

Competing for government procurement contracts: The role of corporate social responsibility

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Research Summary: This study examines whether corporate social responsibility (CSR) improves firms' competitiveness in the market for government procurement contracts. To obtain exogenous variation in firms' social engagement, I exploit a quasi-natural experiment provided by the enactment of state-level constituency statutes, which allow directors to consider stakeholders' interests when making business decisions. Using constituency statutes as instrumental variable (IV) for CSR, I find that companies with higher CSR receive more procurement contracts. The effect is stronger for more complex contracts and in the early years of the government–company relationship, suggesting that CSR helps mitigate information asymmetries by signaling trustworthiness. Moreover, the effect is stronger in competitive industries, indicating that CSR can serve as a differentiation strategy to compete against other bidders.

Managerial Summary: This study examines how companies can strategically improve their competitiveness in the market for government procurement contracts—a market of economic importance (15–20% of GDP). It shows that companies with higher social and environmental performance (CSR) receive more procurement contracts. This effect is stronger for more complex contracts, in the early years of the government–company relationship, and in more competitive industries. These findings indicate that firms' CSR can serve as a signaling and differentiation strategy that influences the purchasing decision of government agencies. Accordingly, managers operating in the business-to-government (B2G) sector could benefit from integrating social and environmental considerations into their strategic decision making.

KEY WORDS

corporate social responsibility, government procurement contracts, information asymmetry, non-market strategy, trust

1 | INTRODUCTION

Government procurement is big business: Every year, large sums of taxpayers' money are spent by governments on goods and services that are of importance to the economy and society at large. Government procurement of goods and services accounts for approximately 15–20% of the gross domestic product (GDP) in developed and developing countries, in many countries this percentage is much higher (World Trade Organization, 2014). This constitutes significant business opportunities for companies, not only nationally but also internationally. For example, the members of the Agreement on Government Procurement (GPA)—which includes Canada, Hong Kong, Israel, Japan, Singapore, Switzerland, USA, the European Union, and many others—have opened procurement activities worth an estimated \$1.7 trillion annually to international competition from GPA member countries (World Trade Organization, 2014).

Despite the economic importance of this market, we know surprisingly little about firm-level strategies to obtain government procurement contracts. In fact, I was not able to find any articles within the management literature that theoretically or empirically explores the question of whether and how companies can improve their competitiveness in the market for government contracts. The extant literature in competitive strategy mainly focuses on the competitive positioning of companies in the business-to-consumer (B2C) and business-to-business (B2B) context (e.g., Dyer & Singh, 1998; Porter, 1980, 2008).

Yet, the market for government procurement contracts is fundamentally different from the B2C and B2B context in several dimensions. In particular, the purchasing decision of the government differs from the one of end consumers and businesses. Specifically, the process of awarding procurement contracts starts when an agency of the federal government identifies a need for the purchase of a good or service and posts a solicitation on the Federal Business Opportunities website. Public procurement projects include a broad range of projects such as the building of airports, schools, stadiums, and tunnels, the construction of military equipment, as well as investments in medical and technical innovations. Companies then submit their proposals. Agency personnel review and evaluate the alternative proposals and make the final decision. Where the government procurement process differs from the B2B and B2C context is that public procurement regulations put constraints on the contracts and award mechanisms that public procurement agencies can use (Tadelis, 2012). In particular, government purchases rely on agency directors. These directors often take into account economic as well as non-economic factors such as political pressure from special interest groups, sensitivity to congressional representatives in a firm's home district, and other political aspects (e.g., Rundquist, Lee, & Rhee, 1996; Shepsle & Weingast, 1981; Weingast, Shepsle, & Johnsen, 1981). The consideration of such non-economic criteria in the purchasing decision makes selling goods and services to the government a unique and different proposition for companies.

Most procurement contracts are variants of "cost-plus" and "fixed-price" contracts. In fixed-price contracts, the supplier is offered a pre-specified price. In cost-plus contracts, no price is pre-specified, but the supplier is reimbursed for the costs plus a fee. In general, cost-plus is the preferred type

for complex projects (Bajari & Tadelis, 2001). In contrast to goods and services provided to consumers and businesses, public procurement projects are typically of high complexity, large scale, and often span multiple years, requiring numerous rounds of project adaptations and contract renegotiations due to unforeseen changes after the contract is awarded and the project has started (Bajari, Houghton, & Tadelis, 2014). Reasons for project adaptations include design failures, unanticipated site and environmental conditions, unforeseen changes in regulatory requirements, etc.

While these changes are difficult to predict for both the government and contractor, the contractor is likely to have superior information about the costs and methods to implement changes (Bajari & Tadelis, 2001). As a result, procurement contracts entail a potentially severe agency problem—contractors have an incentive to exploit their informational advantage at the expense of the government (e.g., by overstating the costs of the project adaptations). The resulting agency costs are borne by the government, and hence the taxpayers.¹

How can firms mitigate these challenges and to which extent can they influence the government's procurement decisions? Given the uniqueness of the government procurement process, the insights of the extant strategy literature do not provide sufficient guidance to answer these questions. In a first effort to fill this void, I theoretically and empirically examine how corporate strategy affects the allocation of government procurement contracts and, in particular, whether and to what extent companies' socially responsible behavior serves as a signaling and differentiation strategy to compete against other bidders.

2 | THEORY AND HYPOTHESES

2.1 | Corporate social responsibility as a signaling tool

A long-standing literature in economics, strategic management, and organization theory examines the role of trust—and conversely opportunistic behavior—in business relationships, and in particular how trust can mitigate issues of information asymmetries.²

At the core of organization economics is the concept of transaction costs, i.e., costs associated with conducting exchange (Coase, 1937). Such transaction costs arise from the difficulty to specify all contingencies in a contract, an issue known as “incomplete contracting” (Williamson, 1985). Incomplete contracts—which are more prevalent for complex projects, such as procurement projects—are prone to strategic behavior (Williamson, 1971, 2005), leading to increased costs of negotiations and renegotiations (Bajari et al., 2014). Limiting these costs is essential for the efficiency and performance of the exchange relationship.

Scholars have long argued that trust helps mitigate issues of information asymmetry, thus lowering transaction costs (e.g., Arrow, 1974; Jones, 1995; Ring & Van de Ven, 1992; Williamson, 1973, 1991; Zaheer et al., 1998). In particular, organizational trust reduces information asymmetries as information is more openly and honestly disclosed by the contracting parties (e.g., Dyer & Chu, 2003; Malmgren, 1961). Also, trust mitigates opportunistic behavior when unforeseen contingencies arise, resulting in decreased transaction costs of exchange (Bromiley & Cummings, 1995). Moreover, trust (and trustworthiness) among contracting parties can be beneficial and a source of

¹This challenge with procurement contracts has received much attention in the economics literature (e.g., Anton & Yao, 1987, 1992; Bajari & Tadelis, 2001; Baron & Besanko, 1987; Holt Jr, 1980; Laffont & Tirole, 1993). This literature focuses on the optimal contract and auction design.

²Interorganizational trust is commonly defined as an organization's expectation that another organization will not act opportunistically (Bradach & Eccles, 1989; Bromiley & Cummings, 1995; Gulati & Nickerson, 2008; Zaheer, McEvily, & Perrone, 1998).

competitive advantage (Barney & Hansen, 1994; Dyer & Chu, 2003; Hill, 1990; Jones, 1995; McEvily, Perrone, & Zaheer, 2003; Obloj & Zemsky, 2015; Zaheer et al., 1998).³ For instance, organizational trust plays an important role in mitigating issues of moral hazard (Holmstrom, 1979) and hold-up (Klein, Crawford, & Alchian, 1978), hereby improving the efficiency of the collaboration (Barney & Hansen, 1994; Hill, 1990). In sum, the above arguments suggest that trust plays an important role in mitigating information asymmetries in business relationships.

