Refinements to Legitimacy Theory in

Social and Environmental Accounting

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

Legitimacy theory has become one of the most cited theories within the social and environmental accounting area. Yet there remains deep scepticism amongst many researchers that it offers any real insight into the voluntary disclosures of corporations. This brief paper outlines responses to two specific concerns identified in the literature. It will eventually form part of a much larger project addressing a range of issues associated with legitimacy theory. First, the paper brings some of the more recent developments in the management and ethical literature on legitimacy and corporations to the accounting table. Second, there are contributions to the theory that have already been made by accounting researchers that are yet to be fully recognised. The author believes that legitimacy theory does offer a powerful mechanism for understanding voluntary social and environmental disclosures made by corporations, and that this understanding would provide a vehicle for engaging in critical public debate.

The problem for legitimacy theory in contributing to our understanding of accounting disclosure specifically, and as a theory in general, is that the term has on occasion been used fairly loosely. This is not a problem of the theory itself, and the observation could be equally applied to a range of theories in a range of disciplines (see for example Caudill (1997) on the abuse of Evolutionary Theory). Failure to adequately specify the theory has been identified by Suchman (1995, p. 572, emphasis in original), who observed that “Many researchers employ the term legitimacy, but few define it”. Hybels (1995, p. 241) comments that “As the tradesmen [sic] of social science have groped to build elaborate theoretical structures with which to shelter their careers and disciplines, legitimation has been a blind man’s hammer.” This paper begins to address these issues.

Not One Theory but Two (at least)

An important issue which needs to be acknowledged is that there are in fact two major classes of legitimacy theory. These are graphically presented in Figure 1 below. The ‘macro-theory’ of legitimation, known as Institutional Legitimacy
Theory, deals with how organisational structures as a whole (capitalism for example, or government) have gained acceptance from society at large. “Within this tradition, legitimacy and institutionalization are virtually synonymous. Both phenomena empower organizations primarily by making them seem natural and meaningful” (Suchman, 1995, p. 576, emphasis in original). In terms of accounting research, given the time frames involved and questions generally being considered, the current business environment, including the capitalist structure, democratic government, etc. are generally taken as a given, a static context within which the research is situated. This assumption would, however, need to be carefully considered for a longitudinal study of any significant length.

Figure 1: Layers of Legitimacy Theory
From the Moral to the Measurable

One layer down from the Institutional Level is what in Figure 1 is called the “Organisational Level” (sometimes referred to as Strategic Legitimacy Theory). “Underlying organizational legitimacy is a process, legitimation, by which an organization seeks approval (or avoidance of sanction) from groups in society” (Kaplan and Ruland, 1991, p. 370). It is from this level that most accounting research tends to draw its understanding of legitimacy. Mathews (1993, p. 350) provides a good definition of legitimacy at this level:

Organisations seek to establish congruence between the social values associated with or implied by their activities and the norms of acceptable behaviour in the larger social system in which they are a part. In so far as these two value systems are congruent we can speak of organisational legitimacy. When an actual or potential disparity exists between the two value systems there will exist a threat to organisational legitimacy.

At its simplest, within the Organisational view “legitimacy [is] an operational resource ... that organizations extract - often competitively - from their cultural environments and that they employ in pursuit of their goals” (Suchman, 1995, p. 575 - 6, emphasis in original). Legitimacy, just like money, is a resource a business requires in order to operate. Certain actions and events increase that legitimacy, and others decrease it. Low legitimacy will have particularly dire consequences for an organisation, which could ultimately lead to the forfeiture of their right to operate.

Although we can describe a firm as being legitimate, and conceive of ‘amounts’ of legitimacy, it becomes a very subjective exercise to try and directly measure legitimacy. Although it has concrete consequences, legitimacy itself is an abstract concept, given reality by multiple actors in the social environment. For a researcher to try and directly establish, or even rank, the legitimacy of various organisations would seem to be a necessarily subjective undertaking, preferencing the researcher’s own views. As Hybels (1995, p. 243) argues, “I reject this view because it is based on a conflation of the roles of observer and participant in social science”.

