott, 1983: 202).

As suggested by institutional theorists, organizations may achieve legitimacy by becoming “isomorphic” with the institutional environment—that is, by adopting organizational forms, structures, policies, and practices that are similar to the ones institutionalized in their environment (DiMaggio & Powell, 1983; Meyer & Rowan, 1977). In an MNE, given the multiplicity and variety of institutional environments and the cross-country differences between these environments, achieving legitimacy through isomorphism becomes a difficult, if not impossible, task (Westney, 1993). However, MNEs do manage to achieve legitimacy in seemingly conflicting multiple institutional environments; they do not necessarily adapt to the local environments in such cases but, rather, manage their legitimacy through negotiation with their multiple environments (Doz & Prahalad, 1980; Fagre & Wells, 1982; Lecraw, 1984; Oliver, 1991).

Operating in a large number of countries and a wide variety of environments suggests that a firm has extensive organizational experience in dealing with legitimacy issues and expertise in scanning different institutional environments, identifying important legitimating actors, making sense of their legitimacy requirements, and negotiating with them. It also suggests that the firm may have significant bargaining power with regard to the states and governments it deals with (Kobrin, 1987; Lecraw, 1984), particularly in the regulatory domain. Thus, large

<sup>3</sup> The institutional profile of a country is characterized by the set of regulatory, cognitive, and normative institutions established in the country.

MNEs with mature international operations facing dozens of institutional environments may find it easier to gain legitimacy compared to smaller or newer organizations that lack the organizational capability required for establishing legitimacy. However, operating in a multiplicity of environments may also present a challenge to maintaining legitimacy, because it makes it more likely that the firm faces legitimacy issues in one or the other of those environments, and this illegitimacy spills over to the rest of the MNE.

We suggest, therefore, that the effects on legitimacy of the number and variety of countries of operation will be different for establishing legitimacy from maintaining legitimacy. It will be easier for the “IBMs” (the more experienced international companies with many varied subunits) to enter a new environment and establish the legitimacy of their subunits there, because of their reputation, experience, and bargaining power. However, it might be more difficult for such MNEs and MNE subunits to maintain their legitimacy, because they will be more susceptible to problems caused by spillovers of illegitimacy from any of the other MNE subunits. Thus:


*Proposition 2: The greater the number and variety of countries in which an MNE operates, the less of a challenge its subunits face in establishing their legitimacy in a particular host country, but the greater the challenge the MNE as a whole and its subunits face in maintaining their legitimacy.*



Another important effect of the variety of institutional environments that MNEs operate in is the *institutional distance* between the home and the host country. The institutional distance between two countries, defined as the difference/similarity between the regulatory, cognitive, and normative institutions of the two countries (Kostova, 1996), will affect both the difficulty of understanding and correctly interpreting local institutional requirements, as well as the extent of adjustment required. This is due to the fact that organizational structures, policies, and practices tend to reflect the institutional environment in which they have been developed and established (Kogut, 1993). Thus, it will be easier for an MNE to understand and adjust to the legitimacy requirements of a country that is institutionally similar to its home country than



of one that is institutionally distant from the home country (e.g., a U.S. MNE in Canada versus China). This effect of institutional distance on legitimacy operates at the level of the MNE subunit. Therefore, we propose the following:

 *Proposition 3: The greater the institutional distance between the home country of an MNE and a particular host country, the greater the challenge an MNE subunit will face in establishing and maintaining its legitimacy in that host country.*

Propositions 2 and 3 apply primarily to MNEs and not to purely domestic firms. Although some variance between local institutions is possible (especially in large and diverse countries like the United States), this within-country institutional variance is likely to be much smaller than between-country variances. Moreover, each country, regardless of how big and diverse it is internally, usually has country-wide institutions that supersede local institutions and can be used in case a conflict arises between local institutional requirements. For example, if a regulation in California is different from a regulation in Minnesota and a conflict occurs as a result of this, there probably exists an institutional mechanism at the federal level that will reconcile the differences. When national borders are crossed, however, as in the case of MNEs, the between-country differences in their multiple institutional environments might be substantial—and the institutional requirements of different countries contradictory. In addition, there are very few institutional mechanisms that have supranational jurisdiction to solve potential conflicts (Sundaram & Black, 1992).


