

# THE LEGITIMACY OF CORPORATE SOCIAL RESPONSIBILITY

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## Abstract

Based on deliberations on the legitimacy of CSR from the perspective of stakeholder and legitimacy theory on the one hand and the more critical view of Milton Friedman and Michael Jensen on the other hand, this paper analyses how major energy companies legitimise their CSR activities in their Annual Reports and their CSR reports. The research indicates that managers recognise the potential contribution of CSR to long-term financial performance of firms as well as the need to socially legitimise the firm's operations. A surprisingly limited number of the companies in the sample take a very explicit strategic approach to CSR by stressing long-term shareholder value maximisation. The CSR policies therefore appear not to focus solely on a strategic stakeholder approach geared towards maximising shareholder value but to reflect considerations raised by legitimacy theory.

**Keywords:** corporate governance, corporate social responsibility, legitimacy

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## Introduction

In recent times 'Corporate (Social) Responsibility' (CSR) or 'Corporate Citizenship' policies have increasingly become incorporated into the strategic planning of companies. Despite the fact that few commentators agree on the legitimate content of such policies, the implicit assumption is frequently that the spread of CSR activities is to be encouraged as an important contribution of companies to the societies they operate in.

Milton Friedman and Michael Jensen are among the few dissenters who dare to question the purpose and legitimacy of CSR. This paper aims to discuss how the more critical arguments regarding the legitimacy of CSR policies fit into the theoretical CSR debate.

Moreover it seeks to analyse how boards of directors of energy companies legitimise CSR activities in Annual Reports and Social Responsibility Reports.

The paper is structured as follows. Section 2 briefly discusses the problems of defining CSR and suggests a working definition based on Carroll's (1999) four categories of Corporate Social Responsibility activities.

Section 3 discusses the rationale for CSR from the perspective of stakeholder and legitimacy theory, while Section 4 investigates CSR from the perspective of Milton Friedman and Michael Jensen. Their perspective suggests that the only legitimate

form of CSR is 'strategic CSR'. Section 5 considers the advantages and limitations of the multiple case study approach employed in this paper. Section 6 investigates how the six chosen energy companies legitimise their CSR activities in their Annual Reports and their CSR reports. Section 7 concludes.

## The problem of defining CSR

One of the most essential problems in the debate about CSR is that there is little agreement on what constitutes CSR and who it should be directed towards (Davis 1960: 70). Depending on the author, the concept of Corporate Social Responsibility or Corporate Citizenship suggests that businesses are expected to deliver on a more or less wide ranging set of corporate responsibilities which include economic as well as legal, socio-economic, moral and charitable objectives.

One of the most widely quoted definitions of CSR is that of Carroll (1979, 1999) who developed four categories of Corporate Social Responsibility activities:

- ✓ Economic responsibilities: Carroll (1979: 500) sees the "first and foremost social responsibility of business" in the production and sale of goods and services and the generation of profits. According to Carroll all of the following responsibilities are directly related and subordinate to this.

- ✓ Legal responsibilities: Businesses are expected to adhere to societies' laws and regulations since societies' legal systems provide the institutional framework businesses need to operate.
- ✓ Ethical responsibilities: Companies are expected to honour wider sets of societies' norms of acceptable behaviour than the mere legal minimum as these also shape the organisation of society. Carroll (1979: 500) acknowledges that many norms might be ill-defined and occasionally contradictory.
- ✓ Discretionary or philanthropic responsibilities (Carroll 1979, 1999): These cover voluntary activities which exceed society's minimum expectations such as charitable donations, social programmes run by companies for their employees and their relatives etc.

Although Carroll's model is probable the most widely referenced definition in the academic literature on Corporate Social Responsibility, many authors who refer to it never-the-less effectively exclude in their consideration of CSR economic responsibilities (e.g. see Aupperle et al 1984; Lantos 2001; Hill et al 2003) or legal obligations (Timms 2004; Commission of the European Communities 2002).