Similarly, in the specific context of government-supplier relationships, the government's trust in suppliers' non-opportunistic behavior is likely to be an important determinant of the purchasing decision. Arguably, the government's trust—and hence the firm's prospects of obtaining government contracts—is affected by a "bundle" of factors, e.g., a firm's pre-existing relationship with the government (that is, the firm's "reputation"), and other credible signals of the firm's trustworthiness.⁴

While closely related, trust and reputation are two different theoretical concepts. In this paper, "reputation" is defined in a game-theoretical sense (e.g., Cabral, 2005)—reputation emerges only when the agent (i.e., the supplier) has successfully completed transactions with the principal (i.e., the government) in the past. As such, reputation is solely based on the agent's track record in fulfilling government contracts.⁵ In contrast, "trust" is the expectation that the contracting partner (i.e., the supplier) will not act opportunistically. This expectation is formed based on the agent's track record (i.e., the agent's "reputation") and other signals of trustworthiness.

Having an existing long-term relationship with the government is likely to be an important factor in the bundle of trust.⁶ Trust develops over time. Having a track record of past successful transactions allows suppliers to establish a reputation for being non-opportunistic contracting partners. As the principle draws inferences about the agent's future contracting behavior based on past behavior, suppliers with a track record of non-opportunistic behavior are expected to behave the same way in the future. Since a firm's reputation entails significant investment, takes time to evolve, and represents a valuable intangible asset (Barney, 1991; Dasgupta, 2000; Hall, 1992), contracting partners are reluctant to jeopardize their reputation by acting opportunistically (Williamson, 1993). Hence, having contracted with the government in the past provides a direct signal of the supplier's trustworthiness and likely affects the government's trust in the supplier.

Besides a supplier's pre-existing contracting relationship with the government, other factors will likely contribute to earning the government's trust. For example, a supplier's reputation as a trustworthy contracting partner among *other* constituencies—such as buyers in the B2B market—may be another contributing factor in the bundle of trust. Its signal is only indirect, though, as the supplier does not establish a contracting history directly with the government.

In addition to its buyers, a firm has several other constituencies (e.g., employees, local communities, society-at-large, the natural environment) with whom it has relationships. For example, the firm may support local communities, donate to charities, engage with advocacy groups, or develop nonpolluting products to benefit the natural environment. It may provide equal opportunity

³While trust characterizes the relationship between contracting partners, trustworthiness is an attribute of the individual contracting partners, i.e., a contracting partner is trustworthy when she is worthy of the trust of others (see, e.g., Barney & Hansen, 1994).

⁴This is analogous to the governance literature that examines different bundles of corporate governance mechanisms (see, e.g., Aguilera, Desender, & Kabbach de Castro, 2012; García-Castro, Aguilera, & Ariño, 2013; Ward, Brown, & Rodriguez, 2009). According to this stream of research, effective firm governance might not need every practice in place as certain governance mechanisms may serve as substitutes for others. Conversely, certain governance mechanisms may complement each other.

⁵In this vein, the essence of reputation is Bayesian updating based on the agent's past interactions with the principal.

⁶Several studies in the B2B context are supportive of this argument. Specifically, they argue that suppliers may build trust through reputation (Banerjee & Duflo, 2000; Doney & Cannon, 1997; Ring & Van de Ven, 1992).

employment, advancement opportunities, and a healthy work-life-balance to its employees, place women and minority members on boards, stand up for human rights, or engage in other socially responsible practices that address the needs and demands of its stakeholders.⁷ While the way and degree to which a firm engages with its various constituencies can differ, being known as a socially responsible firm allows firms to position themselves as “good citizens” and non-opportunistic business partners. In this vein, socially responsible companies are less likely to engage in opportunistic behavior such as corporate fraud (Harjoto, 2017), earnings management (Chih, Shen, & Kang, 2008; Hong & Andersen, 2011), and corruption (Luo, 2006). Moreover, due to the long-term nature of stakeholder engagement—e.g., the adoption of environmentally sustainable practices, the provision of training and career development opportunities, etc.—socially responsible companies tend to be more committed to the long run (Eccles, Ioannou, & Serafeim, 2014; Flammer & Bansal, 2017), suggesting that they are less likely to act opportunistically in the short run.

Taken together, these arguments suggest that the extent to which a firm shows responsibility and concern for its stakeholders is indicative of the firm’s non-opportunistic behavior and long-term orientation. As such, CSR may serve as a signal of trustworthiness, and hence as a contributing factor in the bundle of trust. Accordingly, I posit that—all else being equal—companies with higher CSR are more likely to obtain government procurement contracts. This motivates the following hypothesis.

Hypothesis 1 (H1) *Companies with higher CSR are more likely to obtain government procurement contracts.*

2.2 | Trust signaling capabilities over time

As discussed above, my main argument is that a firm’s CSR is one factor in the bundle of trust that positively influences the award of government procurement contracts. In the following, I explore whether and how the signaling capabilities of CSR change over time as the supplier establishes a long-term relationship with the government.

Companies that have been awarded government contracts in the past can establish a track record with the government. In particular, long-term suppliers with a history of non-opportunistic behavior are expected to behave the same way in the future. Accordingly, suppliers that have been awarded contracts in the past and fulfilled them successfully can earn the government’s trust, and likely have an advantage in future auctions over new suppliers.

While a long-term relationship allows the contracting partners to develop trust, establishing such long-term relationship necessitates time to develop. Hence, it is evident that only over time can a supplier establish a track record as a non-opportunistic supplier to the government. In contrast, at the beginning of the government–supplier relationship, new sellers—by definition—lack a contracting history with the government. In other words, time has not allowed for trust to develop through a long-term relationship. Accordingly, CSR as a signal of trustworthiness is likely more important for new suppliers compared to suppliers that have a long history with the government.⁸

In contrast to establishing a contracting history directly with the government, CSR and other factors in the bundle of trust only provide an indirect signal of a seller’s trustworthiness. Accordingly, I

⁷An activity is considered to be socially responsible if it goes beyond the firm’s maximization of its (single) bottom line and legal requirements and contributes to the social good (e.g., McWilliams & Siegel, 2001).

⁸This argument is in line with Elfenbein, Fisman, and McManus’ (2012) finding that, in the B2C context, the trust signal from charitable donations is particularly important for new sellers.

expect the government's decision to be less sensitive to CSR for long-term suppliers. In other words, a new supplier that engages in CSR is likely less able to compete against a long-term supplier that has a long history of non-opportunistic behavior (even one without CSR). As such, the trust signaling capabilities of a long-term partner's track record of non-opportunistic behavior likely dominate those of a new supplier's CSR.

Moreover, as suppliers build a long-term relationship with the government, they are likely to expand their network and strengthen existing ties with, e.g., government officials and congressional representatives. In turn, this might further diminish the sensitivity of the government's procurement decisions to CSR (or other signals of trustworthiness).

Taken together, the above arguments suggest that CSR is part of a bundle of factors that affect trust and, to some extent, can compensate for the lack of a track record at the beginning of the government-supplier relationship. That is, CSR benefits new suppliers the most, whereas it is less beneficial (if at all) for companies that have a long history with the government. This leads to the following hypothesis:

Hypothesis 2 (H2) *The positive relationship between CSR and the allocation of procurement contracts is stronger at the beginning of the government–supplier relationship.*

2.3 | Corporate social responsibility as differentiation strategy

The above arguments imply that CSR can serve as a signaling strategy. Accordingly, companies can use this signal to differentiate themselves from their competitors in bidding for government contracts.⁹

2.3.1 | Competition

This differentiation strategy is especially relevant in industries with multiple bidders, where firms need to differentiate themselves to increase the chances of being selected. Indeed, the need to differentiate (either through cost or quality) is higher in these industries in order to remain competitive and ensure firm survival. Moreover, competition may trigger companies to engage in unethical behavior, corrupt actions, and other forms of adverse behavior to keep the costs low (for a related argument, see Bennett, Pierce, Snyder, & Toffel, 2013). Accordingly, being able to credibly signal trustworthiness is especially valuable in more competitive industries. In addition, as CSR is more costly in competitive industries—since competitive pressures reduce profit margins and hence the budget that is available for CSR programs—it is likely to provide a more credible signal of trustworthiness.¹⁰

Accordingly, I expect that the trust signaling capabilities of CSR are stronger—and hence CSR as a differentiation strategy is especially valuable to firms—in competitive industries. This motivates the following hypothesis:

Hypothesis 3 (H3) *The positive relationship between CSR and the allocation of procurement contracts is stronger in competitive industries.*

⁹In this vein, it has been shown that CSR can help companies differentiate themselves from their foreign and local competitors (Fernandez-Kranz & Santalo, 2010; Flammer, 2015b) and from other employers (Flammer & Luo, 2017).