### Organizational Complexity and Legitimacy

By definition, complex organizations such as MNEs are not monolithic, unitary entities. They tend to be complex social systems consisting of different activities, product divisions, and locations, which are integrated and interdependent to various extents (Bartlett, 1986; Bartlett & Ghoshal, 1991; Prahalad & Doz, 1987; Rosenzweig & Singh, 1991). Organizational theorists have recognized the fragmentation of complex organizations (Fligstein, 1990; Lawrence &

Lorsch, 1967), but there has been relatively little discussion on the implications of this fragmentation for organizational legitimacy. For example, each subunit faces its own legitimacy issues, and, further, its legitimacy is both influenced by and influences the legitimacy of the whole organization. We discuss these effects in greater depth in the section on legitimacy spillovers.

Here, we focus on one particular issue related to organizational complexity and legitimacy: the need for organizational subunits to achieve internal legitimacy within the organization in addition to legitimacy with the external environment (Westney, 1993). We define internal legitimacy as the acceptance and approval of an organizational unit by the other units within the firm and, primarily, by the parent company. Similar to external legitimacy, internal legitimacy is important for the survival of an organizational subunit because of its dependence on other subunits and on the parent for continuing access to organizational resources such as capital and knowledge (Pfeffer & Salancik, 1978). We believe that the MNE case illustrates how considerations of internal legitimacy can constrain a subunit's efforts to achieve external legitimacy.


Internal legitimacy is likely to result from a unit's adoption of the organization structures, policies, and practices institutionalized within the MNE. These structures, policies, and practices tend to be imprinted by the external institutional environment in which the organization was founded (Kogut, 1993). Therefore, in purely domestic firms, internal legitimacy requirements are likely to be similar to or at least consistent with external legitimacy requirements. In MNEs, internal legitimacy requirements may differ substantially from the external legitimacy requirements in a host country, especially when there is high institutional distance between home and host countries (Kostova, 1997). In such cases adaptation to the external institutional requirements can result in internal inconsistency (Rosenzweig & Singh, 1991). For example, Cargill's willingness to move to labor-intensive technology for its salt operations in India presented a significant departure from its global strategy of using highly automated technologies. Thus:



*Proposition 4: MNE subunits will face a greater challenge, compared to subunits of purely domestic firms, in establishing and maintaining legitimacy in their host environment because of the increased potential for conflict that they face between the requirements for internal versus external legitimacy.*

However, the tradeoff between internal and external legitimacy may not necessarily cause illegitimacy, since certain characteristics of the MNE may, themselves, moderate the problem. Research in international management distinguishes between different types of MNEs, based on their *mindsets, mentalities, and strategies*. As suggested by Perlmutter (1969), some MNEs are "geocentric," in that they develop a global, cosmopolitan orientation that is not tied to any particular national identity. Others are "ethnocentric," in that their identity is strongly rooted in the home country. "Polycentric" MNEs develop a multiplicity of identities to reflect each of the countries they operate in.

The orientation of the MNE will affect the extent of tension between internal and external legitimacy. Geocentric MNEs will be able to respond successfully to the multiple institutional requirements in different countries by adopting supranational structures, policies, and practices that are legitimate worldwide. The adoption of such globally acceptable policies will also ensure internal consistency. Polycentric MNEs may also find it relatively easy to manage the tension between internal and external legitimacy, because they are used to internal inconsistency in their efforts to adapt to each local environment. Ethnocentric MNEs, however, will experience the greatest difficulty in managing this tension, for their practices and policies are not derived from universal principles, nor are they accustomed to internal variety. Formally:



*Proposition 5: The extent of the challenge faced by MNE subunits in establishing and maintaining internal and external legitimacy will be moderated by the orientation of the parent company; it will be easier for subunits of geocentric and polycentric MNEs, compared to subunits of ethnocentric MNEs.*

### Complexity in the Legitimation Process

We now address the legitimacy issues that arise from complexity in the legitimation process. Legitimation—that is, the process through which legitimacy is achieved (Hybels, 1995; Maurer, 1971)—is largely sociopolitical and cognitive in nature. Both the organization and the environment are involved in the legitimation process, in which the organization's legitimacy is continuously tested and redefined. In this process the organization attempts to make sense of the legitimacy requirements of the institutional environment by observing, learning, interpreting, and even influencing those requirements (Doz & Prahalad, 1980; Weick, 1993). The legitimating environment also tries to make sense of the organization and to evaluate its acceptability.

Because of its social and cognitive nature, the process of legitimation is complex, imperfect, and boundedly rational (March & Simon, 1958), especially in the case of MNEs, where both the organization and the legitimating environment may lack the information necessary to correctly understand, interpret, and evaluate each other. We suggest that these characteristics of the legitimation process affect MNE legitimacy by influencing the environment's perceptions of the MNE, as captured in the "liability of foreignness," as well as in the phenomenon of "legitimacy spillovers."

**Liability of foreignness.** Firms doing business abroad face certain costs that purely domestic firms do not—that is, they face a liability of foreignness (Hymer, 1960; Zaheer, 1995b; Zaheer & Mosakowski, 1997), which can arise for a variety of reasons. Here, we focus on the cognitive aspects of the liability of foreignness, as reflected in the lack of information about the MNE on the part of the host country environment, the use of stereotypes and different standards in judging MNEs versus domestic firms, and the use of MNEs (especially large and visible MNEs) as targets for attack by host country interest groups.

The host country legitimating environment typically has *less information* with which to judge an MNE entrant. This could result in delays in legitimation, in continuing suspicion toward the MNE, and in scrutiny of the MNE to a much greater extent than that of domestic firms. In addition, the lack of information on a partic-

ular MNE may lead to the use of stereotypical judgments based on the legitimacy or illegitimacy of certain classes of organizations to which the MNE is perceived to belong. The stereotypes used to judge MNEs may arise from long-established, taken-for-granted assumptions in the host environment regarding MNEs in general, or of MNEs from a particular industry or a particular home country (say, for example, the suspicion that existed in the 1980s of Japanese real estate holdings in the United States). The case of Cargill also illustrates these points. Cargill's arrival in India was equated with the arrival of the British colonialists. "The metaphor really is colonization," "They have come like the British," and "Leave our seeds alone" were all comments made about Cargill by local interest groups (Dewan, 1994).

Another aspect of the liability of foreignness is the *different legitimacy standards* that some institutional environments hold for MNEs compared to domestic firms. MNEs are expected, in many countries, to do more than local companies in building their reputation and goodwill, in supporting local communities, in protecting the environment, and so on. Shell, for example, claims that it has contributed much more to the people of Nigeria and the local community of Ogoniland than any other company in the region, but it still has been subject to fierce criticism both in Nigeria and internationally (Newbury & Gladwin, 1997). Similarly, the standards against which Nike's labor practices are held in China are quite different from the standards that would be applied in judging a local shoe manufacturer. This leads us to the following:

*Proposition 6: MNE subunits will find it a greater challenge to establish and maintain legitimacy in their host environments, compared to domestic firms, because of the stereotyping and different standards applied to foreign firms by the host environment.*

Further, MNEs can become the *target* of different interest groups in the host countries, which may attack the legitimacy of these companies for political reasons and not because of any evidence of wrongdoing (Maitland, 1997). Interest groups can campaign against MNEs simply to gain political clout or to gain publicity as a socially conscious political force. Under these conditions, the MNEs most likely to be targeted

are the larger, better-known MNEs, since they can provide the most publicity and visibility for the interest groups. The cases of Nike, Shell, and Cargill illustrate this *liability of being large and visible*.

