

## A critical review of the application of the legitimacy theory to corporate social responsibility

Dare John Olateju<sup>1\*</sup>, Olakunle Abraham Olateju<sup>2</sup>, Seyi Vincent Adeoye<sup>3</sup>, Idris Suleiman Ilyas<sup>4</sup>

<sup>1,3</sup>Department of Banking & Finance Faculty of Management Sciences University of Jos, Nigeria

<sup>2</sup>Department of Accounting Osun State University, Nigeria

<sup>4</sup>Bursary Department University of Jos, Nigeria

**\*Corresponding Authors:** Dare John Olateju, Department of Banking & Finance Faculty of Management Sciences University of Jos, Nigeria

**Abstract:** Organisations need to strategically position their operational activities to meet the norms, values, expectations and demands of the society to gain legitimate status which are embedded in corporate social responsibility. However, the theories available in literatures have not adequately provided guide to aid practice as organisations still find it difficult to operationalise corporate social responsibility despite efforts from international organisations. The causal-outcome relationship is still glaringly missing in the build-up and applications of these theories. Our review accentuate the constructs in the legitimacy theory to mimic the practice as guides by elaborating how CSR as a variable can affect organisations in various ways paving way for future researchers to experiment. Our recommendations among others is that organisations should operationalise CSR policy as that will grant them legitimate status which in return will reduce organisational risks and increase profitability in the long run.

### 1. INTRODUCTION

The society has expectations from every business organization in their environment(Guthrie, Cuganesan& Ward, 2006). These expectations may be in form of value or interest of the stakeholders in the society which are embedded in corporate social responsibility(Noah, 2017). When these expectations– strategically improvised for in the organizational operations – are not met or are perceived inadequate or inappropriate, the stakeholders lose confidence the organization and that may threaten the existence, survival and the performance of the organization(Dowling & Pfeffer, 1975; Guthrie et al., 2006).Newman, Rand, Tarp & Trifkovic(2016)submit that for a firm to survive, such firm has to develop its CSR policy, level of CSR which can lead to the firm’s closure if not done.

The strategic positioning of organizational day-to-day operational activities and behaviour to truly reflect the norms, values, expectations and demands of the society with a view of being legal and acceptable to the public is the organization ‘s legitimate status and this legitimate status has its root in legitimacy theory(Dowling & Pfeffer, 1975; Guthrie et al., 2006). .

Legitimacy theory has been used in many research papers, especially in the areas of organizational behaviour (Dowling & Pfeffer, 1975), social and environmental disclosure(Guthrie, Cuganesan&Ward,2006), business ventures (Fisher, 2020), environmental accounting(Enahoro, 2009) and many more. According to Guthrie et al.(2006),recent research on environmental and social disclosures are anchored on legitimacy theory because this theory is best used in explaining the dual concepts.

Literatures on CSR policy formulation and performance –which are also important– and the application of legitimacy theory on CSR policy formulation and performance are still very scanty. This creates a lacuna in research in CSR policy formulation and implementation. This has made it difficult for organisations to operationalise CSR policy. The little literatures around fail to provide adequate guides, procedures and benefits for the adoption of CSR policy(Peloza, 2009). Aguinis & Glavas(2012:932) note that there is knowledge gap in the implementation of diverse theoretical

orientations and that causal mechanisms that link CSR with outcome are not expository enough. This also reiterates the position of Wang, Gibson & Zander (2020) after seven years.

Wang, Gibson & Zander (2020:1) state that there is a disconnection between the theories around and the practice of CSR. They establish that theories from current literatures are not adequately developed to inform practice. Their proffered solutions among others were studiously put together to form the basis that birthed this article.

For instance, the stakeholder theory opines that the interest of all stakeholders should be incorporated into business policy without explaining how that can directly affect the operation and performance of the organisations. Likewise the agency theory, that postulates that the interest of the owners which the managers represent must be the only priority without clearly stating the causal-outcome relationship.