¹⁰In a seminal article, Spence (1973) shows that costly signals are more credible, as they are harder (i.e., costlier) to mimic.

2.4 | Types of government contracts

2.4.1 | Project complexity

The need to signal trustworthiness—and the benefits from doing so—is likely to vary across different types of projects. Procurement projects come in various degrees of complexity, ranging from simple projects (e.g., the provision of office supplies) to complex projects (e.g., the development of new technologies). Complex projects—i.e., projects that are larger, multi-year, and cost-plus—often require numerous rounds of project adaptations and contract renegotiations due to unforeseen changes after the contract is awarded and the project has started (Bajari et al., 2014). As such, complex projects are more prone to opportunistic behavior—as suppliers may take advantage of their informational advantage to act strategically (e.g., by overstating costs when adjusting the contract). Consistent with this argument, Karpoff, Lee, and Vendzyk (1999) highlight the non-trivial incidence of fraudulent behavior among complex government contracts.¹¹

The first type of complex projects are *multi-year* projects. Arguably, projects that span multiple years are prone to a classic hold-up problem—once the project has started, contractors have more bargaining power and can “hold up” the government by renegotiating the contract terms to their advantage. Accordingly, given the higher potential for opportunistic behavior, I expect the signaling value of CSR to be higher for multi-year contracts. This motivates the following hypothesis:

Hypothesis 4a (H4a) *The positive relationship between CSR and the allocation of procurement contracts is stronger for multi-year contracts.*

The second type of complex projects are *large-scale* projects. Due to their scale, it is harder to contract upon all potential contingencies and determine the costs *ex ante*. For this reason, large-scale contracts are more likely to entail adaptations and renegotiation, which suppliers may use to their advantage (Bajari & Tadelis, 2001; Tadelis, 2012). Since large-scale projects are more prone to opportunistic behavior, I expect the signaling value of CSR to be higher for these projects.

Hypothesis 4b (H4b) *The positive relationship between CSR and the allocation of procurement contracts is stronger for large-scale contracts.*

Finally, the third type of complex projects are *cost-plus* projects. In cost-plus contracts (as opposed to fixed-price contracts), no price is pre-specified, but the supplier is reimbursed for the costs of executing the contract plus a fee. As such, contractors may behave opportunistically by overstating the costs *ex post*, or exerting too little cost-reducing efforts during the completion of the contract (Baron & Besanko, 1987; Loeb & Surysekar, 1998). Accordingly, I expect the trust signaling capability of CSR to be of higher value for cost-plus contracts.

Hypothesis 4c (H4c) *The positive relationship between CSR and the allocation of procurement contracts is stronger for cost-plus contracts.*

2.4.2 | Defense contracts

The trust signaling capabilities of CSR may differ across government agencies. As previously highlighted, one key characteristic of the government procurement process is the role of agency

¹¹Supplier behavior that triggered fraud investigation includes “falsifying accounting documents, falsifying test results, charging personal expenses to government contracts, submission of invoices that include false claims, bribery, defective pricing of proposals submitted to the government to obtain additional government contracts, fraudulent accounting classifications, intentional mischarging or misallocation of costs, and product substitution” (Karpoff et al., 1999, pp. 811–812).

directors. These directors often take into account economic as well as other factors such as political pressure from special interest groups, sensitivity to congressional representatives in a firm's home district, etc. The consideration of such political and other non-economic factors sets the government procurement process apart from other markets. In fact, the government agency's purchasing decision—particularly related to defense spending—may be fully determined by distributive politics (e.g., Rundquist et al., 1996; Shepsle & Weingast, 1981; Weingast et al., 1981) or be influenced by political connections (e.g., Goldman, Rocholl, & So, 2013), political contributions (Tripathi, 2000), or other political forces.¹² If this is the case, the agency's decision will be less responsive to any type of trustworthiness signals.¹³

Moreover, the trust signaling capabilities of CSR is likely lower for suppliers of controversial products such as alcohol, tobacco, adult entertainment, weapons, etc. While it is unlikely that the government procures from most of these industries, it is certainly a major buyer of military equipment and services (e.g., guns, missiles, military tanks, nuclear and chemical weapons, etc.). Several scholars emphasize the contradictory nature of CSR in the defense industry—e.g., Baker's (2005) “can companies that make products that kill be socially responsible?” (see also Byrne, 2007; Halpern & Snider, 2012). In this vein, CSR may be less of a credible signal in the defense industry.

Finally, companies in the defense industry may not face a need to differentiate themselves to compete for government contracts in the first place given the limited number of military contractors. Indeed, the weapon and ammunition industry typically ranks among the least competitive industries in the economy (e.g., Mahajan, 2006).

In sum, the above arguments suggest that CSR as a differentiation strategy is less valuable to government suppliers in the defense industry. This motivates the following hypothesis.

Hypothesis 5 (H5) *The positive relationship between CSR and the allocation of procurement contracts is weaker for defense contracts.*

3 | DATA

3.1 | Sample selection

The sample used in this study is obtained by merging the KLD database with Standard & Poor's Compustat. The KLD database contains annual ratings of companies' social and environmental performance as of 1991; Compustat contains accounting information as well as additional firm-level information (e.g., industry classification, state of incorporation, etc.) for U.S. public companies. I exclude observations with missing accounting information, as well as companies that are incorporated outside of the U.S. Since lagged values of the KLD ratings are used in the analysis, the relevant sample starts in 1992 instead of 1991. These criteria lead to a final sample of 27,062 firm-year observations from 1992 to 2013.

¹²In this vein, Leitzel (1992) argues that many aspects of defense procurement—such as the tendency for contracts to be distributed among a stable group of leading defense suppliers—are consistent with the political capture argument. For instance, Chesshyre (1985, p. 40) argues that defense procurements are characterized by “[...] collusion between the 53,000 Pentagon officers and civilians charged with procurement responsibilities and the 170,000 suppliers.” Ashford (1985, p. 35) further claims that “[...] the military-industrial complex creates political constituencies that make captives of congressmen, public officials, and labor unions.” As another example, Smith (1989, p. 33) argues that defense procurements serve the interests of an “Iron Triangle” that consists of the Pentagon, defense contractors, and members of Congress with visible military spending in their districts. See also Karpoff et al. (1999) for a discussion of the political economy of defense contracts.

¹³I thank an anonymous reviewer for suggesting these arguments.

TABLE 1 Summary statistics

Variable	Mean	Std. Dev.	1	2	3	4	5	6	7	8
1 Procurement contracts (\$ million)	39.17	675.01								
2 KLD-index	1.381	2.203	0.109							
3 Size	7.440	1.750	0.090	0.505						
4 Return on assets	0.112	0.124	0.005	0.108	0.080					
5 Tobin's Q	1.946	1.336	-0.015	-0.001	-0.326	0.148				
6 Leverage	0.215	0.196	0.002	0.061	0.266	-0.007	-0.194			
7 Cash holdings	0.166	0.197	-0.024	-0.087	-0.426	-0.286	0.466	-0.328		
8 Herfindahl	0.062	0.061	0.011	-0.019	-0.032	0.170	-0.018	0.030	-0.104	
9 Political contributions (\$ 1,000)	14.175	69.532	0.166	0.286	0.317	0.039	-0.025	0.038	-0.073	0.049

Notes. This table reports means, standard deviations, and Pearson correlation coefficients. The sample includes all firm-year observations for companies in the merged KLD-Compustat sample from 1992 to 2013 ($N = 27,062$).

3.2 | Procurement contracts

The process of awarding procurement contracts begins when an agency of the federal government identifies a need for the purchase of a good or service. The agency posts a solicitation on the Federal Business Opportunities website, called a “request for proposal” (RFP). Companies then submit their proposals, which are reviewed by agency personnel who evaluate the alternative proposals and make the final decision (for more details, see Halchin, 2012).

Procurement contracts can be classified into two broad categories: “fixed-price” and “cost-plus” contracts (see FPDS-NG, 2014). In fixed-price contracts, the seller is offered a pre-specified price by the buyer for completing the project. In cost-plus contracts, no price is pre-specified, but the supplier is reimbursed for the costs plus a fee. In general, cost-plus contracts are preferred for projects that are more complex and whose costs are difficult to determine *ex ante* (Bajari & Tadelis, 2001). Once the contract is signed and the project has started, unforeseen changes may lead to renegotiations and modifications of the contract, resulting in substantial adaptation costs (Bajari et al., 2014).

The data on procurement contracts are obtained from the Federal Procurement Data System-Next Generation (FPDS-NG). The FPDS-NG lists all procurement contracts awarded by the U.S. government that exceed a minimal transaction value threshold.¹⁴ Exceptions to this reporting requirement are the U.S. Postal Service as well as legislative and judicial branch organizations. For each contract, the FPDS-NG reports detailed information about the contractor, the type of project, and the pricing agreement (fixed-cost versus cost-plus).

I match procurement contracts to corporations in Compustat by company names. I then aggregate the dollar amount of procurement contracts for each firm and each year. The average company in my sample receives procurement contracts in the amount of \$39 million per year (see Table 1). In auxiliary analyses, I distinguish between contracts that are (a) fixed-cost versus cost-plus, (b) multi-year versus single-year, and (c) large versus small (a contract is coded as large if the dollar amount is greater than the average across all contracts awarded in the same year). I further distinguish between contracts that are procured by the DoD (Department of Defense) as opposed to other government agencies.¹⁵

¹⁴Prior to 2004, the reporting threshold was \$25,000 per transaction. As of 2004, any transaction that exceeds \$2,500 is reported.

¹⁵The average company in my sample receives 98 procurement contracts a year worth \$0.4 M each (i.e., a total of \$39 million per year). The average duration of a contract is about 2.2 years. Multi-year contracts account for 29.6% of all contracts (but 51.7% of the dollar value); cost-plus contracts account for 8.3% of all contracts (but 18.2% of the dollar value); large contracts (i.e., contracts whose value is above the mean in a given year—which is on average \$0.4 M across all years) account for 6.4% of all contracts (but

3.3 | Corporate social responsibility

The CSR data are obtained from the KLD database. KLD is an independent social choice investment advisory firm that compiles ratings of how companies address the needs of their stakeholders. For each stakeholder group, strengths and concerns are measured to evaluate positive and negative aspects of corporate actions toward stakeholders (see KLD, 2010). KLD ratings are widely used in CSR studies (e.g., Chatterji & Toffel, 2010; Flammer, 2015b).

I consider all CSR strengths with respect to employees, customers, the natural environment, and society at large (community and minorities). I then construct a composite KLD-index by adding up the number of CSR strengths along these dimensions.¹⁶ In auxiliary analyses, I further consider sub-indices of the composite KLD-index.

3.4 | Control variables

In my baseline specification (see the methodology section), I control for a vector of firm- and industry-level characteristics that may affect the allocation of procurement contracts and companies' engagement in CSR. In the following, I briefly describe these variables.

3.4.1 | Accounting variables

The accounting data are obtained from Compustat. *Size* is the natural logarithm of the book value of total assets. *Return on assets* (ROA) is the ratio of operating income before depreciation to the book value of total assets. *Tobin's Q* is the ratio of the market value of total assets (obtained as the book value of total assets plus the market value of common stock minus the sum of the book value of common stock and balance sheet deferred taxes) to the book value of total assets. *Cash holdings* is the ratio of cash and short-term investments to the book value of total assets. *Leverage* is the ratio of debt (long-term debt plus debt in current liabilities) to the book value of total assets. To mitigate the impact of outliers, all ratios are winsorized at the 1st and 99th percentiles of their empirical distribution.

3.4.2 | Political contributions

To measure companies' political connections, I focus on donations from corporate Political Action Committees (PAC) to politicians' campaign committees (e.g., Cooper, Gulen, & Ovtchinnikov, 2010). PACs are organizations that raise and spend funds for political campaigns. A corporate PAC can give a maximum contribution to a candidate campaign committee of \$10,000 per election, and these funds must be raised exclusively from the firm's executives, shareholders, and their families.¹⁷ I obtain data on PACs from the Federal Election Commission (FEC). The FEC data cover all

59.4% of the dollar value). DoD contracts and contracts for medical innovation are on average larger (22.5% of all DoD contracts and 22.9% of all medical innovation contracts qualify as large based on the above metric). DoD contracts are identified by department name "Dept of Defense" in the FPDS-NG database; contracts for medical innovation are identified by PSC (product service code) identifiers whose first two digits are "AN" (R&D Medical).

¹⁶In addition to CSR strengths, the KLD database also contains a list of CSR weaknesses, labeled "concerns". Accordingly, an alternative approach is to construct a "net" KLD index by subtracting the number of concerns from the number of strengths. However, recent research suggests that this approach is methodologically questionable. Because KLD strengths and concerns lack convergent validity, using them in conjunction fails to provide a valid measure of CSR (e.g., Johnson-Cramer, 2004; Mattingly & Berman, 2006). Nevertheless, I show in robustness checks that my results are similar if I use this net KLD-index.

¹⁷Note that corporations themselves cannot contribute to candidate campaign committees directly, nor may they contribute funds to PACs aside from covering the administrative and fundraising costs of affiliated PACs. These constraints have been substantially relaxed by the Supreme Court's 2010 Citizens United ruling. For further details on regulations before Citizens United, see Ansolabehere, de Figueiredo, and Snyder Jr (2003) and Federal Election Commission (2007). For the regime after Citizens United, see Federal Election Commission (2011).

campaign contributions made by corporate PACs to each candidate as of 1979. I match corporate PACs to corporations in Compustat by company name. I then aggregate the dollar amount of all campaign contributions made by each firm in each year.

3.4.3 | Competition

To measure the degree of product market competition, I compute the Herfindahl–Hirschman index of industry concentration (henceforth “Herfindahl”). This index is calculated as the sum of squared market shares of all companies in a given 2-digit SIC industry and year. Market shares are computed from Compustat based on firms’ sales. Note that higher values of the index represent lower competition.

3.5 | Summary statistics

Table 1 provides summary statistics for all variables described in this section, along with the correlation matrix. As can be seen, there is a positive correlation between the KLD-index and the value of procurement contracts (10.9%). This positive correlation is suggestive of Hypothesis 1, according to which companies with higher CSR are more likely to receive procurement contracts. Interestingly, the value of procurement contracts also correlates with size (9%) and political contributions (16.6%). The latter is in line with Goldman et al. (2013) who show that political connections are an important determinant of the allocation of procurement contracts.

4 | METHODOLOGY

4.1 | OLS regressions

To examine whether CSR affects the allocation of procurement contracts, I estimate the following regression:

$$\log(1 + \text{procurements}_{it}) = \alpha_i + \alpha_t + \beta \times \text{KLD-index}_{it-1} + \gamma' \mathbf{X}_{it-1} + \varepsilon_{it}, \quad (1)$$

where i indexes firms; t indexes years; α_i and α_t are firm and year fixed effects, respectively; procurements is the dollar amount of procurement contracts allocated to the company; KLD-index is the KLD-index of the company in the preceding year; \mathbf{X} is the vector of control variables (size, ROA, Tobin’s Q, leverage, cash holdings, the logarithm of one plus the dollar amount of political contributions made by the company, and the Herfindahl index) in the preceding year; ε is the error term. I cluster standard errors at the 2-digit SIC industry level (the results are similar if standard errors are clustered at the firm or state level). The coefficient of interest is β . Due to the logarithmic specification of the dependent variable, β measures the percentage change in the value of procurement contracts corresponding to an increase in the KLD-index by one index point.¹⁸ Hypothesis 1 predicts that β should be positive and significant.

¹⁸I construct the dependent variable as $\log(1 + \text{procurements})$ —as opposed to $\log(\text{procurements})$ —to account for the fact that not all companies receive procurement contracts in all years (i.e., $\text{procurements} = 0$). Thus, by construction, the estimate of β captures the change in the allocation of procurement contracts at both the extensive margin (i.e., whether a company receives procurement contracts) *and* intensive margin (i.e., whether a company receives more procurement contracts). In auxiliary analyses (see Table A4 of the online appendix), I examine both margins separately. Specifically, I study the extensive margin by using as dependent variable a dummy variable that indicates whether the company receives procurement contracts in a given year. I then study the intensive margin by using as dependent variable $\log(\text{procurements})$, restricting the sample to firm-year observations where $\text{procurements} \neq 0$.

The inclusion of control variables mitigates the possibility that my findings are driven by omitted variables. For example, it could be that more profitable companies are more likely to receive procurement contracts (e.g., because they are more cost-efficient). At the same time, such companies may be more CSR-friendly (e.g., because they can more easily afford to finance CSR programs). Controlling for profitability (ROA) addresses this potential confound. Similarly, the other controls alleviate concerns that my results are confounded by size, investment opportunities (Tobin's Q), financing decisions (leverage, cash holdings), the company's political contributions, or competition (Herfindahl). In particular, controlling for political contributions addresses the possibility that firms that engage in CSR may have more extensive networks with government officials which helps in procuring contracts. Relatedly, the inclusion of firm fixed effects accounts for any time-invariant firm characteristics that may affect both CSR and the allocation of procurement contracts. Finally, the inclusion of year fixed effects accounts for economy-wide factors that could affect both variables.

While the controls and fixed effects help address potential confounds, they do not fully rule out the possibility that *unobservable* time-varying firm characteristics may drive a spurious relationship between the KLD-index and the allocation of procurement contracts. In other words, Equation (1) is subject to a classic endogeneity problem—CSR reflects a firm choice, and this choice may correlate with unobservable firm characteristics that also affect the allocation of procurement contracts. In such cases, the estimate of β would be inconsistent.

To obtain a consistent estimate of β , one would need an instrument for the KLD-index—i.e., a variable that triggers exogenous changes in the KLD-index. The specific source of exogenous variation I exploit in this paper is the enactment of state-level constituency statutes. I describe this approach in the next section.

4.2 | Instrumental variable (IV) regressions

4.2.1 | Constituency statutes

I instrument changes in the KLD-index using the enactment of constituency statutes as a quasi-natural experiment. Constituency statutes allow corporate officers and directors to take into account the interests of a variety of corporate stakeholders in carrying out their fiduciary duties to the corporation and, as such, trigger an exogenous shift in companies' ability to address their stakeholders' needs (e.g., Flammer & Kacperczyk, 2016; Orts, 1992). The online appendix (Appendix A in Appendix S1) describes the institutional background underlying these statutes.

A total of 35 states in the U.S. have adopted constituency statutes (see Karpoff & Wittry, 2017); five of them adopted the statutes during the sample period (1992–2013).¹⁹ Because the enactment of the statutes does not reflect any firm's strategic decision, such "treatments" offer plausibly exogenous variation in a firm's orientation toward stakeholders.²⁰

¹⁹These states are North Carolina (1993), North Dakota (1993), Vermont (1998), Maryland (1999), and Nebraska (2007). In her evaluation of the constituency statutes, Barzuza (2009) notes that the Maryland and North Carolina statutes are especially stringent. In robustness checks, I verify that my results hold if I only use these two treatments. Moreover, Texas also enacted a constituency statute in 2006. However, it has been argued that the Texas statute has less bite than other constituency statutes (e.g., Tyler, 2010). In robustness checks, I show that my results are similar if the Texas constituency statute is included.

²⁰Consistent with this argument, Luoma and Goodstein (1999) show that companies incorporated in states that have enacted constituency statutes increased stakeholder representation on their board of directors.

4.2.2 | Two-stage least squares

To study the effect of the KLD-index—instrumented by the constituency statutes—on the allocation of procurement contracts, I use two-stage least squares (2SLS). In the first stage, I regress the KLD-index on the enactment of constituency statutes. Specifically, I estimate the following regression:

$$KLD\text{-}index_{it} = a_i + a_t + b \times \text{constituency statute}_{it} + \mathbf{c}' \mathbf{X}_{it} + e_{it}, \quad (2)$$

where constituency statute is the “treatment dummy,” which is equal to one if firm i is incorporated in a state that has enacted a constituency statute by year t .²¹ Effectively, Equation (2) is a difference-in-differences specification, i.e., the coefficient b measures the change in the KLD-index after the treatment (first difference) in the treatment versus control groups (second difference).

In their evaluation of the difference-in-differences methodology, Bertrand, Duflo, and Mullainathan (2004) recommend that standard errors be clustered at the dimension of the treatment. Accordingly, when estimating the first-stage regression, I cluster standard errors at the state of incorporation level. (The results are similar if standard errors are clustered at the 2-digit SIC level or at the firm level.)

The predicted values from Equation (2) provide the “instrumented” KLD-index—i.e., the exogenous component of the KLD-index. In the second stage, I then re-estimate Equation (1) using *KLD-index (instrumented)* in lieu of *KLD-index*:

$$\log(1 + \text{procurements}_{it}) = \alpha_i + \alpha_t + \beta^{IV} \times \text{KLD\text{-}index (instrumented)}_{it-1} + \gamma' \mathbf{X}_{it-1} + \varepsilon_{it}. \quad (3)$$

The coefficient β^{IV} provides a consistent estimate of the effect of CSR on the allocation of procurement contracts.

5 | RESULTS

5.1 | Main results

The main results are presented in Table 2. Column (1) reports estimates from the OLS regression specified in Equation (1). As can be seen, the coefficient of the KLD-index is positive and highly significant ($t = 3.67$). The point estimate of 0.088 implies that an increase in the KLD-index by one index point is associated with an 8.8% increase in the dollar amount of procurement contracts allocated to the company. A look at the control variables provides additional insights into the determinants of the allocation of procurement contracts. In particular, larger and more profitable firms are more likely to receive procurement contracts. The same applies to companies that make larger political contributions, consistent with Goldman et al.’s (2013) findings that political connections matter for the allocation of procurement contracts.

In columns (2) and (3), I address the potential endogeneity of the KLD-index by using 2SLS. The first-stage regression is provided in column (2). As is shown, the enactment of constituency statutes leads to a significant increase in the KLD-index. The corresponding F -statistic is 17.2, which lies well above Staiger and Stock’s (1997) threshold for “strong” instruments. In column (3), I estimate the second-stage regression. The coefficient of the (instrumented) KLD-index is 0.075, which is somewhat smaller than the OLS coefficient in column (1). Importantly, it remains

²¹The Nebraska statute—which was introduced before the start of the sample period—was repealed in 1995, and re-introduced in 2007 (see Tyler, 2010). Hence, for Nebraska the treatment dummy is set to 1 before 1995, switches to 0 as of 1995, and switches back to 1 as of 2007.

TABLE 2 Corporate social responsibility and the allocation of government contracts

Dependent variable	2SLS		
	Log(1 + Procurement) OLS (1)	KLD-index First-stage (2)	Log(1 + Procurement) IV (3)
KLD-index	0.088 (0.024)		
KLD-index (instrumented)			0.075 (0.035)
Constituency statute		0.245 (0.059)	
Size	0.580 (0.089)	0.143 (0.038)	0.582 (0.089)
Return on assets	0.191 (0.353)	0.041 (0.209)	0.191 (0.354)
Tobin's Q	0.100 (0.036)	-0.024 (0.016)	0.099 (0.036)
Leverage	0.736 (0.253)	0.250 (0.114)	0.739 (0.253)
Cash holdings	-1.239 (0.287)	0.473 (0.114)	-1.233 (0.287)
Log(1 + Political contributions)	0.037 (0.015)	-0.026 (0.015)	0.037 (0.015)
Herfindahl	0.032 (1.462)	-0.117 (1.283)	0.031 (1.456)
Year fixed effects	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes
R-squared	0.81	0.76	0.81
Observations	27,062	27,062	27,062

Notes. Standard errors are reported in parentheses. They are clustered at the industry level (except in column (2) where they are clustered at the state level).

statistically significant ($t = 2.14$), suggesting that the positive relationship between the KLD-index and the allocation of procurement contracts is not driven by the endogenous choice of CSR strategies. Overall, the results presented in Table 2 are supportive of Hypothesis 1 according to which companies with higher CSR are more likely to be awarded procurement contracts.

5.2 | Relationship length

In columns (1) and (2) of Table 3, I examine whether the effect of CSR at the intensive margin (i.e., in the subsample where $procurements > 0$) depends on past interactions between the government and the company—arguably, government agencies face lower information asymmetries with companies they have been interacting with for a long time. Such companies build up reputation through past interactions and hence are less likely to benefit from CSR as a signal of trustworthiness.

To examine this hypothesis, I interact the KLD-index with two dummy variables indicating whether “relationship length”—that is, the number of years since the company has been receiving

TABLE 3 Cross-sectional heterogeneity

Dependent variable	Log(1 + Procurement)			
	Length of the relationship		Product market competition	
	OLS (1)	IV (2)	OLS (3)	IV (4)
KLD-index × (Relationship length > Median)	0.023 (0.014)			
KLD-index × (Relationship length < Median)	0.084 (0.024)			
KLD-index (instr.) × (Relationship length > Median)		0.024 (0.020)		
KLD-index (instr.) × (Relationship length < Median)		0.099 (0.035)		
KLD-index × (Herfindahl > Median)			0.036 (0.052)	
KLD-index × (Herfindahl < Median)			0.094 (0.025)	
KLD-index (instr.) × (Herfindahl > Median)				0.050 (0.069)
KLD-index (instr.) × (Herfindahl < Median)				0.074 (0.036)
Size	0.441 (0.071)	0.434 (0.071)	0.616 (0.091)	0.622 (0.092)
Return on assets	0.224 (0.398)	0.214 (0.399)	0.176 (0.355)	0.177 (0.355)
Tobin's Q	0.040 (0.026)	0.040 (0.026)	0.101 (0.036)	0.100 (0.036)
Leverage	0.286 (0.214)	0.279 (0.214)	0.740 (0.252)	0.745 (0.252)
Cash holdings	-0.581 (0.254)	-0.585 (0.255)	-1.238 (0.287)	-1.225 (0.287)
Log(1 + Political contributions)	0.033 (0.010)	0.033 (0.010)	0.038 (0.015)	0.038 (0.015)
Herfindahl	-2.733 (1.143)	-2.795 (1.133)		
Relationship length > Median	0.042 (0.083)	0.059 (0.085)		
Herfindahl > Median			-0.225 (0.127)	-0.213 (0.133)
Year fixed effects	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes
R-squared	0.83	0.83	0.81	0.81
Observations	8,887	8,887	27,062	27,062

Notes. Standard errors (reported in parentheses) are clustered at the industry level.

procurement contracts—is above and below, respectively, the median across all companies. As can be seen, the effect of CSR is large and highly significant for companies that are relatively new to government agencies. In contrast, the effect of CSR is small and insignificant for companies that have a long history with government agencies.²² This evidence is consistent with Hypothesis 2.²³

5.3 | Product market competition

Next, I examine whether the effect of CSR on the allocation of procurement contracts is larger in more competitive industries—i.e., in industries where companies have more of a need to differentiate themselves from their competitors (e.g., by signaling trustworthiness through CSR).

To examine this hypothesis, I interact the KLD-index with two dummy variables indicating whether the company operates in an industry whose Herfindahl index lies above or below the median across all industries.²⁴ As can be seen in columns (3)–(4) of Table 3, I find that the effect of CSR is large and significant in more competitive industries, while it is small and insignificant in less competitive industries.²⁵ This finding is supportive of Hypothesis 3.

5.4 | Types of procurement contracts

5.4.1 | Project complexity

The central tenet of my theory is that CSR helps mitigate information asymmetries by signaling trustworthiness to government agencies. To further assess this mechanism, I examine whether the effect of CSR is stronger for government contracts that are more prone to information asymmetries, such as (a) multi-year, (b) large-scale, and (c) cost-plus contracts.

To conduct this analysis, I re-estimate my baseline specifications using alternative dependent variables. For example, to study whether higher CSR affects the allocation of multi-year procurement contracts, I use as dependent variable $\log(1 + \text{multi-year contracts})$, where *multi-year contracts* is the dollar amount of multi-year procurement contracts allocated to a given company in a given year. The results are presented in Table 4. As is shown in columns (1), (3), and (5) of both panels, CSR has a significant effect on the allocation of contracts that are multi-year, larger, and cost-plus, respectively. In contrast, the estimates in columns (2), (4), and (6) show that CSR has no significant effect on the allocation of other types of contracts. These results are supportive of Hypotheses 4a–4c.

²²The difference between the two coefficients is statistically significant. The *p*-value of the *F*-test is 0.028 in column (1) and 0.036 in column (2).

²³In Figure A1 of the online appendix, I provide a finer-grained characterization of the interaction between relationship length and CSR. Specifically, I plot the average procurement contracts split along two dimensions: the KLD-index (values of 0, 1, 2, 3, and 4+) and relationship length (< 1 years, 1–5 years, 6–10 years, and 10+ years). As is shown, CSR matters the most for new and recent relationships (< 1 year and 1–5 years, respectively), it somewhat matters for intermediate relationship lengths (6–10 years), and it is irrelevant for relationship lengths beyond 10 years. Looking at the level of the curves, it is interesting to note that companies with high CSR (KLD-index of 4+) and a shorter relationship length (< 1 year and 1–5 years) are roughly at par with companies with low CSR (KLD-index of 0) and intermediate relationship length (6–10 years), but remain at a disadvantage compared to companies with low CSR (KLD-index of 0) and a 10+ year relationship length. This is consistent with the argument that CSR is a less informative signal when trust is already established through a long-term partnership.

²⁴Note that the Herfindahl index is a measure of concentration, and hence an inverse measure of competition.

²⁵The difference between the two coefficients is significant in column (3) (*p*-value = 0.032) and marginally insignificant in column (4) (*p*-value = 0.141).

TABLE 4 Types of procurement contracts

Dependent variable	Duration		Scale		Pricing		Defense	
	Log(1 + Multi-year)		Log(1 + Single-year)		Log(1 + Large)		Log(1 + Small)	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Panel (A): OLS Regressions</i>								
KLD-index	0.063 (0.024)	0.025 (0.022)	0.078 (0.021)	0.009 (0.016)	0.065 (0.019)	0.023 (0.026)	0.017 (0.023)	0.071 (0.019)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R-squared	0.77	0.53	0.76	0.64	0.73	0.74	0.77	0.53
Observations	27,062	27,062	27,062	27,062	27,062	27,062	27,062	27,062
<i>Panel (B): IV Regressions</i>								
KLD-index (instr.)	0.069 (0.033)	0.006 (0.032)	0.091 (0.032)	-0.016 (0.023)	0.084 (0.027)	-0.009 (0.037)	0.013 (0.033)	0.061 (0.026)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R-squared	0.77	0.53	0.76	0.64	0.72	0.74	0.77	0.53
Observations	27,062	27,062	27,062	27,062	27,062	27,062	27,062	27,062

Notes. Standard errors (reported in parentheses) are clustered at the industry level. The coefficients of the controls (size, ROA, Tobin's Q, leverage, cash holdings, $\log(1 + political\ contributions)$, and Herfindahl) are omitted for brevity.

5.4.2 | Defense contracts

In columns (7) and (8) of each panel, I further examine whether the effect of CSR differs depending on whether the government contract is procured by the DoD—for which the buying criteria are more likely to be subject to political forces (e.g., Tripathi, 2000)—as opposed to other government agencies. As is shown, the effect of CSR is small and insignificant for DoD contracts, while it is large and significant for other agencies. This lends support to Hypothesis 5.²⁶

5.5 | Extensions and robustness

In the online appendix (Appendix B and Tables A1–A12 in Appendix S1), I provide several extensions and robustness checks. In particular, I provide evidence supporting the assumption that CSR helps signal trustworthiness. First, I document that the effect of CSR on the allocation of procurement contracts is stronger for CSR initiatives related to “institutional” stakeholders (i.e., the natural environment, local community, and society at large) as opposed to “technical” stakeholders (i.e., employees and customers) which is consistent with the trust signaling capability of CSR. Arguably, institutional CSR—because it provides less apparent benefits to a corporation—is likely to provide a stronger signal of trustworthiness than technical CSR (see Godfrey, Merrill, & Hansen, 2009).²⁷ Second, I show that the positive effect of CSR on the allocation of procurement contracts is muted if companies are involved in accounting scandals (which likely undermine a firm’s trust signaling capabilities). Third, I show that higher CSR engagement is associated with (a) higher values of the long-term index of Flammer and Bansal (2017), and (b) a lower probability of engaging in fraudulent accounting, suggesting that CSR is indicative of a long-term orientation and non-opportunistic behavior, respectively.²⁸

6 | DISCUSSION AND CONCLUSION

Does CSR influence the allocation of procurement contracts? My results indicate that the answer to this question is affirmative. Bridging the economics literature on incomplete contracting with the management literature on transaction cost economics and competitive strategy, I argue that CSR mitigates information asymmetries—which are inherent to government procurement—by signaling

²⁶Note that the control variable $\log(1 + \text{political contributions})$ has a coefficient of 0.031 ($t = 2.21$) for DoD contracts and a coefficient of 0.006 ($t = 0.46$) for contracts procured by other agencies in the regressions in Panel (A). (The coefficients and t -statistics are virtually identical in the regressions in Panel (B).) This further confirms that DoD contracts are more likely to be subject to political forces.

²⁷I thank an anonymous reviewer for suggesting this analysis.

²⁸In addition, the online appendix contains several robustness checks. In a nutshell, I show that my results are robust when I (i) consider separately the extensive margin (i.e., whether companies receive procurement contracts) and intensive margin (i.e., whether companies receive *more* procurement contracts); (ii) account for companies’ political influence; (iii) exclude CSR-related procurement contracts (e.g., clean energy), which high-CSR companies might be better qualified to fulfill (for reasons unrelated to the trust signaling capabilities of CSR); (iv) examine the dynamics of the relation between CSR and the allocation of procurement contracts; (v) account for industry and regional trends; (vi) account for corporate governance and governance-related regulations; (vii) include (time-varying) state-level controls that capture the state’s political leaning and pro-social values; (viii) estimate my baseline specifications without controls; (ix) use the “net” KLD-index that combines both KLD strengths and KLD concerns; (x) exclude the Nebraska constituency statute, include the Texas constituency statute, or restrict the set of treated states to the most stringent constituency statutes; (xi) conduct placebo tests that randomize the treated states; (xii) consider alternative functional forms; and (xiii) consider an alternative source of exogenous variation in CSR in the form of close call shareholder proposals (following Flammer, 2015a). Finally, the online appendix also assesses the representativeness of the treated states compared to other states that adopted a constituency statute prior to the beginning of the sample period.

trustworthiness. Accordingly, I posit that companies' social engagement helps improve their competitiveness in obtaining procurement contracts.

To examine this question empirically, I exploit a quasi-natural experiment provided by the staggered introduction of constituency statutes in five U.S. states between 1992 and 2013. These statutes allow corporate directors to take stakeholders' interests into consideration when making business decisions. Hence, they provide exogenous variation in the way U.S. companies address the needs of their stakeholders. Using an instrumental variable methodology—instrumenting CSR with the enactment of constituency statutes—I find that companies with higher CSR receive more procurement contracts. This finding indicates that CSR can serve as a strategic tool to obtain government contracts. Moreover, I find that the effect is stronger for more complex projects—such as multi-year, large-scale, and cost-plus projects—and in the early years of the government-company relationship, suggesting that CSR helps mitigate information asymmetries by signaling trustworthiness. Furthermore, I find that the effect is stronger in competitive industries, indicating that CSR can serve as a differentiation strategy to compete against other bidders. Finally, the effect is weaker for defense contracts, where the decision process is more likely to be influenced by political forces.

6.1 | Contributions

This study contributes to the existing literature in several ways. First, this study adds to the vast literature on competitive strategies (e.g., Porter, 2008). The limelight of this literature is on the competitive positioning of companies in the business-to-consumer (B2C) market. In contrast, the question of how companies can improve their competitiveness in the market for government contracts has remained largely unexplored. This is surprising given the economic importance of this market (15–20% of GDP). To the best of my knowledge, this paper is the first to examine how corporate strategy can affect the allocation of government contracts. By doing so, it represents a first step in exploring a firm's competitive strategy in the B2G context.

Second, this study sheds new light on the role of the government in the business-government relationship—it highlights the role of the government as a "customer" of the firm's products and services, as opposed to being merely the actor that sets the rules of the business environment. In particular, a vibrant literature examines how companies engage with the government and aim to influence the government's legislative and regulatory actions through their non-market strategies—e.g., through corporate political activities such as lobbying and campaign contributions (Bonardi, Holburn, & Vanden Bergh, 2006; Choi, Jia, & Lu, 2014; McDonnell & Werner, 2016; Richter & Werner, 2017; Schuler, 1996), corporate social responsibility (e.g., Lyon & Maxwell, 2004; Werner, 2015), as well as industry self-regulation and other forms of collective action (e.g., King & Lenox, 2000; Lenox, 2006). Taken together, this literature suggests that a firm's non-market strategies can influence the legislative and regulatory business environment. My study contributes to this body of work by exploring an additional avenue through which non-market strategies can benefit companies in their interactions with the government: non-market strategies—such as CSR practices—can help companies obtain government procurement contracts. Hence, the impact of a firm's non-market strategies on the government's decision-making might be broader than the previous literature suggests: non-market strategies influence not only (a) the legislative and regulatory business environment, but also (b) the firm's competitiveness in the B2G market.

Third, this study contributes to the literature that examines whether CSR provides a signal that influences consumers' purchasing decision (e.g., Du, Bhattacharya, & Sen, 2011; Elfenbein et al., 2012; Kotler, Hesekiel, & Lee, 2012; McWilliams & Siegel, 2001). This literature focuses on the

B2C market and, to a lesser extent, the B2B market.²⁹ Based on the insights from this literature, it is far from obvious whether CSR plays a role in the B2G context as well. Specifically, the extant literature suggests that purchasing decisions in the B2C market are more sensitive to companies' CSR engagement than in other markets (e.g., Corey, 1991; Lev et al., 2010). This reflects inherent differences in the purchasing decision-making process.³⁰ Moreover, given the political nature of the government procurement process for some agencies, the purchasing decision might be fully captured by political forces. Accordingly, one may expect the signaling capabilities of CSR to be limited in the B2G context. Yet, in contrast to these predictions, my results indicate that CSR plays an important role in obtaining government procurement contracts.

Fourth, and related to the previous point, my results suggest that the government as a "buyer" acts in a somewhat similar fashion compared to consumers and business buyers. In turn, this implies that existing theories on the competitive positioning of firms might—at least to some extent—generalize to the B2G market. For example, the literature on organizational trust and transaction cost economics highlights the role of trust in reducing information asymmetries in B2B relationships (e.g., Barney & Hansen, 1994; Bromiley & Cummings, 1995; Williamson, 1991; Zaheer et al., 1998) and B2C relationships (e.g., Elfenbein et al., 2012). My study casts these theories in a new light as it expands them to B2G relationships. As mentioned above, this is far from obvious given the inherent differences in the purchasing decision-making process and the political nature of the government procurement process. That being said, my finding that the allocation of defense contracts is less sensitive to CSR suggests that political forces do represent an important boundary condition when applying the above theories to the B2G context.