A similar picture emerges in the political arena: e.g. the European Commission (Commission of the European Communities 2002) and the UK government (Timms 2004) interpret CSR as business activity which contributes to sustainable development by taking account of the economic, social and environmental impacts of business decisions *in excess of legal minimum requirements*.

However, both organisations also stipulate that this activity should *not be directed towards altruism* but "should be good for long-term business success as well as good for wider society" (Timms 2004: 3).

In the case of the UK government this advocacy of 'strategic' CSR (Lantos 2001), i.e. social activities which, in the long-run, are likely to contribute positively to firms' financial performance, is influenced by provisions in UK company law.

This stipulates that directors owe quasi-fiduciary duties to the company and its shareholders and are therefore only able to take account of other stakeholders' interests with the explicit consent of the shareholders or if shareholders stand to benefit from furthering the interests of other shareholders (Davies 2003).

Alternative definitions of CSR by some proponents of both legitimacy theory and stakeholder theory suggest that in terms of scope Corporate Social Responsibility refers only to business decisions which go beyond a company's direct economic or technical interests (Davis 1960: 70) and which are voluntary (Manne and Wallich 1972: 5 cited in Carroll 1979: 498).

## CSR from the perspective of Stakeholder Theory and Legitimacy Theory

Stakeholder theory suggests that companies' CSR policies should be directed towards their stakeholders, such as employees, customers, suppliers, investors and local or central government (Jansson 2005) as "the corporation's continued existence requires the support of the stakeholders and their approval must be sought and the activities of the corporation adjusted to gain their approval. The more powerful the stakeholders, the more the company must adapt" (Gray et al 1995: 53). Most representatives of stakeholder theory do not accept any supremacy of the interests of shareholders over the interests of other stakeholders or of economic responsibilities over other social responsibilities and therefore reject a 'strategic' approach to CSR. Instead they assert that "the very purpose of the firm is to serve and coordinate the interests of its various stakeholders, and it is the moral obligation of the firm's managers to strike an appropriate balance among stakeholder interests in directing the activities of the firm" (Buchholz and Rosenthal 2005: 138).

Supporters of Legitimacy Theory span the net of social responsibility of business wider than suggested by the stakeholder approach and suggest that in return for being provided with an institutional framework for their operations as well as access to markets for resources and products, firms implicitly consent to meet certain expectations society has about their behaviour (Gray et al 1988).

The latter are seen as a firm's duty "to be responsive to society's long-run needs and wants, optimizing the positive effects and minimising the negative effects of its actions on society" (Lantos 2001: 600).

The power different stakeholders have within the organisation is not accepted to be reasonable guide to the importance of their claims. However, with regard to companies' duties Davis (1960: 71) suggests that "social responsibilities of businessmen need to be commensurate with their social power". This implies that larger firms are expected to engage more actively in the ethical and philanthropic aspects of CSR than smaller firms (Davies 1960, Hamid 2004).

According to legitimacy theory content and scale of CSR activities depend on the relationship between societal expectations (e.g. in form of prevalent social ideologies), managers' attitude to what they think are legitimate societal expectations and business behaviour (Gray et al 1988; Zenisek 1979).

However, in pluralist societies, the discussion about the content of legitimate societal expectations and what this implies with regard to business activity is necessarily controversial. Davis (1960, p 71) summarises the range of the debate as follows:

*“On the one hand, it is argued that business is business and anything which smacks of social responsibility is out of bounds (i.e. keep the power but accept no responsibility). On the other, some would have business assume responsibilities as sort of a social godfather, looking after widows, orphans, water conservation, or any other social need, simply because business has large social resources.”*

### **A critical perspective on CSR**

Institutional economic theory suggests that corporations have merely legal, but no actual, personalities. Based on this premise, Milton Friedman consequently asks why this legal construct is supposed to give rise to implicit social obligations which are not covered by the contract it is based upon or by national laws:

*“What does it mean that ‘business’ has responsibilities? Only people have responsibilities. A corporation is an artificial person and in this sense may have artificial responsibilities, but ‘business’ as a whole cannot be said to have responsibilities, even in this vague sense”* (Friedman 1970: 1-2).

Regarding the social responsibility of managers Friedman stresses the need to clearly differentiate between executives’ private social responsibilities and their professional ones:

*“In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business according to their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom”* (Friedman 1970: 2).

Contrary to popular myth in the CSR literature, Friedman (1970) does not stipulate that managers should be exclusively concerned with profit maximisation, as the ultimate objective of the firm depends on the wishes of its owners. As long as the firm has no monopoly powers which would allow it to exploit e.g. customers, suppliers or employees, owners can use their companies, and thereby their own money, to promote social causes as they see fit. However, Friedman is adamant that unless a clear mandate from the company’s owners is provided, ‘philanthropic’ activities which do not serve to improve a firm’s profitability, e.g. via attraction of customers, motivation of staff, creation of goodwill of suppliers or investors, should not be funded by firms.

Michael Jensen’s (2001) view slightly deviates from Friedman’s as he argues that, in the absence of monopoly or externalities, the only social responsibility of firms is the long-term maximisation of the value of the firm. He therefore similarly suggests that stakeholder interests should only be accommodated if the resulting activities are likely to

promote the long-term profitability of the company, i.e. if they can be classed as ‘strategic’ CSR.

Jensen (2001) criticises stakeholder theories for failing to specify how tradeoffs between competing interests of stakeholders should be made. He argues that stakeholder theory effectively provides managers with an opportunity to become unaccountable for their decisions. The ability to claim that poor performance concerning objectives one group of stakeholders is interested in might have been caused by the need to achieve objectives which benefit other stakeholders provides a myriad of convenient excuses for poor managerial performance.

Finally, with regard to the impact of CSR activities on society, Milton Friedman (1970) questions managers’ expertise in selecting social issues which ought to be promoted and in devising viable methods in improving them. Moreover he is concerned about the (lack of) political legitimacy of managers to use money belonging to shareholders (via reduced profits), customers (via higher prices) or employees (via lower wages) to foster social issues dear to their own hearts:

*“Here the businessman – self-selected or appointed directly or indirectly by stockholders – is to be simultaneously legislator, executive and jurist. He is to decide whom to tax by how much and for what purpose, and he is to spend the proceeds – all this is guided by general exhortations from on high to restrain inflation, improve environment, fight poverty and so on and on.”* (Friedman 1970: 4)

In summary, unless the owners of the firm explicitly legitimise CSR activities, both Milton Friedman and Michael Jensen suggest that managers are only legitimately able to pursue ‘strategic CSR’, i.e. CSR which is ultimately expected to benefit shareholder wealth maximisation.

In this case the lack of political legitimacy as well as expertise with regard to the selection and administration of socially responsive activities appears to be secondary. Since it is managers’ legitimate obligation to maximise shareholders’ wealth, they may legitimately engage in CSR activities which serve to improve companies’ financial performance – unless the government legally restricts companies’ rights to influence the supply of public goods or the provision of social and charitable services. Similarly, managers’ lack of expertise regarding the selection and conduct of CSR policies which serve to maximise social welfare is not seen as important, given that the motivation for ‘strategic’ CSR is to engage in social activities aimed at maximising shareholder wealth.

The debate about whether companies may legitimately engage in CSR activities is therefore reduced to the question of whether CSR activities are expected to contribute positively to a firm’s financial performance. However, empirical research into the relationship between firm’s CSR activities and their

financial performance has lead to inconsistent results which are influenced by a variety of methodological problems (Cochran and Wood 1984; Aupperle et al 1984; Gray et al 1995, Balabanis et al 1998; Richardson, et al 1999; Moore 2001; Orlitzky et al 2003).

