Exploring the concept of legitimacy in a transition economy

The case of the Swedish banking industry in Latvia

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Abstract

This thesis examines the concept of legitimacy and its evolution over time in the context of the banking sector of the transition economy of Latvia, where Swedish banks are the dominant player. After an economic boom starting at the turn of the millennia, which was to a great extent financed by the Swedish banks, the Latvian economy has now completely turned around, in the wake of numerous unanswered signs of overheating and the global economic crisis. Although they acted within legal limits, the Swedish banks and their behavior have become the object of criticism in Latvia as well as in Sweden. To study the evolution of the legitimacy granted by their stakeholders, we make use of Suchman’s legitimacy theory and rely on a mix of interviews and secondary data to obtain an overview the events that occurred and understand what the public opinion is regarding these. We then propose an empirical framework to define the aspects of legitimacy that have been damaged, before suggesting strategies to repair it. Our main conclusions are that cognitive and moral legitimacy are the types that were harmed the most, although some ways exist to repair this damage. The results also show that the processes of legitimation are somewhat different in the case of a transition economy, but that the general public’s expectations from the banking sector remain similar to that of Western countries. Furthermore, it seems pointless to try to seek a scapegoat for what went wrong; instead, it would be more useful to look for means to prevent this type of events from repeating in the future.
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1. Introduction

During the hockey world cup this April, television spectators had the opportunity to see Sweden play against Latvia. Aside from the traditional hockey action, one could not help but notice the sponsor all Latvian helmets exhibited, Swedbank. This image was probably a good metaphor of the role Swedbank and the Swedish banks in general have played in financing the expansion of this Baltic country over the past decade. This sight was also commented with irony by some journalists (Greider, 2009); at a time when the country is in the middle of a serious economic crisis, and some fingers are starting to point towards the Swedish banks for responsibility, the Latvian hockey team wears the colors of one of these banks. One critic in particular came from the newly appointed Latvian minister of finance, Mr. Valdis Dombrovskis, who was interviewed about the financial situation in his country last March (Hall, 2009). He claimed that the banking sector in Latvia, where Swedish banks are the dominant actor, has its share of responsibility in this financial crisis. He stated that even though the banks, strictly speaking, operated within the limits of existing laws and regulations, they failed to act in a socially responsible manner over the past years, by being too generous when issuing credit facilities, and by that have a share of responsibility in the unbalanced growth and overheating of the economy.

This situation reflects a growing global concern about the social responsibility of corporations; their role is no longer seen as limited to satisfying their shareholders as it was described by authors such as Friedman (cited in Warren, 1999). As the social cost of corporate activity arises, more responsibility and more accountability are demanded. The firm is thus strongly advised to act in order to maintain its level of legitimacy, and not lose the confidence of its audience (Warren, 1999). This issue is currently a hot topic in Latvia, which is the country that has been hit the hardest of all 27 European Union members by the economic crisis (Vitureau, 2009). After having known a hasty economic growth since the beginning of the 2000s, with double-digit real GDP growth from 2005 to 2007, things have changed drastically for the Baltic republic. In 2008, Latvia saw its real GDP plummet, with a
negative growth of -4.6 percent, while estimations for 2009 are a decline of -13.1 percent and -3.2 percent for 2010 (Eurostat, 2009). Meanwhile, unemployment has boomed and went passed the 10 percent as a percentage of the labor force in November 2008. As of March 2009, it was estimated to have attained 16.1 percent of the Latvian workforce. While fighting dire economic conditions, the country is finally the subject of a rampant inflation, result of the strong and uncontrolled growth of the past years; the yearly average inflation rate has been superior to 6 percent since 2004, and respectively passed the 10 percent and 15 percent marks in 2007 and 2008 (Eurostat, 2009).

Those years of expansion coincide with that of growing Swedish presence in the Latvian banking sector. The Swedish banking industry and its main players started to establish themselves in Latvia during the late 1990s; Nordea entered first in late 1997 (Nordea, n.d), Swedbank and SEB quickly followed and entered in 1998 (Swedbank, n.d. and SEB, n.d.). Following their entry, all gradually expanded their market shares through a series of consolidations over the years, to ultimately become the dominant actors in their sector and the premier lenders to the Latvian economy. In 2006, the former Hansabank, daughter company of Swedbank, accounted for 29 percent of the lending in Latvia, SEB for 18 percent and Nordea for 8 percent. Once summed, we see that those three Swedish banks dominate the market for lending, with an added market share of 54 percent. The same thing goes for mortgages; Hansabank had 30 percent of the market, SEB 16 percent and Nordea 11 percent, thus totaling 57 percent of market shares (Figure 2.4, International Monetary Fund, 2007). As of 2008, those numbers had changed very little, with only a slight decrease of this percentage. Still, Swedish banks remain the clear dominant player in the Latvian banking sector (Nordea, 2008, SEB, 2008 and Swedbank, 2008).

The positive outcomes of the Swedish banks’ foreign direct investments for the Latvian society are obvious. The banks have contributed to the development of a functioning financial sector. Furthermore, the society has been given access to capital that made possible investments in infrastructures, houses, industry, etc. And of course, the banks are also a relatively large employer.

However, this ambient euphoria still reigning in Latvia not so long ago, result of rapidly increasing salaries along with GDP growth, together with this existence of a too generous
banking sector, also led to less desirable outcomes. One of the most significant ones, with the rest to be discussed and analyzed further on in this thesis, was the creation of an economic bubble, and of a real estate bubble in particular, which burst turned out to be dramatic to many Latvians. Instead of the better future all hoped for after the fall of the Soviet Union, many Latvians have now ended up in a hardly sustainable situation, which will more or less require them to repay debts for the rest of their existence (Lindstedt, 2009).

As a result, politicians, researchers and the general public in Latvia have all started to look for what went wrong and where the responsibility lies, in their eyes, for all that has happened. Swedish banks obviously turn out to be one evident direction in which to look, putting the legitimacy they were granted by Latvians to the test. In this context, it therefore appears interesting to study this evolution of legitimacy in the banking sector of that transition market that is Latvia. Our aim is first to better understand the reasons why the Swedish banks’ legitimacy was harmed by using a framework which we propose, before suggesting repairing strategies which could be adopted by the banks. Furthermore, since legitimacy remains a concept which is yet to be fully explored, we hope that our case will contribute to a better understanding of the concept in the cases of a transition economy, and of the banking industry.

2. Theoretical framework

Studying legitimacy goes beyond focusing only on the economic aspect of a corporation’s activities. As for corporate social responsibility, the financial aspect is only one of the elements the firm has to deal with; it cannot be dissociated from the political, social, and institutional framework of the economy within which the firm operates (Gray et al., 1995). In this regard, two theories which appear as relevant for our study are the stakeholder theory and the legitimacy theory, which complete one another and help explain corporate behavior in more dimensions than the sole economic one. Effectively, stakeholder and legitimacy theory should not be seen as theories competing against each other. As explained by Gray et al. (1995), they should instead be seen as two overlapping perspectives which allow us to
interpret different factors at different levels of both resolution and perception. In other words, using these two theories in a combined manner enriches our understanding of corporate social practices, and thus seems to be the appropriate choice to better appreciate the object of our study. Being more central to our study, legitimacy theory will although be given a longer development.

2.1. Stakeholder theory

Stakeholder theory was proposed by Freeman, in an effort to challenge the formerly dominant assumption of the primacy of shareholders (Freeman, 2002). The main idea that he puts forward is that organizations need to satisfy all of their shareholders in order to be successful in their businesses. This leads us to defining who stakeholders are. In the stakeholder theory, stakeholders are the groups or the individuals that the organization and its operations affect or are affected by, be it in a positive or a negative manner. All these shareholders are entitled to make some claims and demands, but due to different personal interests, there are possibilities for these claims to be conflicting. And not only are they conflicting as such, but they also affect each other’s outcomes in terms of harms or benefits and rights and obligations. As for the different stakeholder groups, Freeman distinguishes the followings: management, local community, customers, employees, suppliers, owners (Freeman, 2002).

2.2. Legitimacy theory

Legitimacy is a concept which has been discussed and researched for several decades now, and the broad scope of available literature concerning the subject is the result of different takes that researchers have had throughout the years, with several significant works such as those of Downling and Pfeffer (1975) or DiMaggio and Powell (1983). Taking these contributions into consideration, key in our reflection has been Suchman’s approach of legitimacy (1995), which appears as the most thorough and comprehensive. He proposes an exhaustive view of the concept and makes a typology of all the types of legitimacy that different authors have come up with, explaining the importance of the approach in
determining the result. As he claims, legitimacy is too often studied from a variety of narrow perspectives, which in the end fail to capture the big picture. He further looks into the ambiguities which may exist in the use of this concept of legitimacy as well. His definition is as follows:

“Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions”, (Suchman, 1995, p. 574).

In other words, legitimacy is a social construct which is the result of a successful congruence between the behavior of an entity and the set of beliefs of the collective audience it is judged by. What matters here is the opinion of the group, not what single individuals may think; although legitimacy is possessed objectively, it is crafted subjectively (Suchman 1995). Therefore, being successful in either gaining or retaining legitimacy demands that an organization understands the norms, values, beliefs and definitions of its environment, and adapts in consequence to be able to reach the goals it has set itself. However, the path towards the gain or the conservation of legitimacy will be different depending on the expectations of the audience, which vary with the type of organization and the type of industrial field, and depending on the kind of social and cultural context the organization finds itself in.

Taking different approaches to legitimacy is also what researchers do when it comes to studying it. Those adopting the strategic view see legitimacy as something over which management has relatively large control and as an asset that entities use to attain their objectives (Downling and Pfeffer, 1975). There is here a distinction made between symbols and values, used by the organization to gain legitimacy, in opposition to factual and tangible outcomes produced by the corporation, on which the audience bases its judgment. The second approach is the institutional one. Here, legitimacy is not an asset which can be used as such, but a set of beliefs, which is often common to managers and to the audience, and which usually has to be followed in order for the organization to be accepted (Powell and DiMaggio, 1983). It emphasizes the strong cultural pressures an organization is subject to, due to its embeddedness in an industrial environment defined by a set of constitutive beliefs. Put more simply, these two points of view oppose in that in one, legitimacy is a resource the organization can manipulate, while in the other it is seen as an inevitable part of life expressed through a taken for granted system of beliefs, thus one over which the organization possesses
little to no control (Swidler, 1986). The strategic perspective, with its more managerial standpoint, has a “looking out perspective”, while the institutional one, based more on the view of the audience, has a “looking in perspective” (Suchman, 1995, p.577).

In reality, both these perspectives exist at the same time. Management try to build successful strategies they believe will enhance the public’s perception of their organizations. In the meantime, it is very hard to sell something that you don’t believe in yourself; therefore the management and the constituents need to be, in a deeper sense, synchronized. Like Suchman, we are adopting an integrative approach, taking into consideration both these perspectives, since there are obvious advantages using a theory that reflects real life as much as possible.

2.2.1. A typology of legitimacy

Having introduced the basics of legitimacy theory, we shall now review a key addition proposed by Suchman (1995). Effectively, he proposes a classification of the different types of legitimacy into three categories; pragmatic legitimacy, moral legitimacy and cognitive legitimacy. When reviewing those three types, it is assumed that the entity is desirable within the constructed social system it belongs to; what distinguishes them though, is that they rely on different behavioral dynamics (Suchman, 1995).

Pragmatic legitimacy, to begin with, is based on direct exchanges between the organization and its audience, an audience mostly caring about what consequences the behavior of an organization has for them. In other words, this audience decides to grant legitimacy to a firm based on what they have to gain in doing so. It is a sort of give and take, which at the basic level can be considered as exchange legitimacy. At a little more advanced level, individuals may broaden their interest considerations, i.e. they can decide to grant an organization legitimacy that maybe does not correspond to their direct interest, but does it when considering their larger, and still personal, interests. It is then labeled influence legitimacy. The final form of pragmatic legitimacy, dispositional legitimacy, helps qualify firms that have attained a high level of personification and importance in society. In that case, the audience will treat the firm in the same manner as they do a person, and will legitimate organizations which they believe they share values with, or organizations that appear to them as trustworthy. This more advanced form of pragmatic legitimacy is not to be neglected, since
like for a good person, the audience may be more likely to forgive an organization which it believes to be good. Thus it can make it easier for the corporation enjoying this kind of legitimacy to keep or regain the audience’s trust when going for example through times of crisis (Wartick and Cochran, cited in Suchman, 1995).

The second type, coined moral legitimacy, differentiates itself from the former type by leaving behind considerations of self-interest. Instead, it gives as its name indicates more weigh to the moral aspect, and sees the audience defining as legitimate the behaviors which are considered as good, as the right thing to do, according to the norms and value system of this audience. Depending on the moral system of the audience, this right thing to do will be evaluated according to different criteria. If the group values results, we will talk about consequential legitimacy. If executing tasks the right way is what matters to the audience, be it for rational reasons or not, the organization is then to gather procedural legitimacy. When this attachment to procedures is generalized to the whole firm, it should instead be called structural legitimacy. In that case, the organization will be granted legitimacy because it is seen as fit for its kind of activity, i.e. people will trust them because they appear as a serious business doing things the way one expects them to be done, although here the quality of results does not matter. To obtain moral legitimacy from its audience, it should be noted that an organization does not need to actually act in accordance with the audience’s norms and values; creating stories explaining how their actions fit with those norms and values can be sufficient (Meyer and Rowan, 1977). This goes along with DiMaggio and Powell’s explanation to why firms have become so similar to one another in their organization; they claim this is due to the corporate will to attain legitimacy in their environment, and is not the result of a quest towards higher efficiency (DiMaggio and Powell, 1983). A fourth and final form of moral legitimacy exists, personal legitimacy, which rests on the charisma of a leader (Suchman, 1995).

The third type, cognitive legitimacy, rests on neither personal interest, nor the evaluation in relation to a coherent system of beliefs. This type of legitimacy recoups the point of view described by Swidler (1986) who talked of the taken for grantedness of a system of beliefs. In its most developed form, this is what cognitive legitimacy is about; people see no other possibility than the existing system. In its weaker form, cognitive legitimacy will be more about proposing the audience something its system of values allows it to get an understanding of; otherwise, the audience will reject it. According to Suchman (1995), market economies in particular very rarely reach that state, underlining the gap that may exist between market and
planned economy, and pointing in the direction of some possible difficulties when making the transition from one to the other. Moreover, he adds that those three types are most likely to collide when social institutions are poorly articulated or the country is going through historical transitions.

Suchman (1995) finally makes use of these threes types and their subcategories that he proposed to create a typology of legitimacies, represented with a matrix, as follows:

![Matrix of Legitimacies](image)

Figure 1, source: Suchman, 1995.

With this matrix indirectly emerge archetypes, with two being of particular interest for this study. Archetype one corresponds to the so-called permanence legitimacy. This form of legitimacy is of the deepest cognitive type, taken for granted, works over the long term and defines structurally legitimate organizations with a good behavior. In this category notably fall banks. Archetype three is then coined inevitable, and describes organizations which are procedurally legitimate, and subject to constituent direction, i.e. influenced by the interests of the audiences, such as law firms, medical clinics or local schools. They are, when compared to archetype one, quite similar except for the fact that they are granted legitimacy based on their actions. Whether this would be a better category to place banks into is an issue which will be considered.
2.2.2. The challenges of legitimacy

Suchman (1995) not only describes these three types of legitimacy, he also categorizes the different challenges faced by an organization on its quest towards legitimacy, depending on the situation it finds itself into. Effectively, different corporate situations will require different tactics, and thus three main situations are distinguished; gaining legitimacy, maintaining legitimacy, repairing legitimacy.

