

## **Interstate Conflicts and the ESG Strategy of Foreign MNEs**

### **ABSTRACT**

This study examines the effect of interstate conflicts on the strategy of the subsidiaries of foreign multinational enterprises (MNEs). Although the magnitude and impact of interstate conflicts between home and host countries on businesses have been growing, scholarly research on the strategies of foreign MNEs under interstate conflicts is scarce. Based on global strategy and corporate social responsibility (CSR) research, we argue that interstate conflicts create an enduring legitimacy crisis for the subsidiaries of foreign MNEs in a host country. Thus, to alleviate the legitimacy crisis, foreign MNEs will engage more in environmental, social, and governance (ESG) activities in a host country. However, we further argue that the legitimacy-enhancing benefits of ESG firms can enjoy will be heterogenous depending upon the degree of the interstate conflict; thus, the curvilinear effect of interstate conflicts on ESG is also present. The empirical results strongly support our arguments, even after considering the various institutional characteristics of home and host countries. This study contributes to the international business and CSR literatures.

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## INTRODUCTION

*“The ongoing trade and political dispute between South Korea and Japan ... As the countries are two of the world’s largest economies and giants in technology, the tit-for-tat dispute also has global implications ... The issue has angered many in South Korea, with people boycotting Japanese goods.”* (December-2, 2019, BBC)

*“Ties between Washington and Beijing have grown increasingly antagonistic over the past year... The United States added dozens of Chinese companies ... to a trade blacklist.”* (December-18, 2020, CNBC)

*“South Korean giant well-positioned to increase its fourth-place market share if West bars industry’s biggest player and China retaliates.”* (July-27, 2020, Wall Street Journal)

Business environment and environmental shocks or changes significantly affect corporate strategies (Morgeson, Mitchell, & Liu, 2015; Tilcsik & Marquis, 2013). In addition to the business environment that every firm must cope with, foreign multinational enterprises (MNEs) located and operating in a foreign host country have an additional layer to deal with—international relations between their home and host countries (Oh & Oetzel, 2017). As one of the three examples presented above illustrates, MNEs sometimes benefit from ties or relationships between home and host countries. However, because of the conflicts between home and host countries, as two other episodes also evidently epitomize, MNEs are often severely penalized by the consumers in a host-country market and the host-country government (Bartlett, 2021; Eden & Miller, 2001). In recent times, the number of conflicts and degree of tension between countries have been intensifying owing to the amplified nationalism in many countries and clash and dissent over several global issues, such as trade and climate change. This most recent trend has apparently complicated foreign MNEs’ management of their host country’s business environment and stakeholders (Evenett, 2019; Soule, Swaminathan, & Tihanyi, 2014).

Although the magnitude and influence of international relations and conflicts between home and host countries on businesses have been growing, our knowledge on various aspects of international relations and conflicts, particularly its effects on foreign firms and their strategies,

remains limited (Aguilera, Henisz, Oxley, & Shaver, 2019; Shi, Hoskisson, & Zhang, 2016). First, studies have emphasized the importance of various aspects of home- and host-country institutional environments but these studies have largely focused on various rather stationary political and institutional factors of a host country such as types of political regime, regime stability, institutional quality (Henisz & Delios, 2004; Musacchio, Lazzarini, & Aguilera, 2015). Given that the relationship between countries is not static but changing, this dynamic nature will naturally keep shaping the business surroundings of foreign MNEs and, thus, their strategy; however, we do not have much knowledge on this (Wang, Weiner, Li, & Jandhyala, 2021).

Second, even a few notable exceptions that examine interstate relations or conflict have mainly focused on how interstate relations can affect the entry- or exit-related decisions of foreign MNEs, such as foreign direct investment (FDI), cross-border mergers and acquisitions (M&As), strategic alliances, or survival of foreign MNEs (e.g., Arikan, Arikan, & Shenkar, 2020). Undoubtedly, these are critical decisions that foreign MNEs must make in their internationalization process (Ghemawat & Thomas, 2008; Kogut & Zander, 1993). However, the effect of home- and host-country relations is not limited to entry or exit decisions but more relevant to and significantly affecting strategic activities of subsidiaries of foreign MNEs located and operating in a host country; the lack of scholarly research significantly limits our understanding of foreign MNEs' strategic decisions in dealing with interstate relations or conflicts.

Moreover, strategic decisions on FDI and related entry modes, driven by host-country characteristics or pre-existing relations between countries, are endogenous in most cases. This is because only foreign MNEs that can deal with the various political and institutional factors of the host country have considered and are willing to make such strategic moves, which makes causal inference problematic (Shaver, 1998). What types of strategic actions do foreign MNEs take to

deal with the exogenous shocks driven by the relationship between the home and host countries when they run their businesses in a foreign country? Why do they engage in these strategies? Does every foreign company show the same behavioral pattern, or is there any heterogeneity in their strategic response? These are the key questions whereof our knowledge remains limited, but they have important theoretical and practical implications vis-à-vis foreign MNEs coping with more turbulent global political environments (Lu, Ma, & Xie, 2021).

Thus, in this study, we propose that interstate conflict is one of the fundamental and permanent sources of the liability of foreignness (Hymer, 1960/1976; Zaheer, 1995). Although foreign MNEs can partially alleviate and decrease the effect of the severity of the liability of foreignness (Siegel, Pyun, & Cheon, 2020; Zaheer & Mosakowski, 1997), their home-country ties cannot be perfectly wiped out unless these firms are completely perceived as domestic firms by host-country stakeholders. Therefore, we argue that foreign MNEs engage more in environmental, social, and governance (ESG) activities as a means to overcome their liability of foreignness driven by interstate conflict.<sup>1</sup> Studies on corporate social responsibility (CSR) have illustrated that firms engage in CSR activities as insurance to alleviate any future negative events that occur to a firm (Jia, Gao, & Julian, 2020; Luo, Kaul, & Seo, 2018) because CSR activities are viewed as public goodwill or moral capital (Godfrey, 2005). This allows foreign MNEs to bypass the idiosyncratic risks in the face of negative events (Fombrun, Gardberg, & Barnett, 2000; Godfrey, Merrill, & Hansen, 2009), interstate conflicts in the current study context.

However, we further posit that this effect is not only linear but also curvilinear because some foreign firms do not see or cannot enjoy the benefits of ESG (Shiu & Yang, 2017) depending upon the degree of interstate conflict, which creates strategic heterogeneity in their

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<sup>1</sup> In this study, we assume that corporate ESG activities is a manifestation of CSR activities thus interchangeably use the term following related studies (e.g., Hawn, Chatterji, & Mitchell, 2018; Benton, Cobb, & Werner, 2021).

ESG activities. Thus, as opposed to the conventional view that foreign MNEs will make an effort to overcome the liability of foreignness, we argue that foreign MNEs will strategically consider the effectiveness of their strategy in the presence of the interstate conflict. Foreign MNEs will elect to avoid taking actions to overcome the legitimacy concern driven by interstate conflicts if they believe that ex-ante and ex-post ESG benefits are not effective.

Empirically, we examine 1,433 firm-year observations with 207 publicly traded subsidiaries of foreign MNEs from 23 countries located in 34 countries between 2002 and 2019 (86 home- and host-country pairs). Our empirical results strongly support our argument that subsidiaries of foreign MNEs attempt to enhance their ESG performance following interstate conflicts between home and host countries. However, as the anticipated outcomes of their ESG efforts are not as effective, we also observe an inverse quadratic relationship between interstate conflict and ESG performance. Moreover, both the linear and curvilinear effects of interstate conflict on ESG performance remain unchanged and are still supported even after we account for various home- and host-country institutional characteristics.

This study makes several theoretical contributions. First, it contributes to international business literature, particularly the intersection of the international political economy and global strategy. Notwithstanding its culminating influence on international business, the concept of the liability of foreignness has been criticized and challenged (Kronborg & Thomsen, 2009; Luo, 2002; Luo & Mezias, 2002) because of its lack of theoretical clarity and its many anecdotal evidence that shows that foreign firms are not penalized but sometimes better treated by host-country governments (Mallon & Fainshmidt, 2017; Nachum, 2003, 2010). By showing that interstate conflict can be the fundamental source of permanent discrimination, this study enhances our understanding of the liability of foreignness.

Furthermore, our study enhances our understanding of the CSR literature and foreign MNEs' CSR activities. Several studies argue and illustrate that CSR activities provide insurance-like benefits that firms can alleviate stakeholder legitimacy concerns by engaging in CSR in the wake of adverse events (Godfrey, 2005; Jia et al., 2020; Luo et al., 2018). Studies on foreign MNEs' CSR also suggest similar claims that foreign MNEs can increase their legitimacy through CSR activities, thus enabling them to mitigate the effect of the liability of foreignness. However, the fundamental assumption of these studies is that engagement in CSR activities will result in a positive effect in alleviating legitimacy concerns (Mithani, 2017). Thus, the most recent theoretical focus has been on *when* and *why* CSR activities can be more effective and useful (e.g., Crilly, Ni, & Jiang, 2016; Hawn, 2021; Jacqueminet & Durand, 2020). By showing not only (1) that foreign MNEs' ESG engagement is, in general, a strategy firms have chosen to alleviate any negative events but also (2) that foreign MNEs strategically calculate the anticipated outcomes of their ESG efforts, which creates a heterogeneity in their ESG activities, we further shed light on companies' strategic CSR in the context of international business.

## **THEORY AND HYPOTHESES**

### **Transient or Permanent Effect of the Liability of Foreignness**

Over the decades, the liability of foreignness has been one of the most important theoretical perspectives in international business. Notwithstanding the nuanced differences in theoretical arguments across studies, in principle, the fundamental argument of the liability of foreignness converges at the point that foreign firms suffer from their foreignness; the liability comes from three major sources: (1) institutional unfamiliarity that foreign MNEs have less knowledge of the foreign host country; (2) relational hazard that foreign MNEs are socially less embedded in the host-country; (3) discriminatory treatment, whereby foreign MNEs are treated unequally compared to domestic firms (Eden & Miller, 2004; Hymer, 1960/1976; Zaheer, 1995).

Although the liability of foreignness has significantly influenced and shaped our understanding of foreign MNEs and their strategies, more recently, the theory has been scrutinized and criticized for multiple reasons (Lu et al., 2021).

First, some studies argue that the liability of foreignness can be overcome without much difficulty, especially as foreign MNEs increase their host-country experience and become more embedded in the host-country society (Perkins, 2014; Zaheer & Mosakowski, 1997). Therefore, the effect of the liability is transient and thus will ultimately disappear (Delios & Beamish, 2001; Gaur & Lu, 2007). Second, studies have even started to claim that the liability of foreignness no longer exists, albeit it can sometimes be more advantageous (Nachum, 2003, 2010). For example, Shi and Hoskisson (2012) argue that foreign MNEs in a host country can exploit various types of tangible (e.g., preferential tax policies) and intangible (e.g., perquisites driven by their foreignness) benefits that domestic firms cannot enjoy, which leads them to achieve better firm-specific outcomes.

However, interestingly, when Hymer (1960/1976) first theorizes the concept, he argues that being foreign is a stigma, and thus, foreignness cannot be easily overcome (Eden & Miller, 2004; Devers, Dewett, Mishina, & Belsito, 2009). Furthermore, it is not difficult to find real-world examples that many foreign firms still suffer from their foreignness, a manifestation of the existence of the liability of foreignness (Evenett, 2019; Kim, 2019). If it is true that foreignness stigmatizes foreign MNEs, they cannot overcome the liability as easily and fully as it is originally constructed as well as currently observed. This theoretical prediction and anecdotal evidence are apparently contradictory to several studies that argue that the liability of foreignness is not something permanent but transient, and even foreign firms are better treated.

The opposing predictions pose important questions regarding whether there is any enduring factor that makes foreign MNEs suffer from the liability due to their foreignness, and if

they exist, what strategies they may use to mitigate the negative effect of the liability of foreignness. Hence, we propose that *interstate conflict is one of the fundamental sources of the liability of foreignness, which drives persistent discriminatory treatment*, and subsidiaries of foreign MNEs will attempt to enhance their ESG performance to mitigate the negative effects driven by interstate conflict. In the following section, we discuss why interstate conflict can be the fundamental source of persistent discrimination in connection to the liability of foreignness.