Despite the lack of consistent empirical evidence proponents of 'strategic' CSR raise a wide variety of reasons why CSR might benefit firms' long-term financial performance.

For one, companies which engage in CSR and are able to credibly convey this to investors might benefit if their securities are included in the investment portfolios of 'ethical investors' or 'socially responsible' mutual funds or unit trusts. This increase in demand for the company's securities is expected to lead to a fall of its cost of capital. The social responsible investment (SRI) sector consists mainly of mutual funds and units trusts which invest exclusively in firms which meet certain requirements in relation social or environmental issues. E.g. in the UK, while with an estimated market capitalisation of £10 billion in 2003 (Gascoine 1999, cited in Friedman and Miles 2001: 526) the SRI sector is only a minor player in terms of share market, a growth rate of 76.9% between 1997 and 1999 indicates the potential of this market sector to quickly increase in importance.

However, in the short run more important is probably the increasing interest of large scale institutional investors in the CSR activities and reports of their investments. In recent years large pension funds, particularly those for public sector employees such as TAA and CalPERS,<sup>1</sup> have increasingly put pressure on companies to exceed legal norms with regard to employee relations and environmental standards. The reason for this is twofold.

Firstly, the reputation of high profile investors such as pension funds and insurance companies is likely to suffer if they invest in companies, which attract negative publicity. This is particularly dangerous for companies where customers expect particularly high standards of ethical behaviour, such as in the pension and life assurance business. Secondly, investors are concerned that the 'corporate irresponsibility' cannot only damage the reputation but also the profits of their investments.

One famous example for investor intervention was CalPERS' demand in 2003 that the multinational pharmaceutical company GlaxoSmithKline should consider allowing more firms in developing nations to produce its HIV/Aids drugs under licence.

The president of CalPERS, Sean Harrigan, emphasised that: "We feel that the pharmaceutical industry faces very specific risks in regards to reputation and this is particularly true in the case of

Aids. How the company handles this risk is important to long-term shareholders" (cited in Dyer 2003).

These concerns are understandable as according to the Co-operative Bank "boycotts by ethically motivated consumers cost big brands £2.6 billion a year" (Business in Society 2004).

While fiduciary requirements do not allow pension funds such as CalPERS to place non-financial considerations above risk-return considerations, these firms are never-the-less able, and increasingly willing, to consider the collateral benefits of the promotion of CSR activities by the companies they invest in:

*"The Board expects those who manage the companies whose equity securities are held in the Fund's portfolio to conduct themselves with propriety and with a view toward responsible corporate conduct that is consistent with practices and policies including, but not limited to, those articulated in the Global Sullivan Principles of Corporate Social Responsibility and the MacBride Principles. A level of performance above minimum adherence to the law is generally expected. If any improper practices come into being, the Board expects corporate management to move decisively to eliminate them and effect adequate controls to prevent recurrence"* (CalPERS 2003).

Additionally to the potential damages to their investments' reputation which might affect future sales, recruitment and capital costs, investors are also likely to consider the impact of fines and compensation claims for breach of legal standards. E.g. Exxon had to spend \$US 2 billion for clean up operations after the Exxon Valdez oil spill and Union Carbide was ordered to pay \$US 3 billion in compensation for the chemical pollution of Bhopal (Friedman and Miles 2001: 545).

As highlighted by the guidance on 'Assessing the effectiveness of the company's risk and control processes' included in the Turnbull Committee report (Institute of Chartered Accountants 1999), the importance of risk management within companies is increasingly seen to include the management of reputational and environmental risks.

While negative publicity on CSR related topics can tarnish a company's reputation and thereby alienate customers, investors and employees, an increasing number of firms engage in strategic CSR in order to improve the reputation of their brands for marketing purposes. Marketers expect that the increasing interest consumers take into firm's social and environmental reputations will influence their purchasing behaviour (Menon and Kahn 2003; Maignan 2001; Bronn and Vrioni 2001).