As an alternative, rather than trying to subjectively measure a firm’s legitimacy directly it can instead be inferred from the fact that being legitimate “enables organizations to attract resources necessary for survival (e.g., scarce materials, patronage, political approval)” (Hearit, 1995, p. 2). Hybels (1995, p. 243) develops this in some detail:
Legitimacy often has been conceptualized as simply one of many resources that organizations must obtain from their environments. But rather than viewing legitimacy as something that is exchanged among institutions, legitimacy is better conceived as both part of the context for exchange and a by-product of exchange. Legitimacy itself has no material form. It exists only as a symbolic representation of the collective evaluation of an institution, as evidenced to both observers and participants perhaps most convincingly by the flow of resources. … resources must have symbolic import to function as value in social exchange. But legitimacy is a higher-order representation of that symbolism – a representation of representations.

Hybels (1995, p. 243) argues that good models in legitimacy theory must examine the relevant stakeholders, and how “Each influences the flow of resources crucial to the organizations’ establishment, growth, and survival, either through direct control or by the communication of good will”. He identifies (p. 244) four critical organisational stakeholders, each of which control a number of resources. These are summarised in Table 1 below.

### Table 1: Critical Organisational Stakeholder

<table>
<thead>
<tr>
<th>STAKEHOLDER</th>
<th>RESOURCES CONTROLLED</th>
</tr>
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<tbody>
<tr>
<td>(1) The state</td>
<td>Contracts, grants, legislation, regulation, tax (Note that the last three of these could be either a ‘negative’ or ‘positive’ depending on the implementation)</td>
</tr>
<tr>
<td>(2) The public</td>
<td>Patronage (as customer), support (as community interest), labour</td>
</tr>
<tr>
<td>(3) The financial community</td>
<td>Investment</td>
</tr>
<tr>
<td>(4) The media</td>
<td>Few ‘direct resources’; however, can substantially influence the decisions of stakeholders (2) &amp; (3) (if not (1))</td>
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The last of these has received considerable attention. The power of the media has been noted by a number of researchers, including Patten (2002, p. 153), who states “that while increased media attention can certainly lead to the potential for increased pressures from any of the three sources [dissatisfaction of public; new or proposed political action; increased regulatory oversight], increases in pressure can
also arise, particularly with respect to regulatory oversight.” See also Deegan et al. (2000, 2002).

Companies try to manage their legitimacy because it “helps to ensure the continued inflow of capital, labour and customers necessary for viability… It also forestalls regulatory activities by the state that might occur in the absence of legitimacy… and pre-empts product boycotts or other disruptive actions by external parties… By mitigating these potential problems, organizational legitimacy provides managers with a degree of autonomy to decide how and where business will be conducted” (Neu et al., 1998, p. 265). Researchers need to move away from trying to directly assess legitimacy, and instead focus on measuring it in terms of the resources relevant stakeholders provide. “Rather than engage in the further development of entirely abstract constructions of the legitimation process… researchers should investigate the flow of resources from organizational constituencies as well as the pattern and content of communications” (Hybels, 1995, p. 244).

But Wait… There’s More

As shown in Figure 1 Organisational Legitimacy Theory suggests that a firm may be in one of four phases with regard to its legitimacy. These phases are outlined below, some examples of industries/firms that might be considered to be operating in each of these phases are included (further research needs to be undertaken in this area).

Establishing Legitimacy. (E.g. Stem Cell based bio-tech). This first phase represents the early stages of a firm’s development and tends to revolve around issues of competence, particularly financial, but the organisation must be aware of “socially constructed standards of quality and desirability as well as perform in accordance with accepted standards of professionalism” (Hearit, 1995, p. 2).

Maintaining Legitimacy. (The majority of organisations). This is the phase that most firms would generally expect to be operating in, where their “activities include: (1) ongoing role performance and symbolic assurances that all is well, and (2) attempts to anticipate and prevent or forestall potential challenges to legitimacy” (Ashford and Gibbs, 1990, p. 183). However the maintenance of legitimacy is not as
easy as it may at first appear. Legitimacy is a dynamic construct. “Community expectations are not considered static, but rather, change across time thereby requiring organisations to be responsive to the environment in which they operate. An organisation could, accepting this view, lose its legitimacy even if it has not changed its activities from activities which were previously deemed acceptable (legitimate)” (Deegan et al., 2002, p. 319 - 20).

**Extending Legitimacy.** (E.g. Alternative Health Providers). There may come a point where an organisation enters new markets or changes the way it relates to its current market. This can give rise to a need to extend legitimacy which is “apt to be intense and proactive as management attempts to win the confidence and support of wary potential constituents” (Ashford and Gibbs, 1990, p. 180).