The biggest challenge when willing to gain legitimacy is basically the problem usually faced by newcomers in general, that is to become accepted by the new group which you wish to become a part of. From there on, three different strategies can be adopted by the organization in order to cope with its environment. The first solution is adaptation, i.e. accepting to fall in the mould of your audience’s norms and values. It has the advantage of posing few challenges (Meyer and Rowan, 1977). The firm can otherwise prefer to choose an environment in which it knows it would easily fit. The final possibility is for the organization to manipulate its environment, but the more taken for granted legitimacy is, the more difficult the challenge will prove to be.

The second challenge is maintaining legitimacy, especially when events that threaten the organization’s legitimacy appear. Maintaining legitimacy requires first of all avoiding being blinded by your successes or apparent lack of problems. In other words, managers should not lose grip with reality, and remember that the support of one group does not mean the support of all. Another technique is to stockpile legitimacy by capitalizing on what you have done well, in order to make it last.

The final challenge is repairing legitimacy, after your organization has lost it or has been caused significant harm, and shares some features with gaining legitimacy. One big issue with that situation is what Suchman (1995) calls the retractation cascade, when audiences stop supporting your organization because they are unwilling to be associated with your declining image. In that case, even former supporters can turn their back on you. The organization which legitimacy has been damaged then needs to act and start a process of corporate apologia. It seeks to wipe off the harm done to its image by dissociating itself and marginalizing the bad part of the organization to prevent it from tainting the rest. In the meantime, it adopts a strategy of corrective action, which means either denying the problem or acknowledging its misbehavior and its moral implications. This second part of the strategy
is completed by reaffirming values shared by the audience (Hearit, 1995). From there on, two courses of action can be followed; reorganize the part of your organization from where the failure originated, or setup a sort of surveillance system to strongly signify your commitment to righteousness. But organizations should beware of the so-called self-promoter’s paradox; rather than reassuring, being too extreme in willing to exhibit an improved behavior may end up nurturing suspicion and doubt among your audience (Jones and Pittman, cited in Harvey, 2001).

3. Method

Studying the evolution of legitimacy implies not only to look at the actual situation, but also to take into consideration past events and their context. In this regard, our main source for data collection has therefore been newspaper articles which convey not only opinions, but also the values and norms of a society at the moment they are written (Downling & Pfeffer, 1975). More specifically, we decided to focus on Swedish newspapers for several reasons. The first reason is that our study is centered on Swedish banks and Sweden and its news sources always keep an eye out open on what is happening on the other side of the Baltic Sea. Secondly, if foreign newspapers may have seemed relevant at first, it appeared after reading articles from the Financial Times and The Economist that their distance in terms of geography was reflected in their interest for the topic of Swedish banks in Latvia. In other words, they remained much more detached and factual. We chose to elude Latvian sources as well after having consulted The Baltic Times, Dienas Business and Baltic Business News, since they offered few articles giving subjective pictures of the situation and when they so did, we found the same type of article in the Swedish newspapers. A third and simple reason is that none of the writers of this thesis masters the Latvian language, which would have been needed to take part of the larger daily newspapers, Latvian equivalents of Dagens Nyheter or Svenska Dagbladet.

To begin our study, we chose to use the Swedish database Affärssdata, which offers a centralized access and research tool for a very comprehensive selection of Swedish
newspapers. To be as broad and thorough as possible, we based our research on only two terms which were *Lettland* and *bank*, the Swedish for *Latvia* and *bank*, the word *bank* being in the singular form to maximize search results. We then asked to obtain all search results including both those terms. As for the time span of our study, we deemed it relevant to start after the end of the Soviet era, with our first relevant article being from 1995. We then arbitrarily decided to end it at the date of May 15, 2009, our last relevant article being from May 11, 2009. In terms of numbers, the search for articles gave a result of 1,900 articles with a content of both “Latvia” and “bank” during the whole period from 1992 to May 15, 2009. Out of these, we collected 238 articles, which are the newspaper articles we base our discussions on.

Choosing which articles were relevant to our study was done by going through all the search answers, and picking up those matching the criteria we defined. The main criterion was for the article to convey an opinion or an attitude, be it positive or negative, towards what it focused on. Effectively, numerous articles showed up to be solely factual and were therefore eliminated, such as referrals to quarterly results where the articles merely displayed the figures for the respective bank. For the rest, they were first classified according to the attitude adopted, whether it was positive or negative. To fall in the positive category, an article had to present the banking entities and their actions in a positive light, notably by putting forward what they are doing well and overall by describing them using a range of positive terms and adjectives. Articles classified as negative then exhibited the opposite characteristics. It should also be noted that some articles could fit in both categories, if for example two different parties with different opinions expressed themselves, but these were few. We then classified the articles based on who expressed this opinion using five different categories; the banks, the governments, the regulators, the journalists, the public opinion.

The final classification was a bit more advanced and organized the newspaper articles in the four categories of: economic citizenship, legal citizenship, ethical citizenship, discretionary citizenship. This classification was created by Carroll (1979) and has since then been used by other researchers and theorists, e.g. Maignan et al. (1999) and Kuznetsov et al. (2009), who felt that the existing framework for studying corporate citizenship was not sufficient; they wanted other tools to better assess the issue of what a business is responsible for, and to better take into account the many activities constituting corporate citizenship. The point in using this classification in our study is therefore to obtain the most complete representation possible of
the Swedish banks’ behavior. In place of a traditional definition, each type of citizenship is defined by a list of criteria. Economic citizenship is about conducting a sound business which strives for continuous improvement. Legal citizenship concerns knowledge of the law, and respect of it by the company and its employees, inside and outside company boundaries. Ethical citizenship examines whether the company has a comprehensive code of conduct and a trustworthy behavior. Finally, discretionary citizenship considers the positive impact the corporation has on its environment, on the life of its employees and on that of the population in general, by for example taking part in sponsorships of events of public interest or giving charity to purposeful societal activities.

When classifying our articles, the two most common types of citizenship we found were the economic and the ethical ones. Again, when classifying the articles according to their type of citizenship and who expressed an opinion, there was the possibility for them to fall in more than one single category. In order to assure the relevance of our findings, it is important to note that each of the authors of this thesis made his/her own assessment and classification, and that the final choices were, in the case of a discrepancy between them, the result of a discussion ending up in a consensus.

Going through all those newspaper articles was the first step of our study. It aimed at giving us a good overview of the evolution of the general perception of Swedish banks in Latvia, and it was especially needed to get a good general idea of the early years. Effectively, we considered that interviews about past events of this nature may not necessarily remain so accurate, and were also concerned that opinions expressed might be influenced to some extent by what has happened since, and is happening now. But interviews appeared to us as relevant for a better insight in recent events, and in this sense as a good complement to our secondary data in order to reach our goals. Thus the second part of our work consisted in the conduct of interviews. Three were carried out; one related primarily to the time before 2006, while the other two covered also present time.

The selected interviewees are persons considered to be in different ways way knowledgeable about the Swedish banking business in Latvia, without being employees of the banks themselves. The interviewees are: Mr. Stig Friberg, the trade commissioner and former head of the Swedish Trade Council in Latvia from 2001 to 2005; Mr. Alf Vanags, the director of
the Baltic International Centre for Economic Policy Studies (BICEPS) which started in 2002; and finally, Mr. Rejnis Berzins, one of the founders of a newly established non-governmental organization (NGO), LAKRA (Latvijas Kreditnemeju Apvieniba, or in English, Latvian Borrowers Association), a lawyer working part-time and on a voluntary basis with LAKRA.

Our interviewees were chosen because of their knowledge of Latvia’s financial and societal development. Moreover, they provide us with different angles on the situation. Mr. Friberg stands for the earlier period of strong growth and has a certain insight into various Swedish companies and their efforts to establish themselves in Latvia. Mr. Vanags is a representative for the political and economical research community. Finally, Mr. Berzins has a very hands-on knowledge about, and good insights into, the individual aspects of the financial situation. While the first two interviewees, due to the nature of their function, have a broad view of the Latvian society, the member and founder of LAKRA also brings to the picture a view of how the situation is like for Latvians in the everyday, contributing with insights more related to the ethical aspect of current banking activities.

All three individuals were interviewed via telephone, and each interview lasted between 30 and 45 minutes. The documentation of these interviews was done by taking notes during the phone calls, and although the interviews started with a predefined questionnaire, the interview questions evolved during the interview in order to get an in-depth understanding of the interviewees’ insights and opinions. The interview questionnaire is displayed in appendix 1.

As for the questionnaire, we inspired ourselves from the categories used by Maignan et al. (1999) in a survey, which was itself built on a questionnaire developed by Carroll (1979). We then modified it to fit an interview situation and took away questions that were irrelevant for our purpose.
4. Empirical study

4.1. Corporate citizenship expressed in newspaper articles

We will now consider the evolution of the legitimacy of the Swedish banking industry in Latvia as seen through the eyes of the media. This will be done by using the data which we gathered when going through all the newspaper articles relevant to our subject, and later organized. Our classifications will here allow us to see what attitude is more often adopted when writing about the Swedish banking industry in Latvia, who expresses it and thus which audience is more in favor of the banks and vice-versa, and finally what areas of citizenship are given most consideration. The analysis will consist in three parts: from 1992 to 2009, i.e. over the whole period, from 1992 to 2005 and from 2006 to 2009. The first part is of course to give an overview of the whole period, while the aim with the second and third parts is to see whether a significant change occurred in the picture given by the press of Swedish banks with the degradation of the economic situation.

4.1.1. Overview, from 1992 to 2009

Over the whole period, there are more negative opinions expressed overall, although the percentage of articles being positive remains significant, reaching 47 percent. One should also not forget that some articles, though few, contained both attitudes.

Without surprise, the two most positive publications are economic ones; Dagens Industri has 60 percent of positive attitudes, while Veckans Affärer reaches 83 percent. They are also the two newspapers, along with Affärsvarlden, to focus the most on the economic aspect of corporate citizenship. Moreover, these publications and articles were those that gave space for the banks’ own opinions. In these papers, especially within Dagens Industri and Veckans Affärer, the journalists expressed themselves less than in other media as well.

Oppositely, the newspapers which had a dominant proportion of negative attitudes were also those that focused more on ethical citizenship, with at least one third of their articles for each
newspaper. They were also those with the largest proportion of opinions expressed by journalists and the public opinion.

From this it seems that we can differentiate two opposite trends among the Swedish press, with the exception of Affärsvärlden which is a little harder to classify; one trend that is more business promoting and the other which to a larger extent takes the stand for the public opinion. This seems to prove the idea expressed by Dowling and Pfeffer (1975) that media reflect the norms and values of their audiences; different audiences having different kinds of concerns about the situation in Latvia, the publications which aim at addressing them differ in what they are offering.

4.1.2. From 1992 to 2005

We then divide our time span in two parts, considering first the period from 1992 to 2005, the period of expansion before any signs worth worrying about really appeared.

Immediately, we are offered a very different picture, with a clear majority of articles being on the positive side, 84 percent of them expressing positive attitudes. Looking at the data for the area of citizenship, the focus is almost completely and only about economic citizenship, the other aspects being barely mentioned. The large majority of these opinions are then expressed by banks and journalists, other categories being almost absent as well. It is also interesting to notice that during that period, Dagens Industri has the lowest percentage of positive attitudes, and the most articles about ethics, although the corresponding numbers are still 72 percent and only 11 percent.

During these years, the Swedish banks were presented in the media as professional and efficient (Hastad, 1999), safe (Larsén, 1998), and possessing a good know-how of the business (Waikla, 1999). They were considered as having had a strong contribution to the development of Latvia, and notably to its financial sector, in which Swedish banks also introduced higher standards (Blomgren, 2002).
4.1.3. From 2006 to 2009

During the three following years, from 2006 to 2009, the shift is rapid and brutal, with now 76 percent of articles presenting negative attitudes about the Swedish banks in Latvia. Once again, Dagens Industri and Veckans Affärer remain the most positive papers, with respectively 47 and 67 percent of positive attitudes. Moreover, they are still the channels that present the banks’ opinions, and occupy the first and the third place in the ranking of the newspapers most focused on economy and less on ethic. Another interesting point is the strong overall growth of articles expressing a view of ethical citizenship, now concerning 45 percent of all articles, while the legal and discretionary ones remain insignificant. Banks are less present among the interviewees, while regulators, governments and the public opinion to a larger extent are given a voice.

During this period, the Swedish banks became the object of criticism for being too aggressive (Lans, 2007) and having a questionable behavior when it came to their lending policy (Flores, 2007, Forsberg, 2008 and Sönne 2009), which was considered as having contributed to the loss of balance and the overheating of the economy (Braconier, 2007), and for which they should be taking more responsibility (Schück, 2007). The banks were ultimately pointed at by the Latvian government in Dagens Industri (27 February 2009) for, according to them, having contributed to the country’s problems.

What these results show is first and foremost that a change in the opinion can happen very quickly, and that the press is best described as versatile, maybe even populist. As in Suchman’s (1995) retractation cascade system, a manager should not take his allies and favorable audiences for granted, since, as we see here, they can rapidly shift their sympathy and positive attitude from one subject to another. One might go a step further stating that it seems like the financial aspect is the only thing media are interested in displaying as long as the financial development is positive, while ethical perspectives become an issue for concern only when harder financial situations appear for a company or for an industry as a whole. In other words, one could say that media in general express maybe too little critic towards business when times are good, but perhaps too much when times get rougher.
4.2. The interviews

We will now present a brief summary of the interviews, in order to put forward some important points.

All three interviewees gave a similar answer to the first question. They stated that the foreign banks in Latvia have been important for the whole societal development, since they have been able to finance important infrastructural projects and because they have contributed to modernize the financial market in Latvia during the transition period.

Furthermore, all three gave a negative answer to the question of whether they believed that today’s situation would have been different had the foreign banks not been present. They reserved themselves for the possibility that there might have been a lack of capital though, which would have restrained credit expansion. But in essence, they all believe that the banks’ activities during the period of growth have been understandable and logical in their quest for market shares and expansion.

When asked how trustworthy the banks are in the eyes of the general public, only two interviewees felt that they could answer this question; Mr. Friberg felt he was not updated on today’s situation since he moved from Latvia in 2006. The two others then both believed that the public’s opinion is changing towards a more negative attitude. Mr. Vanags pointed out though, that only Parex bank has had troubles due to a movement of panic from its clients, causing them to withdraw their deposits from the bank; this led in turn to a liquidity crisis and the takeover of the bank by the Latvian government. His conclusion is therefore that people in general still trust the foreign banks more than they do the Latvian banks; or, he reflected further, it might be that it is the Swedish government the Latvian public trusts rather than the banks. Another statement came from Mr. Berzins regarding the public trust; “It has changed very fast; up till now banks were considered as very solid, professional and kind establishment. But today people very fast change their opinion they say things like “the banks don’t care for people only about numbers”.”
4.3. Combining the theoretical and empirical frameworks

Before going further with the analysis, a description of how theory and empirically are combined into a framework that can serve as a basis for the analysis is needed to clarify the analytical part.

To create the tool to conduct our analysis, we wanted to use in combination two elements presented in the earlier sections. The first one was Suchman’s theoretical approach for maintaining and repairing legitimacy based on its three types of pragmatic, moral and cognitive legitimacy (Suchman, 1995). The second one was the classification introduced by Carroll (1979) to categorize the different aspects of corporate citizenship, and used as a method of structuring the way media cover and write about our chosen subject. A way to link between those two perspectives was then needed. Hence, with the help of the literature, a two-dimensional table was created in which the two perspectives are cross-categorized (Figure 2). Worth noting is that the cross-categorization should only be seen as an indication of where we believe the main focus lies for the respective categories; in other words, we chose to somewhat simplify reality for reasons of clarity.

Going through the four categories of corporate citizenship and starting out with the economic perspective, we believe that this category is first and foremost related to pragmatic legitimacy. The argument behind this is that the public perception of a company’s financial performance is generally relatively vague. Knowledge is rather limited to a spectrum of stakeholders, i.e. the owners and shareholders, and their relationship is based on an exchange type of relation which, in turn, fits the definition of pragmatic legitimacy. Of course, a firm’s financial strength seen over a longer period of time has an impact on cognitive legitimacy as well. Nevertheless, in the context of this study, which covers a relatively short time period of only one business cycle, it appears as too far-fetched to state that there is a strong relation between economic citizenship and cognitive legitimacy. For this reason, this relation is represented in the table by a cross of a lighter color.

Legal citizenship is defined as the way in which a company follows and adapts to rules and regulations of the environment in which it exists. Accordingly, this aspect of citizenship corresponds primarily to moral legitimacy. The public’s perception of a company as an entity that follows existing rules, norms and standards, strengthens the company’s moral legitimacy,
and vice versa. But, as in the case of economic citizenship, a constant negligence of rules, norms, standards will in the long run harm the cognitive legitimacy of the company or the industry as a whole. This view is expressed with a lighter cross in the square for cognitive legitimacy and legal citizenship. In contrast, it is not easy to influence the legal aspect of corporate citizenship through manipulation or the use of strategies that change the judgment of the public. Therefore, there is no cross in the box where pragmatic legitimacy and legal citizenship meet.

Moving further to ethical citizenship, we believe that this category primarily matches cognitive legitimacy. An organization that acts unethically will very often be confronted with a public opinion that will, in the extreme case, question its existence. Oppositely, an organization can reach the status of taken-for-granted, by being viewed as a trustworthy actor that brings value to society through its actions and which behavior reflects a high standard of ethical values, in line with those of the society as a whole. Here, one should also mention that there is a grey area between acting within the limits of the law and acting ethically, i.e. between the letter and the spirit of the law; in the figure below, this is represented with a lighter cross, in the box where moral legitimacy and ethical citizenship cross. As was the case for legal citizenship, the ethical aspect is not easy to manipulate in order to get the public more favorable to your organization. This is showed by the lack of a cross in the square for pragmatic legitimacy and ethical citizenship.

Regarding discretionary citizenship, we found no articles dealing with this aspect, thus making it less interesting to explore any further. Nevertheless, it is our belief that this is an aspect a company can use both as a mean to quite simply look good, but also as the expression of a sincere wish from management to take part in philanthropic activities such as charity that the discretionary aspect relates to both pragmatic legitimacy as well as moral legitimacy. It is although rare for these types of activities to be that interwoven with the organization itself or its core activities. They are not either that continuous, as to have a long term impact on the cognitive legitimacy.
<table>
<thead>
<tr>
<th>Type of legitimacy / Area of corporate citizenship</th>
<th>Economic</th>
<th>Legal</th>
<th>Ethical</th>
<th>Discretionary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pragmatic legitimacy</td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Moral legitimacy</td>
<td></td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Cognitive legitimacy</td>
<td>X</td>
<td>X</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

Figure 2, own creation.

With this reasoning, we now have a guideline for translating the classification of the articles according to the four categories of citizenship into the theoretical understanding of legitimacy. In the following chapter, we will use this guideline to understand the factual development of the public’s perception of Swedish banks in Latvia. Firstly, we will attempt to analyze what went wrong in the perspective of legitimacy. Thereafter, we are applying Suchman’s strategies for maintaining and repairing legitimacy as an attempt to understand what could be done, primarily from a management perspective but also from a societal perspective.

5. Analysis

5.1. The profile

In this part, we are trying to establish a legitimacy profile for the Swedish banks in Latvia. This is done by using the legitimacy archetypical profile for banks proposed by Suchman (1995) as a foundation, and to which we add the Latvian context, in order to obtain a modified profile fitting our specific subject of interest. After having built this profile, we will analyze what went wrong and the impact this process has had on the legitimacy of Swedish banks in
Latvia. In the end, we propose strategies to repair and maintain legitimacy in order to move forward.

5.1.1. The environment of financial institutions in general

To understand the specifics of the environment and industrial field banks are operating in, it seems appropriate to use Scott and Meyer’s illustrative fourfold typology (Figure 3). According to this view, banks in general exist within an organizational field characterized by strong technical pressures as well as institutional ones (Scott and Meyer, 1991). From here on, it should be noted that the descriptions will be based on the Swedish legislative structure, unless some other country is specifically described. Nevertheless, this description is applicable to most other countries, including Latvia, where there exists a developed financial sector, since the field of financial institutions is to a very large extent harmonized on an almost global basis.

<table>
<thead>
<tr>
<th><strong>Technical Controls</strong></th>
<th><strong>Institutional Controls</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stronger</strong></td>
<td><strong>Stronger</strong></td>
</tr>
<tr>
<td>Utilities</td>
<td>General manufacturing</td>
</tr>
<tr>
<td>Banks</td>
<td>Pharmaceuticals</td>
</tr>
<tr>
<td>General Hospitals</td>
<td></td>
</tr>
<tr>
<td><strong>Weaker</strong></td>
<td><strong>Weaker</strong></td>
</tr>
<tr>
<td>Mental health clinics</td>
<td>Restaurants</td>
</tr>
<tr>
<td>Schools</td>
<td>Health clubs</td>
</tr>
<tr>
<td>Legal agencies</td>
<td>Child care</td>
</tr>
<tr>
<td>Churches</td>
<td></td>
</tr>
</tbody>
</table>

Figure 3, source: Scott, 2003.

The technical pressure is strong since the banks are strongly outcome controlled. Their products are heavily restricted and regulated in relation to quality and pricing and operational security. The institutional pressure is very strong as well, since the banks are required to comply with an extensive set of complex and relatively detailed rules that regulate daily business decisions and operations. Besides control by auditors, tax authorities and others, which is applicable to all industries, controls are performed by the Financial Supervisory Authority (FSA) or *Finansinspektionen* in Swedish, as well as the Central Bank. The FSA presents its role is to be the promotion of stability and efficiency in the financial system, as
well as to ensure an effective consumer protection. They authorize, supervise and monitor all companies operating in Swedish financial markets. The FSA is accountable to the Ministry of Finance. The way the controls are performed is by extensive reporting requirements as well as personal regular meetings with key persons within the financial institutions and in-situ inspections. In addition, the central bank, responsible for the monetary policy including payment stability in Sweden, is monitoring and regulating certain areas of the financial sector in Sweden (Riksbank, n.d.). In other words, organizations operating in the banking industry are participating in a business system that combines complex technical requirements with a strong public good component (Scott, 2003).

Other existing bodies also serve as a link between regulative authorities and financial business organizations, a link that is needed in order to intermediate between the conflicts that these two equally strong pressures, technical and institutional, inevitably create. This is an industry that has to get things done efficiently and profitably within a complex technical environment, at the same time as it has to follow equally complex rules guarding the everyday life. These bodies are for example the Swedish Bankers’ Association (Svenska Bankföreningen) and the Swedish Securities Dealers Association (Svenska Fondhandlareföreningen). Together with the FSA and the Central Bank, these organizations can be seen as the financial sector’s macro structure, mirroring the strong control pressures that this sector is subject to. Quite naturally, this external macro structure has to correspond with the banks’ internal organization. The study of organization charts of the Swedish banks give at hand that this is taken care of via relatively heavy staffed legal, compliance, risk and internal auditing departments (Nordea, SEB, Swedbank, 2008). Most other countries, especially Western but also other countries with an existing financial market, have the same structure of governing and supporting macro structure (Suchman, 1995).

5.1.2. To be a legitimate financial institution in general

In combination with Suchman’s legitimacy theory (1995), being a legitimate financial institution would imply that banks need to establish all three kinds of legitimacy. First, they need a cognitive legitimacy based on being perceived as taken-for-granted. They also need to establish a moral legitimacy based on structure, exhibiting compliance with rules and
regulations, and overall showing that they are well-integrated within the institutional environment surrounding the banks. Finally, they also need a pragmatic legitimacy based on proving to be an efficient, knowledgeable and not too bureaucratic counterpart for companies as well as for private individuals (Figure 1).

Since we are focusing here on Swedish banks operating in Latvia, we need to consider whether the above description of the mix of different types of legitimacy needed for a bank is applicable to the Latvian society, or if there are circumstances that change this description slightly or completely.

5.1.3. The Latvian context

Latvia, as well as other former members of the Soviet Union, is usually referred to as a transition economy, i.e. a country undergoing a systemic shift from a totalitarian communistic regime to a western democratic and capitalistic society. In addition, Latvia is a small country with only 2.2 million inhabitants (European Union, 2009). These two factors have an impact both on the institutional environment surrounding the financial industry and on the public’s perception of banks in general, and of foreign banks in particular.

Firstly, Latvia is undergoing very rapid changes, and building a legal system in general and a legal system regulating financial institutions in harmony with the rest of the EU in particular takes time. For this reason, some areas remain less regulated than elsewhere in Western countries. Areas that still need further development are for example consumer protection legislation, handling of overdue loans and pledged assets (Rejnis Berzins, 2009 pers. comm., 18 May).

Secondly, Latvia is a very small financial market with a limited number of actors. This, together with the fact that the country has, for a number of reasons, chosen a currency board tightly linked to the Euro, has led to a situation in which the central bank only has the potential to steer the activity level of the economy via the commercial banks. A tight currency board regime strongly limits the central bank’s possibility to use the interest rate tool as a mean to, for example, cool down the economy in the case of an overheating. The only possibility the central bank has to affect the activity level in the economy is then to try to influence the commercial banks to restrain, in case of overheating, the credit expansion. But
trying to influence the supply by demanding from the commercial banks to voluntarily limit
their business has not proved to be very successful. Thus, the tool left for the Latvian
government is to use the fiscal policy to stabilize the economy, as explained in Dagens
Indutri, January 22, 2009.

Thirdly, there is a history of murky business from the time when the privatization process
started in the early nineties. Publicly owned assets were transferred to private hands, and
throughout this process numerous tales of fraud and corruption circulated in the society,
creating mistrust between the public, politicians and businessmen (Kuznetsov et al., 2009 and
Dagens Nyheter, January 15, 2009). Western governments and politicians are in general,
among people in Latvia, viewed as more trustworthy and less corrupt than their own political
elite, and this view has to some extent spilled over to Western firms, including Swedish
banks. The general public has, during the Swedish banks’ investment phase, perceived these
banks as trustworthy and professional. One could almost say that there is a tendency to
naivety in the way Western societies have been idealized.

One example supporting this view is the case of the Latvian bank, Parex Bank, one of the
largest banks in Latvia together with Swedbank, SEB and Nordea. Like the Swedish banks,
Parex faced a higher ratio of credit losses when the economic recession started. Like in
Sweden, the Latvian government issued a guarantee of the bank, stating that all deposits in the
bank were to be recovered if the bank was to face financial difficulties that would threaten its
survival. But unlike the clients of the Swedish banks who also received a guarantee from the
Swedish government, the clients of Parex didn’t trust the Latvian government’s guarantee.
This led to a run on Parex; clients simply withdrew their savings from the bank, thereby
causing a liquidity crisis in Parex. Following these events, the bank’s situation became of
such grave nature that it was eventually taken over by the government. This picture of
complete trust in Swedish banks might be about to change though, as we shall discuss later in
this paper (Rejnis Berzins, 2009, pers. comm., 18 May, Alf Vanags, 2009, pers. comm., 18
5.1.4. The profile – conclusion

So, does the suggested legitimacy archetype Suchman prescribed for banks in general also fits with banks within a transition country such as Latvia? According to our analysis, the answer should be yes, although it seems appropriate to make a few adjustments. The alteration from Suchman’s profile should rather be in the sense of a reinforcement of the need for legitimacy, especially cognitive and moral legitimacy, due to the specific character Latvia has as described above. Effectively, cognitive legitimacy being the Swedish banks’ greatest strength in Latvia, it is very important for them to wisely handle the great trust bestowed upon them and by that to continue to be viewed as an important part of the societal infrastructure. Since Latvia is a country that has little experience of trusting powerful organizations or people, moral legitimacy is very important as well; the banking sector needs to follow the rules at all times, and be very clear about routines and structures, by explaining what they are doing and why.

<table>
<thead>
<tr>
<th>Types of legitimacy</th>
<th>Suchman’s archetype</th>
<th>Modified profile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pragmatic legitimacy</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Moral legitimacy</td>
<td>X</td>
<td>XX</td>
</tr>
<tr>
<td>Cognitive legitimacy</td>
<td>X</td>
<td>XX</td>
</tr>
</tbody>
</table>

Figure 4, own creation.

5.2. What went wrong

In this part the authors are trying to analyze the media dynamics from a legitimacy perspective. We divide the story in two parts, where the first part is an analysis of the period until 2005 (approximately); and the second part continues from there and covers the period until May 2009.
5.2.1. Pre economic recession and crisis (until 2005)

The first factor of importance, when trying to understand what went wrong, is the Latvian market’s situation characterized by a highly competitive environment. From the articles published in the newspapers we have read, we can follow how the Swedish banks expanded their businesses in the Baltic region. Below follow a few examples of headlines displayed in articles from Dagens Industri throughout the years from 2000 to 2005, and reading this makes the competitive situation quite clear. It should be noted that the titles were translated into English between parentheses by the authors.

13 06 2005    SEB växer i Lettland (SEB expands in Latvia)
29 06 2001    Lettiska Parex rustar mot SEB och FSB (Latvian Parex prepare for SEB and FSB)
19 01 2001    Nordiska bankrivaler kämpar om Litauen (Nordic banking rivals fight for Lithuania)
29 08 2000    SEB tar nästa steg i baltisk strategi (SEB takes its next step in Baltic strategy)
27 08 1999    Het höst i Baltikum (Hot autumn in the Baltics)
21 05 1999    Drömsits för Hansapank (Hansapank’s dream position)
24 02 1999    Merita Nordbanken redo för storaffär i år (Merita-NB ready for major investment)

The underlying atmosphere displayed here is sort of an adventurous, lucrative market expansion, where the banks are competing against each other for their share of the Latvian and Baltic banking market.

Another sign of the fierce competition were the bonuses paid out to the employees in the banks, promoting sales volumes above all. In a documentary program about the Swedish banks in Latvia made by the Swedish Television (Bek and Trane, 2009), employees of Swedbank were interviewed and described how this bonus system incited the staff to sell as many credits as possible. These stories are also supported by the newspapers, which present further accounts of primarily the Swedish banks’ expansive and generous credit policies. One can look at appendix 3 for examples.

A second factor of importance for explaining what went wrong, is the lack of restraining incentives from regulators in Latvia. The Latvian government implemented, in connection with the transition to the capitalistic market system, a strict currency board, locking the Latvian currency (LAT) to the Euro (EUR). The purpose for this choice was to prepare the country for an entrance into the European Monetary Union. As a consequence, the government’s and the Central Bank’s possibilities to restrain an overheating situation by
increasing interest rates became non-existing. Again, quotes relating to this situation are to be found in appendix 3.

These above listed factors, in combination with the specifics of a transition market, i.e. a market characterized by a relatively low degree of public experience from this type of competitive market in which commercial banks try their best to sell their services to the public, resulted in an overheating situation and in the creation of rapidly growing market bubbles on the brink of explosion.

But as is usually the case in such situations, the implications of our actions are not fully understood until afterwards. Accordingly, most of the criticism against the banks starts to increase in volume around the years 2006 and onwards. According to our collected statistics there were only 16 percent, i.e. 10 out of 74 articles, about the Swedish banks in Latvia that expressed a negative view of some kind; whereas between 2006 and 2009, 76 percent or 123 out of 162 articles expressed a negative view. These negative views were, to a large extent, related to the banks’ activities that took place previous years.

In conclusion, and relating to the legitimacy profile, the period up until 2005 appears to be a period during which the Swedish banks’ legitimacy profile seems to be intact and even thriving. The banks enjoy a good reputation within Latvia; they are seen as professional, financially strong, service-minded and as good business partners (Vanags, Berzins and Friberg, pers. comm).

5.2.2. During recession and crisis (from 2006)

As mentioned above, during this period we have included 162 articles about the Swedish banks in Latvia; out of these 123, i.e. 76 percent, display a negative attitude towards the banks. In this part, we’re trying to establish the essence of the criticisms the banks are facing.

Firstly, when looking at the 36 articles that convey a positive view of the banks, during from 2006 to 2009, one can conclude that out of these, 32 articles deal with the financial perspective, e.g. positive reactions towards the IMF loan that was granted to Latvia, as well as positive reports about the banks’ ability to financially manage the crisis. According to our profile, these types of comments for which the main recipients are shareholders and investors, mainly affects the pragmatic legitimacy, meaning that the rest, the 4 articles conveying other
positive messages besides the economic ones, are almost negligible. Considering in addition that economic citizenship is still to the largest part also valued negatively, with 95 articles conveying a negative attitude, it is not surprising that the share prices have plummeted with 50 to 75 percent during the last year or so. Thus, despite the fact that there is a more mixed picture regarding pragmatic legitimacy, it is fair to say that the total outcome is definitely on the negative side. At the moment, rapid fluctuations are part of the pragmatic legitimacy aspect. Should the financial situation get better, the situation regarding pragmatic legitimacy would look much brighter.

Secondly, in the light of our secondary data and our interviews, it seems that, when the economic situation is hardening, the Latvian clients of the banks experience a harder attitude in their contacts with the bank. Regarding the handling of overdue loans, there is a perception of Swedish banks acting rough and taking advantage of the weaker legislative framework in Latvia which leaves room for the banks to try to recover their assets more forcefully than what they do and are allowed to do in Sweden (R. Berzins, 2009, pers. comm., 18 May and Leijonhufvud, 2009). Another example is given in Realtid, April 18, 2009; “...Nordea tar i med hårdhandskarna. En stor lettisk sportbutikskedja beskyller banken för stöld och påtryckningar...” According to our profile, this situation of perceived unethical behavior on behalf of the banks, probably causes a dent in the public opinion's view of the Swedish banks' cognitive legitimacy and to a certain extent the moral legitimacy as well.

Thirdly, and with the same type of reasoning as the second point above, it seems that there is an opinion that the banks are taking advantage of the Latvian people’s ignorance about their rights vis-à-vis the banks. There are examples of contracts people have signed with the banks that leave the client no room for a possible debt reconstruction, a normal and regulated procedure in our western economies (Berzins, 2009, per. Comm., 18 May). Also this factor, a perceived unethical behavior towards clients of the banks, will damage the cognitive legitimacy.

A fourth point, is that there are voices that question whether or not the Swedish banks are, apart from an unethical behavior, also trespassing the limits of legal behavior in their efforts to recover their assets. Various newspapers are reporting about the police or other authorities that are supposedly going to investigate the banks’ behavior when handling bad debts (Braconier, 2009 and Dagens Industri, May 9, 2009). Even though these alleged investigations have not yet resulted in any reports about whether or not the banks have broken
the laws, the mere suspicion expressed will probably have a negative effect on the legitimacy for the banks. In line with our framework, legal misconduct results primarily in a weakening of the moral legitimacy. But should this aspect evolve further in a negative direction, it would eventually also hurt the cognitive legitimacy.

5.2.3. What went wrong - conclusion

We have described the development of the Latvian public’s perception of the Swedish banks in Latvia during the post-Soviet era, starting from the period when the Swedish banks started their investments in Latvia and the Baltic region, approximately between 1995 and 2009.

During this time the banks have gone from being perceived as professional, competent and trustworthy to a situation in which people, through channels such as media, politicians and other organizations such as LAKRA which helps the banks’ clients in their contacts with the banks, are questioning their behavior. According to Suchman (1995) and our own analysis, we believe that this development has damaged the perceived legitimacy of the Swedish banks in Latvia, especially the cognitive and moral aspects of legitimacy, i.e. the aspects of legitimacy that according to our profile are the most important ones.

The banks communication with the public through media, which do not include marketing activities, mostly takes place referring to the financial perspective, i.e. they address their communication towards shareholders and investors rather than their clients and the public in general. One might therefore assume that there could be an underestimation of the seriousness of what is now going on in the general public’s perception of the banks.

One might speculate about the reasons why the banks seem to underestimate the accusations they are facing. An explanation could be a lack of management understanding of the differences between the Latvian and the Swedish societies. Sweden has a long banking history of over 150 years, thus people believe and see the banks as trustworthy, even when the times are bad. Rules and procedures are clear and most people understand how to act when in financial trouble. In Latvia people have a history of a modern capitalistic economy only since 1990, there’s a lack of consumer protection laws and there’s a lack of knowledge and competence among individuals regarding how to handle a difficult financial situation. Therefore the need to communicate and to educate the clients of the banks is a necessity.
Another possible explanation might be that since the banking market is an oligopoly and the Swedish banks are the dominant player in Latvia, the risk of not communicating is limited as long as they all behave in the same way, which up until now seems to be the case. However, this seems to be a rather short-sighted strategy considering the long-term perspective and consequences, a dent in the cognitive and moral aspects of legitimacy can cause.

But, who is to blame for the situation? It is not within the scope of this paper to answer that question, but one could at least have a brief discussion about this. There are different opinions and views about who is to blame, and three main directions appear. The first is of course the banks. But there are also other views; the economic research community and other financial professionals often defend the banks and put the blame on the government instead. The arguments for this perspective, as presented in *Dagens Nyheter*, January 22, 2009, are that it is perfectly logic for a business in a capitalist market to compete, and that to simply ask the banks to restrain themselves does not work. Instead, it is the government that should set up restrictions via a tight fiscal policy and through regulative measures that would force the banks to restrict their lending activities, as written in *Dagens Industri*, January 22, 2009. Other voices that are heard points out that the Latvian people in general have had unrealistic expectations concerning their financial development; consequently, they have simply been taking loans that are too large in relation to what they can manage, and therefore, according to this view bear a share of the responsibility.

Effectively, reality is probably that complicated; there is not one party that is to blame for this situation, but many factors and parties that have contributed, and to try to measure how large a part the various factors and actors should take is probably not in anyone’s interest. The most important should be to find means to avoid these situations in the future.

5.3. Doing it right – legitimation strategies

After having discussed the reasons behind the loss of legitimacy of Swedish banks in Latvia, we shall now look at the strategies that are offered to them in order to turn things to their advantage again.
The Swedish banks’ legitimation strategies in the Latvian market should first and foremost be directed towards the moral and cognitive forms of legitimacy; these two types have not only traditionally been their biggest strength, but they are also the pillars of legitimacy for banking institutions in general. Furthermore, it is important for organizations so much based on those two types of legitimacy to prevent any possible phenomena of retractation cascade (Suchman, 1995).

The first general recommendation one can give is to aim at closing the gap which exists between the corporate social responsibility (CSR) statements, which all banks have, and reality. These general CSR statements should apply to all markets the banks are present and doing business in, and not only in Sweden for example. And, as we have seen during this study, there are very obvious spillover effects between markets, meaning that bad publicity in one market becomes bad publicity in all markets (Kostova and Zaheer, 1999). The most obvious corrections would then consist in adopting Swedish practices regarding procedures of bad debt recoveries. This would mean for the banks to abandon procedures that are harsher or more forceful than they are in Sweden, even though they are legal according to the Latvian law.

Another step is to reaffirm the values of your organization, and showing that these coincide with that of the Latvian society, in other words engage a process of corporate apologia (Hearit, 1995). In combination with that, the Swedish banks should consider taking measures concerning the part of the organizational chain which has been the most criticized or questioned. This is either done by overtly dissociating the rest of the organization from the criticized, or considered guilty, part, or by replacing some part of the staff which has been considered as involved in the activities which will now be conducted in another fashion.

Furthermore, the banks should also change the way they communicate with their stakeholders, all their stakeholders. This is meant with a thought to give a special focus to the general public, which in a transition market often needs to be informed and to some extent, educated to the rules of the new system. Understanding not only their needs, but also the state of mind they are finding themselves into, can help the organization avoid more faux-pas in their legitimation strategy. In addition, the banks should get involved in the measures that need to be taken by the government at the societal level; this includes the need to reshape the financial
Finally, pragmatic legitimacy is in a way, more easily repaired, since it is mostly based on the extent and quality of the economic services they are giving their audiences. As we have seen in the aforementioned, the issues with the general public are more of a moral or cognitive nature. Where the Swedish banks’ pragmatic legitimacy has been hurt is more on the side of its shareholders and the financial markets, which have sanctioned these organizations notably through decreasing share prices and valuation. Due to the nature of pragmatic legitimacy, repairing is therefore more straightforward than it is for the two other types; it means reorganizing, this time to improve financial efficiency, to reassure this audience in the long run.

6. Conclusion

In this thesis, we focused on analyzing the evolution of the legitimacy Swedish banks operating in Latvia are granted by their local audience, and tried to sort out the reasons behind their loss of legitimacy. To do so, we proposed a framework which links the three main existing types of legitimacy, i.e. pragmatic, moral and cognitive legitimacy, to what can be considered as the key aspects in describing corporate citizenship, i.e. economic, legal, ethical and discretionary citizenship. This framework provided us with a guideline to interpret the numerous relevant Swedish newspaper articles we collected, which constituted our secondary data. This data was completed with material extracted from interviews we conducted of individuals knowledgeable about the actual situation in Latvia. Inspiring ourselves from Suchman’s first archetype in which he classifies banks, the combined use of our two sources of information then allowed us to propose a modified archetype to qualify the legitimacy profile which we believe best fits a banking organization in Latvia, and in the context of a transition market in general. As a result, moral and cognitive legitimacy quite clearly appear as the types to prioritize when being active in a transition economy. Moreover, it seems more important than elsewhere to cater to all your stakeholders, which includes communicating to
the general public, since the rules of the new economic system individuals are now finding themselves into is not necessarily anchored in everyone’s mind yet. For this same reason, their behavior can retain a part of unpredictability and volatility, as proved by the example of Parex bank, which we described.

Thereafter, we considered Suchman’s strategies for maintaining and repairing legitimacy in an effort to understand what could be done to right misbehaviors that occurred, primarily from a management perspective but also from a societal perspective. When looking at the reasons behind the banks’ questionable behaviors, the first explanation is their aggressive sales ambitions; competition was tough and bonus systems based on sales were introduced, while regulators were not setting much restriction and the market was still very immature. This was although only understood later one. When the economic situation started to turn around, an aggressive behavior was then exhibited in the practices used to recover bad loans, with still little regulation through a deficient legal framework, and individuals lacking knowledge of their rights. Not only were thus the moral and cognitive legitimacy harmed, but the pragmatic one was also, as a consequences of the economic downturn, and then the crisis. In this regard, the best answers to this situation seem to be first giving increased attention to moral and cognitive legitimacy strategies by taking measures such as those describe in our thesis; make corporate social responsibility statements a reality, implement bad debt recovery systems similar to ours, dissociate their organization from personal who might have misbehaved or renew their staff to send a message to the general public, communicate to inform and educate the Latvian public opinion. At the societal level, there appears a need to reshape the financial system and render it more accountable to its audience, give the state more tools for control and regulation and of course keep implementing and reinforcing the legal framework.

To conclude, our thesis and the framework we propose should be seen as an attempt to better understand the evolution and the loss of legitimacy as it occurred in the case of the Swedish banks in Latvia of course, but also more generally to provide a better understanding of what influences legitimacy in transition markets and in the general sector of banking. Yet, we see several ways to take this understanding further. The study could first be extended to more countries, such as Latvia’s Baltic neighbors. The media analysis could be more thorough, notably by using tools to systematize and categorize articles, and by looking into Latvian sources. Another suggestion would be to test the impact on legitimacy different managerial strategies have, so as to better understand how legitimacy can be influenced.
References

Books and journals


**Web documents**

*Affärsdata*, newspaper articles database, retrieved from http://www.ad.se


Appendixes

Appendix 1 - Interview questionnaire

1) What role do you believe the banks have today/ have had in the past for the Latvian society?

2) What do you consider the main causes of the current financial crisis in Latvia to be?

3) Do you think that the current economical situation in Latvia today would have been different if the majority of the banks in Latvia were Latvian owned? Motivate!

4) How trustworthy do you believe the Latvian population considers the Swedish or other foreign banks to be? Do you believe that they trust Swedish / foreign owned banks more or less than Latvian banks? Please motivate.

What is your own picture about Swedish banks in Latvia:

5) Considering Financial performance? What do you base your opinion on?

6) Considering reputation? What do you base your opinion on?

7) Considering how successful Swedish banks have been in identifying and pursuing opportunities in Latvia? What do you base your opinion on?

8) How ethical do you consider the behaviour of the Swedish banks to have been/be? What do you base your opinion on?

9) What is your opinion of the way Swedish banks treat their employees in Latvia? What do you base your opinion on?

10) In your opinion; have the banks behaved responsible from a societal point of view?
   - If yes: What could the banks have done to reduce public criticism against them?
   - If no: What could/should they (the banks) have done differently?

11) Are there areas that need to be improved in order to increase financial institutions social responsibility? Please motivate.
Appendix 2 – Graphs

Positive versus negative attitudes as expressed in the Swedish press over our periods of study:

Repartition of the types of citizenship represented in the Swedish press over our periods of study:
Appendix 3 – Quotes from Swedish newspapers

”...I en i dagarna publicerad rapport om finansiell stabilitet varnar Riksbanken för den snabba utlåningstillväxten i de baltiska länderna. ”Hushållen och företagen i de baltiska länderna fortsätter att öka sin upplåning i hög takt. Även om detta sker från låga nivåer kan utvecklingen inte fortsätta på sikt....” in Dagens Industri, December 9, 2006


”...forskaren Alf Vanags vid Baltic International Center for economic policy studies i Riga... Ja, inte var det exporten som stod för tillväxten. Det var för lätt att tjäna pengar under fastighetsboomen. Bankerna borde inte ha varit så aggressiva i sin utlåning men trots att de vet att de är en del av en bubbla lönar det sig för den enskilda banken att hålla igen, säger han...”, in Svenska Dagbladet Näringsliv, October 26, 2008.

”...De svenska bankerna är en del av Lettlands problem, säger landets nye regeringsbildare Valdis Dombrovskis, som i går fick presidentens uppdrag att ta Lettland ur den ekonomiska kris som fällt den avgående regeringen.... Förra regeringen misslyckades med att reglera kreditmarknaden, så de svenskägda bankerna verkade inom ett bristfälligt regelverk, menar Dombrovskis... “, in Göteborgs-Posten, February 27, 2009.