Finally, a firm's CSR reputation might allow it to increase the goodwill of its current employees and to recruit better employees (Orlitzky et al 2003). With regard to recruitment, empirical evidence indicates that a firm's CSR reputation is particularly

<sup>1</sup> CalPERS is the largest US pension fund.

important for the recruitment of job seekers with high levels of job choice (Schmidt Albinger and Freeman 2000).

### **Methodology: Evaluating CSR policies via CSR Reports**

Research into Corporate Social Responsibility relies heavily on content analysis of company publications, in particular annual reports, CSR reports, company web-pages as well as third party reports, e.g. media coverage or reports by CSR interest groups (Aupperle et al 1985; Cochran and Wood 1985; Balabanis et al 1998; Campell et al 2003). Although such documents cannot be regarded as providing an objective perspective of events and policies (Bryman and Bell 2005), the majority of CSR research relies on corporate social reporting as a proxy for firm's approach to and engagement in corporate social responsibility.

The academic approach to CSR research is mirrored by SRI investors, who tend to rely heavily on company reports in their assessment of firms (Friedman and Miles 2001). The same appears to apply to external CSR ranking organisations. Using ratings for firm's CSR activity provided by the Council on Economic Priorities and disclosure rankings from the Association for Investment Management and Research Corporate Information Committee, Gelb and Strawser (2001) find that there is a significant positive relationship between firms' disclosure of CSR activities and their CSR rating.

Research by Gray et al (1995) on CSR reporting of UK companies between 1979 and 1991 indicates that during this period both the proportion of large companies which report on CSR as well as the volume of CSR reporting has significantly increased. While initially CSR reporting was dominated by mandatory disclosure of employee related issues and charitable donations, more recently voluntary reporting on environmental issues, community related topics and health and safety issues have grown significantly in importance.

However, the increase in the volume of non-financial information reported is probable not only related to the increase in interest in companies' policies on social and environmental issues but also to the proliferation of the internet, which has reduced the costs of providing company reports and improved their accessibility (Jones and Xiao 2003). Empirical research indicates that other factors which influence CSR disclosure are country of origin, firm size, industry, capital intensity and senior managers' attitudes (Gray et al 1995; Balabanis et al 1998; Adams et al 1998). Today about half of the FTSE250 companies publish CSR reports and the vast majority comment on CSR policies in their annual reports.

However, among practitioners and in the academic literature there is a wide variety of opinion regarding the topics CSR reports should cover, who

should be reporting and to whom such reports should be addressed (Gray et al 1988; Gray et al 1995; Friedman and Miles 2001). The lack of statutory standards both in terms of the range of topics companies are expected to report on and the format of the reporting leads to a lack of consistency in CSR reporting which makes it difficult to meaningfully compare the CSR activities of companies based on their annual or CSR reports. This situation raises questions about the representativeness of the necessarily limited sample of companies included in this research.

While CSR reports are not the only source of information about CSR related activities of firms, they serve two important purposes: Firstly they reduce the transaction costs of stakeholders who are interested in CSR activities and who otherwise need to rely mainly on information from the media or special interest groups. Secondly they allow the company to influence which information is provided and how it is presented.

The second aspect is particularly interesting as it relates to the credibility of the information displayed. While in most countries financial reports are legally expected to provide a 'true and fair view' of the economic health of a corporation, there are no such legal requirements for CSR reports.

Criticism of the lack of validity of the information provided in CSR reports (Stittle 2002) has led some companies to have their CSR reports audited by professional auditors or at least vetted by charities. Currently, of the 132 of the FTSE 250 companies which report on CSR, 45 have their reports independently verified (Business in the Community 2004).

However, the lack of generally accepted guidelines for the conduct and content of such audit and vetting procedure means that it remains largely unclear how non-financial data in CSR reports is validated.