Fifth, this paper contributes to the large literature on CSR and financial performance (e.g., Flammer, 2013, 2015a; Flammer, Hong, & Minor, 2017; Margolis, Elfenbein, & Walsh, 2007; Margolis & Walsh, 2001, 2003; Orlitzky, Schmidt, & Rynes, 2003). Overall, this literature points toward a positive relationship between CSR and financial performance. Yet, the precise mechanisms through which CSR practices create value are not fully understood. One strand of the literature highlights benefits that originate from employees and customers. Studies in this vein emphasize the role of CSR in improving employee engagement (Flammer & Luo, 2017), fostering employees' innovation (Flammer & Kacperczyk, 2016), and establishing a unique customer base (Du et al., 2011), among others. Another strand of the literature highlights the role of CSR in gaining access to external markets (Cheng, Ioannou, & Serafeim, 2014; Zolotoy, O'Sullivan, & Klein, 2017). In particular, Cheng et al. (2014) argue that firms with better social practices have better access to external capital markets as CSR helps decrease agency costs and information asymmetry through enhanced stakeholder engagement and transparency. My study contributes to this line of work as it shows that CSR practices enhance firms' ability to access the market for government procurement contracts, and especially contracts that are more prone to information asymmetries. By doing so, I highlight a novel channel through which CSR may create value—improved access to public procurement contracts.

²⁹Studying B2B procurements has proven difficult due to the lack of data on private procurements. Accordingly, the existing evidence is either qualitative (Homburg, Stierl, & Bornemann, 2013) or inferred by contrasting companies operating in SIC industries that are classified as being either B2B or B2C (Lev, Petrovits, & Radhakrishnan, 2010).

³⁰More precisely, "[t]he purchasing decision of an individual consumer is affected not only by product attributes, but also by social group forces, psychological factors, and the consumer's situational forces. In contrast, in industrial purchasing, the decision-making process is highly formalized, using defined procurement procedures, and subject to economic (cost/value) analysis" (Lev et al., 2010, p. 186, adapted from Corey, 1991).

6.2 | Limitations and directions for future research

While this study makes several contributions to the literature, it also has limitations that call for future research.

First, this paper is among the first to examine the impact of a firm's strategy on its competitiveness in the B2G market—an economically sizable market that has received little attention in the strategy literature. As discussed above, my findings suggest that, to some extent, government buyers act in a similar fashion as individual consumers or business buyers. Moreover, they suggest that the signaling role of CSR fades over time as the supplier-government relationship matures, which highlights the importance of considering temporal aspects in competitive strategy research. These insights raise the question of whether, and under what conditions, the existing theories in competitive strategy generalize to the B2G context. In particular, they call for future research that (a) explores which existing theories in competitive strategy are applicable to the B2G context (along with their boundary conditions), and (b) develops new theories that are specific to the B2G context. Both are exciting avenues for future research.

Second, this study examines the effect of one specific type of non-market strategy—namely a firm's social engagement—on the firm's competitiveness in the B2G market. A firm's repertoire of non-market strategies includes other strategies such as corporate political activities, private politics, and collective actions, all of which may influence the allocation of government contracts. In this vein, future work could explore the impact of the full repertoire of non-market strategies on a firm's competitiveness in the B2G market, along with their role in the B2B and B2C markets. The interplay between the different strategies is not *a priori* obvious given that (a) firms are likely to operate in multiple markets, and (b) a firm's non-market strategies may act as substitutes or complements.³¹ Accordingly, a fruitful avenue for future research is to consider non-market strategies as a whole and examine their effectiveness in the three different markets (i.e., B2C, B2B, and B2G).

Third, this study focuses on one channel through which the government is responsive to firms' CSR practices—the allocation of procurement contracts. Future research could build on this study and explore whether CSR practices help obtain other benefits from the government (e.g., tax benefits, subsidies) that create value for the firm. Another potentially fruitful direction is to explore the signaling capabilities of other firm-level strategies. While this study acknowledges the existence of other factors in the bundle of trust—besides a firm's CSR practices—it leaves the door open for future research to explore these factors in depth. In particular, future work could (a) identify the full set of factors that signal trustworthiness to the government, (b) examine whether the findings of this study are generalizable to other strategies that signal trustworthiness (e.g., non-corruptive behavior), and (c) whether the importance of such signaling strategies intensifies in less trustworthy business environments.³² Relatedly, the results of this study suggest that the signaling capability of CSR is strongest at the beginning of the supplier-government relationship and fades as this relationship matures. In this context, a natural question is whether CSR is the most effective signal of trustworthiness compared to other signals. Future work could make ground on this question by studying the comparative effectiveness of the full set of factors that contribute to the bundle of trust, and explore how this comparative effectiveness changes as the supplier-government relationship matures.

³¹For example, political lobbying may help secure contracts in the B2G market. At the same time, it might signal opportunistic behavior and hence undermine the trust signaling capabilities of CSR, hurting the firm not only in the B2G, but also in the B2B and B2C markets.

³²A case in point is the Indian tech company Infosys whose track record of non-corruptive behavior is often considered to be key to its ability of signaling trustworthiness and obtaining procurement contracts from governments and companies around the world (*Harvard Business Review*, 2011).

Fourth, this paper examines the role of trust across different types of contracts. The types of government procurement contracts considered in this study (e.g., cost-plus, fixed-price, multi-year) are also found in the private sector. Future work could study whether my findings generalize to private procurement contracts. An important caveat though is that it is difficult to obtain data on private procurements. This is in contrast to government procurement contracts that are compiled in the FPDS-NG registry on a systematic basis.

Finally, an important limitation of this study is that trustworthiness (and trust, respectively) is not directly measured, but merely inferred. While this caveat is common in the literature that infers trustworthiness from observable firm behavior (e.g., Cheng et al., 2014; Lev et al., 2010; Zolotov et al., 2017), a challenging—but potentially fruitful—avenue for future research is to make ground on the measurement of trustworthiness.

6.3 | Managerial implications

Lastly, the findings of this study have relevant managerial implications. First, as mentioned above, the market for procurement contracts is sizeable: it represents 15–20% of GDP. Interestingly, the B2G market has received relatively little attention in strategy research, which focuses its attention on the B2C market, and to a lesser extent the B2B market. Part of the reason might be that governments are assumed to be insensitive to a firm's strategy. My findings suggest otherwise: firms' non-market strategies (such as their CSR engagement) can influence the purchasing decision of government agencies. The amounts at stake are far from trivial—the average firm in my sample receives government contracts worth \$39 million.

Second, the fact that CSR influences the allocation of government procurement contracts implies that CSR can serve as a signaling and differentiation strategy to compete against other bidders, and ultimately achieve a competitive advantage. Accordingly, managers operating in the B2G sector—particularly those without a contracting history with the government—could benefit from integrating social and environmental considerations into their strategic decision making.³³

Third, in auxiliary analyses, I find that the trust signaling capabilities of CSR differ across CSR initiatives. Specifically, my findings indicate that CSR initiatives related to “institutional” stakeholders (i.e., the natural environment, local communities, and society at large) provide a more effective signal of trustworthiness, and hence enhance the chances of obtaining procurement contracts more strongly (compared to CSR initiatives related to a firm's “technical” stakeholders such as employees and customers). Accordingly, managers operating in the B2G sector might want to focus their efforts on CSR initiatives related to their institutional stakeholders. This is especially important if the company faces resource constraints and cannot afford to engage with all stakeholder groups.

Finally, my results show that the effectiveness of CSR initiatives in obtaining procurement contracts is not uniform across government agencies. That is, other factors (such as political forces) might be the dominating force in the award process of specific agencies. For example, the DoD does not appear to be sensitive to a firm's CSR practices. Hence, firms competing for contracts awarded by the DoD might be better off investing in other forms of non-market strategies (e.g., political lobbying) to compete for defense contracts.

³³These findings are likely to generalize to the B2B context as firms' purchasing behavior is less sensitive to political forces—that is, one would expect that CSR plays an even stronger role in obtaining procurement contracts in the B2B market. Hence, these managerial implications are likely to extend to procurement in general (i.e., B2G and B2B).

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