Secondly, there is inadequate and little explicit explanation on application of legitimacy theory to CSR policy formulation and implementation – the areas that are still lacking in the existing literatures – which this article stands to fill (Pelozo, 2009; Wang et al., 2020).

Our review links legitimacy theory to practice by exploring the causal relationship of CSR to its outcomes. For instance, if an organisation gets involved in CSR, it stands to gain legitimate status, and if not the organisation may be faced with certain risks like reputational risk, market risk, hostile risk, financial risk and so on (Filatotchev & Nakajima, 2014; Gangi et al., 2018).

Two, by diving away the legitimacy theory from the traditional domicile of reporting (Guthrie et al., 2006) to CSR policy formulation and implementation, we emphasise some of the constructs in legitimacy theory to provide practical applications of CSR to practice and also open up the floor for new areas for research on CSR policy formulation and implementation by providing propositions in this article.

## **2. REVIEW OF RELATED LITERATURES**

### **2.1. Corporate Social Responsibility as a Policy**

The concept and practice of corporate social responsibility is well established in extant literatures. Since 1960s when the concept was first introduced, perceptions of what constitute CSR have evolved. As recent literatures suggest, a general consensus seems to exist amongst experts and scholars and it is from this perspective we define corporate social responsibility (CSR) as an organizational policy that integrates social and environmental matters into business operations (Aguinis, 2011:858; Ajao et al., 2020; Campbell, 2019). The organizational policy has to do with its corporate governance. It has to be voluntary and beyond Carroll's economic, legal, ethical and philanthropic model. It's a corporate policy that meets the present needs and as well provides for the future needs of the stakeholders paving way for sustainability (Ajao et al., 2020). Ashrafi, Magnan, Adams & Walker (2020) argue that integration of CSR into business strategic decisions and operation processes will help to improve the organizational performance. To incorporate CSR into the operations of the organization, there is need for organizations to formulate their own policy to guide their CSR (Helg, 2007).

The social matters involve the combination of the interest of the organization, society, and all its stakeholders simultaneously into the business operations (Helg, 2007). (Yoon & Chung, 2018) The environmental part of our definition implies avoiding any harm to the environment and if there is any, the firm should responsibly take care of it to enable environmental sustainability (Campbell, 2019).

Guthrie et al. (2006) argue that a *social contract* exists between a business organization and the society in which it operates and that this social contract is one of the myriads of expectations of the society from the business organization. He went further to argue that the survival of the organization will be threatened if the society perceives a breach in this contract. Vishwanathan, Oosterhout, Heugens, Duran & Essen, (2020) corroborated the argument of Guthrie et al. (2006) by their stakeholder reciprocation mechanism that when a firm performs CSR, the stakeholder reciprocates by endorsing the firm. The arguments so far imply that CSR policy and implementation can lead to more cooperation from stakeholders and increase productivity for the firm which will in turn affect the firm's performance (Vishwanathan et al., 2020). So, our argument is that whether a firm makes profit or not, the societal expectations will be there and will need to be met.

**Proposition 1: We propose that having CSR policy will improve CSR performance and CSR performance will positively impact the organizational performance.**

### **Theoretical Background**

Legitimacy theory originated from organizational and social system theory that view organization as complex component that must interact with the environments in order to survive (Guthrie et al., 2006). Legitimacy theory states that for an organization to gain legitimate status, which is the approval and support of the society and elimination of threat to survival, such an organization should maintain integration of its value system with that of the social system within which it operates (Dowling & Pfeffer, 1975; Guthrie et al., 2006; Noah, 2017). CSR can be a good means for organizations to gain the legitimate status (Guthrie et al., 2006). Ashrafi et al. (2020) argue that organizations are forced to use CSR to legitimate their business actions. Noah (2017) notes that organizations can meet public needs and expectations through CSR. Based on the argument above, we argue that CSR's performance can infer a legitimate status on an organization.

**Proposition 2: CSR's performance can have a significant effect on the legitimate status of an organization.**

An organization can strategically use CSR to meet societal need. When this is done, it will project the good image of the organization. As Vishwanathan et al. (2020) argue, CSR has positive relationship with the reputation of the organisation because it brings reputational risk to minimal. Invariably, CSR reduces reputational and market risk of the organizations (Gangi et al., 2018). Bansal & Clelland (2004) argue that legitimate status – CSR, of a firm reduces stock market unsystematic risk more than illegitimate ones. Saha et al. (2019) argue that CSR brings organizational failure's risk to minimal and improve organizational performance. Vishwanathan et al. (2020:320) argue that CSR serves as a risk mitigation mechanism, reduces firm specific risk and reduces firm's risk exposure. We join the above authors to argue that CSR will reduce organizational risks.

**Proposition 3: CSR will have negative relationship with organizational risks**

CSR has three branches as identified by our working definition: Corporate governance, environmental and social matters (Aguinis, 2011). The scope of this work is only limited to the last aspect of CSR which is social expectations of the society. This could be donations, charitable gifts, sponsorship, fixing or providing essential commodity like road, water, electricity, schools and so on. Guthrie et al. (2006) argue that an organization's meeting the societal expectations of their social system will earn them a legitimate status. When an organization has a legitimate status, their operational activities and behavior will truly reflect the norms, value, expectations and demands of their society with a view of being legal and acceptable to the public (Dowling & Pfeffer, 1975; Guthrie et al., 2006; Noah, 2017).

The social system in which such an organization operates naturally grants it conducive and peaceful environment to thrive and survive which will in turn translate to corporate performance in exchange for their CSR; this is termed "social contract" (Dowling & Pfeffer, 1975). Dowling & Pfeffer (1975) and Guthrie et al. (2006) argue that there exists social contract between the organization and the society and when a breach of this social contract is perceived, there will be a threat to the survival of this organization (Dowling & Pfeffer, 1975). This implies that the system will not accommodate any breach in the contract (Guthrie et al., 2006). The supplier may cease to supply, customer may stop patronizing, the host community may become hostile, tax may be unfavourable, and there may arise lots of litigations to force the organization back to the performance of its social contract or go out of business (Vishwanathan et al., 2020). For instance, Many Nigerian banks spend hundreds of millions of naira on litigation yearly (banks financial statement, 2013 – 2018), the amount that would have added up to the performance of such banks. We argue that as stakeholders perceive non-performance of CSR, the organizational performance will be negatively affected in the same proportion.

**Proposition 4: We propose that non-performance of CSR will have negative relationship with organizational performance**

A breach in the social contract can be in form of non-performance, perceived non-performance and under performance of CSR by the society. Non-performance implies that the organisation is not carrying out its CSR. Perceived non-performance means that there is contradicting beliefs between the organisation and the society. While the former believe they are performing, the latter believe otherwise. The last implies that the organisation is perceived to be under performing their CSR. This

may be due to their reporting system because the public wants to see that the organisation have CSR policy and that they are performing it. Legitimacy theory is appropriate to explain the concept of CSR because it is not just about organisations honouring their social contract by having CSR policy but also about emphasizing that the organisations should perform and report the performance of this social contract. Aguinis & Glavas (2012:933) refers to performance of CSR as “policies and actions by organizations”. We argue that legitimacy theory is appropriate to guide and explain the concept of CSR policy and implementation.