Consequently research based on CSR reports should be interpreted conservatively due to the lack of credibility, comparability and reliability in terms of coverage and vetting.

The sample chosen for this research consists of six multinational energy companies, which all generate a significant proportion of their income by oil exploration and petrochemical production. As such the companies face similar challenges with regards to their environmental impact, issues of work safety as well as potential human rights violations in many countries they operate in. While the companies are similar in size, they differ in the countries in which they are incorporated in.

The analysis of the companies' CSR policies is based on statements included in their Annual Reports and CSR Reports 2004. Due to the rapid development of CSR reporting using reports dating from the same year should help to make comparisons between reports more reliable.

## Case Studies

### Total

Total is a multinational energy company registered in France with a turnover of about € 122 billion. Based on Total's Annual report (2005a: 2) business objectives are stated as "to perform in line with the best of its peers in terms of growth and profitability, while expanding its activities in an environmentally-conscious manner". In its annual report Total (2005a) highlights a wide range of CSR activities, particularly those geared towards its employees and sustainable development. However, while the report describes the activities as such, it does not explain the underlying philosophy behind many of these activities except in areas of risk reduction and compliance with legal requirements. Consequently it is unclear whether the company is pursuing 'strategic CSR', aimed to benefit ultimately its shareholders, or a stakeholder or legitimacy approach.

However, Total's (2005b) CSR report clearly takes an approach rooted in legitimacy theory:

*"The CSR report is one of the most effective ways we have of expressing our commitment to open dialogue with our partners and with civil society. People expect a lot from us because of the industry we're in, our size, our financial clout and our geographic reach. We're asked about our work practices, our ethical principles, our industrial safety performance, our environmental stewardship, and our contribution to employment, research and local development. People also want to know how we see the future of energy and of the climate. In addition, corporate social responsibility is driving continuous improvement, since we have our own questions and problems. We need to hear what people from outside the organization have to say, so transparency, dialogue and feedback are critical to the way we exercise corporate social responsibility"* (Total 2005b: 1).

The management states that the company's CSR policy is intended to be responsive to society's expectations on a wide range of issues and reports on those in detail. The report does not acknowledge the supremacy of the interest of any group of stakeholders (including shareholders) over another. Neither the annual nor the CSR report makes any link between CSR and shareholders' interests, indeed, the term "shareholder value" does not feature in either of Total's reports analysed.

### British Petroleum (BP)

British Petroleum is a multinational energy company registered in the UK with a turnover of about € 123 billion.

According to BP's annual report, the company's main business objective is the maximisation of shareholder value.

*"Our fundamental purpose, as defined by BP's board, is to maximize shareholder value on a long-term basis by providing constantly improving goods and services in a strongly competitive way. To be sustainably successful, we have to gain and retain the support of many people, including employees, shareholders, customers and communities"* (BP 2005a: 30).

The company engages in CSR at a strategic level in order to pursue its main objective of shareholder value maximisation. However, the company stresses that it tries "to ensure that our relationships with non-governmental organizations (NGOs), customers, suppliers, communities and governments are founded on the basis of mutual advantage".

While the statements in the company's CSR report (BP 2005b: 1) are overall consistent with the message in the annual report, the way they are expressed changes and thereby puts less emphasis on the creation of shareholder value:

*"The road to sustainability begins with our fundamental purpose as an organization – to provide better goods and services in the form of light, heat, power and mobility to increasing numbers of people and thereby to deliver shareholder value on a long-term basis. To succeed, we need to do this in a way that is profitable, consistent and sustainable. ... To deliver consistent performance, we fund controlled investment that supports long-term growth, balancing this with returns to shareholders and the interests of all who are affected by our work."*

### ChevronTexaco

ChevronTexaco is a multinational energy company registered in the USA with a turnover of about US\$ 151 billion.

