Institutional Uncertainty and Market Signals in Transition Economies: Deceptive Mimicry in Russia's Post-Communist Banking Industry

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Abstract

We propose that foreign investors from western, developed countries are highly susceptible to strategies of deceptive mimicry in transition economies. By "deceptive mimicry, we refer to the imitation of the form of a signal in the absence of substantive content (Gambetta, 2005). The high levels of institutional uncertainty present in early stages of reform in transition economies are likely to lead some foreigners to rely on familiar, market signals to evaluate domestic organizations, and the same institutional uncertainty is likely to lead domestic organizations to successfully mimic western-style signals. Under these conditions, foreign investors are likely to find that the use of familiar signals lead to consequences opposite to those desired. We test our propositions about the consequences of deceptive mimicry by looking at the characteristics of Russians banks that received foreign loans prior to the August 1998 financial crisis and the subsequent survival of the banks following the crisis. We show that foreign investors relied on western-style signals to make investment decisions before the crisis, but it was exactly the banks that displayed these signals that were more likely to fail afterwards.

Research in multiple disciplines has shown that economic actors in developed economies rely on *perceivable signals* to discriminate between potential partners with regards to desired *unobservable qualities*. For example, when investors look for opportunities (Certo, Daily, Cannella and Dalton 2003; Stuart, Hoang, and Hybels, 1999), employers look for workers (Heywood and Wei, 2004; Spence 1974), or customers look for products and services (Ambler and Hollier, 2004; Nelson 1974), economic agents use signals to infer the presence of desirable characteristics. While the importance of market signals is well-documented in the western academic literature (see also Podolny, 2005; Allen and Faulhaber, 1989; Cohen and Dean, 2005), most empirical research has taken place in the United States. The presence of a relatively stable and effective institutional environment is a basic assumption that is rarely explicitly addressed. An important question for foreign investors is whether signals that are reliable at home can be relied upon to the same effect abroad.

The question of the efficacy of market signals is particularly important for foreigners wishing to enter transition economies. Transition economies are the set of states in East Asia, Central and Eastern Europe, and the former Soviet Union that exited from socialism in the 1980s and 1990s (Peng, 2003; Hoskisson, Eden, Lau, and Wright, 2000). These economies have introduced new policies that have led to liberalized markets and privatized organizations. Yet, while new rules designed to govern new market sectors were often introduced with the stroke of the pen, the legislative, judicial and political structures to enact new laws in practice have taken more time to develop. Instead of a rapid transition from socialism to western-style capitalism, the policies of initial reform in transition economies have left a period of incremental evolution full of institutional uncertainties. A central challenge for firms in such environments is the development of strategy while the rules of the game are not fully known (Peng, 2003; Meyer and

Peng, 2005; Spicer, McDermott and Kogut, 2000).

Under these conditions of institutional uncertainty, we propose that some foreign investors are likely to rely on western-style market signals to gather and evaluate information. By 'western-style' market signals, we mean that foreigners from western, developed countries are likely to look for local manifestations of market signals that are similar to the ones they rely upon in their home countries. Foreigners are unlikely to have access to local sources of information to evaluate partners or opportunities and therefore are likely to rely on impersonal techniques of evaluation such as market signals (Peng, 2003). Foreigners are also likely to notice and respond to market signals because they are familiar sources of information that they have used elsewhere (Boisot and Child, 1999).

While our first proposition is that foreigners are likely to use western-style signals to gather and evaluate information in transition economies, our second is that, if used, western-style signals are likely to have the opposite results to those desired. To model the dynamic interaction between foreign and domestic actors in the development of new market signals in transition economies, we build on Gambetta's (2005) general model of "deceptive mimicry." In a review of the concept of mimicry across multiple disciplines, Gambetta argues that the emergence of a new signal is likely to engender a mimicked response. If a new signal gains traction as a meaningful technique of evaluation, then some actors will try to imitate the form of the signal in the absence of substantive content.

We propose a similar dynamic between foreign investors and domestic actors in transition economies. If domestic actors understand that foreigners will look predominately at certain types of signals when investing in transition economies, then domestic actors are likely to mimic those signals to attract foreign investment. An important consequence of such mimicry is

that the reliability of western-style market signals as a source of valuable information is likely to change dramatically in the context of transition economies. The presence of a familiar signal may reflect efforts to manage impressions rather than a substantive commitment to invest in market resources and capabilities. Under these conditions, a foreigner may discover that the use of western-style signals may lead to consequences that are the *opposite* of those usually found at home. Instead of a familiar signal reflecting a desired characteristic, such as the soundness of an organization or the presence of reliable management, foreigners who rely on western-style signals in transition economies may find that these signals reflect opposite qualities, such as an unsound organization or the presence of opportunistic leadership.

Our argument shares similarities with the work on symbolic management that demonstrates that firms often display signs to manage external impressions and relationships, while, at the same time, decoupling this symbolic activity from substantive operations (Meyer and Rowan 1977; Fiss and Zajac, 2006; Westphal and Zajac, 1998). We suggest a similar role for mimicry here. In an effort to gain western legitimacy, domestic actors may choose to display western-style signals even if they lack the substantive content to support such appearances.

We differ from existing research, however, in that we look more closely at the interaction between those who display signals and those who receive them. Symbolic management research usually focuses on the causes and consequences of imitative strategies from the perspective of the mimic; research has identified the many rewards that organizations may gain from successfully decoupling symbol from substance (Fiss and Zajac, 2006; Westphal and Zajac, 1998). In contrast, the consequences of mimicked signals for those who mistakenly rely on them are less examined. For instance, Zucker (1986:65) observes that signals "cannot be solely symbolic – over time receivers will discount the signal unless it remains correlated with the underlying quality or

characteristic it represents." Our use of the concept of "deceptive mimicry" is designed to make a similar point. If foreign investors misinterpret what a signal represents, then the outcomes are more than symbolic. There are likely to be strong, negative consequences to relying on deceptive market signals.

We develop and test hypotheses of foreign susceptibility to deceptive mimicry in the context of the Russian banking industry during the 1990s. The empirical examination of deceptive mimicry is difficult in any setting because the underlying qualities to which signals are correlated are unobservable at the time a decision needs to be made. Only when signals are tested over time does additional evidence become available to evaluate whether initial beliefs turned out to be validated. The August 1998 financial crisis in Russia provides a unique setting to examine these issues in the early stages of the development of a new market in a transition economy. We are able to observe the foreign use of signals before the crash as well as develop a measure of whether these signals proved reliable in predicting survival following it.

The paper is organized as followed. First, we present our theoretical model that identifies the types of conditions under which we are likely to find deceptive rather than reliable signals in emerging economies. Second, we operationalize and test our model within the Russian context and present the empirical results. Our hypotheses of deceptive mimicry are supported in the Russian context; our data demonstrates that western-style signals had the opposite consequences in Russia than they tend to have in western institutional contexts. Third, we review qualitative data that provides additional evidence of the role of deceptive mimicry in explaining our findings. We conclude by discussing the theoretical and business implications of our study.