For organisations to reap the benefit of CSR, they may have to go beyond lip service to CSR (Idowu, 2014). Having CSR policy is not enough like making the policy work (Aguinis & Glavas, 2012). When the performance of CSR is not substantial – that is below 6% of the total profits before deduction of such donations – it may have little or no impact on the performance of the organisation. You can refer to Nigeria Companies Income Tax Act, Cap. 60 Lfn; 1990 (2016:2.3)

*Except to such extent (if any) as the president may by order in the Federal Gazette otherwise direct, any deduction to be allowed to any company, under subsection (1) of this section, for any year of assessment, shall not exceed an amount which is equal to ten percent of the total profits of that company for that year as ascertained before any deductions under section 24 of this Act.”*

Idowu's (2014) findings on six Nigerian banks reveal that the banks' CSR expenditures are less than three percent of their profit after tax. This is not too good compare to ten percent allowable expenses by the Nigerian law. Organisations should perform CSR in such a way that the society will feel and appreciate it. CSR will need to touch the stakeholders before releasing their approval or endorsement to the organization (Vishwanathan et al., 2020). It should not be a one-time-off but a continuous activity for organizations to reap the benefits. We argue that CSR needs to be substantial and continuous to impact organizational financial performance.

**Proposition 5: We propose that CSR policy and substantial implementation will have positive relationship with financial performance**

The people will enjoy the benefit of CSR and change their view about the organisation. This will in return promote the good image of the firm. This is not expected to happen overnight. So it is expected that the benefit of CSR should not reflect in the profit of the same year. Belasri et al. (2020) note that performing CSR may take years to deliver value-enhancing results but it will surely deliver. In the same vein, Saha et al. (2019) argue that CSR positively affects financial positions in the long run. It requires short-term spending and will only generate income in the future. Ashrafi et al. (2020) lend a voice to the argument with their ‘enlightened self-interest’ that the organisations that involve in CSR will reap the long-term self-benefit in due course. Vishwanathan et al. (2020) argue that the organizational reputation has positive relationship with corporate performance. Saha et al. (2019) conclude their findings that CSR has a direct impact on financial performance over the years. We argue that CSR may seem not to have effect on the organizational performance in the short run, but it will in the long run.

**Proposition 6: CSR will have positive relationship with financial performance in the long run**

Ashrafi et al. (2020) reports that a lot of efforts have been made to establish the positive relationship between CSR and the long-term interest of the shareholders. They argue further that CSR represents the long-term social interest of the shareholders and will accomplish the traditional economic gain which they seek. Saha et al. (2019) argue that CSR brings unlimited payback, advantage and inflow of new institutional investors to the organization. Vishwanathan et al. (2020) argue that current set of investors perceive firms that are into CSR as legitimate and as a good omen of future profitability for such firms. Yoon & Chung (2018) found that external CSR practices improve market share and internal CSR practices improve operational profitability of the firm. Vishwanathan et al. (2020) also argue that unprecedented increase in the price of shares has been noticed to accompany the mere public announcement of the adoption of CSR initiatives by firms. We argue that CSR will increase shareholders' wealth in the long run.



**Proposition 7: CSR will increase shareholders' wealth**

**3. CONCLUSION**

Since the advent of CSR, it has been difficult for organisations to operationalise CSR policy because of scanty literatures available addressing this important area and because these literatures fail to provide adequate guides, procedures and standard for practice (Aguinis & Glavas, 2012; Wang et al., 2020). We have been able to fill these gaps by using legitimacy theory. We establish causal and outcomes relationship and the main component lacking in theories available in current literatures as identified by Aguinis & Glavas (2012). We also applied legitimacy theory to CSR policy, the thing that is still lacking in the available literatures (Wang et al., 2020). Another unique aspect of our article is the accentuation of the constructs in the legitimacy theory by elaborating how CSR as a variable can affect organisations in various ways paving way for future researchers to experiment. We also made propositions for future researchers to explore. The organisations should walk the talk by putting CSR policy in place in their organisations (Idowu, 2014). A desk may be designated for that and performance frequently measured against the standard (which we propose to be ten percent of profit before tax). We also recommend that organisations should operationalise CSR as that will grant them legitimate status which in return will reduce organisational risks and increase profitability in the long run.

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