### **Interstate Conflict as a Fundamental Source of the Discrimination**

The business environment is one of the most important considerations for companies (Tilcsik & Marquis, 2013), and this is particularly critical to foreign MNEs because they must deal with both home- and host-country environments (Gaur & Lu, 2007; Hillman & Wan, 2005). Thus, many studies in international business have examined not only various home- and host-country markets and institutional factors, such as culture, social, and/or national systems but also differences in these factors that determine foreign MNEs' strategies in a host country to better deal with the institutional differences between the home and host countries (Buchner, Espenlaub, Khurshed, & Mohamed, 2018; Delios & Henisz, 2000; Siegel, Licht, & Schwartz, 2013). More recently, studies have increasingly paid more attention to the dimensions in international politics and political economy and how this affects the strategies of foreign MNEs (e.g., Albino-Pimentel, Oetzel, Oh, & Poggioli, 2021; Li, Meyer, Zhang, & Ding, 2018); one of them is interstate conflict.

First, under the definition that interstate relations are a dyadic relationship between two countries (Crescenzi, 2007; Tuathail & Agnew, 1992), they are fundamentally non-static but dynamic, especially as their characters may be either cooperative or conflictual, depending on numerous political or diplomatic interests and events in either/both nation(s), which consistently vary over time (Li et al., 2018). For example, as evident in interstate security relations formed



through military pacts or security treaties, such security relations typically persist and are thus stable over time (e.g., the North Atlantic Treaty Organization, Five Eyes). Countries that form military or security ties with each other, considered ally countries, naturally have a good relationship (Gartzke & Gleditsch, 2004; Mansoor & Murray, 2016). However, it is also true that countries may experience conflict or dispute on national or international issues depending on the specific issue they are dealing with (e.g., temporary trade disputes between countries, the recent U.S. and French diplomatic dispute over AUKUS). This makes the temporal relationship between countries fluctuate, positively or negatively, even if their overall relationship measured by other factors (e.g., military agreement, inter-governmental networks) is stable.

Furthermore, given that interstate relations manifest positive or negative dynamic relationships between two countries (Bremer, 1992; Crescenzi, 2007), it creates varying positive or negative externalities at a different point at a different level. Hence, interstate relations also affect the operations and strategic decisions of foreign MNEs (Wang et al., 2021). Studies in international business have documented that host-country stakeholders evaluate foreign MNEs based on various factors at both the organizational level and foreign MNEs' home-country characteristics (Lubinski & Wadhvani, 2020; Ramachandran & Pant, 2010; Vasudeva, Nachum, & Say, 2020). As home-country characteristics are easily observable in connection to a foreign MNE (Li, Yang, & Yue, 2007; Tse & Gorn, 1993), the evaluation of the home country will naturally become a characteristic of foreign MNEs (Peterson & Jolibert, 1995; Roth & Romeo, 1992). This implies that depending upon how a foreign MNE's home country is evaluated at a different time, this will also differentially influence the perception of the foreign MNE in a host country. Therefore, it is sensible to expect that the interstate relations between home and host countries will influence the perception of foreign MNEs in the eyes of host-country stakeholders (Bertrand, Betschinger, & Settles, 2016; Duanmu, 2014).

In particular, negative interstate relations (i.e., interstate conflicts) between home and host countries will likely incur a legitimacy crisis for the subsidiaries of foreign MNEs from the home country (Dacin, Oliver, & Roy, 2007; Makino & Tsang, 2011). For example, studies have shown that national antipathy triggered by the diplomacy, politics, military actions, and/or trade between two countries can lead to administrative actions by the host government against foreign firms operating in a country (Bertrand et al., 2016; Duanmu, 2014). Furthermore, interstate conflict can drive the administrative actions by the state and provoke negative sentiments among consumers in the host market. Thus, it often causes consumer engagement in activism, such as boycotts on the services and products of foreign subsidiaries and stigmatization on media (Li & Vashchilko, 2010; Varman & Belk, 2009; Zeng & Sparks, 2020). One of the most recent interstate conflicts between South Korea and Japan vividly illustrates that interstate conflict can cause various administrative actions and consumer boycotts against MNEs from each country as their relationship worsens. This is regardless of whether the two countries have generally maintained cooperative relationships in the past (BBC, 2019).

To sum up, regarding the proposition that foreign MNEs do not suffer from the liability of foreignness to be sustained, foreign MNEs must not be discriminated due to their associated characteristics, including foreignness and home-country attributes (Denk, Kaufmann, & Roesch, 2012; Luo & Mezias, 2002) thus the costs of doing their business must be comparable to that of domestic firms. When the relationship between home and host countries is good, foreign MNEs might be treated considerably similarly to domestic firms as they accumulate more host-country experiences and become more embedded in the host-country society (Perkins, 2014; Zaheer & Mosakowski, 1997). This implies that the liability of foreignness may not be observed, or the effect can be quite negligible. However, when two countries are in conflict, it is not unreasonable to expect that a foreign MNE would be penalized due to its home country and, thus

discriminated, which it would have not experienced if it were a local firm. Unless the foreign MNE becomes a domestic firm or its foreign identity can be completely removed, it will still suffer from liability due to its foreignness, particularly driven by interstate conflicts (Maher, Clark, & Maher, 2010; Tse & Gorn, 1993).

Therefore, under the assumption that host-country stakeholders' perception of home country is, by nature, another firm identity permanently tied to a firm (Cuervo-Cazurra, 2011; Luo & Wang, 2012), we propose that legitimacy perception driven by interstate conflicts does not disappear but always exists, thus critically affecting foreign MNEs in a foreign host country. Hence, among the three sources of the liability of foreignness—institutional unfamiliarity, relational hazard, and discrimination—interstate conflict can be considered as a permanent source of discrimination. Thus, to mitigate the effect of legitimacy concern, the source of discrimination in a host country, driven by interstate conflicts, we argue that foreign MNEs will attempt to enhance their ESG performance because it can help firms increase their legitimacy in the existence of negative exogenous events (Godfrey et al., 2009; Zhou & Wang, 2020).

### **Enhancement in ESG to Mitigate the Discriminatory Effect Driven by Interstate Conflict**

Alleviating legitimacy concerns has been one of the most important strategic efforts by foreign MNEs in a host country because legitimacy-building increases the likelihood of being accepted by the host market, which leads to a better performance and, ultimately, their survival in the host country (Brønn & Vidaver-Cohen, 2009; Zaheer & Mosakowski, 1997). The core mechanism is that greater legitimacy helps foreign MNEs to gain social trust, thus enabling them to suffer less from liabilities in the host-country society (Lu, Song, & Shan, 2018; Johanson & Vahlne, 2009). Hence, foreign MNEs attempt to engage in various strategic efforts to secure and increase their legitimacy in a foreign market and CSR is also a strategic option that foreign MNEs consider pursuing to increase their legitimacy (Mithani, 2017; Rathert, 2016).

Although firms' motivations to engage in CSR activities can vary (Luo et al., 2018), studies generally agree that one motivation for firms to engage in CSR is to improve legitimacy (Aguinis & Glavas, 2012; Marquis & Tilcsik, 2016). Engagement in CSR can effectively shield firms from negative events, which can affect not only their reputation or legitimacy but also their performance (Flammer, 2013, 2015; Henisz, Dorobantu, & Narthey, 2014) because stakeholders are less prone to evaluating firms' legitimacy based only on adverse events (Godfrey, 2005). For example, Luo and her colleagues (2018) develop and test a formal model in which a market exists for reputation and firms buy this reputation insurance for a possible future negative event. Their empirical test further supports the argument that organizational philanthropy helps firms reduce negative reactions from the relevant stakeholders, a manifestation of the insurance benefits of CSR. By looking at the regulatory shock to the stock market, another study by Jia et al. (2020) also illustrates a similar result that firms actively advance CSR to reduce potential risk driven by the regulatory shock while enjoying the insurance-like benefits of CSR. This also confirms the risk-reduction and legitimacy-enhancing motives of CSR driven by negative events.

The benefits of the legitimacy-enhancing effect of CSR are also well illustrated in studies on foreign MNEs (e.g., Campbell, Eden, & Miller, 2012; Mithani, 2017). Institutional pressure from various stakeholders in a host country is one of the most prominent reasons that foreign MNEs engage more in pro-social or CSR activities (Aguilera, Rupp, Williams, & Ganapathi, 2007; Marquis, Glynn, & Davis, 2007). By seeking social engagement in the host country and responding to the local actors' perceptions and requests, several studies argue that foreign MNEs can improve the overall trustworthiness, reputation, and local image of MNEs (Dorobantu, Henisz, & Narthey, 2017; Husted, Montiel, & Christmann, 2016). This is because CSR activities by foreign MNEs will be considered beneficial to the host-country society (Darendeli & Hill, 2016; Rana & Sørensen, 2021). For example, in a study examining foreign MNEs' philanthropic

activities in the wake of natural disasters, Mithani (2017) shows that foreign MNEs' contribution to philanthropic activities critically helps them mitigate the effect of the liability of foreignness. Other studies present similar results that subsidiaries of foreign MNEs can increase their legitimacy in the host country by adopting and improving CSR practices because the positive social behaviors of foreign MNEs can positively influence their host-country stakeholder perceptions (e.g., Marano, Tashman, & Kostova, 2017; Rathert, 2016).

In sum, under the assumptions that (1) interstate conflicts can cause a legitimacy crisis for foreign MNEs, thus making foreign MNEs suffer from discrimination due to their foreignness; (2) ESG activities will enhance the legitimacy of foreign MNEs by positively shaping and influencing the perception of host-country stakeholders, it is not unreasonable to expect that foreign MNEs will try to engage more in ESG activities to alleviate legitimacy issues driven by interstate conflicts. Therefore, we argue that as the interstate conflict between foreign MNEs' home and host countries increases, foreign MNEs will attempt to advance their ESG performance to enhance their legitimacy, thus lessening any negative consequences in the foreign host country.

*Hypothesis 1: As the interstate relations (conflicts) between the home and host countries worsen (increase), the subsidiaries of foreign MNEs in a foreign host country will attempt to improve their ESG performance to mitigate the adverse effects of interstate conflicts.*

### **Non-linear Effects of the Liability of Foreignness on Foreign MNEs' ESG**

Although it is almost axiomatic that foreign MNEs must engage in various strategic activities to overcome the liability of foreignness (Bell, Filatotchev, & Rasheed, 2012), it may also be true that not every foreign MNE will try to overcome the liability of foreignness (Görg & Strobl, 2003; Hennart, Roehl, & Zeng, 2002). First, this might be because there is an institutional constraint that prevents foreign MNEs from overcoming the liability of foreignness. For example, Kim (2019) argues that due to national security concerns, foreign defense contractors

attempting to sell their weapons systems to host-country governments are fundamentally penalized; thus, their liability of foreignness is difficult to overcome. Mata and Freitas (2012) also show that even after accounting for the footlooseness of foreign MNEs, their exit rates are markedly higher than domestic firms, which implies host-country institutional constraints that inhibit foreign firms from effectively overcoming the liability. Second, conventional strategic efforts by foreign MNEs may not be effective. For example, Siegel et al. (2019) claim that it is substantially challenging for foreign MNEs to take advantage of the host-country labor market because of their foreignness. Thus, foreign MNEs' efforts to recruit talented local employees are far less effective than high-status local firms.

Notably, CSR works for firms as insurance to mitigate risks driven by negative reactions from relevant stakeholders in the wake of adverse events (Godfrey, 2005; Jia et al., 2020). However, not every firm needs to have or can enjoy this insurance-like benefit, which would create heterogeneity in that companies that do not see the insurance benefits of CSR will not engage in pro-social activities. To the extent that firms engage in CSR activities to mitigate legitimacy risks ex-ante and fix the risks ex-post (Crilly et al., 2016; Zhou & Wang, 2020), we expect that foreign MNEs will not venture into CSR activities if they believe that either outcome cannot be effectively achieved.