Theory:

Deceptive Mimicry in Transition Economies

To model the dynamic interaction between foreigners choosing to rely on familiar market signals in transition economies, and domestic actors trying to imitate the same signals, we rely on Gambetta's (2005) concept of "deceptive mimicry." In his review of evolutionary models of signal development across disciplines, Gambetta (2005) posits that the introduction of any new signal is likely to engender its own mimicked response. He uses a biological example to illustrate:

> In biology, the standard mimicry case has two phases. First, there emerges a mutant of some k-possessing type of organism who bears a clearly perceivable sign, m. K is any unobservable quality of the mutant, for example toxicity, and m is, say, a bright marking or distinctive odor. If a predator of that mutant learns to associate k to m and refrains from attacking it when perceiving m, this gives the mutant a selective advantage over other k-possessors without m. This mutant is called 'model'. The discerning predator too is advantaged relative to one that does not perceive m or associate it to k.
>
> In a second phase, there emerges a mutant without the k property (say, non-toxic) but also bearing m. Observing m the predator refrains from attacking the non-toxic mutant for it takes it to be the toxic one. This second mutant too becomes selectively advantaged, in this case over other non-k bearing organisms without m. This mutant is called 'mimic', and the action by which mimic 'persuades' the predator that it has k and induces it to respond accordingly, is called mimicry.

According to this notation, "models" are those actors that display a sign, m, and truly possess an underlying characteristic, k, and "mimics" are those actors that display a sign, m, but do not possess the desired characteristic, k. If successful, "mimics" are able to gain advantages over models, and over other non-k bearing actors, since mimics have the benefit of appearing to possess desirable characteristics that they do not actually have to spend the resources to develop and maintain.

Gambetta (2005) argues that the field of evolutionary biology has made the most advances in studying deceptive mimicry and therefore uses an example from that literature. His broader point, however, is not to discuss the substantive content of the biological example, but instead to argue that the process described in a deceptive mimicry model is a general one that has many applications to human affairs as well. Humans consistently imitate the manners,

expressions and behaviors of others to pass themselves off as someone they are not. "Deceptive mimicry," he argues, is as important in understanding the social evolution of signs and signals in economic systems as in biological ones.

Gambetta (2005) notes the presence of elements of the deceptive mimicry model in the field of economics as well, such as in the incentives for a seller to deceive a buyer (Akerlof, 1970) or an employee to exaggerate his or her capabilities to an employer (Spence, 1974). He argues, however, that less research has taken place into deceptive mimicry in economics than in biology because economists have "focused more on the honest rather than on the dishonest signals, and on separating rather than on weaker equilibria. As a result, the mimics and the myriad of strategies that they employ, while understood in their broad outline, have remained in the shadow." The general focus on the long-term economic benefits to honest signals, he argues, leads to models that explain why mimicry is likely to be short-lived rather than to models that are able to explain the "the myriad of strategies" that leads mimicry to be a constant feature in economic life. He suggests that a multi-disciplinary approach is necessary to look at the processes that allow some economic actors to enact their own environments under conditions of uncertainty through the active gaming of signs and symbols.[1]

In this paper, we apply Gambetta's (2005) process model of "deceptive mimicry" to the interaction between foreign and domestic actors in displaying and receiving signals in transition economies. We suggest that foreign investors are likely to rely on familiar signs and strategies when coping with the highly uncertain business environment in transition economies (Boisot and Child, 1999; Peng, 2003). The same uncertainty provides the opportunity for domestic actors to

[1] Research into symbolic management in organizational theory is a good example of a literature that looks at the "myriad of strategies" that mimics take in enacting their environment through the strategic use of signs and symbols (e.g., Meyer and Rowan, 1977; Fiss and Zajac, 2006; Westphal and Zajac,1998; Elsbach, 1994). But note that that the "deceptive" part of Gambetta theory is rarely examined in these accounts of mimicry. The reasons why some individuals come to rely on certain signals is less examined than the strategies of those who display them.

engage in the type of deceptive mimicry that Gambetta (2005) describes. By investing in displaying signs that are familiar to foreign investors, mimics are able to develop advantages over other model organizations and over other organizations that do not invest in signaling. From this perspective, domestic actors are active participants in the way that they are viewed and evaluated by foreigners. If some domestic organizations in transition economies begin to attract foreign investment by displaying certain signs, then mimics are likely to enter the market by displaying the same signs.

Our intent is not to identify the specific market signals domestic actors will mimic across all transition economies for all types of foreign investor. Instead, we suggest that any application of deceptive mimicry is highly context specific; it is mimics' knowledge of local contexts that allows them to imitate signals that outsiders interpret as meaningful. Domestic actors are likely to mimic signs that appear to be familiar and reliable to foreigners because it is precisely these signals that will reap the highest rewards if successfully copied. To focus our analysis, however, we specifically focus on foreign investor from developed, western economies. We refer to 'western-style signals" as the local manifestations of market signals that are likely to be familiar to investors with experience in western, developed economies.

We choose this group of foreign investors for two reasons. First, we concur with Peng (2003) that foreign investors from developed economies are likely to be a large and important group of investors in transition contexts.[2] Given the important presence of this type of investors in transition economies, it is likely that efforts at mimicry are likely to target signals familiar to investors from western, developed countries.

[2] Peng (2003) argues that market participants from all western, developed countries, despite differences between them, are likely to have more experience with impersonal market strategies than domestic organizations in transition economies. We use the terminology of "western" to refer to the broad set of developed, countries in North America and Europe that have established the type of predictable and impersonal rules that Peng (2003) describes.

Second, we suggest that the type of reforms implemented in many transition economies also contribute to the role of western-style signals as targets of mimicry. New legal forms emerged from the market reform process in transitional economies that often mirrored those found in western, developed economies: joint-stock companies, stock markets, corporate governance by-laws, accounting standards, and securities and exchange commissions all developed quickly through policy reform (Kogut and Spicer, 2002). Some prominent, western advisors claimed that the radical restructuring of transition economies to match western models could take place rapidly with the implementation of the correct policies (Sachs 1993; Boycko, Shleifer, and Vishny, 1995). Given these conditions, it is likely that at least some foreigners would believe that the business environment in transition economies would converge quickly on western best practice, supporting the conviction that western-style signals should have similar meanings abroad as they do at home.

While new laws may have appeared on the books that mirror those found in western, developed economies, the laws in practice in transition economies still remained highly contested and easily avoidable in early stages of transition (Coffee, 1996; Peng, 2003; Spicer, et. al., 2000). While domestic firms may often seem to be producing information that confirms to western standards – such as in the production of corporate governance by-laws, financial and accounting data or third-party endorsements or certifications – the emergent nature of the regulatory system in transition economies makes the costs of producing deceptive, western-style signals much lower in transition economies than in more established institutional systems.

Our argument is not that domestic actors always engage in mimicry with the initial intent to defraud. Deceptive mimicry may take place through exaggeration, bluffing, self-delusion, and the unwitting omission of relevant information as well as outright fraud and swindling. Most

likely, a mixture of motives will define the types of deceptive strategies mimics apply in any market setting. From the vantage point of the foreigners, however, the motivations of mimics are most likely less important than their consequences. If foreigners rely on signals in transition economies in the same ways as they do in developed economies, they are likely to experience outcomes that differ strongly from initial strategic intent.

We develop two propositions in applying the model of deceptive mimicry to foreign investment in transition economies. *First, we propose that foreign investors from developed, western countries are likely in early stages of transition to rely on familiar, western-style market signals in evaluating the potential quality and commitment of domestic organizations.* A number of researchers have remarked, in general, of the motivation for foreigners from developed countries to rely on familiar strategies when coping with uncertainty in transition economies. Boisot and Child (1999: 247) remark that a common strategy of western enterprises in China is to "attempt to reduce cognitive complexity through imposing familiar routines and standards upon business." Peng (2003) further elaborates that the use of impersonal strategies to gather information and structure governance systems will be a particularly familiar routine for foreigner investors. The lack of accessibility to more personalized systems of information provides strong motivation for foreigners to rely on familiar, impersonal strategies in transition economies. From this perspective, western-style market signals are likely to be used because they are both accessible and familiar. They provide a source of familiar and public information that foreigners are able to tap into given their status as outsiders in transition economies.[3]

Our second proposition is that western-style signals, if used, are likely to prove deceptive

[3] Foreign investors from developed countries who doubt that familiar, impersonal techniques could be imposed with success in transition economies are likely to wait until a later stage of transition to enter. In contrast, it is likely that foreigners who enter first are more likely to experiment at first with western-based strategies, such as relying on familiar market signals.

in their consequences. Since foreigner investors are likely to rely on western-style signals in evaluating domestic organizations, domestic actors may deliberately focus on imitating the form, but not the substance, of western business practices. Those wishing to attract foreign investment may invest in skillfully presenting the mannerisms, appearances and signals that westerners have come to associate with successful businessmen and businesses in the hope of convincing foreigners that their organizations possess qualities that actually do not exist.