Thus, although size may provide power in market activities, such as in obtaining a contract with a local supplier or the local government, it is perhaps a source of vulnerability in nonmarket activities<sup>4</sup> (Baron, 1994), such as the maintenance of legitimacy. While this would apply, to some extent, to all large firms—whether MNEs or purely domestic—we suggest that MNEs are more vulnerable to these types of attacks, for several reasons. First, MNEs operate in multiple institutional environments with varying regulatory, cognitive, and normative standards. This provides opportunities for interest groups to identify practices used by the firm in some country that may be unacceptable in another country and to use those as a rallying point. Further, such attacks are more difficult to counter because distance and language barriers make it difficult for the public to ascertain the facts. Thus, large and visible MNEs are particularly susceptible to legitimacy attacks from interest groups. Formally:

*Proposition 7: Larger and more visible MNEs and their subunits will find it a greater challenge than will smaller and less visible MNEs and their subunits to maintain legitimacy, because they are more vulnerable to attacks from interest groups.*

Although, in general, multinational firms are subject to the liability of foreignness as reflected in Propositions 6 and 7, there could exist specific situations in which being an MNE brings with it an initial level of legitimacy, rather than illegitimacy. Such situations could arise in environments in which local firms have lost their legitimacy because of an economic, political, or social cataclysm (e.g., in Eastern

<sup>4</sup> Market activities include "those interactions between the firm and other parties that are intermediated by markets or private agreements. These interactions typically are voluntary and involve economic transactions and the exchange of property," whereas nonmarket activities are those that are "intermediated through public institutions," typically do not involve economic transactions or property exchange, and may be voluntary or involuntary (Baron, 1994: 1).

Europe or, more recently, in Indonesia). The resulting public awareness of local firms' misdeeds—whether it be links with organized crime or charges of nepotism and corruption—serves to legitimate nonlocal firms. The illegitimacy of local firms also could arise in countries that have protected local business to the point that the absence of competition has made them insensitive to their customers and the public, as well as in countries where there exists a long-standing sense of inferiority and xenophilia. In such cases it is possible that *all* local firms lack legitimacy and, as a result, almost any nonlocal firm is immediately perceived as more legitimate. Thus:

*Proposition 8: The less legitimate local firms are in a particular institutional environment, the less challenge MNE subunits will face in establishing and maintaining legitimacy in that host environment.*

**Legitimacy spillovers.** We suggest that as a result of the complexity inherent in the social, cognitive, and boundedly rational nature of the legitimation process, the legitimacy of a given organizational unit in a particular environment is not independent of the legitimacy of other organizational entities with which the unit is cognitively related. As has been shown in cognitive psychology, people make sense of social events by categorizing them on the basis of such cognitive structures as schemas and stereotypes (e.g., Markus & Zajonc, 1985). Further, under conditions of bounded rationality, people's judgments about particular events are affected by their judgments about similar events that fall into the same cognitive category—a phenomenon often referred to as the "representativeness heuristic" (Tversky & Kahneman, 1974). Therefore, it is likely that when an institutional environment judges the legitimacy of a particular organizational unit, it will refer to the legitimacy of other organizational units that are similar to the focal unit, since they belong to the same cognitive category—for example, to the same class of organizations.

Thus, the legitimacy of a foreign subsidiary of an MNE may be judged based on the legitimacy of all subsidiaries of that MNE or of all subsidiaries of the same home country in that host country. For example, if a Brazilian shoe manufacturer were to open an operation in Indonesia,

it is likely that its legitimacy would be judged based on inferences drawn from such classes of organizations as "other Western firms in Indonesia," "other foreign shoe makers in Indonesia," and "Brazilian firms" in general. These judgments may also be influenced by the environment's knowledge about that firm's subunits in other countries.


We call this phenomenon a *legitimacy spillover* and suggest that, although valid for all types of organizations, legitimacy spillovers are particularly salient for MNEs. Legitimacy spillovers can come from different sources and occur in different directions. There can be *positive* spillovers, which contribute to legitimacy, and *negative* spillovers, which hurt legitimacy. Positive and negative spillovers may not be completely symmetric in their effects, in that negative spillovers are likely to have a stronger effect on legitimacy than will positive spillovers. The fact that a particular subunit is legitimate does not necessarily add much to the legitimacy of other subunits or of the organization as a whole. However, the illegitimacy of any subunit is likely to hurt the legitimacy of other subunits and of the organization. The collapse of BCCI (Bank of Credit and Commerce International) worldwide, because of its problems in Britain and the United States, illustrates the potentially strong effects of negative spillovers.

We distinguish between *internal spillovers*, which occur within an organization, and *external spillovers*, which occur between organizations. Internal spillovers reflect the interdependence in legitimacy across subunits *within* an organization. They can happen vertically—that is, between the subunit and the MNE as a whole—or horizontally—that is, across subunits. Vertically, the parent firm's reputation could affect the legitimacy of its subunits (Fombrun, 1996), and vice versa. For example, with the Southeast Asian subsidiaries of Nike experiencing problems with the image of their labor practices, the legitimacy of Nike as a whole is being questioned. Horizontally, a firm's illegitimacy in one subunit (e.g., Cargill's seeds project in India) can have a negative impact on the legitimacy of its other subunits (Cargill's salt project in India). Thus, we offer the following:

*Proposition 9: MNE subunits will face a greater challenge in establishing and maintaining legitimacy when the*








*MNE as a whole or any of its other subunits experiences legitimacy problems; similarly, the MNE as a whole will also face a greater challenge in maintaining legitimacy if any of its subunits experiences legitimacy problems.*

External spillovers reflect interdependence in legitimacy between organizations belonging to the same classes, such as those from the same home country or industry. For example, once there is a precedent for a Japanese auto maker to start operations in the United States, it becomes easier for other Japanese auto makers to do likewise. Historically shared perceptions about certain countries or regions in a particular host country can also influence the legitimacy of any firm from that country (e.g., Israeli firms in the Middle East or Russian firms in the former Eastern Bloc).

Spillover effects are likely to be particularly strong in the initial period of *establishing* the legitimacy of a new subsidiary (rather than while *maintaining* it), when both the subsidiary and the legitimating environment operate under conditions of bounded rationality. On the one hand, the subsidiary lacks knowledge about the institutional environment—its requirements and its legitimating actors—and, thus, is limited in its ability to achieve legitimacy by adapting to or negotiating with the institutional environment. On the other hand, the legitimating actors in the local environment lack knowledge about the particular subsidiary and may make initial judgments about its legitimacy based on inferences from other similar subsidiaries or from the parent MNE's reputation (Fombrun, 1996; Fombrun & Shanley, 1990). As time passes, the subsidiary is likely to learn about the institutional environment and how to deal with it, and the local environment is also likely to accrue information about the particular subsidiary and begin to judge it more correctly. As a result, the dependence on inferences from analogs may decrease. This proposition is congruent with the ideas of inertia and time dependence of legitimacy (Singh et al., 1986):

*Proposition 10: The extent of the challenge faced by an MNE or an MNE subunit in establishing and maintaining its legitimacy will be negatively (positively) related to the legitimacy*

*(illegitimacy) of other organizations belonging to the same organizational classes; these legitimacy spillover effects will be particularly strong for MNE subunits at the time of entry into a new host country.*



## DISCUSSION

In this article we have focused on MNEs because they provide a unique context in which to extend existing theories of organizational legitimacy, as well as to develop elements of a theory of MNE legitimacy. We have explored three types of complexity illustrated by the MNE case (in the legitimating environment, in the organization, and in the process of legitimation) and developed propositions on the extent of the challenge faced by MNEs and their subunits in establishing and maintaining legitimacy. Although some of these complexities (in particular, environmental complexity) have been recognized by scholars (e.g., Boddewyn, 1995; Evan & Freeman, 1988; Lawrence & Lorsch, 1967; Scott, 1995; Thompson, 1967), their implications for organizational legitimacy rarely have been explicitly examined.