**Defending Legitimacy.** (E.g. Uranium Mining). Legitimacy may be threatened by an incident (internal or external), and therefore require defence. “Legitimation activities tend to be intense and reactive as management attempts to counter the threat” (Ashford and Gibbs, 1990, p. 183). Even barring a major incident it is likely in the Western Capitalist system that almost every corporation will regularly need to defend its legitimacy, by the mere fact that “corporations must fulfil both a competence and community requirement to realize legitimacy… Satisfaction of stockholder interests often occurs at the expense of community concerns (e.g., the despoiling of the environment, the use of labour) while, conversely, responsibility to the larger community often occurs at the expense of the stockholder” (Hearit, 1995, p. 3).

It is this last phase that has tended to be the main focus of accounting researchers. It also provides us with the clearest opportunity to examine the crucial link between legitimacy and resources. Lindblom (1994), a key paper cited by many Social and Environmental Accounting researchers, also seems relevant specifically to this phase only. An example of work in this area is Deegan *et al.*’s (2000) study of five major incidents (including the Exxon Valdez oil spill and the Bhopal Disaster) which provided a context to examine the annual reports of related (in industrial terms) Australian firms to see if there had been a significant change in their social or environmental reporting. They concluded:

The results of this study are consistent with legitimacy theory and show that companies do appear to change their disclosure policies
around the time of major company and industry related social events. … These results highlight the strategic nature of voluntary social disclosures and are consistent with a view that management considers that annual report social disclosures are a useful device to reduce the effects upon a corporation of events that are perceived to be unfavourable to a corporation’s image (Deegan et al., 2000, p. 127).

The Diagnosis Needs Refinement

This is where the traditional legitimacy model stops. However my own research, into the tobacco industry, Tilling (2004), and that of other researchers, including experimental research undertaken by O’Donovan (2002), suggest a further development of the Organisational Legitimacy Level, as depicted in Figure 2 below. Added to the model is the possibility that a firm may not successfully (or may be unable to) defend the threat to its legitimacy and actually start to lose legitimacy.

Figure 2: Refinement of the Organisational Level of Legitimacy Theory

In this model the defence phase is usually entered by an organisation after some form of one-off ‘incident’ or ‘accident’ which threatens its legitimacy. This phase could be characterised as being ‘acute’, it can be serious, some times even fatal, but usually, with proper management, the organisation can maintain, or at least recover, its legitimacy. However should there be an ongoing series of events,
indicative of a systemic issue, e.g. the nuclear power industry, or a single event with permanent consequences which cannot be effectively managed, e.g. realisation that the organisation’s product is not safe such as the tobacco industry, an organisation is likely to have its legitimacy eroded over a period of time (the ‘loss’ phase), which can be characterised as ‘chronic’. The issue can be difficult to manage, and generally leads to declining legitimacy, however the loss may be managed and slowed over a long period of time, or significant change could lead to reestablishment of legitimacy.

The ‘loss’ phase is most likely to be preceded by sustained media and NGO scrutiny, and accompanied by increasing government regulation, monitoring and possibly taxation. Within this phase there are likely to be periods where the company will increase its voluntary social and environmental disclosure in an effort to meet specific threats (such as to postpone or defeat proposed regulations) or to communicate systemic corporate change (similar to the defence phase). However, with each new restriction average total disclosure can be expected to decrease. This idea is alluded to by O’Donovan (2002) who argues, based on experimental evidence, that the lower the perceived legitimacy of the organisation, the less likely it is to bother providing social and environmental disclosure.

**Watch This Space**

Legitimacy theory offers researchers, and the wider public, a way to critically unpack corporate disclosures. However the understanding and study of the theory must become more sophisticated, drawing on developments both within the accounting literature and beyond. Only then will the full potential of legitimacy theory for examining a wide range of disclosures be fully realised. Areas that would provide useful insights include at the moment the asbestos industry (as it goes through the disestablishment phase), brothels (as they become much more legitimate within the Australian context), and the forestry industry (as it tries to defend its legitimacy), to name but a few. The knowledge gained will then be used to provide better and more useful information to inform decision making by stakeholders. In this way society is empowered to have greater control and oversight over the way resources are allocated.
References:


