Institutional Theory as a Driver of CSR: An Integrative Framework

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Abstract

The paper uses institutional theory as a lens to explain CSR activities of organizations. The article, in particular, focuses on three specific areas in CSR: CSR as a substitute for institutional mechanisms, CSR focus of multinational corporations and CSR reporting. The rationale for examining these three areas using institutional theory is explained. The paper then proceeds to verify the correctness of propositions of institutional theory, as applied to the focus areas. The study finds that CSR focus substitutes rather than complements existing institutional mechanisms, which is contrary to theory. The role of multinationals as institutional entrepreneurs straddling different institutional environments is verified. The study suggests that institutional mechanisms enable homogeneity as well as heterogeneity in CSR reporting.

Keywords: institutional theory, CSR, institutional mechanisms, MNC
INTRODUCTION

Institutional theory broadly states that the behavior of firms is governed by its institutional environment or field. The constituents of the field include the organization’s social context, the scope of its activities, and its network of social relationships (Doshi & Khokle, 2012). The institutional field tends to bring uniformity in business practice through three mechanisms: coercive, mimetic and normative. Coercive mechanisms refer to pressure techniques that aim to bring business practice in line with societal expectations. Mimetic practices refer to peers’ pressure on firms to conform to certain behaviors. Normative practices refer to internalization of beliefs about the suitability of certain behavior (DiMaggio & Powell, 2000). Broadly, the institutional forces drive agent’s behavior by aligning agent’s beliefs with societal norms, with the alignment being caused by either internalization of norms or external pressure.

Norms drive group behavior especially when the groups’ normative focus and member’s group identification is high (Terry & Hogg, 1996; Kallgren, Reno & Cialdini, 2000). Organizations can be conceptualized as a consciously coordinate social unit that functions on a relatively continuous basis to achieve a set of goals (Robbins, Judge & Vohra, 2013). Hence, organizations being a specific type of groups are likely to be affected by group norms. CSR denotes a voluntary, organizational-level behavior that includes not harming stakeholders (Campbell, 2007) and looking at social and environmental issues besides business issues (Jackson & Apostolakou, 2010). As institutions influence an organization’s selection of norms and alignment of behavior with norms, the institutional theory can explain CSR activities, including reporting. This article specifically focuses on three areas where institutional forces affect CSR activity: the relationship between formal institutional mechanisms for interacting with stakeholders and CSR focus, the interaction between multinational corporations’ (MNCs) CSR focus and institutional mechanisms and the role of institutional mechanisms in bringing homogenization in CSR reporting. The three focus areas are inter-related as the relationship between formal institutional mechanisms and CSR focus in the home country is likely to affect MNCs CSR focus in other countries and their reporting standards. As the USA is home to the greatest number of Fortune 500 countries, it is
possible that the CSR norms of USA will be reflected in the operations and CSR reporting of USA-based MNCs.

MNCs provide an interesting case study for the impact of institutional forces on firm’s behavior. MNCs operate in multiple institutionalization fields and hence the applicability of neo-institutionalism for their activities has been questioned (Kostova, Roth, & Dacin, 2008). Kostova et al. (2008) suggest that the concepts of organizational field and institutional isomorphism in the traditional sense are not applicable to MNCs. The authors had further suggested that MNCs engage in actor-specific manipulation and negotiation and, hence, legitimacy for MNCs is associated with heterogeneity rather than homogeneity. The article examines the CSR activities of MNCs to test the validity of Kostove et al. (2008) propositions.

Besides being theoretically relevant, the effect of institutional forces on MNC’s behavior is also practically relevant. With increasing globalization, the economic clout and social importance of MNCs is increasing. As their operations are spread over several countries, the coercive power of governments, especially those from developing countries, over MNCs is limited. Hence, norms are important to ensure voluntary, social positive actions by MNCs. Institutional theory can help clarify the mechanism through which norms affect behavior at group and organization level

CSR reporting is examined to test the effects of institutional isomorphism on firms’ CSR practices. Firms are legally mandated to follow national accounting standards and there is a move to standardize reporting of financial results globally by using IFRS (International Financial Reporting Standards). Assuming similar institutional pressures on standardization of CSR reporting would indicate moves toward greater homogenization.

**CSR as a substitute for institutional mechanisms**

Campbell (2007) proposed that CSR focus is strengthened when there are institutional mechanisms for communication between different stakeholders and the governmental institutions are
effective and pro-CSR. However, studies suggest that explicit CSR is stronger when institutional communication mechanisms are weak and governments are more laissez-faire in their economic policies.

A secondary data-based study of firms in Western Europe, with the country of incorporation as the higher level factor, suggested that CSR activities act as a substitute for institutionalized coordination mechanisms between stakeholders (Jackson & Apostolakou, 2010). Countries were categorized into two groups: liberal market economies (LME), with weak institutional coordination mechanisms and coordinated market economies (CME), with strong institutional coordination mechanisms. CSR activities were higher in LMEs than CMEs. Society-oriented CSR and investor-oriented CSR were not correlated with the strength of laws protecting employee rights and investor rights.

Institutional pressures not only drive CSR spending but also affect CSR policy. Based on a comparison of the private sector-driven CSR of the USA and the government-driven CSR of France, Avetisyan and Ferrary (2013) found greater isomorphism of CSR policies and a greater institutionalization of academic studies on CSR in France. On the other hand, CSR policies in the USA show greater pluralism as they are driven mostly by firms’ philanthropic interests and their efforts to build a positive image. The private-sector driven CSR policy in the US led to the emergence of sustainability rating indices (SRI) while the government-driven CSR in France led to more stringent environment regulations and guidelines.

Institutional theory is suitable for explaining national-level differences in corporate governance, including CSR because it takes into account the role of national-level institutions. A review of the CSR policies in USA and Europe suggests that explicit CSR, measured in terms of company donations or reporting of CSR activities on the website, is more pronounced in the USA than Europe (Matten & Moon, 2008). The authors explain it by suggesting four nation-level institutional determinants that differ between USA and Europe:

1. Greater role of the state in Europe than the USA
2. USA financial system is capital markets-based while the European system relies more on banks.
3. Larger role of state in employee training in Europe and a more rigid labor system.
4. The Greater moral worth of capitalism in the USA and increased importance to personal philanthropy.

These institutional level differences lead to greater focus on explicit CSR in the USA and implicit CSR in Europe. However, due to the greater internationalization of operations, European firms are being subjected to “coercive, mimetic and normative pressures” that is leading to a greater isomorphism with USA business practices (Matten & Moon, 2008).

**Institutional theory, multinational corporations, and CSR**

Institutional mechanisms, especially coercive and normative mechanisms, lead to the institutionalization of CSR practices within MNCs (Bondy, Moon, & Matten, 2012). MNCs operate in their multiple countries with different institutional frameworks and hence are subject to multiple and sometimes divergent institutional pressures. Hence, the study of institutional pressures on MNCs and their reactions helps specify the boundary conditions of institutional theory.

Institutional theory has viewed firms as passive recipients of institutional pressure. However, firms, especially MNCs, can and do play a big role in shaping institutional policies and attitudes towards the environment (Child & Tsai, 2005). Moreover, the authors found that the role of MNCs in institutional development is not environmentally regressive. MNCs provide the technical knowledge necessary for formulating new regulations and monitoring their compliance and also show greater isomorphism than local firms as far as compliance with host country regulations is considered. The reasons for MNCs progressive policies regarding environmental standards include firm strategy, the need for legitimacy, institutional pressures in the country of incorporation and desire for standardization of operations across countries.
MNCs role as institutional entrepreneurs seems to be dependent on their financial performance and the institutional distance between home and host countries. Positive associations have been found between standardization of environmental norms and MNCs financial performance (Aguilera-Caracuel, Aragón-Correa, Hurtado-Torres, & Rugman, 2012). On the other hand, institutional distance negatively impacted the standardization of environmental practices. However, the strength of the negative relationship declined when headquarters financial performance was healthy. Environmental institutional differences were measured by comparing four parameters: overall environmental institutional score, normative environmental institutional score, regulatory environmental institutional score and cognitive environmental institutional score.

The different institutional pressures on MNC subsidiaries to conform to host and home countries institutional mechanisms need not lead to either globalization/standardization or localization of CSR activities. On the other hand, their CSR activities will lie on a continuum between the two extremes, which will be determined by factors such as the area of operations, the strengths of the organizational culture of the parent company and the degree of ownership of the parent firm (Naguib & Ratiu, 2010). Subsidiaries of MNCs operating in emerging countries are more likely to be influenced by the conflicting institutional pressures as the institutional pressures driving CSR, especially explicit CSR, are more intense in the country of incorporation than in the host country (Jamali & Neville, 2011). The authors also concluded that while global institutional pressures are leading to greater homogenization of CSR policies, actual CSR activities are still directed by national-level institutional processes and traditions.

**Institutionalization of CSR reporting**

CSR reporting is an ideal place to study the isomorphic pressures generated by institutional theory as reporting tends to take standardized forms. The globalization of firm operations and the adoption of global operations, as well as the move towards explicit CSR, suggest increased the tendency toward homogenization of CSR reporting globally. This is reflected in the increased use of sustainability
reporting guidelines, such as Global Reporting Initiative’s (GRI) G3.1 and G4, International Integrated Reporting Council’s (IIRC) International Integrated Reporting Framework, and Sustainability Accounting Standards Board’s (SASB) Sustainability Accounting Standards, by firms globally. Though these standards are basically voluntary, companies increasingly face societal and government pressures to adopt such standards (Eccles & Saltzman, 2011; Vigneau, Humphreys, & Moon, 2015) to enhance comparability and transparency of CSR reports (Eccles & Saltzman, 2011; Einwiller, Ruppel & Schnauber, 2016). Weber, Brooks, and Wong (2016) argued that GRI, IIRC, and SASB should be considered complimentary guidelines since organizations may choose to follow one or a combination of these.

Governments have been the most influential institutional driver of CSR reporting (Tschopp, Wells, & Barney, 2011). Governments have driven CSR reporting through five processes: mandating, facilitating, partnering, endorsing and demonstrating. Hence, unsurprisingly, European countries, where the government has a larger role, have been found to lead the US in CSR reporting (Berinde & Andreescu, 2015; Weber, Brooks, & Wong, 2016). National regulators in countries, such as Denmark, have promoted integrated reports (IR) by making IR mandatory for largest companies on comply or explain basis (Lueg, Lueg, Andersen, & Dancianu, 2015). Further, the European Union’s Directive 2014/95/EU requires all European Union countries having more than 500 employees to report their CSR performance following appropriate guidelines from 2017 onwards (Weber, Brooks, & Wong, 2016). On the other hand, use of only GRI reporting guidelines for CSR is more prevalent in the US and only a few organizations prepare integrated reports or follow SASB’s standards (Weber, Brooks, & Wong, 2016). Integrated CSR reports combine financial and non-financial-environmental, social and governance (ESG) (Eccles & Saltzman, 2011) information and forecasts about future risk while traditional sustainability reports only enumerate the firms’ CSR activities. This is in line with the conclusion of Jensen and Berg (2012) that differential institutional pressures results in the emphasis on different types of annual CSR reports.
Global CSR reporting guidelines, such as GRI and UN Global Compact, promote homogenization in the final report with more detailed reporting frameworks, such as GRI, promoting greater standardization (Einwiller, Ruppel & Schnauber, 2016). However, the institutional and cultural differences between MNEs manifested as country-of-origin effects. It was found that while German MNEs (a coordinated market economy) reported more on environmental issues, US MNEs (a liberal market economy) exhibited a stronger emphasis on society, especially the community. This shows that though MNEs are accountable to all stakeholders worldwide, they are more impacted by their home country institutions and expectations.

The country-of-origin effects and the need to balance the institutional demands of different countries might lead to the use of multiple accounting standards by an MNC, indicating a lack of isomorphism (Jamali, 2010). Using the five predictive factors (cause, constituents, content, control and context) identified by Oliver (1991), the paper found that acquiescent behavior was driven by concerns with legitimacy and reputation. However, conditions like low coerciveness, lack of definite global standards and large and diffused number of institutional actors like NGOs provided a large scope for avoidance and manipulation.

Despite the adoption of different forms of CSR reporting standards, the homogenizing influence of institutional forces on CSR reports have been observed in petroleum refining firms (O’Connor & Gronewold, 2013). Similarly, the institutional pressure to conform to social norms has been found to force firms with a poor rating on environment-related issues to improve their environmental performance more than other firms (Chatterji & Toffel, 2010).

DISCUSSION

A review of the literature suggests only mixed support for the predictions of institutional theory regarding firms’ CSR focus. The proposition that high level of support by government institutions for CSR is linked to high firm CSR focus is not verified as US firms have higher explicit CSR than European firms although the US government is less proactive. With respect to CSR reporting, the homogenizing
powers of institutional mechanisms seem limited as multiple CSR accounting standards were used by the same firm. However, widespread use of CSR reports among large firms in the same sector and homogenization in the presentation of CSR reports were also visible, suggesting organizational isomorphism. The literature review also suggested that MNCs exploited their exposure to multiple institutional mechanisms to reinforce home country norms or adapt to host country norms. Thus, institutional pressures for MNCs can be the cause of not only converging but also diverging practices.

**Propositions**

It is proposed that countries with a strong social and governmental focus on CSR will have high implicit CSR as CSR activities are mandated by legal or quasi-legal structures, such as the presence of community and union members on the board. On the other hand, the presence of strong social support for CSR, coupled with low government intervention, will lead to high explicit CSR as companies would highlight their CSR activities. Based on this distinction the following propositions are suggested:

1 a. High social support for CSR and high government support for CSR will lead to high implicit CSR and replace voluntary CSR with legal mandates.

1 b. High implicit CSR will be associated with homogenization as legal mandates will be worded similarly and unambiguously.

1 c. High social support for CSR, coupled with a high market orientation, would lead to high explicit CSR as firms publicize their CSR activities to gain legitimacy and consumer support in a competitive market.

Once a particular CSR activity, such as CSR reporting, has been institutionalized in a market economy, it will be perceived as a new business opportunity and hence a large number of players will be attracted towards providing services related to that activity. The different players might try to formulate different standards of CSR reporting, leading to heterogeneity in CSR practices. If the standards are formulated by private bodies, they are treated as normal goods by the market with their survival dictated by market forces. If there are no objective criteria for evaluating the different standards, it is likely that different standards will co-exist in the market together, as seen in the US context. This is formalized as:
2. a. High explicit CSR in a market economy will lead to a multitude of organizations that aim to promote different standards of CSR reporting.

2. b. The absence of objective measure for ranking the different standards of CSR reporting is positively associated with the prevalence of multiple standards of CSR reporting.

Proposition 2a and 2b indicate that, for CSR reporting, institutional pressures have created greater heterogeneity in CSR standards. When firms have options of choosing between different standards, they would choose the standard that best fits their strategy. This is formalized as:

2. c. Firms’ choice of CSR reporting standards is aligned with their strategy.

Standardizing CSR operations across nations would help MNCs focus on their core operations rather than spend time on tweaking their CSR operations in order to ensure fit with host country’s institutional environment. Hence, they are likely to act as institutional entrepreneurs who will advance their home country’s institutional framework in other countries. For example, multinationals headquartered in the USA will advance explicit CSR while European MNCs will advance implicit CSR. This is formalized as:

3. The relative success of US MNCs vis-à-vis European MNCs will be positively related to the adoption of explicit CSR standards including CSR reporting.

Home country CSR practices might be better aligned with the personal values of the top management. However, these practices might not have social legitimacy in the host country. In such circumstances, MNCs are likely to adopt CSR practices for strategic, rather than ethical purposes. The pressure to adopt certain CSR policies for purely strategic purposes is likely to be higher for consumer goods firms, as compared to industrial goods firms, because of their more direct and frequent interaction with the public. This is formalized as:

4. a. MNCs sensing a greater institutional discrepancy between home and host country are more likely to pursue strategic CSR

4. b. Ceteris paribus, MNCs in consumer goods industries are more likely than MNCs in industrial goods to pursue strategic CSR.
Based on the above review and proposition, the following framework has been proposed (figure 1).

**CONCLUSION**

Institutional theory has been exhaustively used by scholars to study firms’ CSR activities. A review of these studies suggests that the institutional environment not only creates pressure for convergence but it also creates new choices for firms, especially with respect to CSR reporting. The choices are higher for firms that operate in multiple institutional contexts such as multinationals. Another finding of the literature review is those firms’ CSR focus acts as a substitute to institutional mechanisms for interacting with stakeholders. This finding is contrary to the commonly accepted propositions of institutional theory. To account for the divergent finding, there is a need to pursue research that aims for a complete conceptualization of institutes. A complete conceptualization would include the creation of a nomological net that includes the antecedents and consequences of institutions and the moderators and mediators of the various relationships.
REFERENCES