With regard to the effects of environmental complexity, we have explored the influence of the normative and cognitive institutional domains and the greater challenge they present to MNE legitimacy than does the regulatory domain. As for organizational complexity, we have suggested that subunits of geocentric or polycentric MNEs will be better placed to manage the tension between internal and external legitimacy than will subunits of ethnocentric MNEs. Finally, exploring the boundedly rational nature of the legitimation process has led us to understand why, for instance, MNEs might suffer from a liability of foreignness in their acceptance by the environment, why large and visible organizations are particularly vulnerable to attack by political interests, and why complex organizations are vulnerable to legitimacy spillovers, both from within and outside.

This article contributes to theories of organizational legitimacy because the MNE presents an extreme example that pushes the boundaries of these theories in areas that have been overlooked in the past. For instance, the MNE example suggests *multiple levels* of organizational legitimacy: in complex organizations there are

clearly issues of the legitimacy of the whole organization, as well as of its parts. The legitimacy of the whole organization is not necessarily simply the average legitimacy of its parts, although legitimacies at the two levels clearly are related. The tension between internal and external organizational legitimacy, while more apparent in the MNE case, also applies, to some extent, to all complex organizations. Finally, the case of the MNE reveals the social and cognitive nature of the legitimation process and its bounded rationality. For example, the MNE case pushes us to think about how positive and negative legitimacy spillovers may occur within an organization as well as between organizations.

This article also presents the first steps toward building a theory of MNE legitimacy. Although some aspects of MNE legitimacy can be accommodated by general theories of organizational legitimacy, there are certain characteristics of MNEs that are different enough to call for a distinct approach. To start with, the sheer number and, more important, the possibility of extreme variety across the multiple institutional environments that MNEs confront create legitimacy issues not faced by purely domestic firms. The overall legitimacy of an MNE may be affected to a greater extent by some host environments than by others. For instance, environments with the strictest legitimacy requirements may be most critical (e.g., BCCI lost its overall legitimacy from problems in Britain and the United States—not in its home countries of Abu-Dhabi and Luxembourg). In addition, the existence of multiple environments with varying legitimacy standards creates greater opportunities for interest groups to attack MNEs and MNE subunits and to question their legitimacy. Further, the tension between the MNE's internal legitimacy requirements, which are imprinted by the home country legitimating environment (Kogut, 1993), and the legitimacy requirements of its subunits' host countries is likely to create difficulties for the subunits—difficulties purely domestic firms will not have. However, these challenges to external legitimacy will be moderated by the parent MNE's international orientation—whether geocentric, polycentric, or ethnocentric. Finally, the boundedly rational nature of the legitimation process creates special problems for MNEs. For instance, the effects on legitimacy of insti-

tutional distance between home and host countries and the liability of foreignness, particularly at market entry, apply only to the MNE case.

When we speculate on the role of legitimacy in MNEs and other complex organizations, we must bear in mind some issues. Perhaps the most troubling question—one that becomes particularly salient as we consider the difficulties likely to be faced by MNEs in their quest for legitimacy in their multiple host environments—is why MNEs need to be legitimate at all in all of their different environments. While researchers traditionally have assumed that legitimacy is required for access to resources, and for survival, the answer may not be that simple. It is possible for organizations not to be wholly legitimate and still be profitable—even survive over the long term—especially if, as is often the case with MNEs, they have alternative sources of resources and organizational support. There is also the question of MNE legitimacy over time. Although over time MNEs may become more like domestic organizations in terms of their legitimacy (Zaheer & Mosakowski, 1997), the problem for MNEs is that they cannot afford to become complacent. MNEs are much more vulnerable to cross-border legitimacy spillovers than are purely domestic firms. Legitimacy, therefore, may take on a more "punctuated" quality in MNEs compared to the stable, inertial character of legitimacy in purely domestic firms. These issues would clearly benefit from empirical research.