First, foreign MNEs that do not envisage any potential immediate risks ex-ante might not engage in ESG activities. One of the interesting findings in Luo et al.'s (2018) study is that there is a positive association between firm's philanthropic donations and the number of potential negative events. This implies that firms that actively seek ways to mitigate potential risks by engaging more in ESG activities are likely to be those expecting potential reputational hazards. In other words, firms that neither expect a potential reputational hazard nor thus benefit much from an insurance effect are less likely to engage in ESG activities. Second, if foreign MNEs

expect that they cannot effectively remedy their legitimacy crisis through ESG ex-post, these firms also appreciate the benefits of ESG much less. Although the effect of the liability of foreignness is expected to apply to every foreign firm, it is also true that the degree of liability varies depending on organizational or home-country characteristics (Bell, Filatotchev, & Aguilera, 2014; Edman, 2016; Wu & Salomon, 2017). This implies that depending on the home country of foreign MNEs, some firms may be better placed to alleviate legitimacy issues, while the other firms will not effectively overcome the legitimacy concern even if they engage in ESG.

Returning to interstate relations, we expect that the benefits to enhance ESG performance will be heterogeneous and non-linear, depending on the relationship between home and host countries, which determines the degree of legitimacy of the home country. On the one hand, firms from a home country with a considerably positive relationship with the host country do not see the benefits of ESG as much as other multinationals from a country with a rather worse relationship. In other words, unless interstate conflicts significantly worsen, which is extremely unlikely, their ex-ante insurance benefits are not as high. On the other hand, the benefits firms can enjoy will be less salient and effective for firms from home countries with high interstate conflicts with the host country. Heightened interstate conflicts mean that a country's image might be tainted and stigmatized because host-country stakeholders will see foreign MNEs' home countries as disparate from them (Arikan et al., 2020; Linville, Salovey, & Fischer, 1986). This stigmatization of home-country perceptions or images will significantly limit the strategic degree of freedom of the subsidiaries of foreign MNEs (Lubinski & Wadhvani, 2020; Sofka & Zimmermann, 2008). Therefore, even if foreign MNEs stigmatized by their home-country engage in ESG, their activities will not be positively evaluated by host-country stakeholders (Shiu & Yang, 2017). Thus, their ex-post efforts might not be as effective as those of other firms from home countries without stigmatization (Crilly et al., 2016).

In sum, the expected benefits of ESG will be heterogeneous across firms, particularly depending on the degree of interstate conflict. Foreign MNEs will not attempt to enhance their ESG performance if they don't see or expect either the ex-ante or ex-post benefits of their ESG activities. Hence, we argue that although foreign MNEs attempt to improve their legitimacy to overcome the liability of foreignness by engaging in ESG activities, there also exists a non-linear effect between interstate conflicts and ESG performance. In particular, we expect to see an inverted U-shape between the interstate conflicts and ESG performance of the subsidiaries of foreign MNEs.

*Hypothesis 2: There is an inverted U-shape relationship between interstate conflicts and the ESG performance of the subsidiaries of foreign MNEs.*

## **METHODS**

### **Data and Sample**

The major data source we use is the Refinitiv Eikon database, which provides comprehensive data on firms' ESG as well as organizational and financial data. Since corporate ESG data is available from 2002, our sample period ranged from 2002 to 2019. Given that our main research interest is to examine the effect of interstate conflicts on the subsidiaries of foreign MNEs' ESG, we attempt to first identify each company's ultimate ownership and whether they are foreign-owned and controlled. We follow the global ultimate ownership measure, a conservative way to account for both the ownership and controllability of a firm (Kim, 2019). Among the firms identified as subsidiaries of foreign MNEs, we exclude those whose ultimate owner is established or headquartered in 52 tax haven countries based on the Hines (2010) list.<sup>2</sup> Furthermore, the characteristics of the ultimate owners must be considered (Surroca, Tribó, &

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<sup>2</sup> It is generally considered that firms in tax havens differ from subsidiaries of foreign MNEs because of their motivation to avoid tax (Lee, 2020). To ensure that our results are robust, we include these companies in a separate regression analysis, but the results remain unchanged and still support our arguments.



Zahra, 2013; Zhou & Wang, 2020); thus, firms without the information are also excluded from the final sample. Thus, in our final sample, we have 1,433 country-year observations with 207 subsidiaries of foreign MNEs owned by 164 companies from 23 home countries, which are located, operating, and publicly traded in 34 host countries. Table 1 provides the summary statistics for selected host-country characteristics.

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### **Dependent Variable**

The dependent variable is the annual ESG score of the foreign MNEs' subsidiaries in a host country (*ESG score*). Refinitiv Eikon provides the percentile performance scores of each firm on three pillars on ESG—Environment (E), Social (S), and Governance (G)—and we use the aggregate measure of the ESG score as our dependent variable (please see Appendix S1 for more details on how the ESG measure in the database is constructed). Thus, the higher the ESG score, the more a foreign MNEs' subsidiary engages in ESG activities in a foreign host country.

### **Explanatory Variables**

We measure interstate conflict, our main explanatory variable, using the Goldstein conflict–cooperation scale, which is indexed in the Global Database on Event, Location, and Tone (GDELT), the most widely used database for studying interstate relations and conflicts (e.g., Hu, Natarajan, & Delios, 2021; Wang et al., 2021). The GDELT provides more than 250 million data points regarding daily reported events by news media in print, broadcast, and online forms (Leetaru & Schrod, 2013). All relevant information—including affiliated actors and country, type of event, intensity of conflict or cooperation, and tone—are machine-coded into the database, and all duplicate reports are compiled into a single event record. The Goldstein scale is provided for each event (Goldstein, 1992) and, depending on the event type, the impact of each event is scaled from -10 (most conflictual) to +10 (most cooperative) in the measure, which is

calculated by taking the average of the scores of all events. Based on the Goldstein scale of every single event in a given year, we calculate the annual average Goldstein scale score between home and host countries and lag one-year to make an inference on the effect of interstate conflicts on ESG. For ease of interpretation, we reverse the score of the original annual average of the Goldstein scale: the higher our explanatory variable, the more interstate conflicts exist between the home and host country (please refer to Table A1 in the Appendix, which shows the reversed Goldstein score for each type of event). To preempt a potential multicollinearity issue, we mean-center the variable (*interstate conflict*). To test our second hypothesis that there will be a curvilinear effect of interstate conflict on subsidiaries of foreign MNEs' ESG, we create a quadratic term of 1-year lagged annual average Goldstein scores (*interstate conflict squared*).

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To confirm and validate the use of Goldstein scores as a measure of interstate relations (conflicts), we further provide the plots of the Goldstein scale on a few examples of interstate conflicts. Figure 1a illustrates the annual average Goldstein scale score between the United States and China, while Figure 1b depicts the monthly change in the Goldstein scale around the trade disputes between the two countries in 2018. The green line in Figure 1a indicates the year 2018, when the United States–China trade dispute started. Similarly, Figures 2a and 2b show the annual and monthly averages of the Goldstein scale scores between the United States and Russia, respectively. The two green lines in Figure 2a, respectively, illustrate the tension between the United States and Russia due to the Russo-Georgian War (Tsygankov & Tarver-Wahlquist, 2009) and the economic sanctions imposed by the United States, owing to Russia's involvement in the Ukrainian crisis and the annexation of Crimea (Gould-Davies, 2020). Figure 2b highlights the monthly average score of the Goldstein scale when the United States imposes economic sanctions on Russia and Russian companies when Russia gets involved in Ukraine. All these

figures corroborate that the Goldstein scale adequately represents the magnitude of interstate conflicts, which confirms the validity of our explanatory variable—the measure of interstate conflict in our analysis.

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Please insert Figure 3 about here  
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Figure 3 depicts the three-way relationship between the Goldstein scale and ESG score by year, where the surface represents a linear prediction of all the three variables. The figure shows that while the ESG score tends to increase yearly, the average ESG score and Goldstein scale are also positively associated.

### **Control Variables**

We control for several firm-level variables in the main specification that can potentially influence corporate engagement in ESG activities. First, we control for multiple organizational variables of a foreign subsidiary. To account for a firm's size, we control for the natural logarithm of total assets (*total assets*) because prior studies show that the size and capacity of firms enable the implementation of CSR activities (Gallo & Christensen, 2011). Studies show that financial slack helps firms determine their corporate capacity to implement CSR (Aguilera-Caracuel, Guerrero-Villegas, Vidal-Salazar, & Delgado-Márquez, 2015; Surroca, Tribó, & Waddock, 2010) and allows them to allocate financial resources for CSRs instantaneously when necessary (Zhang, Li, Jiang, Zhang, Hu, & Liu, 2018), considering the high liquidity of the resource (Mishina, Pollock, & Porac, 2004). Thus, we use the debt to equity (*D/E ratio*) as a measure of slack resources by dividing the total debt of a company by the total amount of company equity, which indicates potential resources to be allocated. Relatedly, we also include return on assets (ROA), as a firm's profitability is considered one of the major factors that drive CSR activities (Nelling & Webb, 2009; Waddock & Graves, 1997).

Furthermore, we consider the leverage of a foreign subsidiary and the amount of resource commitment in a host country market (Kronborg & Thomsen, 2009) by controlling for the *debt ratio*—calculated by dividing the total amount of debt by the total amount of assets of a company—and measuring the total amount of tangible assets, particularly their physical assets (*property, plant, and equipment; ppne*). Controlling for the physical assets of a foreign subsidiary is particularly important because corporate commitment is one of the indicators that local stakeholders consider for cooperation (Cao & Alon, 2021). When the subsidiaries of foreign MNEs are exposed to the effect of the increasing tension between the home and host countries, resource commitment may motivate them to engage in CSR, especially as their first priority may be to protect their investment in a host country (Mata & Freitas, 2012).

We also control for multiple ultimate parent characteristics. As the controllability of a parent company increases, the subsidiaries of a foreign MNE will likely follow the parent company's strategic direction (Chandler, 1991; Nell & Ambos, 2013; Sengul & Gimeno, 2013). To account for the effect of the parent company's controllability and ownership, we control for the percentage of equity owned by the home-country parent company (*ultimate parent: equity share*). We also include the ESG score of the parent company (*ultimate parent: ESG score*). The subsidiaries of foreign MNEs operating in a host market are under institutional duality pressure (Hillman & Wan, 2005; Kim, 2019), which implies that the parent company's strategic direction can be easily transplanted in the foreign subsidiary. By controlling for the parent company's ESG score, this will effectively capture the strategy alignment between the foreign subsidiary and its parent company (Husted et al., 2016; Rodrigues & Krishnamurthy, 2021), which could be the most relevant alternative route to engage in ESG activities. Finally, we also control for the visibility of the parent company (*ultimate parent: global Fortune 500 company*). Studies have shown that corporate sustainability is connected to corporate reputation rankings (Bermiss,

Zajac, & King, 2014). As the expectations of relevant stakeholders, including the public and media, toward these firms listed in the rankings are relatively high (King & McDonnell, 2015; Zhou & Wang, 2020), these companies might attempt to enhance their ESG activities. Thus, we create a binary variable indicating whether an ultimate parent company is listed in Fortune 500.<sup>3</sup>

### **Identification Strategy and Statistical Analysis**

Conflicts between countries are sometimes endogenous to the extent that animosity or tensions between countries may have persisted over time (e.g., border conflicts between India and Pakistan), which is often rooted in historical contexts (Arikan et al., 2020). Nonetheless, nations holistically approach diplomatic issues while prioritizing their national interests coupled with both political and economic interests (Abdelal & Kirshner, 1999). Thus, interstate conflicts, compared to animosity, can develop quickly and unexpectedly because of home- and host-country political environments (e.g., South Korea's sanction on Myanmar after the military coup), even if both countries have maintained a good relationship. This implies that interstate conflict can be an exogenous shock, which firms cannot foresee and anticipate reasonably ex-ante, contrary to historically rooted conflicts between countries. Therefore, our study context, which examines the effect of interstate conflict on foreign MNEs' strategy, is relatively free from endogeneity concerns. However, it is still possible that an endogeneity issue, omitted variable bias in particular, can be present. Thus, we attempt to lessen the endogeneity issue as follows.

First, we use the one-year lag of the Goldstein scale, wherefrom the temporal structure of the explanatory variable allows us to alleviate in part the endogeneity concern. Furthermore, we also employ various fixed effects to control for any unobserved heterogeneity at multiple levels.

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<sup>3</sup> Due to firm fixed effects, some variables that do not vary over time but are assumed to affect foreign firm activities are not included in the regression analysis; these variables are automatically dropped. This includes firm age, M&A history, and other country institutional characteristics, such as historic animosity, geographic distance, common language, common colonizer, military cooperation, and the like.

To control for time-specific unobserved heterogeneity, we control for year fixed effects.

Depending on the industry, firms' exposure to interstate conflict might be different; therefore, we also control for industry fixed effects. Basically, the nature of conflict is bilateral between home and host countries; thus, we also control for home- and host-country pair fixed effects. Foreign subsidiary (firm) fixed effects are included to account for any unobserved firm heterogeneity.

Therefore, the regression equation is as follows:

$$ESG\ score_{i,t} = a + \beta_1 * (Interstate\ conflict_{i,t-1}) + \beta_2 * (Interstate\ conflict_{i,t-1})^2 + \delta' X_{i,t} + \varepsilon_{i,t}$$

, where  $ESG\ score_{i,t}$  denotes the ESG score of a subsidiary of a foreign MNE  $i$  in year  $t$ ,  $Interstate\ conflict_{i,t-1}$  is the annual average of the Goldstein scale between the host and home country for firm  $i$  in year  $t-1$ ,  $(Interstate\ conflict_{i,t-1})^2$  is the quadratic term of the annual average of the Goldstein scale, and  $X_{i,t}$  is the vector for all control variables.

## RESULTS

Table 2 presents the descriptive statistics and pairwise correlations of the variables included in our main estimation model. Table 3 shows the main firm fixed-effects panel regression results of the ESG score as our main dependent variable, while Table 4 provides the regression results to rule out major alternative explanations. We provide additional robustness checks in Tables A2 and A3 in the Appendix. The mean variance inflation factor (VIF) is 1.30, with no individual VIF exceeding 2.04, which is an acceptable level of multicollinearity.

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Please insert Tables 2–3 and Figures 4–5 about here  
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The main regression results are shown in Table 3, wherein model 1 only includes control variables. Models 2 and 3 include two of our main explanatory variables, interstate conflict and its squared term, separately, while model 4 is our main specification with two explanatory variables together. In Hypothesis 1, we argue that interstate conflict will lead the subsidiaries of foreign MNEs to engage more in ESG activities, and the coefficient of interstate conflict in

model 4 supports our hypothesis. We also claim in Hypothesis 2 that even if there is a linear relationship between interstate conflict, the inverse curvilinear effect will also be observed. The coefficients of the quadratic term of interstate conflict in model 4 are negative and statistically significant at  $p\text{-value} < 0.01$ , which also strongly supports our argument. Additionally, we conducted Grubbs's (1969) test, the maximum normalized residual test, to detect outliers in our sample. The test iterates the search for outliers until there are no outliers in the sample. We search for potential outliers by iterating 16,000 times and find that there is one possible outlier ( $t = 5.50, \hat{Y} = 25.871$ ) in our sample. Thus, we run a regression after excluding this outlier, but the results remain unchanged and are consistent with our argument.

We further illustrate the effect of interstate conflict on the subsidiaries of foreign MNEs' ESG activities. Figure 4 shows that as the interstate conflicts between the home country of a foreign MNE's subsidiary and the host country increase, the subsidiaries of foreign MNEs endeavor to achieve higher ESG scores. However, Figure 5 also shows that foreign subsidiaries from either the highest or lowest conflict-prone home countries do not attempt to increase their ESG scores as much as other foreign MNE subsidiaries in between, as hypothesized.

### **Robustness Checks**

*Ruling-out alternative explanations (Table 4).* In Table 4, we provide additional regression results to rule out major alternative explanations. In model 1, we control for additional characteristics of the ultimate parent of a foreign subsidiary. Although we control for several ultimate parent characteristics in the main specification, we further control for the ultimate parent's organizational capability to rule out the possibility that these organizational characteristics can influence the subsidiary's ESG score (Rodrigues & Krishnamurthy, 2021). We control for the same organizational variables as those at the subsidiary level: total assets, D/E

ratio, ROA, debt ratio, and PPNE. Regardless of the inclusion of these additional variables, the results remain unchanged and still support our hypotheses.

In models 2 and 3, we attempt to account for potential institutional pressures driven by the home and host countries. Firms' strategic behaviors can also be driven by institutional pressures from various sources to secure legitimacy, and CSR is not an exception (Martínez-Ferrero & García-Sánchez, 2017). Thus, under the assumption that a subsidiary of a foreign MNE is regulated by both home- and host-country institutions (Hillman & Wan, 2005), the overall ESG level in both countries might affect the ESG score of foreign MNEs to secure legitimacy in both home and host countries. Furthermore, this institutional pressure can also be manifested as the institutional distance between two countries because this distance would more or less complicate the adaptation of the subsidiaries of foreign MNEs to the host-country environment (Ghemawat, 2001; Kostova & Zaheer, 1999). Thus, we control for the average ESG score for all firms in the home and host countries in the entire Refinitiv Eikon database (model 2) and the signed distance of the average ESG score between home and host countries (model 3). Including these variables does not affect the results; our arguments are still strongly supported.

In models 4 and 5, we further control for home- and host-country characteristics. Host-country institutional environments are critical for firms to consider in formulating and implementing a strategy, which could also influence the legitimacy and effectiveness of their strategies (Ortas, Gallego-Álvarez, & Álvarez, 2019). Thus, in model 4, we control for host-country institutional characteristics—the degree of corruption, regulatory quality, rule of law, and political stability (Jeong & Weiner, 2012; Spencer & Gomez, 2011)—which we obtain from World Governance Indicators from the World Bank. In model 5, we also account for economic and political relations between home and host countries, including home- and host-country GDP and the natural logarithm of trade volume between the two countries. We also control for the



Polity IV distance to account for political institutional differences between home and host countries (Henisz, 2000). Regardless of the inclusion of these additional country-specific institutional, economic, and political variables, models 4 and 5 confirm that our results are still robust, thus strongly supporting our hypotheses.

***The effect of interstate conflicts (Table A2).*** Our study critically hinges upon the assumption that the interstate conflict is an exogenous factor driving ESG activities of foreign MNEs' subsidiaries. Although our explanatory variable, an interstate conflict, is lagged by one year and the relationship between the home and host countries is presumably exogenous, we further attempt to validate our theoretical and empirical approach by conducting an additional difference-in-differences (dif-in-difs) analysis.

Following prior studies using fixed-effects dif-in-difs (e.g., Jia, Huang, & Zhang, 2019; Shi, Hoskisson, & Zhang, 2017), we first create a *treatment* group variable, assigning 1 if the interstate relation between the home and host countries of foreign MNEs is either neutral or negative, in which the reversed Goldstein scale is greater than the value “-2” (admit wrongdoing/apologize) at Year<sub>*t-1*</sub>. All other firms from home countries with the reversed Goldstein scale lower than -2 are regarded as the nontreatment group; thus, we assign 0 to these companies. We consider -2 as the threshold in determining the treatment versus control group since the reversed Goldstein scale assigned to events with lower or equal to -2 connotes positive diplomatic events (Goldstein, 1992).

Then, we create a *post-shock* time variable. Since interstate conflicts occur simultaneously and arbitrarily across the world, we try to capture all observable interstate conflicts each year if interstate conflicts occurred between home- and host-country. To simulate this, we first create a dummy variable (*post-shock*) and assign 1 if the average annual score of the reversed Goldstein Scale at year *t-1* is greater than 0 (a turning point to hostile relations). If the

score is less than or equal to 0, we assign 0 as the home-host relationship has not entered a hostile stage. Finally, based upon these two newly created variables, we make an interaction term between treatment and post-shock variables (*treatment x post-shock*), which is the main interest of dif-in-difs model, and include the interaction term as a main explanatory variable in the analysis (please refer to Appendix S2, which also provides a detailed explanation of how each variable is coded with illustrating examples).

Each model in Table A2 corresponds to Table 3, model 4 (model 1) and Table 4, models 1 through 5 (models 2 through 6), respectively. The coefficients of the interaction term in Table A2 are positive and statistically significant. The results strongly support our claim that the interstate conflict between home and host countries is a critical factor driving subsidiaries of foreign MNEs to engage more in ESG activities. Furthermore, the negative and statistically significant coefficients of a quadratic term of the lagged interstate conflict (*interstate conflict squared<sub>t-1</sub>*) indicate that there is an inversed U-shape relationship between the interstate conflict and foreign MNEs' ESG. This also strongly supports Hypothesis 2 that foreign MNEs will choose not to enhance their ESG performance because they may not see ex-ante and ex-post benefits of ESG as the interstate relations between home and host countries are closer to both ends of the positive or negative relationship.

**Double clustering (Table A3).** We test the effect of interstate conflict, and by nature, this involves home and host countries; thus, the variation of our explanatory variable is at the home- and host-country level pair. Thus, we further test our specification by correcting standard errors for clustering at both the firm and home–host country pairwise levels (Bertrand, Duflo, & Mullainathan, 2004). The regression results in all the models in Table A3, which correspond to Table 3, model 1 and all models in Table 4 respectively remain unchanged, which strongly supports our arguments.

## DISCUSSION

*“Casualwear chain Uniqlo’s flagship store in Seoul...will close its doors at the end of next month...a focal point of the South Korean boycotts of Japanese products that began in summer 2019...The boycott movement has not fully died down... Relations between Japan and South Korea are now considered to be at one of its lowest points in history... There is little sign of a thaw in bilateral ties.”* (December-14, 2020, Nikkei Asia)

*“Uniqlo has closed more than 50 stores in Korea in the wake of “NO JAPAN” boycotts in 2019...Uniqlo has emphasized ESG (Environmental, Social, and Governance) as a means to overcome the boycott against it.”* (September-7, 2021, DNEWS)

We live in a globalized society where we see and use many foreign produced or imported products, watch foreign films, listen to foreign songs, and so on. Globalization in many parts of our life has made people believe that every part of the world is connected; thus, being foreign is no longer a significant factor driving discrimination. However, we can still easily experience numerous cases wherein being foreign still matters. Xenophobia against foreigners is still huge social problem in many societies, and these cascade down to foreign firms located and operating in a foreign country (Arikan & Shenkar, 2013; Friebel & Heinz, 2014).

In this study, based upon the original theoretical conceptualization of the liability of foreignness and many recent studies that foreignness is a still a critical factor foreign firms still have to overcome (Hymer, 1960/1976; Kim, 2019), we propose that interstate conflict can be one of the permanent sources of discrimination against foreign firms. We build upon theoretical claims and findings in CSR and foreign MNEs’ CSR (Crilly et al., 2016; Godfrey, 2005; Luo et al., 2018; Mithani, 2017) and argue that foreign MNEs attempt to improve their ESG performance because engaging in ESG activities will help them alleviate the interstate crisis-driven legitimacy crisis, thus overcoming the liability of foreignness. However, we further highlight that even if most foreign MNEs attempt to enhance their ESG performance to alleviate the negative legitimacy effect driven by interstate conflict, some will not see the ex-ante and ex-

post benefits of enhancing their ESG activities in a foreign country. Thus, such firms will not attempt to improve their ESG performance.

The findings of this study support our theoretical claim about the effects of the interstate conflict on foreign MNEs' ESG performance; however, the research's empirical context and operationalization still have limitations. In particular, we examine the ESG performance of publicly traded subsidiaries of foreign MNEs in a foreign market. Although likely, most foreign companies targeted by either administrative actions or consumer boycotts are larger firms (King, 2008; McDonnell, King, & Soule, 2015), there are still many small and medium-sized foreign companies operating and located in foreign host countries. Furthermore, enhancing ESG performances might not be a viable option for these rather smaller foreign companies. However, this suggests an interesting future research agenda. Even if ESG might not be a strategic option for some types of companies, our findings illustrate that interstate conflicts can penalize foreign firms in a foreign host country. Future research might need to further delve into whether these rather smaller foreign subsidiaries show similar behavior to larger multinational companies, or maybe they engage in different strategic activities, such as cooperation with activists (Odziemkowska, 2021), to better deal with interstate conflicts.

Nevertheless, our study makes several theoretical contributions. First, our study contributes to the international business literature. Although many scholars have emphasized the importance of interstate conflict, research on interstate relations is scarce (Aguilera et al., 2019; Lubinski & Wadhvani, 2020; Shi et al., 2016). Even studies examining interstate conflict have not paid considerable attention to the strategic initiatives of these foreign subsidiaries but have focused on cross-border investment (e.g., Arikan et al., 2020; Wang et al., 2021), which overlooks the strategies of subsidiaries of foreign MNEs that are already located and operating in a foreign host country (Edman, 2016). By examining and showing that the interstate conflicts can

cause a critical legitimacy concern for the subsidiaries of foreign MNEs, which compels them to engage more in ESG activities to lessen the negative legitimacy effect of the interstate conflict on their everyday operation and performance in a host country, our study sheds light on the underexplored mechanism between the interstate conflict and foreign subsidiary strategy.

Furthermore, despite its culminating role in international business, the liability of foreignness has been criticized by scholars, particularly because of its relevance to the current globalized business environments and its transient effect (Denk et al., 2012; Lu et al., 2021; Luo & Mezas, 2002). However, the assumption of these critiques critically hinges upon the fact that foreign MNEs are considered the same as domestic firms in every aspect, which is not true in many cases. By proposing and showing that interstate conflict can be a fundamental source of discrimination against foreign firms even in the current era, our study contributes to the liability of foreignness literature, which still needs more rigorous scholarly attention (Lu et al., 2021).

Future research might need to further delve into different country characteristics that can affect the perception of the home country differently (Linville et al., 1986; Sofka & Zimmermann, 2008). Although we have identified one potential factor that can stigmatize foreign MNEs, country characteristics are multidimensional; thus, there may be other factors that can affect the legitimacy of foreign MNEs differently. For example, although two countries have conflicts, the legitimacy crisis might be less if they share the same political ideology or social norms such as democratic principles (Gartzke & Gleditsch, 2004). In other words, the effect of different country characteristics might interact with each other, which can create different perceptions and, thus, the legitimacy of foreign MNEs' home countries. Future studies that examine this multidimensional effect of country characteristics and legitimization/stigmatization and how foreign MNEs deal with this will help deepen our understanding of foreign firm operations.

Finally, our study also contributes to the CSR and ESG studies. One motivation for firms' engagement in CSR is to mitigate the risks that could negatively affect firms' legitimacy (Godfrey, 2005; Jia et al., 2020; Luo et al., 2018); foreign MNEs' CSR is not considerably different (Crilly et al., 2016; Mithani, 2017). However, although the degree of benefits firms can enjoy might be heterogeneous across companies, the fundamental assumption of these studies is that engaging in CSR will help firms alleviate legitimacy concerns considerably. We show that firms that are less likely to enjoy these insurance-like benefits either because they do not expect more negative events ex-ante or because they believe that ESG cannot easily fix the problems ex-post do not attempt to enhance ESG performance. Thus, our study provides a boundary condition in which firms strategically venture into ESG activities.

This study also has practical implications for corporate managers. Companies formulate and implement strategies to maximize their intended effects and ESG is not an exception. Even if ESG, in general, can help firms overcome potential legitimacy crises by alleviating negative perceptions or reactions from relevant stakeholders (Luo et al., 2018), our study suggests that this positive effect of CSR might not be applicable to some types of firms—stigmatized firms in our study context. This implies that corporate managers may want to assess their legitimacy and consider this when they decide to engage in counterbalancing strategies. Otherwise, their efforts will not produce their anticipated outcomes.

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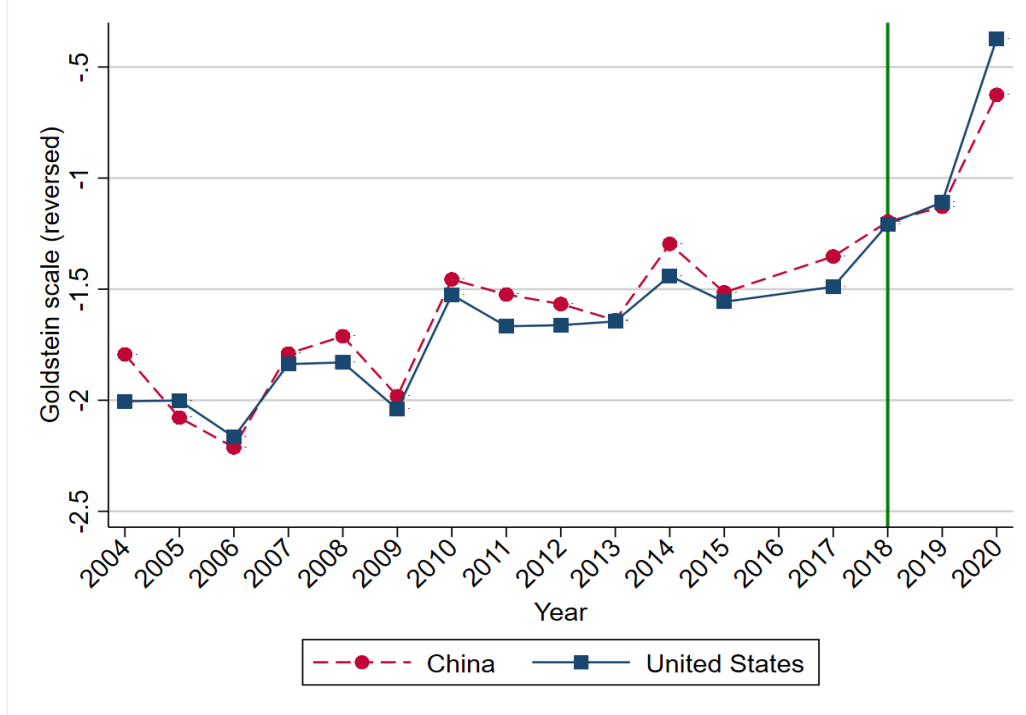
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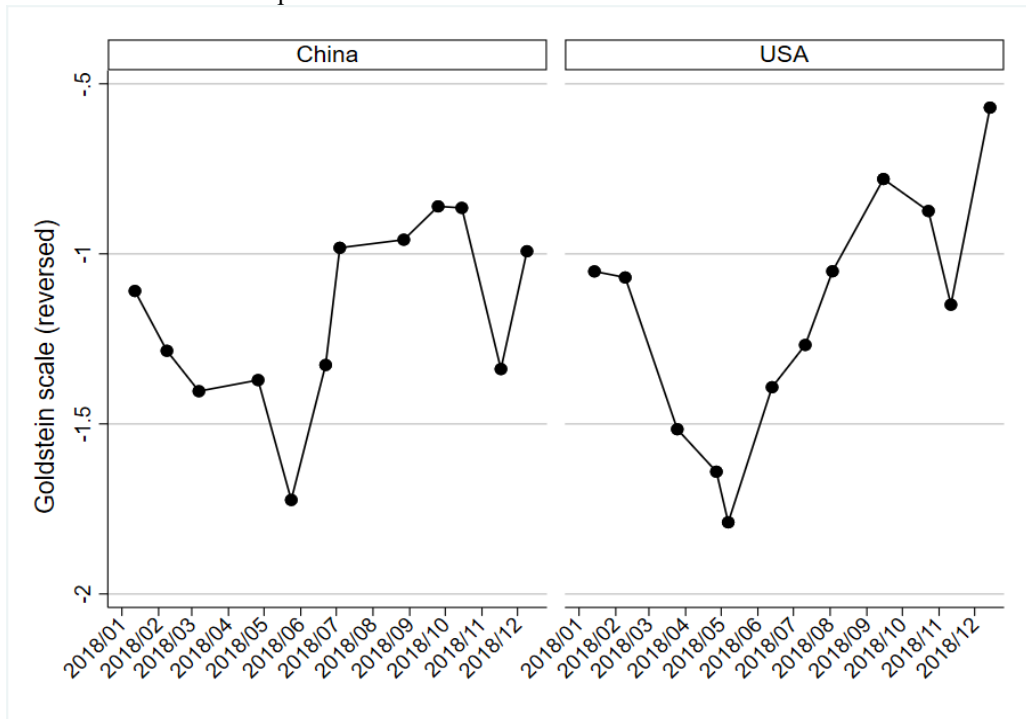
**Figure 1a: Annual Average Change in the Goldstein Scale between the United States and China**

The figure below illustrates the annual average change in the Goldstein scale between the United States and China.



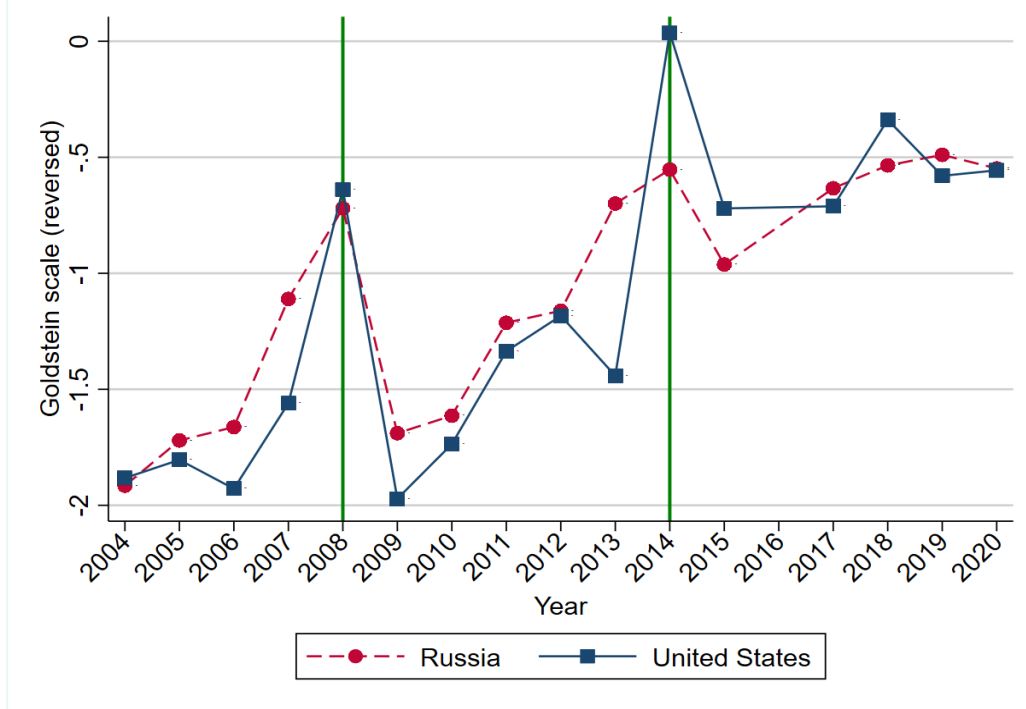
**Figure 1b: Monthly Average Change in the Goldstein Scale between the United States and China in 2018**

The figure below illustrates the monthly average change in the Goldstein scale between the United States and China around the 2018 trade dispute between the two countries.