The annual report (ChevronTexaco 2005a: 8) states that the company's objective is "to create long-term stockholder value while delivering new energy supplies to meet growing worldwide demand". The purpose to "to increase competitive returns and stockholder value" appears to stand on equal footing with the objective to "to deliver the energy needed to fuel economic development and growth around the world" (ChevronTexaco 2005a: 2).

According to its CSR report (ChevronTexaco 2005b: 2) the company prioritises its CSR policies according to those issues which are most relevant to the company and its' stakeholders. This seems to imply that the firm takes a stakeholder approach to CSR. The firm lists its stakeholders as shareholders, employees, business partners, host governments, customers, local communities and civil society organisations such as business forums, multilateral institutions, charities, think tanks, academic institutions, religious organisations, non-governmental and governmental development

institutions (ChevronTexaco 2005b: 13). While not stressing shareholder value maximisation the company does acknowledge that its CSR policy supports the long-term growth and profitability of the company (ChevronTexaco 2005b: 6). This does not necessarily imply a strategic approach to CSR.

The company's CSR report merely states that "Our vision is to be the global energy company most admired for its people, partnership and performance" (ChevronTexaco 2005b: 7). The ultimate purpose of this vision remains unclear. Based on the statements in its reports, the company appears to follow a stakeholder oriented approach rather than a shareholder value maximising approach.

### **Shell (Royal Dutch Shell Group)**

Shell is a multinational energy company registered in the UK and the Netherlands with a turnover of about US\$ 193 billion.

Although it refers to the group's objectives 14 times, (Shell 2005a), Shell's annual report does not actually spell out what these objectives are. The reason for this oversight might be the company's preoccupation with changes to its corporate governance structure in the wake of its proven reserve accounting scandal in 2004.

With regard to the company's CSR policy, the annual report does however clearly indicate that the company's management believe that CSR "will provide real competitive advantages that will be a key part in the future success and profitability" (Shell 2005a: 12) of the firm. This also reflects Shell's 2003 Annual Report which sets out the company's main objectives as delivering "superior shareholder returns" (Shell 2004: 12). As a consequence of these statements it appears that the company takes a strategic approach to CSR.

In its 2003 annual report (Shell 2004) the management also set out, how its CSR policy is expected to contribute to the company's financial performance:

*"In 1997 we committed to contribute to sustainable development. We recognised that, to stay successful, we needed to find more socially and environmentally sustainable ways to meet society's needs. We remain convinced that engaging with stakeholders and integrating social and environmental considerations better throughout the lifetime of our projects makes us a more responsive, competitive and profitable company, in the long and short term." ...*

*"Our efforts to contribute to sustainable development in these ways helps us create value for our shareholders by reducing our operational and financial risk, by cutting costs through 'eco-efficiency' (producing more with less energy and materials), by building closer relationships with customers and by helping us create new products to meet their needs. It also influences the development*

*of our portfolio, and attracts and motivates staff."* (Shell 2004: 6)

While Shell's 2004 CSR report consistently refers to its stakeholders with regard to shaping its CSR policies, it also points out the importance of understanding society's expectations towards the company (Shell 2005b: 6). This is a theme which has been covered in Shell's Annual Reports for some time:

*"While profitability is essential for commercial success, society is demanding that companies should be accountable for more than just financial performance. They should, for example, be ever more transparent in the way they do business, respect human rights and meet ever stricter environmental and social standards. We believe that companies that understand and respond to these essentials will be best able to thrive."* (Shell 2001: 20).

Despite Shell's strategic approach to CSR its management appears to recognise the premise of legitimacy theory, that companies must be seen to play a legitimate part in the societies in which they operate.

### **Lukoil**

Lukoil is a multinational energy company registered in Russia with a turnover of about US\$ 33 billion.

The company clearly states that its main objective is shareholder value maximisation (Lukoil 2005). Its CSR policy is geared towards this goal:

*"We are also highly aware that industrial safety, health and social well-being of our employees are essential for best operating and financial results"* (Lukoil 2005: 7).

Never-the-less, the annual report indicates that the management also believes in the need to engage in CSR to legitimise the company's existence and operations:

*"Lukoil views social responsibility as an integral part and logical consequence of successful business. We see it as evident that a company as large and successful as Lukoil should take on voluntary obligations to serve society, whose framework is essential for its business activities"* (Lukoil 2005: 61).

### **CSR and Legitimacy**

As large multinational energy companies all of the firms in the sample are characterised by high social and political visibility. The fact that this does not only lead to economic and political power but also to vulnerability towards public perception has generally been recognised since 1995, when Shell felt required to reconsider its disposal policy for the decommissioned oil platform Brent Spar due to public protests (Bate 1995).

This might be the reason why even companies in the sample, which explicitly take a strategic approach to CSR, appear to recognise the need to

legitimise the existence and operation of the firm, although they largely fail to explain where they see the need to legitimise their operation derives from.

According to Lindblom (1994: 2; cited in Gray et al 1995: 54), there are four main strategies, firms can employ to generate legitimacy:

- ✓ The firm can inform its public about changes in its performance and activities.
- ✓ The firm can try to change the public's perception of the firm's behaviour without actually changing it.
- ✓ The firm can try to deflect attention away from contentious issues by raising the profile of related activities. E.g. companies with a poor track record in terms of pollution might invest in environmentally friendly industries or donate to environmental charities.
- ✓ The firm can try to change its public's expectations about its performance.

The analysis of the company's annual and CSR reports suggests that all of the firms in the sample engage in all of the four strategies. The comparative length and detail of the reporting on CSR activities reflects the fact that all of the sample companies operate in a politically highly visible industry and are comparatively large. This fits with empirical research (Adams et al 1998; Clarke and Gibson-Sweet 1999; Patten 2002) which finds that industries with a high political visibility are more active with regard to CSR reporting than others. This research also supports the contention that CSR reporting differs between different countries (Adams et al 1998; Clarke and Gibson-Sweet 1999; Patten 2002). This is most obvious with respect to Lukoil, which is the only company in the sample which does not publish a free-standing CSR report although it covers CSR related issues in its annual report and provides information on CSR on its web-site.

The annual and CSR reports of the firms in the sample indicate that the companies expect CSR policies to contribute to their long-term financial performance. However, as seen above, empirical research into the relationship between CSR or CSR reporting and financial performance of firms however does not provide any clear evidence that this assumption indeed does hold (Cochran and Wood 1984; Aupperle et al 1984; Gray et al 1995; Balabanis et al 1998; Richardson, et al 1999; Moore 2001; Orlitzky et al 2003). Only few of the sample firms provide any indication how they expect CSR activities to influence their financial performance.

## Conclusion

Based on the annual and CSR reports of the companies sampled, managers appear to believe that CSR can make a positive contribution to firm's long-term financial performance and that companies need

to engage in CSR in order to legitimise their existence and operations.

However, only few firms provide any information to shareholders about how the potential link between CSR and company performance is expected to operate. Similarly, it remains largely unclear where the need to legitimise the firm's existence and operation through voluntary engagement in social or environmental activities derives from. While this does not necessarily mean that managers overstep their legitimate remit by pursuing CSR policies on behalf of the company, it is unclear who or which mechanisms control managers' performance in this aspect of business. In order to generate a better understanding about the legitimacy of CSR and its boundaries research into the motivations of managers and company directors to engage in CSR policies is needed.

This is particularly urgent since recent corporate scandals seem to justify Milton Friedman's and Michael Jensen's weariness about the legitimacy of non-strategic CSR and the problems this might pose to managers' and directors' accountability. In cases such as HealthSouth and Tyco International CSR policies were frequently indistinguishable from private charitable interests of senior managers and directors (Strom 2002). In companies such as Enron and AIG the suspicion exists that senior management used corporate donations to ensure the goodwill of independent directors (Kirchgaessner 2005, Cohen 2002).

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