With this article we hope to begin a conversation on aspects of organizational legitimacy that are brought to the surface when we examine complexity in the environment, in the organization, and in the process of legitimation. Clearly, this is just a beginning, for much more conceptual work is needed on exploring important issues that we have not addressed here. Some of the most interesting issues worth exploring further are the question of the contingencies that moderate the importance of a particular type of complexity and the question of the possible interactions between them that may have serious implications for the challenges organizations face in achieving organizational legitimacy. We believe that the ideas we introduce in this article can serve as

a basis for such future theoretical developments.

The propositions we present here are testable, especially if one uses approaches to the measurement of organizational legitimacy that recently have begun to emerge in the literature. Deephouse (1996), for instance, codes public media reports to gauge the legitimacy of an organization, and this type of textual analysis could be used to establish legitimacy, as well as to identify the sources of legitimacy problems, such as in which institutional domain a problem had its origins. The propositions on the maintenance of legitimacy are particularly amenable to testing with these methods, since the loss of legitimacy is often a "critical incident" around which the textual analysis can be organized.

A downside of these methods, especially cross-nationally, arises from both language problems and from the fact that the media do not operate by the same norms across countries on what they report. A solution to this problem may be to examine a matched sample of foreign and domestic firms in the same country. Assessing the ease or difficulty of establishing and maintaining legitimacy, or the tension between internal and external legitimacy, is best done through surveys of international division managers and/or foreign subunit managers in large MNEs. Some of the propositions (e.g., Propositions 9 and 10 on legitimacy spillovers) may lend themselves more readily to traditional population ecology methods. Propositions regarding institutional distance can be operationalized by adapting constructs measuring the characteristics of different institutional environments (Kostova, 1997).

Our discussion of legitimacy issues in the MNE has significant practical implications. By identifying the factors that cause difficulty in establishing and maintaining legitimacy, we have given practitioners the basis for proactively managing the legitimacy of their organizations, instead of simply responding to legitimacy crises as they occur in a "trial and error" manner. Some specific practical recommendations include, but are not limited to, the following. MNEs need to continuously monitor legitimacy in all national environments and must not become complacent about legitimacy in any of them. They need to design strategies to respond to varied legitimacy requirements and, perhaps

even more important, have strategies in place to deal with legitimacy spillovers and crises. Further, managers of MNEs need to pay attention to all three domains of legitimacy—especially the more tacit normative and cognitive domains. They also need to recognize the tradeoff between internal and external legitimacy and the benefits of creating a geocentric or polycentric orientation within the MNE to reduce the tension between the two. Managers of MNEs need to be aware, too, of the stricter legitimacy standards to which MNEs are held, and of the legitimacy risks related to size and visibility.

As for legitimacy spillovers, MNEs can try to buffer themselves in the public eye from organizational classes that are likely to jeopardize their legitimacy, and they can deliberately identify with more legitimate organizations. Since positive and negative spillovers may also accumulate over time, a firm might build up a reputation for being legitimate and use this buffer to counter a potential loss of legitimacy in the future—akin to the notion of building a stock of "moral capital."<sup>5</sup> An example of an MNE subunit that has been successful in building moral capital to overcome the negative views of Japanese subsidiaries in the United States is Toyota's U.S. subunit. This subsidiary has taken pains to communicate to the American public—through corporate advertising—its espousal and support of quintessentially American causes. This example also illustrates the fact that MNEs need not only to build a good track record but also to clearly communicate that record to the legitimating environment because of the socially constructed nature of organizational legitimacy.

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