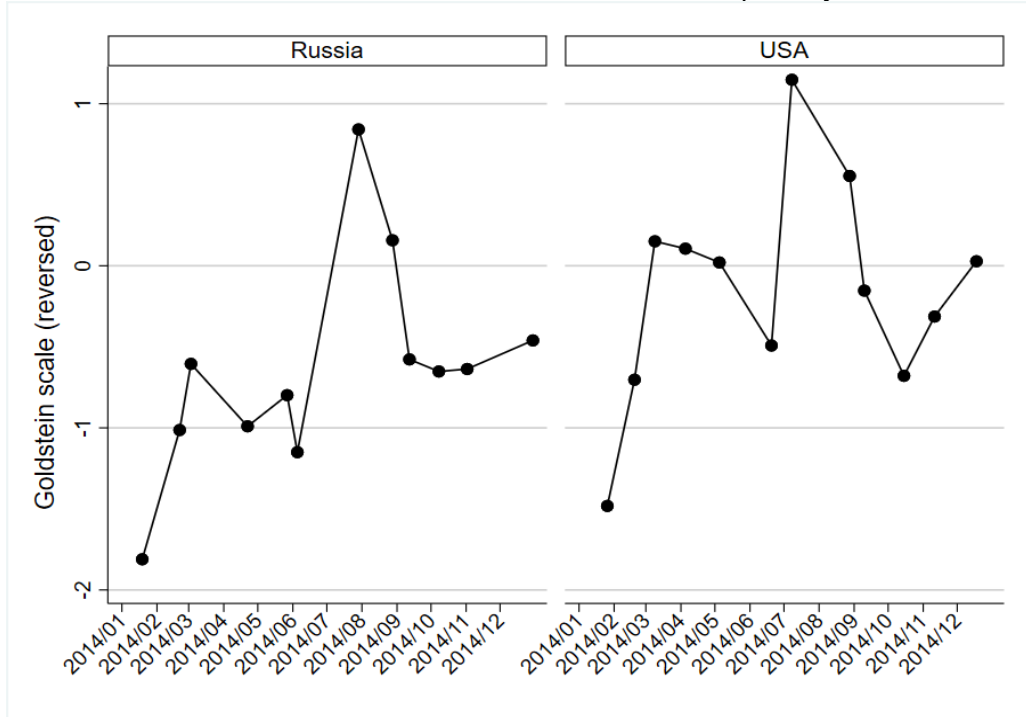
**Figure 2a: Annual Average Change in the Goldstein Scale between the United States and Russia**

The figure below illustrates the annual average change in the Goldstein scale between the United States and Russia.



**Figure 2b: Monthly Average Change in the Goldstein Scale between the United States and Russia in 2014**

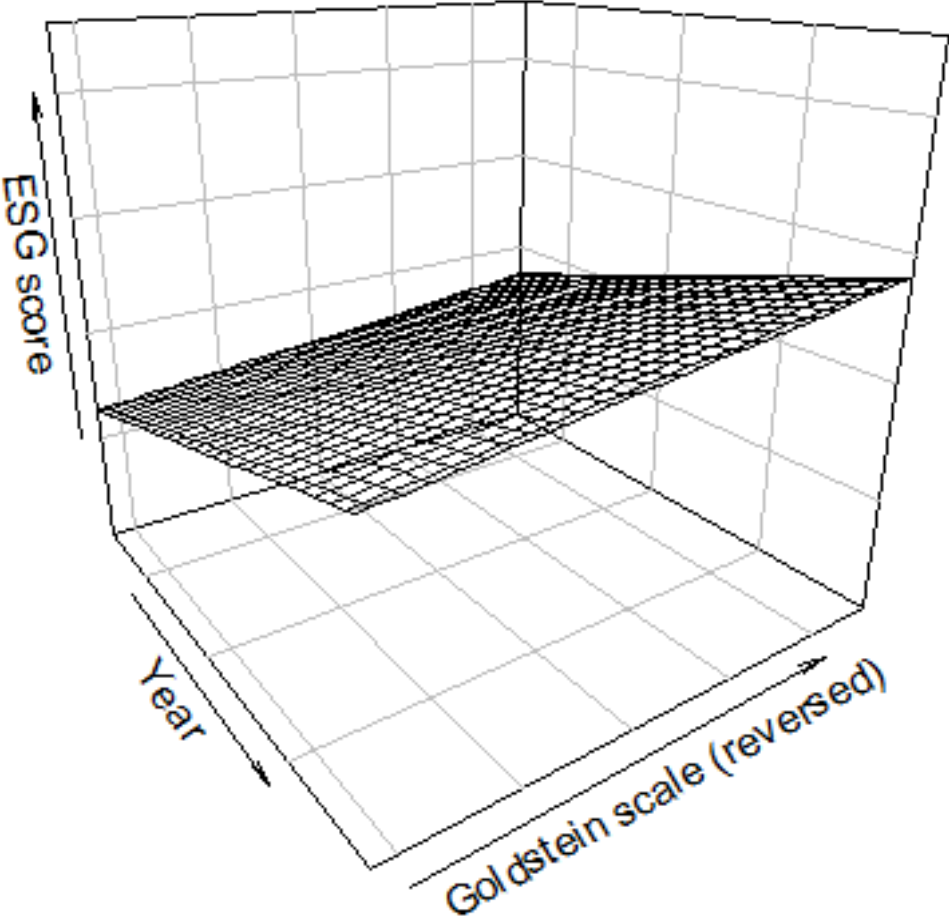
The figure below illustrates the monthly average change in the Goldstein scale between the United States and Russia due to Russian involvement in Ukraine and an economic sanction imposed by the United States consequently.





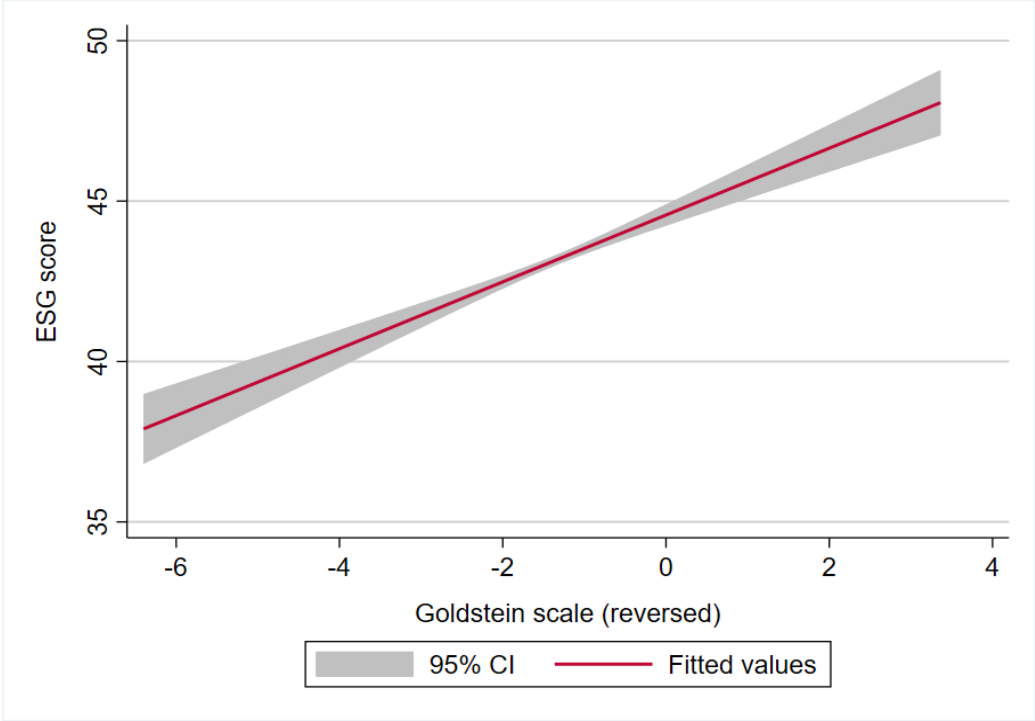
**Figure 3: 3D Scatter Plot (X-axis: Goldstein Scale; Y-axis: ESG Score; and Z-axis: Year)**

The figure below illustrates the relationship between the annual average Goldstein scale (reversed) and ESG score throughout our sample period.



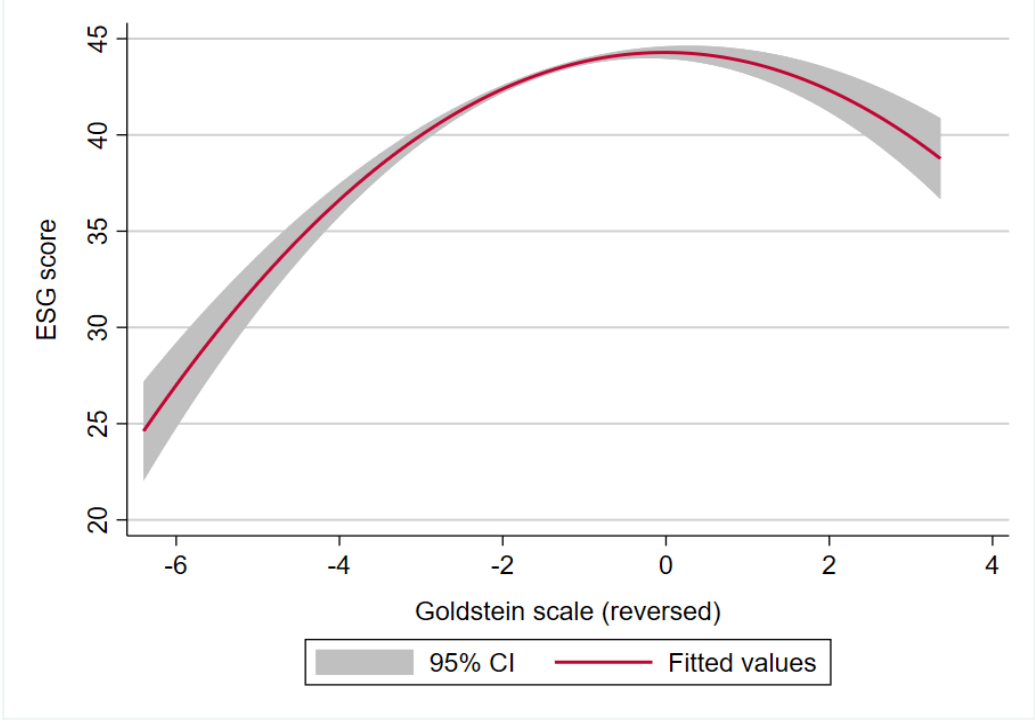
**Figure 4: Linear prediction between the Goldstein scale and ESG score (Hypothesis 1)**

The figure below illustrates the linear prediction, corresponding to Hypothesis 1, suggesting that the subsidiaries of foreign MNEs in a host country will attempt to achieve higher ESG scores as interstate conflicts between home and host countries increase.



**Figure 5: Quadratic prediction between the Goldstein scale and ESG score (Hypothesis 2)**

The figure below illustrates the quadratic prediction, corresponding to Hypothesis 2, suggesting that there is an inverted U-shape (curvilinear) relationship between the interstate conflicts and ESG score.



**Table 1: Summary Statistics for the Countries in the Sample**

This table presents summary statistics for selected variables showing host-country characteristics in the sample; host-country GDP (in billions), host-country GDP per capita (in thousands), and number of firms and average ESG score of all firms in the host country, and number of firms and average ESG score of subsidiaries of foreign MNEs in the host country.

Country	Host-country GDP	Host-country GDP per capita	All firms in the host country		Subsidiaries of foreign MNEs in the host country	
			Number	ESG	Number	ESG
Argentina	420.15	10.09	165	33.48	2	46.24
Austria	378.22	44.66	298	44.52	15	61.16
Australia	1,085.62	47.86	4,077	35.18	118	36.06
Belgium	460.68	42.01	474	41.70	11	67.31
Brazil	1,627.23	8.19	989	48.29	25	35.80
Canada	1,473.55	42.71	4,031	35.38	70	29.18
Chile	204.11	11.67	1,264	44.66	39	55.97
China	7,056.60	5.18	1,932	31.58	2	42.91
Czech Rep	187.50	17.92	41	43.41	12	45.56
Egypt	204.55	2.41	105	25.42	18	21.34
Finland	239.21	44.45	478	52.12	9	52.62
France	2,507.27	38.51	1,631	56.06	21	64.11
Germany	3,360.57	40.96	1,545	50.46	56	46.16
Hungary	127.08	12.78	47	55.80	11	77.97
India	1,635.84	1.30	1,038	47.45	65	58.61
Indonesia	665.65	2.70	367	44.36	14	31.49
Israel	16.99	52.74	205	39.32	28	46.97
Italy	241.91	30.50	853	49.92	36	40.43
Japan	4,858.80	38.15	6,421	40.26	24	40.19
Malaysia	134.95	8.00	540	42.59	10	73.58
Mexico	1,050.59	8.84	394	42.95	10	52.54
Oman	56.41	16.72	55	26.17	5	41.87
Peru	196.36	1.08	111	30.52	13	20.67
Poland	441.00	11.56	318	38.09	55	51.04
Portugal	216.91	20.76	189	52.54	11	27.97
Russia	1,361.33	9.49	413	38.48	12	15.22
South Africa	299.13	5.74	1,174	47.80	64	66.39
South Korea	1,167.57	23.36	1,274	44.24	8	31.19
Spain	1,295.59	28.37	823	56.04	54	56.24
Sweden	477.79	50.23	1,066	49.89	18	40.79
Taiwan	461.40	19.89	1,346	40.52	10	43.50
Thailand	318.57	4.72	397	49.68	2	53.41
U.K.	2,561.29	40.57	5,505	44.83	250	42.19
U.S.	15,792.93	50.74	21,602	36.97	335	35.96

**Table 2: Descriptive Statistics and Pairwise Correlations**

This table presents the descriptive statistics and pairwise correlations of variables in the main analysis at the firm level. \* denotes significance at the 5% level.

Variables	Mean	S.D.	1	2
1 ESG score	39.746	19.403	1	
2 Interstate conflict (1-year lagged)	-0.172	0.909	0.009	1
3 Interstate conflict squared (1-year lagged)	0.855	2.440	0.022	-0.120*
4 Total assets (logged)	21.946	1.596	0.333*	-0.035*
5 D/E ratio	0.870	9.133	0.001	0.011
6 ROA	0.034	0.257	0.077*	0.041*
7 Debt ratio	0.566	0.291	0.110*	-0.004
8 Property plant and equipment (logged)	19.968	2.202	0.333*	-0.007
9 Ultimate parent: Equity share	8.338	21.929	0.234*	0.060*
10 Ultimate parent: ESG score	59.677	20.853	0.344*	0.006
11 Ultimate parent: Global Fortune 500 company	0.254	0.435	0.157*	0.041*

	3	4	5	6	7	8	9	10	11
3	1								
4	0.041*	1							
5	-0.003	0.037*	1						
6	0.006	0.078*	-0.009	1					
7	0.034*	0.376*	0.046*	-0.061*	1				
8	0.067*	0.660*	0.029	0.091*	0.183*	1			
9	0.015	0.284*	-0.002	0.048*	0.118*	0.159*	1		
10	-0.039	0.124*	-0.015	0.028	-0.042	0.105*	0.322*	1	
11	-0.026	0.087*	-0.008	0.049*	0.001	0.050*	0.271*	0.429*	1

**Table 3: Firm Fixed-Effects Panel Regression of ESG Score**

This table presents the results of firm fixed-effects panel regression, in which the ESG score of foreign subsidiaries in a foreign host country is the dependent variable. Only control variables are included in model 1, while models 2 and 3 include interstate conflict and its squared term separately. Model 4 is our main specification, with two main explanatory variables. All models include year, industry, home- and host-country pairs, and firm fixed effects.

Standard errors are corrected for clustering at the firm level and are presented in parentheses. \*\*\*, \*\*, \*, and † denote significance at the 0.1%, 1%, 5%, and 10% level, respectively.

<b>DV: ESG score</b>	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>	<b>Model 4</b>
Interstate conflict (1-year lagged)		1.123* (0.498)		1.324** (0.473)
Interstate conflict squared (1-year lagged)			-0.327* (0.151)	-0.416** (0.139)
Total assets (logged)	0.634 (1.628)	0.564 (1.631)	0.576 (1.621)	0.477 (1.630)
D/E ratio	-0.100 (0.082)	-0.103 (0.081)	-0.096 (0.082)	-0.099 (0.081)
ROA	-2.710 (3.777)	-2.665 (3.751)	-2.867 (3.789)	-2.856 (3.768)
Debt ratio	-1.870 (1.844)	-2.087 (1.847)	-1.912 (1.835)	-2.178 (1.843)
Property plant and equipment (logged)	-1.360 (0.876)	-1.382 (0.885)	-1.261 (0.876)	-1.260 (0.891)
Ultimate parent: Equity share	-0.020 (0.037)	-0.018 (0.038)	-0.019 (0.036)	-0.017 (0.038)
Ultimate parent: ESG score	0.029 (0.058)	0.024 (0.058)	0.030 (0.058)	0.024 (0.058)
Ultimate parent: Global Fortune 500 company	-2.464 (1.512)	-2.529† (1.519)	-2.540† (1.522)	-2.638† (1.535)
Constant	57.170* (28.178)	59.671* (27.889)	56.647* (28.183)	59.453* (27.982)
Year fixed effects	Included	Included	Included	Included
Industry fixed effects	Included	Included	Included	Included
Home–host country pair fixed effects	Included	Included	Included	Included
Firm fixed effects	Included	Included	Included	Included
R-squared	0.803	0.804	0.803	0.805
Number of home–host country pairs	86	86	86	86
Number of firms	207	207	207	207
Number of observations	1,433	1,433	1,433	1,433

**Table 4: Firm Fixed Effects Panel Regression of ESG Score (To rule out alternative explanations)**

This table presents the results of fixed-effects panel regression in which the ESG score of foreign subsidiaries in a foreign host country is the dependent variable. In models 1 through 5, additional firm- and country-level variables are included to rule out alternative explanations; ultimate parent characteristics in model 1, home- and host-country average ESG score in model 2, signed ESG distance of home- and host-country in model 3, host-country institutional characteristics in model 4, and home- and host-country economic relations along with institutional characteristics in model 5. Standard errors are corrected for clustering at the firm level, and these are presented in parentheses. \*\*\*, \*\*, \*, and † denote significance at the 0.1%, 1%, 5%, and 10% level, respectively.

<b>DV: ESG score</b>	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>	<b>Model 4</b>	<b>Model 5</b>
Interstate conflict (1-year lagged)	1.309** (0.457)	1.319** (0.475)	1.324** (0.469)	1.264* (0.498)	1.003* (0.487)
Interstate conflict squared (1-year lagged)	-0.435** (0.138)	-0.410** (0.144)	-0.421** (0.142)	-0.396** (0.141)	-0.324* (0.159)
Total assets (logged)	0.767 (1.655)	0.526 (1.604)	0.517 (1.602)	0.236 (1.666)	0.435 (1.609)
D/E ratio	-0.100 (0.084)	-0.098 (0.079)	-0.099 (0.080)	-0.093 (0.078)	-0.047 (0.099)
ROA	-2.031 (3.738)	-2.895 (3.748)	-2.827 (3.761)	-2.735 (3.617)	-2.944 (3.632)
Debt ratio	-2.021 (1.841)	-2.149 (1.834)	-2.171 (1.836)	-2.231 (1.747)	-2.205 (1.705)
Property plant and equipment (logged)	-1.435 (0.907)	-1.248 (0.881)	-1.273 (0.886)	-1.158 (0.890)	-1.340 (0.861)
Ultimate parent: Equity share	-0.015 (0.038)	-0.018 (0.037)	-0.017 (0.038)	-0.017 (0.039)	-0.016 (0.039)
Ultimate parent: ESG score	0.024 (0.062)	0.024 (0.058)	0.025 (0.058)	0.020 (0.058)	0.021 (0.057)
Ultimate parent: Global Fortune 500 company	-2.300 (1.624)	-2.623† (1.567)	-2.612† (1.551)	-3.053* (1.496)	-2.478 (1.672)
Ultimate parent: Total assets (logged)	-2.034 (1.865)				
Ultimate parent: D/E ratio	-0.007 (0.012)				
Ultimate Parent: ROA	-10.333 (6.544)				

Ultimate parent: Debt ratio	-0.603 (6.981)				
Ultimate parent: Property plant and equipment (logged)	0.740 (1.407)				
Host ESG score average		0.081 (0.189)			
Home ESG score average		0.030 (0.255)			
Signed distance of ESG between home and host countries			0.036 (0.157)		
Control of corruption				3.065 (4.388)	3.979 (4.352)
Government effectiveness				-7.885 (5.538)	-9.459† (5.610)
Regulatory quality				-0.599 (4.314)	0.256 (4.393)
Rule of law				8.023 (7.664)	6.893 (7.701)
Political stability				-0.098 (2.855)	1.073 (3.000)
Host country GDP (logged)					-0.000 (0.000)
Home country GDP (logged)					2.433 (6.671)
Trade volume between home and host countries (logged)					3.195 (2.388)
Polity IV distance					0.115 (0.377)
Constant	90.126† (49.482)	53.405 (32.593)	58.894* (27.606)	60.337* (29.240)	-2.320 (55.276)

Year fixed effects	Included	Included	Included	Included	Included
Industry fixed effects	Included	Included	Included	Included	Included
Home–host country pair fixed effects	Included	Included	Included	Included	Included
Firm fixed effects	Included	Included	Included	Included	Included
R-squared	0.807	0.804	0.805	0.806	0.805
Number of home–host country pairs	86	86	86	86	83
Number of firms	205	207	207	207	199
Number of observations	1,407	1,433	1,433	1,433	1,358

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## APPENDIX

### Appendix S1: Detailed Explanation on Refinitiv Eikon ESG Score Construction Methodology

Regarding the construction of the ESG score, first, Refinitiv Eikon compiles data points related to over 400 relevant categories disclosed in many different sources, such as corporate annual reports, corporate sustainability reports, company websites, non-governmental organizations websites, and news. Based on the data collected, 178 comparable measures are selected and allocated according to 10 categories: resource use, emissions, innovation, workforce, human rights, community, product responsibility, management, shareholders, and CSR strategy. Each score of the 10 categories is measured using the following percentile rank formula:

$$\text{Percentile score} = \frac{N_{\text{worse}} + \frac{N_{\text{same}}}{2}}{N}$$

where N denotes the number of companies with a value,  $N_{\text{worse}}$  indicates the number of companies with a worse value, and  $N_{\text{same}}$  indicates the number of companies with the same value included in the same category. Additionally, the magnitude scale of each category score is calculated based on either the industry mean or transparency weights. For numeric data, the magnitude is calculated by measuring the portion of a particular sector contributing to the gross number. For binary data, the level of disclosure of each data point in an industry group is considered to be the magnitude. Using the magnitude scale, the category weight is measured with the value of the magnitude scale of a single category over the sum of magnitudes of all categories in each pillar. Finally, the 10 categories are aggregated based on their relevance to the three respective ESG pillars by multiplying each category score with the ratio of category weights to the total sum of category weights for each pillar. All outcomes are independently audited by outside parties and experts (Refinitiv, 2021).

## Appendix S2: Creating Treatment and Post-shock Time Variables in Difference-in-Differences Regression Analysis

The table below illustrates how we constructed and coded *treatment* and *post-shock* time variables for the difference-in-differences analysis in Table A2 in the Appendix. First, if the reversed Goldstein Scale at  $t-1$  between home- and host-country is greater than -2 (*interstate conflict<sub>t-1</sub>>-2*; *column A*), this observation is coded 1 and, thus, assigned to the treatment group; it is assigned 0 otherwise (*column B*). Second, if the reversed Goldstein Scale at  $t-1$  is greater than 0 (*interstate conflict<sub>t-1</sub>>0*), *post-shock* variable is coded 1 and 0 otherwise (*column C*).

For instance, for firm A in the table below, the lagged reversed Goldstein Scale is greater than -2 in 2007, 2008, and 2009 (*column A*). Thus, this observation is assigned 1 for the treatment group (*column B*). On the contrary, observation in 2006 is lower than -2 (*column A*), so 0 is assigned to firm A (*column B*). Furthermore, the lagged reversed Goldstein Scale (*interstate conflict<sub>t-1</sub>*) is greater than 0 in 2008 and 2009 for firm A; hence, a *post-shock* variable is coded 1 for these two years and 0 for 2006 and 2007 (*column C*).

Column		A	B	C
Firm	Year	Reversed Goldstein Scale at Year <sub>t-1</sub>	Treatment Status at Year <sub>t</sub> (if A>-2)	Post-Shock at Year <sub>t</sub> (if A>0)
A	2006	-2.5	0	0
A	2007	-1.7	1	0
A	2008	0.1	1	1
A	2009	2	1	1
B	2005	-5	0	0
B	2006	-4	0	0
B	2007	-3	0	0
B	2008	-4	0	0
C	2008	2.3	1	1
C	2009	3.2	1	1
C	2010	4.5	1	1
C	2011	5	1	1

**Table A1: Goldstein Scale for Each Event**

The table below shows the original and reversed Goldstein scale for each event coded between two focal countries as a proxy for interstate conflict.