While the possibility of attracting foreign investment provides the motivation to mimic western-style signals in transition economies, the emergent nature of the regulatory governance system in these societies provides an important explanation of the low-costs involved in the implementation of such a strategy. The costs of deceptive mimicry in any market depend on the institutional context. In the United States, for example, an established institutional regime governs the types of signals firms are able to display. Accounting standards supply investors and customers with relatively credible business information; reputable rating agencies differentiate between reliable and unreliable organizations; watchdog agencies, like the Securities and Exchange Commission, non-governmental organizations and independent financial media, bring activities that breach laws and norms to public attention; and a strong judiciary enforces compliance to legal standards (Khanna and Palepu 1997). In this type of environment, it is difficult, although certainly not impossible, to produce deceptive information over a long period of time without external accountability.

In contrast, the emergent nature of the regulatory governance system in transition economies makes it difficult to discover, publicize and punish mimicry. The effectiveness of a country's legal system, the strength of its accounting and governance practices, and the capabilities of its regulatory structures all contribute to the reliability of information and the transparency of

business practices within any national context (Kurtzman, Yago and Phumiwasana, 2004; Rao, Pearce and Xin, 2005). Yet, it is precisely these formal institutional governance systems that are still only partially operational in early stages of transition (Peng, 2003). Knowledge of what distinguishes a reliable from an unreliable signal has yet to be clearly discerned in early stages of change in transition economies. The opportunities for engaging in deceptive mimicry, as well as the possibility of avoiding punishment if caught, are therefore much greater in the transition context. The very uncertainty that leads foreigners to rely on market signals also allows mimics to imitate these signals at relatively low cost.

An important consequence of the relatively low cost of mimicry is that the reliability of western-style market signals as a source of valuable information is likely to change dramatically in the context of transition economies. The low cost of mimicry makes it difficult for economically sound (so-called "model") organizations to successfully distinguish themselves from less scrupulous competitors. By putting form before substance, deceptive mimics can make promises about future business potential that more sound businesses would be reluctant to make. Further, even in institutional environments with few social controls over the disclosure of information, the successful imitation of western-style signals, such as a high degree of advertisement or high third-party quality ratings, may still be expensive to achieve. Deceptive mimics may be more leveraged and susceptible to external shock than those firms who invest directly into their businesses without concern for the immediate impact on short-term signals. Following a classic adverse selection model (Akerlof, 1970), more sound businesses may simply choose not to compete in a market for foreign investment where mimicry leads to unrealistic expectations and demands.

We do not suggest that all markets in transition economies will be characterized by adverse selection in the types of organizations that seek western funding. Instead, we propose that in the

early stages of development, foreign investors are particular susceptible to strategies of deceptive mimicry. Given the high degree of uncertainty in these environments, foreigners will face strong motivation to rely on familiar routines and practices to find meaningful sources of information to evaluation opportunities and partners (Boisot and Child, 1999; Peng, 2003). At the same time, these countries are often characterized by an emergent regulatory system and opaque governance practices, which greatly decrease the costs of producing deceptive signals and increase the costs of identifying them. While the potential for deceptive mimicry is possible in any institutional environment, we suggest that the dangers of using western-style signals are particularly high during early stages of market transition.

Empirical Context: Foreign Loans to Russian Banks

The role of uncertainty over the meaning of signs is a critical feature of any application of a deceptive mimicry model. It is uncertainty that leads some actors to rely on familiar signals to evaluate others, and it is the same uncertainty that allow the objects of evaluation to successfully mimic signals. The deceptive mimicry model does not predict what the target of mimicry will be in a particular case. Mimics choose to imitate the signs that they believe receivers will interpret as having substantive significance. Determining what those signs are, and how best to mimic them, are part of the skills necessary to successfully implement mimicry and depend on local context (Gambetta, 2005).

Similarly, our proposition that foreigners are particularly susceptible to deceptive mimicry does not specify the types of western-style signals that are likely to be mimicked in any particular situation. The actual manifestation of mimicry – what exact signs are imitated, how and to what effect -- requires a socio-political analysis of a particular, situated context. In this section and the

next, we use the Russian banking industry during the 1990s as the context for an initial operationalization and test of our general propositions.

Background

Russia's private banking system emerged from market reform policies first initiated by Gorbachev in the late 1980s, and then consolidated by Yeltsin's introduction of "shock therapy" in 1992 in the newly independent Russia.[4] In the late 1980s, a private banking system had not existed in Russia. In contrast, by the end of 1994 over 2500 private banks had been licensed. Despite demand for traditional banking services arising from the liberalization of prices and the privatization of enterprises, most of the new banks profited from practices that reflected the uncertain and transition institutional environment of the time. So-called "pocket" banks assisted their founding enterprises to engage in opaque asset and monetary transfers. Many "de novo" banks profited strongly from cheap access to government funds in return for political support and financial reward (Johnson, 2000).

Between 1992 and 1994, a series of scandals hit Russia's emergent financial markets as many financial organizations that appeared to operate as "banks" – for instance, offering time deposits to the population – turned out not to have the proper state accreditation to legally offer these services. The collapse of the unlicensed financial organizations in 1994, combined with the failure of many of the largest licensed banks following the collapse of the interbank loan market in August 1995, led to a series of new reforms in the banking industry and the entry of new banks that promised more scrupulous behavior (Spicer and Pyle, 2002). In 1995, the Russian Central

[4] For a further description of the relationship between Russian reforms and the emergence of the new private banking industry, see Johnson (2000), Freeland (2000), Spicer and Pyle (2002), Frye (2000: chapter 8), Shleifer and Treisman (2000: Ch. 3), Perotti and Gelfer (2001), Puffer, McCarthy, and Naumov (2000), and Sychova, Michailov and Timofeyev (2001).

Bank increased its capital requirements for all banks and in May 1996 introduced a specialized regulatory agency, OPERU 2, to provide stringent oversight over Russia's commercial banks. These commercial banks within OPERU-2 had few ties to the previous period, thus representing an active choice to try to create a new slate for the development of a vibrant banking market. The new market participants who entered OPERU-2 also invested heavily in advertising in an effort to differentiate themselves from the less scrupulous banks that previously dominated Russia's financial marketplace (Spicer and Pyle, 2002; Avdasheva and Yakovlev, 2000).

The promises of stricter regulation, and the entry of new domestic counterparts promising serious investment in the long-term development of the industry, helped lead to the entry of large, western banks actively seeking to offer loans to the new Russian banks promising to develop the untapped Russian banking market (Sweeney, 1997). With interest rates at 5.25 percentage points above LIBOR, the Bank for International Settlements (1998) estimates that Russian banks received an estimated $12.1 billion of syndicated loans from foreign sources between 1995 and 1997. Much of Russia's international borrowing leading up to 1997 came from syndicated credits issued by western, financial institutions (Sweeney, 1997). [5]

The entry of foreign banks into the Russian loan market corresponded with the development of new third-party ratings and accreditation systems designed to identify the most reliable banks among the thousands that operated on the market at the time. For instance, the Central Bank of Russia regularly published data during the mid-1990s from the private rating company, the Rating Information Center (RIC), in its own in-house statistical abstracts (Spicer and Pyle 2002). The Central Bank also supervised the exclusive OPERU-2 regulatory agency that

[5] Syndicated loans are assembled by a "lead bank" or core group of banks, which are usually large global banks located in financial centers such as New York or London. While smaller banks from many countries around the world are able to participate in the credit issue, they take part as minority partners. The lead bank takes responsibility for research and analysis efforts when issuing and servicing the loans (Dodd, 1989).

promised strict accounting reporting and supervision among a small number of select Russian banks.

The Financial Institutions Development Project (FIDP), led by the World Bank and the European Bank for Reconstruction and Development, also began during this time period. The FIDP was developed as part of a package of other measures proposed by the G-7 countries aimed at providing comprehensive support to the Russian transition. The aim of the project was to create a core group of banks that would:

> " … serve as models of "good banks" for the entire financial sector. … Participating banks would be required to meet prudential standards pertaining to their capitalizations, lending and resource mobilization practices, and financial reporting. This would be complemented by yearly audits carried out according to international standards." (FIDP Project Information Document, 1994).

The program, initiated by a $200 million loan from the EBRD and the World Bank to the Russian government signed in June 1994, included funds to support the internal restructuring of participating banks and to "twin" each Russian bank with a respected western bank for training in risk management, strategic planning and credit management. Accreditation into the program required a comprehensive and in-depth screening of Russian banks involved a three day diagnostic review of each bank undertaken by a team of senior western bankers, which included face-to-face interviews with a bank's top leadership as well as analysis of a long-form audit based on International Accounting Standards (Guerin, 2005).

The Use of Western-Style Signals

Our first general proposition about the implications of deceptive mimicry for foreign investment in transition economies was that foreigners will be likely to use western-style signals to shape investment decisions. As discussed above, three relevant third-parties offered ratings and

accreditations in the Russian banking market during the mid-1990s: the Rating Information Center (RIC) rating agency, the World Bank/EBRD sponsored Financial Institutions Development Project (FIDP), and the Russian Central Bank Specialized Regulatory Organization, called OPERU-2. All of these third-party actors seemed to be providing valuable information to foreign banks that, given their own status as outsiders in the Russian environment, they would find difficult to find through more informal channels. Given that western investors have been shown to rely on the ratings of reputable third parties to make investment decisions in developed markets (e.g., Carter and Manaster,1990; Megginson and Weiss, 1991; Stuart, Hoang and Hybels, 1999), we hypothesize that foreign banks were likely to rely on local manifestations of similar signals in the Russian context:

Hypothesis 1a: The higher a bank's rating from RIC, the more foreign loans it received.

Hypothesis 1b: If a bank was an accredited member of the Foreign Institutions Development Project, the more foreign loans it received.

Hypothesis 1c: If a bank was an accredited member of OPERU-2, the more foreign loans it received.

Another familiar signal accessible to foreigners at the time was the degree to which Russian banks invested in advertising. In the financial and economic literatures, advertising has long been considered as a possible way to signal firm product or service quality (Ambler and Hollier, 2004; Kihlstron and Riordan, 1984; Spence, 1974; Nelson, 1974). This literature starts from the observation that higher quality providers are more willing to incur greater up-front costs than other firms to attract new clients. By committing to high expenditures on advertising (even advertising that is not particularly informative), a firm demonstrates to consumers that it expects its investment to be recovered (Ambler and Hollier, 2004). Essentially, investments in non-salvageable assets

such as brand recognition act as a bond to insure credibility (Nelson, 1974). Organizations without a long-term commitment to its products and customers would be unlikely to invest in assets that promise only long-term returns.

Given the experience of using advertising as a signal in developed economies and the salience of the signal in the Russian context, we propose that foreign bankers were likely to rely on advertising as an important signal when distinguishing between Russian banks in their lending decisions. The major Russian banks in this emerging market had not yet established reputations, and there were few alternative metrics by which to judge the financial soundness of the bank or the competency of its management. In contrast, even a cursory look at the mass media demonstrated large differences in advertising expenditures across banks. If westerners believed that that advertising worked as a signal in Russia as in the west, then advertising expenditures would be a salient and credible signal in Russia's banking industry; only those banks that believed that they would recoup their investment in the long run would invest in large upfront expenditures on advertising. In this case, foreign investors would be more likely to offer loans to Russian banks that advertised more heavily. We hypothesize that before the August 1998 crash:

Hypothesis 1d: The higher a bank's advertising expenditure, the more foreign loans it received.

While we propose that foreigners are likely to rely on western-style signals in gathering and evaluating information in transition economies, we also suggest that it is unlikely that domestic organizations will rely on the same criteria in making investment choices. Western-style signals are not only less likely to be a familiar technique for domestic actors, but domestic actors also more likely to have access to personal systems of networks and relationships that provide more individualized sources of information for choosing partners and opportunities (Peng, 2003). We therefore hypothesize that the western-style signals proposed to be important for attracting foreign

loans will not prove to be significant variables in explaining the amount of domestic loans that Russian banks received. In short, foreigners, but not domestic actors, will be likely to use western-style signals in the Russian context:

Hypothesis 2: The amount of domestic loans that a Russian bank receives will be uncorrelated with the presence of western-style market signals.

While we could repeat this "null" hypothesis for each of the individual signals previously identified, we instead develop a general hypothesis that suggests that domestic actors will not rely on any of the western-style signals in making their own investment choices.

The August 1998 Financial Crisis: A Test of the Accuracy of Market Signals.

Our second proposition developed in the theory section examined the question of whether, if used, western-style signals proved reliable in their consequence. A deceptive mimicry argument suggests that foreign lenders are more likely to use western-style signals than domestic lenders *and* that the same western-style signals are more likely to lead to negative, rather than positive, outcomes. In this section, we propose that the August 1998 financial crisis in Russia provides a nature experiment to examine the accuracy of the signals previously identified.

On August 17, 1998, the Russian government declared a default on its government bond obligations and a devaluation of the ruble, which had previously fluctuated within a tight Central Bank controlled corridor. Because of their unbalanced exposure to hard currency liabilities and ruble-denominated assets, including government securities, a number of banks were driven into insolvency. The "dependence of banks on external borrowings" also led the government to declare a 90-day moratorium on foreign bank debt following the August default (Russian Central Bank, 1998: 86). The hope was to allow Russian banks time to meet their foreign debt and forward

currency obligations.

Most observers agree that the least solvent banks used the 90 day moratorium to strip the most liquid assets from their banks (Sucher, 1999). The Central Bank's supervision of insolvent banks was both slow and opaque (*Moscow Times*, August 17, 1999: VIII). Although the Central Bank eventually created a specialized regulatory agency, the Agency for Restructuring Credit Institutions (ARCO), to supervise bank restructuring and liquidation, delays of up to 13 months in removing the previous management following the August crisis only further exacerbated asset stripping. While many Russian banks successfully survived the August crisis and met renegotiated foreign obligations, the regulators who eventually came to control the largest insolvent banks found few assets to pay back foreign creditors.

The August 1998 crash provides a strong test to the reliability of the endorsements, certifications and signals of Russian banks that preceded it. The Financial Institutions Project was specifically designed to identify "good banks" within the Russian context that had a strong long-term commitment to developing the new Russian banking market. The private banking rating company, Rating, had published bank reliability ratings before the crash, and the Central Bank had promised strict regulatory control over a group of select banks. The stated intent of all these third-party actors was to provide information that would allow outside observers to choose the most committed and reliable banks to hedge against the type of risks posed by such events like the August 1998 crash.