Goldstein scale (original)	Goldstein scale (reversed)	Event
-10	10	Military attack; clash; assault
-9.2	9.2	Seize position or possessions
-8.7	8.7	Nonmilitary destruction/injury
-8.3	8.3	Noninjury destructive action, exercise, display; military build-up
-7.6	7.6	Armed force mobilization
-7	7	Break diplomatic relations
-7	7	Threat with force specified
-6.9	6.9	Ultimatum; threat with negative sanction and time limit
-5.8	5.8	Threat with a specific negative nonmilitary sanction
-5.6	5.6	Reduce or cut off aid or assistance; act to punish/deprive, walk out on
-5.2	5.2	Nonmilitary demonstration
-5	5	Order person or personnel out of country
-4.9	4.9	Expel organization or group, insist, demand compliance
-4.9	4.9	Issue order or command
-4.4	4.4	Threat without specific negative sanction stated
-4.4	4.4	Detain or arrest person(s)
-4.1	4.1	Reduce routine international activity; recall officials
-4	4	Refuse; oppose; refuse to allow, demand, threat
-4	4	Turn down proposal; reject protest
-3.8	3.8	Halt negotiation
-3.4	3.4	Denounce; denigrate; abuse
-3	3	Give warning
-2.4	2.4	Issue formal complaint or protest
-2.2	2.2	Charge; criticize; blame; disapprove
-2.2	2.2	Cancel or postpone planned event
-1.9	1.9	Make complaint (not formal)
-1.1	1.1	Grant asylum, action, role or position
-1.1	1.1	Deny an attributed policy
-0.9	0.9	Deny an accusation

-0.2	0.2	Comment on situation
-0.1	0.1	Urge or suggest action or policy
-0.1	0.1	Explicit decline to comment
-0.1	0.1	Request action; call for
0	0	Explain or state policy; state future position
0.1	-0.1	Ask for information, yield to order, submit to arrest
0.6	-0.6	Surrender
0.6	-0.6	Yield position; retreat; evacuate
1	-1	Meet with; send note
1.2	-1.2	Entreat; plead; appeal to; beg
1.5	-1.5	Offer proposal
1.8	-1.8	Express regret; apologize
1.9	-1.9	Visit; go to
1.9	-1.9	Release and/or return persons or property, retract statement
2	-2	Admit wrongdoing; apologize
2.5	-2.5	Give state invitation
2.8	-2.8	Assure; reassure
2.8	-2.8	Receive visit; host
2.9	-2.9	Suspend sanctions; end punishment; call truce, to meet or negotiate
3	-3	Agree to future action or procedure
3.4	-3.4	Ask for policy assistance
3.4	-3.4	Ask for material assistance, hail, applaud, extend condolences
3.4	-3.4	Praise
3.6	-3.6	Endorse other's policy or position; give verbal support
4.5	-4.5	Promise other future support
4.5	-4.5	Promise own policy support
5.2	-5.2	Promise material support
5.4	-5.4	Grant privilege; diplomatic recognition; de facto relations
6.5	-6.5	Give other assistance
6.5	-6.5	Make substantive agreement, buy, sell, loan, borrow
7.4	-7.4	Extend economic aid; give
8.3	-8.3	Extend military assistance

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**Table A2: Firm Fixed-Effects Difference-in-Differences Regression of ESG Score**

This table presents the results of the firm fixed-effects difference-in-differences regression, in which the ESG score of foreign subsidiaries in a foreign host country is the dependent variable. The treatment is assigned to firms operating in the host country having either a neutral or negative relationship with the home country, where the reversed Goldstein scale at  $t-1$  is greater than -2. The time effect (post-shock) is assigned 1 for year  $t$  when the reversed Goldstein scale at  $t-1$  is greater than 0, and 0 otherwise. Model 1 is the main model corresponding to Table 3, model 4 and each model from models 2 through model 6 corresponds to models 1 through 5 in Table 4. Standard errors are corrected for clustering at the firm level and are presented in parentheses. \*\*\*, \*\*, \*, and † denote significance at the 0.1%, 1%, 5%, and 10% level, respectively.

<b>DV: ESG score</b>	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>	<b>Model 4</b>	<b>Model 5</b>	<b>Model 6</b>
<i>Dif-in-difs interaction: Treatment x Post-shock</i>	4.043* (1.670)	4.085* (1.662)	4.085* (1.729)	4.136* (1.676)	3.919* (1.723)	2.941† (1.771)
Interstate conflict squared (1-year lagged)	-0.540*** (0.120)	-0.562*** (0.129)	-0.537*** (0.130)	-0.550*** (0.124)	-0.518*** (0.121)	-0.410** (0.139)
Total assets (logged)	0.525 (1.615)	0.812 (1.641)	0.585 (1.590)	0.576 (1.589)	0.303 (1.658)	0.490 (1.601)
D/E ratio	-0.095 (0.082)	-0.096 (0.085)	-0.093 (0.081)	-0.094 (0.081)	-0.089 (0.079)	-0.041 (0.099)
ROA	-2.737 (3.767)	-1.924 (3.741)	-2.762 (3.748)	-2.696 (3.759)	-2.651 (3.606)	-2.813 (3.621)
Debt ratio	-1.913 (1.831)	-1.764 (1.831)	-1.883 (1.821)	-1.904 (1.824)	-2.007 (1.737)	-2.011 (1.694)
Property plant and equipment (logged)	-1.237 (0.876)	-1.415 (0.892)	-1.229 (0.865)	-1.253 (0.869)	-1.144 (0.879)	-1.330 (0.850)
Ultimate parent: Equity share	-0.020 (0.037)	-0.018 (0.037)	-0.020 (0.037)	-0.020 (0.037)	-0.019 (0.038)	-0.019 (0.038)
Ultimate parent: ESG score	0.028 (0.058)	0.028 (0.061)	0.028 (0.058)	0.029 (0.058)	0.024 (0.058)	0.025 (0.057)
Ultimate parent: Global Fortune 500 company	-2.541† (1.526)	-2.221 (1.615)	-2.518 (1.561)	-2.508 (1.547)	-2.990* (1.490)	-2.398 (1.674)
Ultimate parent: Total assets (logged)		-1.967 (1.881)				
Ultimate parent: D/E ratio		-0.006 (0.013)				
Ultimate parent: ROA		-10.026 (6.467)				

Ultimate parent: Debt ratio		-0.473 (7.092)				
Ultimate parent: Property plant and equipment (logged)		0.814 (1.419)				
Host ESG score average			0.090 (0.188)			
Home ESG score average			0.016 (0.260)			
Signed distance of ESG between home and host countries				0.048 (0.159)		
Control of corruption					3.658 (4.329)	4.427 (4.313)
Government effectiveness					-7.774 (5.563)	-9.323† (5.636)
Regulatory quality					-1.117 (4.301)	-0.182 (4.400)
Rule of law					8.144 (7.686)	7.052 (7.697)
Political stability					-0.236 (2.870)	0.976 (3.001)
Host country GDP (logged)						-0.000 (0.000)
Home country GDP (logged)						2.824 (6.700)
Trade volume between home and host countries (logged)						3.328 (2.395)
Polity IV distance						0.086 (0.377)
Constant	57.404* (28.130)	84.905† (49.834)	51.443 (32.525)	56.691* (27.798)	57.840* (29.188)	-7.941 (55.835)

Year fixed effects	Included	Included	Included	Included	Included	Included
Industry fixed effects	Included	Included	Included	Included	Included	Included
Home-host country pair fixed effects	Included	Included	Included	Included	Included	Included
Firm fixed effects	Included	Included	Included	Included	Included	Included
R-squared	0.851	0.854	0.851	0.851	0.852	0.853
Number of home-host country pairs	86	86	86	86	86	83
Number of firms	207	205	207	207	207	199
Number of observations	1,433	1,407	1,433	1,433	1,433	1,358

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**Table A3: Firm Fixed-Effects Panel Regression of ESG Score (Double Clustering both at the Firm and the Home–Host Pair)**

This table presents the results of fixed-effects panel regression in which ESG score of foreign subsidiaries in a foreign host country is the dependent variable. Model 1 is the main model of our regression analysis (Table 3, model 4) while models 2 through 6 correspond to models 1 through 5 in Table 4, respectively. Standard errors are corrected for clustering at both the firm- and home–host country pair levels, and these are presented in parentheses. \*\*, \*, and † denote significance at the 0.1%, 1%, 5%, and 10% level, respectively.

<b>DV: ESG score</b>	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>	<b>Model 4</b>	<b>Model 5</b>	<b>Model 6</b>
Interstate conflict (1-year lagged)	1.324** (0.429)	1.309** (0.411)	1.319** (0.433)	1.324** (0.426)	1.264** (0.452)	1.003* (0.422)
Interstate conflict squared (1-year lagged)	-0.416** (0.154)	-0.435** (0.151)	-0.410* (0.158)	-0.421** (0.159)	-0.396* (0.156)	-0.324† (0.166)
Total assets (logged)	0.477 (1.370)	0.767 (1.404)	0.526 (1.351)	0.517 (1.339)	0.236 (1.391)	0.435 (1.279)
D/E ratio	-0.099 (0.062)	-0.100 (0.066)	-0.098 (0.061)	-0.099 (0.062)	-0.093 (0.059)	-0.047 (0.063)
ROA	-2.856 (3.105)	-2.031 (3.207)	-2.895 (3.051)	-2.827 (3.088)	-2.735 (2.899)	-2.944 (2.665)
Debt ratio	-2.178 (1.727)	-2.021 (1.740)	-2.149 (1.730)	-2.171 (1.725)	-2.231 (1.590)	-2.205 (1.470)
Property plant and equipment (logged)	-1.260 (0.784)	-1.435† (0.748)	-1.248 (0.774)	-1.273 (0.782)	-1.158 (0.789)	-1.340† (0.712)
Ultimate parent: Equity share	-0.017 (0.034)	-0.015 (0.035)	-0.018 (0.034)	-0.017 (0.034)	-0.017 (0.034)	-0.016 (0.034)
Ultimate parent: ESG score	0.024 (0.060)	0.024 (0.064)	0.024 (0.060)	0.025 (0.059)	0.020 (0.059)	0.021 (0.059)
Ultimate parent: Global Fortune 500 company	-2.638 (1.623)	-2.300 (1.695)	-2.623 (1.646)	-2.612 (1.625)	-3.053† (1.554)	-2.478 (1.650)
Ultimate parent: Total assets (logged)		-2.034 (2.186)				
Ultimate parent: D/E ratio		-0.007 (0.009)				
Ultimate parent: ROA		-10.333 (7.227)				
Ultimate parent: Debt Ratio		-0.603 (7.963)				



Ultimate parent: Property plant and equipment (logged)		0.740					
Host ESG score average		(1.309)					
				0.081			
				(0.209)			
Home ESG score average				0.030			
				(0.269)			
Signed distance of ESG between home and host countries					0.036		
Control of corruption					(0.167)		
						3.065	3.979
						(4.827)	(4.790)
Government effectiveness						-7.885	-9.459†
						(4.896)	(5.007)
Regulatory quality						-0.599	0.256
						(4.541)	(4.769)
Rule of law						8.023	6.893
						(8.100)	(8.269)
Political stability						-0.098	1.073
						(3.271)	(3.445)
Host country GDP (logged)							-0.000
							(0.000)
Home country GDP (logged)							2.433
							(8.078)
Trade volume between home and host countries (logged)							3.195
							(2.828)
Polity IV distance							0.115
							(0.396)
Constant	59.453*	90.126†	53.405†	58.894**	60.337*	-2.320	
	(22.603)	(51.628)	(31.073)	(21.991)	(23.441)	(63.644)	
Year fixed effects	Included	Included	Included	Included	Included	Included	Included
Industry fixed effects	Included	Included	Included	Included	Included	Included	Included
Home-host country pair fixed effects	Included	Included	Included	Included	Included	Included	Included

Firm fixed effects	Included	Included	Included	Included	Included	Included
R-squared	0.805	0.806	0.804	0.804	0.805	0.805
Number of home-host country pairs	86	86	86	86	86	83
Number of firms	207	205	207	207	207	199
Number of observations	1,433	1,407	1,433	1,433	1,433	1,358

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