A number of factors of the institutional environment in Russia support the proposition that western style signals were likely to prove deceptive, rather than accurate, in this context. Despite the initiation of rapid institutional change based on western economic models in the early 1990s, the regulatory environment in Russia was slow to develop the degree of legal enforcement found in

developed, western economies. Rao, Pearce and Xin (2005), for instance, rate Russia as having the least (49th) market-supporting government out of 49 countries examined, while the United States ranked 13. Kurtzman et al. (2004) reach a similar conclusion in their cross-national analysis of economic transparency. Russia is ranked 40th, and the United States 6th, out of 48 countries examined.

The lack of regulation and economic transparency lowers the cost of producing mimicked, western-style market signals in the Russian context. For example, even if the Russian government promised strong regulatory oversight in such specialized agencies such as of OPERU-2, they had little capabilities, and perhaps few incentives, to implement such promises in practice, thus making it easier for Russian banks to transit deceptive signals with little risk of detection through legal oversight. Even if caught and accused, Russian mimics may also be able to escape legal punishment against with little difficulty.

A related argument about the low cost of deceptive mimicry can also be made about the World Bank/EBRD Financial Institutions Development Project (FIDP), even though this international organization had no direct connections to the Russian government. On the one hand, western experience and insider knowledge based on extensive due diligence might have been considered a reliable source of information in the uncertain Russian environment. On the other hand, this argument presupposes that western actors had sufficient knowledge of the Russian institutional environment at the time to distinguish between "models" and "mimics" in the application process. As we have suggested elsewhere, it is precisely the mimics in these types of institutional environments that have a certain advantage in impression management, since they are willing and able to invest in appearances more than other organizations. In fact, since other western investors looked at FIDP accreditation as a credible signal of financial soundness and

long-term commitment, deceptive mimics had particularly strong incentives to try to manipulate their appearances to meet accreditation standards in this program. If the FIDP experts relied on western-style signals in their own decisions, such as a reliance on the presence of formally reported financial data and strategic plans, they also were highly susceptible to a mimicry strategy. If they were unable to distinguish *a priori* between "mimics" and "models" banks, then they too would be susceptible to deceptive signals in choosing the "wrong" banks for their program.

A similar logic can apply to the meaning of advertising in the Russian context. First, if Russian banks believed that they were more likely to receive western financing if they advertised highly, the potential costs to advertising in comparison to its potential rewards were quite low. As already mentioned, the Bank for International Settlements (1998) estimated that Russian banks received an estimated $12.1 billion of syndicated loans from foreign sources between 1995 and 1997. The Russian Central Bank also estimated that Russian banks held over $22 billion worth of forward currency contracts to foreigners before the financial crisis (Russian Central Bank, 1998). The potential rewards for many Russian banks to the mimicry of western-style signals far exceeded the costs involved in producing those signals. Moreover, if the banks considered that there would be a good possibility of avoiding repayment on foreign loans and contracts in the case of failure, then the potential costs to mimicry were even lower.

In fact, banks that avoided investment in the substantive tasks of maintaining traditional banking services would actually have more resources available to spend on advertising and other signals than more prudent competitors, making it difficult for more risk-adverse banks to compete for western funding and investment. Mimics who received high levels of foreign investment could also use the money to maintain a high level of signaling despite a continued lack of profitable market activities. In this case, signal-based investment could be self-reinforcing; western support

could lead to higher-levels of western-style signals, which in turn could lead to more western support.

In this type of environment, foreigners who relied on western-style signal in Russia during the 1990s would most likely choose organizations that were, at best, highly leveraged and susceptible to external shocks, and, at worse, little concerned with long-term reputation and therefore less scrupulous in their business activity. We hypothesize that:

Hypothesis 3a: Banks with higher ratings were less likely to survive the August crisis than banks with lower ratings.

Hypothesis 3b: Banks that were members of the FIDP program were less likely to survive the August crisis than banks that were not members.

Hypothesis 3c: Banks that were members of the OPERU-2 program were less likely to survive the August crisis than banks that were not members.

Hypothesis 3d: Banks with higher advertising expenditures were less likely to survive the August crash than banks with lower advertising expenditures.

Data Analysis

To test our hypotheses, we present three analyses. First, we use foreign borrowing by Russian banks as the dependent variable in a hierarchical regression analysis to examine whether foreigners before the August 1998 crisis relied on Western-style signals when choosing which banks to offer loans (Analysis 1). Second, we use domestic borrowing by Russian banks as the dependent variable in a hierarchical regression analysis to examine whether domestic actors before the August 1998 crisis relied on western-style signals when choosing which banks to offer loans (Analysis 2). Finally, we use bank survival following the financial crisis as the dependent variable in a logistic, hierarchical regression analysis to examine whether the same signals proved to be

reliable in predicting the viability of Russian banks (Analysis 3).

Sample

We collected data on the top 225 banks in asset size in Russia based on their 1997 end of year reports to the Russian Central Bank. The reported data included asset size, amount of loans from foreign banks and the amount of investment in state government bonds (GKO/OFZ) as of the end of December 1997. Of the top 225 banks, we removed 13 foreign banks from the list of top reporting banks.[6] The remaining 212 banks held 96.4% of the total assets of the Russian banking system at the time, reflecting the high concentration of assets in the hands of the largest Russia banks. An additional 18 banks were eliminated because we were unable to find founding dates (see Control Variables below). All 18 of these banks had headquarters in regions outside of Moscow and all were of small asset size, with combined holding of 2.4% of the assets of our full sample. Moreover, these banks received less than 1% of total foreign loans.

We also combined data reported from the bank SBS and Agroprombank under the single bank of SBS-Agro, given that these banks merged. Finally, we removed the Russian State commercial bank, Sberbank, because it held approximately six times the assets of the next largest bank and had direct access to Russian government funds, therefore making it a strong outlier in Russia's transitional banking system. In the end, our analysis included full data on 193 Russian banks out of the original 225 top reporting banks.

Dependent Measures

As previously mentioned, we conducted three analyses with three different dependent variables: Foreign Borrowing by Russian Banks (Analysis 1), Domestic Borrowing by Russian

[6] Foreign banks could receive licenses to open one building in Russia at the time. They were not allowed to open subsidiaries and they could only own up to 12% of the assets of a Russian bank (Coker, 1998).

Banks (Analysis 2) and Post-Crisis Survival (Analysis 3). These variables were measured as follows:

Foreign Borrowing by Russian Banks. We used the amount of foreign borrowing from non-resident banks as reported in millions of rubles to the Central Bank as of the end of December 1997. We run a logarithmic transition to compensate for a positive skewness in the data.

Domestic Borrowing by Russian Banks. We used the logarithm of the amount of domestic borrowing by Russian banks as reported in millions of rubles to the Central Bank as of the end of December 1997.

Post-Crisis Survival. We used government licensing data to identify which of our sample banks lost their licenses from August 1998 to July 2000. The two year period is an accepted time sample used to determine which banks ceased operations due to the financial crisis (see, for instance, Sychova et. al. 2001: 80). We created a binary dummy variable, assigning 1 to those banks that lost their licenses by July 2000 or were put under the Agency for Restructuring Credit Institutions (ARCO) control while assigning 0 otherwise. Of the 193 banks in our sample, 26 lost their license over this two year period. An additional 9 banks were put under Agency for Restructuring Credit Institutions (ARCO) control during this 2 year time period. None of these banks continued to operate after being put under government control, and it is another accepted measure of a bank's failure to survive the crash (Sycova et. al, 2001).

Independent Measures

In each of the three data analyses, we use the same four independent variables: Advertising, Bank Rating, Membership in FIDP, Membership in OPERU-2. These variables were measured as follows:

Advertising. We used data from the Gallup ad company in Russia to measure advertising

expenditures (Gallup AdFact, 1998). The company monitored all daily bank advertisements in 11 television stations, 19 radio stations, outdoor billboards, and 180 published sources as of June 1998. The expenditures of the 100 top advertising banks based on average prices for advertising in the different venues and were reported in dollars for the three months from June-August 1998. The top advertisers during this period were Rossisskiy Kredit with total expenditures of $2,396,000 and SBS-Agro was second with $806,000. The 100th bank on the list spent $2520. We assigned a value of zero to all banks in our sample that did not make the top 100 list. We run a logarithmic transformation on the advertising cost to compensate for a strong positive skewness in the data.

Bank Rating. The Rating Information Center (RIC) provided the most comprehensive ratings of Russian banks at the time, publishing a list of the top 100 reliable banks in Russia on a 1 (most reliable) to 6 (least reliable) scale. Our list of RIC ratings was published in the English language newspaper, *The Russian Review*, December 1997. If a bank did not make it into the top 100 reliable banks we assigned it a score of 7.

Membership in the Financial Institutions Development Project (FIDP). We use a dummy variable to indicate whether a bank was accredited by the FIDP as of December 1997. The list of accredited banks comes from the *Russian Review*, December 1997. Thirty banks in our samples were accredited members of the FIDP.

Membership in OPERU-2. We used a dummy variable to indicate whether a bank was a member of the OPERU-2, the specialized regulatory agency run by the Russian Central Bank designed to provide stringent oversight of leading Russian banks. The list of accredited banks comes from the *Russian Review*, December 1997. Thirteen banks in our sample were members of OPERU-2.

Control variables

Finally, the data analysis used four control variables: Asset Size, Government Bond/Asset, Founding Year, and Ownership. These variables were measured as follows:

Asset size. We included a bank's asset size in millions of Rubles because it is conceivable that foreign banks simply targeted large banks in their investment decisions. We run a logarithmic transformation on the asset size because initial investigation of this data showed a strong positive skewness.

Government Bond/Asset. We included this as a control variable in our examination of post-crash survival as it is possible that exposure to government bonds following the August 1998 crash was the primary factor in bank failure. We report the extent of a bank's holding in government bonds divided by total assets, both figures as reported in the bank's 1997 end of year reporting to the Central Bank.

Founding year. The founding year is the date when the bank was established. We included the founding year because foreign banks may have targeted older banks, assuming more experience and reputation, in their investment decisions. The founding dates from the bank were gathered from the 1999 Intelbridge directory of major Russian banks (Intelbridge, 1999).

Government Ownership. We used a dummy variable to indicate whether a bank had significant ownership ties to governmental entities. We indicated banks that had significant ties to the Russian Central Bank, the Moscow City Government and other regional governments. We also included Gazprom as having significant government control, as the federal government controlled 51% of this large oil and gas company. Ownership data came from the Intelbridge 1999 directory and from expert opinion of the holdings of government-connected business groups (see *Expert*, March 23, 1998: 28-29).

Results

Table 1 reports correlation statistics among the variables used in our data analyses. As reported in Table 2, our first analysis uses hierarchical regression with foreign borrowing as the dependent variable to test whether foreign investors relied on western-style signals when offering loans to Russian banks. The logarithm of asset size, the founding year and government ownership were entered as control variables in step 1. The control variables explained 39% of the variance in foreign borrowing by Russian banks, and among the control variables asset size had a significant effect on foreign borrowing (β=.61, $p<.01$). This result suggests that while foreign investors were more likely to make loans to larger banks, asset size alone does not explain the variability in lending patterns.

In step 2, we entered the independent variables for the logarithm of advertising, the RIC rating, FIDP membership and OPERU-2 membership. To compensate for the possibility of an endogenity problem such that advertising, RIC rating, FIDP membership and OPERU-2 membership both influence, and are influenced by, foreign borrowing, we followed the procedure of a two stage regression analysis (see Hamilton and Nickerson, 2003). We first estimated advertising cost, RIC rating, FIDP membership and OPERU-2 membership in terms of the exogenous variables in the regression equation (log asset size, founding year, government ownership) and then used these estimated values of log advertising cost, RIC rating, FIDP membership and OPERU-2 membership in the regression analysis that is presented in Table 2. The independent variables (log advertising cost, RIC rating, FIDP membership and OPERU-2 membership) that were estimated this way explained 17% of foreign borrowing by Russian banks.

Hypotheses 1a, 1b, and 1c predict that third-party endorsements result in more foreign loans. The results indicate that the effect of RIC rating on foreign borrowing was not significant, thus hypothesis 1a was not supported. At the same time, both membership in the World

Bank/EBRD Financial Institutional Development Project (FIDP) and membership in the OPERU-2 program led to significantly more foreign borrowing (β=.14 $p<.01$ in case of FIDP and β=.34 $p<.01$ in case of OPERU-2) , providing support for hypotheses 1b and 1c. Taken together, these results support the proposition that foreign investors relied on the ratings of some reputable third parties when making loans to Russian banks.

Hypothesis 1d predicts that banks with greater advertising received more foreign loans. These results indicate that advertising expenditure was a significant predictor (β=.17 $p<.01$) of foreign borrowing by Russian banks, providing support to this hypothesis. We need to note, however, that the relationship between advertising expenditure and foreign loans do not exclude the possibility that the relationship goes both ways. While advertising influences the amount of foreign loans a bank received, foreign loans may have also provided additional resources for banks to spend more on advertising.

As reported in Table 3, we also tested whether the same signals that affected foreign borrowing also affected the degree of domestic borrowing by Russian banks. We followed the same procedures as with foreign loans. At the first step we entered the control variables, including the log asset size, years of operation and ownership. From these control variables only the effect of the log asset size had a significant effect on domestic borrowing (β=.21 $p<.001$) Next, we entered the estimated values of the log advertising cost, RIC rating, FIDP membership and OPERU-2 membership (these were estimated by the exogenous variables to compensate for a potential endogeneity problem). With the exception of OPERU-2 membership, which effect was marginally significant (β=.10, $p<.1$), none of the other independent variables had a significant effect on domestic investment, indicating that unlike foreign investors, domestic Russian lenders did not rely on signals of advertising, RIC rating or FIDP membership to make their investment

decisions. This provides support for hypothesis 2 which predicted no relationship between these western-style signals and domestic investment.

As reported in Table 4, we used hierarchical regression analysis to whether western-style signals predicted bank survival following the 1998 financial crash in Russia. Log asset size, founding year, government ownership, and government bond/asset were entered as control variables in step 1. Among these variables, log asset size (β=1.42 $p<.01$) bond/asset (β=4.00 $p<.05$) and founding year (β=-.27 $p<.05$) had a significant effect on whether a bank survived the 1998 crash.

In Step 2, we entered the independent variables RIC ratings, FIDP membership, OPERU2 membership and advertising. Hypotheses 3a, 3b, and 3c predict that banks with third-party endorsements were less likely to survive the August 1998 financial crisis. No significant relationship was found between RIC rating and post-crisis survival, thus hypothesis 3a was not supported. However, consistent with hypotheses 3b and 3c, those banks that were members of FIDP and OPERU-2 were also more likely to cease operations following the crisis (β=.30 $p<.01$ and β=.10 $p<.05$). Consistent with hypothesis 3d, those banks who advertised more were also less likely to survive the crisis (β=1.08 $p<.01$). Taken together, these results support the proposition that market signals that tend to be reliable in developed markets proved to be deceptive rather than reliable in the Russian environment.

Qualitative Evidence

Our empirical test examines the implications of deceptive mimicry from the viewpoint of foreigners choosing where to invest in the Russian market. In this section, we complement our empirical results with a qualitative description of the behavior of Russian banks. An examination of the qualitative data that came available after the August 1998 crash provides additional

evidence that at least some of the largest Russian banks actively manipulated western-style signals to seek foreign financing despite little intent to build sustainable banking organizations.

We turn first to an examination of the World Bank/EBRD supervised program of the Financial Institutions Development Project. A World-Bank sponsored retrospective evaluation of the FIDP provides qualitative evidence to support a deceptive mimicry argument in the Russian context. The report's authors write that it was apparent early in the program that the accreditation process had made serious mistakes in choosing participating Russian banks:

> In general, the concept of accreditation of banks "at the entry point" – meaning before they actually started work under the project -- turned out to be wrong in many ways, since many banks started misusing their accreditation status without working toward the objective of the program. … A number of banks used FIDP … exclusively as a means to promote their names among foreign counterparts (for example, Menatap). …Further, banks demanded unlimited access to foreign financing. Such banks as SBS-Agro, Uneximbank, Rossiskii Kredit and Imperial were notorious for this. (Blaszcyk and Radygin, 2002: 43)

Many Russian banks were more interested in using the signal of FIDP accreditation to attract foreign financing more than they were interested in using the program to increase substantive capabilities to operate efficiently as a bank. The goal was to convince foreigners that they would operate as a bank, instead of actually developing the structures to actually succeed as one.

Why were these underlying traits not picked up in the accreditation process? The authors of the FIDP evaluation conclude that the original due diligence focused too much on the external appearances of the bank and too little on its internal governance: "[i]nsufficient attention was … paid to the issue of corporate governance. This added greatly to the due diligence risks of the World Bank, since the project financed a number of banks whose owners could not conform to generally accepted international criteria of 'fitness and property.'" The FIDP eventually came to realize its mistakes as early as 1997, but they never implement a "de-accreditation' system to remove banks from the program that were clearly abusing the system.

The FIDP report provides one piece of evidence of the role of deceptive mimicry in explaining our results. The behavior of the largest banks after the crash provides additional support. Although the signals that Russian banks emitted might have suggested that they had confidence in their ability to recoup their investments in the long run, their behavior in the post-crash environment shows that they were clearly prepared to avoid accountability if they happened to fail in their banking ventures.

Following the August crash, many of the largest "failed" banks exploited the weak regulatory environment to quickly transferring their remaining good assets into new legal entities (so-called "bridge" or "shadow" banks) with essentially the same set of owners (see Johnson (2000): 220-221). New “bridge” banks held none of the liabilities of their “daughter” banks, leaving obligations to creditors in the hands of banks that just had many of their best-performing assets stripped from their control. For instance, soon after the August crash, Alexander Smolensky, the founder and head of SBS-Agro, helped establish the First Mutual Credit Society, a bank that absorbed many of the assets of his old institution but none of its liabilities. Despite receiving more than $200 million in stabilization credits from the CBR, SBS-Agro claimed to be unable to meet its obligations, offering many of its depositors settlement packages composed of office furniture and package tours (*Moscow Times*, August 17, 1999).

Smolensky even mocked his former clients for their naiveté, saying that his “hair stood on end” when he saw that some investors had deposited more than $1 million in his bank; they “must be idiots,” he observed (*Wall Street Journal,* October 4, 2000: A1). In addition, when asked about the foreigners who lost more than $1 billion in SBS-Agro, he replied that they deserved only “dead donkey ears” (*Wall Street Journal*, October 4, 2000: A1). The line of jilted creditors included Chase Manhattan Bank, Deutsche Bank, Banque Societe Generale, Bank of

American Corp., Lehman Brothers Holdings Inc., and the EBRD.[7]

Many of the largest failed banks created similar "bridge" banks. *Rossiisskii Kredit* created *Impeksbank* to continue its operations. *Menatep St. Petersburg* took over *Menatep's* forty-six Moscow branches and acquired several of its sister bank's regional offices as well. *Promstroibank St. Petersburg* similarly took over the operations of *Promstroibank Russia*. The rapid deployment of "bridge" banks to rapidly move liquid assets from bankrupt banks was possible because the formal ownership structure of the banks were deliberately designed from the outset to obscure lines of accountability in case of failure. Many of these banks had clearly planned for this type of contingency.

Finally, an understanding of the historical and political background to the banking system of the time provides further evidence for an argument of deceptive mimicry. Moving from one business to the next, leaving behind empty shells of companies with unmet liabilities and escaping with new organizations with liquid assets reflected the broader uncertainties of the Russian institutional environment at the time (see, for example, Kogut and Spicer, 2002). Throughout their entire short history, Russian banks traditionally earned their profit through opaque deals with governments and enterprises that had little to do with traditional banking services. By the time of the August crash, the so-called banking oligarchy had already used their political connections to diversify into oil and gas, making the long-term success of their banking operations less important to the success of their transition business groups.

It was not simply that the largest failed banks could not afford to pay back their liabilities to foreign creditors, it was in many cases that they chose not to do so. This is not to say that all banks went bankrupt after the crash because of deliberate strategies to pursue short-term profits at

[7] The Wall Street Journal (October 4, 2000: A1) reported that "western banks grumble bitterly in private, but, exhausted and embarrassed by the SBS-Agro fiasco, shun public complaints. Says one banker: 'It's like being a Nazi hunter. You have to dedicate your whole life to it. Life's too short.' "

the expense of long-term sustainability. Instead, we suggest that the qualitative data provides strong evidence that at least some of the largest banks failed for this reason.

Discussion

In our theory section, we developed two primary propositions. First, foreigners from western, developed economies will be likely to use western-style signals in coping with market uncertainty in transition economies. Second, if used, these western signals will ultimately prove to be deceptive in their consequences. In particular, we argued that the presence of deceptive signaling will be highest in early stages of reform in transition economies when there is uncertainty over the effectiveness of new, formal institutions. It is the high levels of institutional uncertainty that leads some foreigners to rely on familiar, market signals to evaluate domestic organizations, and it is the same institutional uncertainty that creates the opportunity for domestic organizations to mimic the same signals.

Consistent with our propositions, we found that foreign investors in Russia relied upon western-style signals in discriminating between Russian banks in offering loans. Russian banks that advertised more heavily, participated in a special government-sponsored regulatory agency, and were accredited by a World Bank-sponsored foreign aid program were more likely to receive foreign loans. We also found that the use of western-style signals had the opposite consequences in Russia than they tend to have in developed markets. Consistent with our propositions, it was precisely the banks that advertised the most heavily, that joined a specialized government-sponsored regulatory agency, and were accredited by a World-Bank sponsored foreign aid program that were most likely to go out of business following the August 1998 financial crisis.

Moreover, we have presented qualitative evidence to support the proposition that the concept of deceptive mimicry helps to explain our empirical results. Whether the mix of reasons

was weighted more toward the macro-level shock, risky investment strategies, or asset stripping, the August events and their aftermath demonstrated that the signals that foreigners had hoped would provide initial guidance in discriminating between successful and unsuccessful Russian banks had proven deceptive in their consequences.

One important limitation of the paper is that data constraints did not allow us to determine the source of different forms of foreign loans to Russian banks. The wide-spread use of syndicated loans to lend to Russian banks suggests the strong presence of large, global banks at the center of the lending network. However, we are unable to identify on a case-by-case basis the origin of each loan. It is possible that certain types of foreign banks are more susceptible to the mimicry of western-style signals than others. Thus, banks from economies with a strong, universal banking tradition may be more attune to the dangers of relying on impersonal market signals, and therefore be less likely to follow impersonal, market signals in making investment decisions. One interesting question for future research is to look more carefully at whether firms from different countries are less susceptible to deceptive mimicry than others. A related question is whether foreign firms are able to develop capabilities that allow them to better see through efforts of deceptive mimicry in transition economies over time.

A second limitation of this study is that we restricted our investigation of market signals to a limited number of signals in the form of advertising and various types of third party ratings and endorsements. It is possible that there are other signals that we did not analyze that influenced the investment decisions of foreigners in Russian banks. In addition, our focus on western-style signals also did not allow us to look at whether domestic lenders relied on other types of market signals in their investment decisions or whether they simply eschewed all forms of market signals in favor of more personalized sources of information. The challenge of identifying the type of

signals that may prove meaningful in any particular context is an important avenue for continued research.

Despite these limitations, we believe that our theoretical model and empirical test provide a first step into what we consider to be a broader agenda of investigating the dynamic interaction between those who display signals and those that receive them in international business research. For instance, Henisz and Delios (2002) review a growing number of papers in international business that look at the importance of social cues in shaping firm's decision of where and how to enter a new markets (e.g., Guellin, 2001; Henisz and Delios, 2001; Lu, 2002). Henisz and Delios (2002) remark that while these studies have looked closely at the antecedent conditions that drive imitative strategies, they have yet to evaluate the consequences of a reliance on social cues to make substantive decisions. They call for future research to "focus on the outcomes of decisions made in response to social cues. To the extent that following social cues provide new information valuable to a particular decision, the organizational performance of firms that follow an imitative strategy should be higher" (Henisz and Delios, 2002: 357).

Zucker (1986) makes a similar argument about the need to look at both causes and consequences in the study of social symbols in market activity. While Henisz and Delios (2002) raise the question of when organizations should rely on the actions of other firms as meaningful social cues, Zucker (1986) raises the more general question of when organizations should trust the formal rules, regulations and symbols of the institutional environment in shaping individual strategy. She remarks that it took decades in the United States to construct the collective meanings and structures that allowed for strategic actors to rely on formal institutions as a strategic means to expand exchange across tradition kin-based and geographical ties. If there is only decoupling between symbol and substance over the long run, she argues, then market

participants are unlikely over time to continue to rely on collective rules and norms in everyday practice (see also Tolbert and Zucker, 1997).

We also suggest a feedback loop between the reliability of a market signal and its continued use. Over time, investors are likely to stop using signals that do not produce desired results, which, in turn, decreases the incentives for mimics to invest in imitating these signals. This suggests a limit to deceptive mimicry. The success of deceptive signals may entice other mimics to enter the market, but, ultimately, if outside observers stop relying on these signals, then the use of the signal is unlikely to continue. The challenge in transition economies, we have argued, is that it is often unclear about the stage of development of a particular market signal. It is not simply that economic actors respond to social cues out of habit and inertia; they also rely on symbolic communication because they seek a possible solution to the complex problems of uncertainty faced in transition economies. Understanding the conditions when such a strategy is likely to achieve desired outcomes, and when it is not, remains an important topic for continuing research.

We believe that deceptive mimicry has numerous implications in settings other than transition markets. The recent accounting scandals in the United States provide one such example. In retrospect, firms such as WorldCom and Enron invested more in the appearances of profitability than in the development of a sustainable business. Coffee (2003) posits that it was a breakdown in the complex gate-keeping system designed to monitor and check the accuracy of a firms' accounting reports and public statements that allowed for such a high degree of deception to take place in US financial markets. We suggest that in any situation in which the fundamental rules of the game are in question, and there is uncertainty of the proper way to evaluate performance claims, then mimicry is likely to be successful in convincing outsiders that firms possess qualities

that actually are not present. We believe that future research can easily expand the study of the institutional conditions that support deceptive mimicry beyond the context of transition economies.

However, we suggest that the institutional environments of transition markets are particularly susceptible to this type of strategy. In these contexts, there is strong uncertainty over the proper metrics to judge quality and the lack of pre-existing firm reputations makes it difficult to use alternative means to discriminate among firms on the market. Moreover, the weak regulatory environments in these settings decrease the possibility of potential punishment even if early promises are not fulfilled. In short, there is strong demand among foreigners for the development of an observable metric to judge quality in transition economies. Yet, at the time, the institutional context shapes incentives such that the supply of such signals is often deceptive. Future research is required to further examine both the cause and consequences of deceptive mimicry in transition market contexts.

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Table 1

Correlation Table

	Foreign borrowing (log)	Domestic borrowing (log)	Survival	Bond/asset	LogAsset	Owner-ship	Year	RIC rating	OPERU	FIDP
Domestic (log)	.23**									
Survival	.32**	.15**								
bondasset	.12*	-.03	.10							
logasset	.62**	.22**	.28**	.15**						
ownership	-.18**	-.00	-.01	-.12*	-.32**					
years	.21**	.10	-.23**	-.11*	.22**	-.04				
rating	.08	-.05	.15**	.11*	.08	.05	-.09			
OPERU	.55**	.23**	.28**	.10*	.58**	-.19**	.23**	-.01		
FIDP	.47**	-.10	.29**	.06	.49**	-.13**	.22**	.07	.31**	
Advertise (log)	.58**	.11	.26**	.03	.34**	.03	.15**	.05	.45**	.34**

* p< .05 **p<.01

Table 2

Regression Analysis for Foreign Borrowing (Log)

Predictors	**Model 1**	**Model 2**
Step 1.		
LogAsset	**0.61****	**0.33****
Founding year	**0.07**	**0.04**
Gvt. Ownership	**- 0.07**	**-0.03**
Step 2.		
RIC rating		**0.03**
FIDP membership		**0.14****
OPERU-2 membership		**0.34****
Logadvertising		**0.17****
R^2	**.39****	**.56****
Delta R^2		**.17**
Delta F	**83.62****	**37.98****
df	**3**	**7**

Standardized Beta Coefficients are reported
N= 193
+p<1 *p<.05 **p<.01

Table 3

Regression Analysis for Domestic Borrowing (Log)

Predictors	**Model 1**	**Model 2**
Step 1.		
LogAsset	**0.21****	**0.17***
Founding year	**0.06**	**0.08**
Gvt. Ownership	**- 0.07**	**-0.03**
Step 2.		
RIC rating		**-0.03**
FIDP membership		**-0.08**
OPERU-2 membership		**0.10^{+}**
Logadvertising		**0.06**
R^2	**.05**	**.07**
Delta R^2		**.02**
Delta F	**5.13**	**2.03**
df	**3**	**7**

+p<1 *p<.05 **p<.01
N= 193

Table 4

Logistic Regression Analysis for Post Crisis Failure

Predictors	**Model 1**	**Model 2**
Step 1.		
LogAsset	**1.42**** **(.31)**	**.49.** **(.41)**
Bond/asset	**4.00*** **(1.98)**	**5.49*** **(2.27)**
Founding year	**-.27*** **(.11)**	**-.26*** **(.11)**
Ownership	**.29** **(.49)**	**.20** **(.12)**
Step 2		
RIC rating		**0.94** **(0.7)**
FIDP membership		**0.30**** **(0.07)**
OPERU-2 membership		**0.10*** **(0.00)**
LogAdvertising		**1.08**** **(0.41)**
Chi-square	**40.51****	**16.00****
df	**4**	**8**

Beta Coefficients are reported with standard errors
N= 193
+p<1 *p<.05 **p<.01