

# LEGITIMACY SEEKING BEHAVIOUR: CASE STUDY FROM CONTROVERSIAL INDUSTRY

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## Abstract

Since December 6<sup>th</sup>, 2016, all EU companies employing over 500 employees are obligated to follow EU Directive 2014/95/EU on non-financial reporting.<sup>1</sup> This act requires large companies to disclose information on their performance and on how they manage social and environmental challenges. In this study, we focus on legitimacy seeking behaviour of companies from the controversial tobacco producer Philip Morris, Czech Republic. We perform content analysis of published annual reports to find features of pragmatic legitimacy, which attempts to convince the corporate stakeholders that behaviour of the said company is in line with current level of common social norms and usual behavioural patterns. Furthermore, we find that the company was contemplating these requirements some time before the directive's official announcement at the end of 2016. This is probably the most tangible outcome of the introduction of this EU directive.

**Key words:** legitimacy, CSR, non-financial reporting, controversial industry

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## Introduction and motivation

Philip Morris International (PMI) is an American multinational producer of tobacco and cigarettes, founded in 1900. Their products are sold in over 180 countries outside the United States. The most recognized and bestselling product of the company is the Marlboro Brand. The company is listed on NYSE, Euronext and is also traded as component of S&P 100 and S&P 500. The Czech company was established in 1993, as an outcome of the large privatization activity of the late 1990s, when the state-owned company, Tabak Kutna Hora, was sold to international consortium Philip Morris. The company has since become a dominant employer in the region. As part of the international consortium, the company has

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<sup>1</sup>The EU Directive on disclosure of non-financial information and diversity information (2014/95/EU) was published at the end of 2014. The European Member States were given two years to transpose the EU Directive into national legislation. From reporting year 2017, the legal requirements for transparency on non-financial information in management reports of large public interest entities

been listed on the Prague Stock exchange since its inception in 1993. Their reporting is prepared according to the rules of the owner and has a relatively long history. Annual reports have been audited by renowned auditors from the “Big Four” and the parent company is listed on international stock exchanges worldwide. In this study, we concentrate on annual reports from two periods, 2011- 2013 and 2014- 2016, and strive to identify the specific features dealing with corporate legitimacy. Organizational legitimacy was characterized by Suchman (1995), who identified three primary forms: pragmatic, based on audience self-interest; moral, based on normative approval; and cognitive, based on comprehensibility and taken-for-grantedness.

Generally, the main stakeholders are company employees, company clients and the environment. Controversial industries need to implement CSR in their reporting either as a separate sustainability report or a dedicated section in their annual report. According to EU Directive 2014/95/EU, companies have to disclose relevant information on policies, risks, and results in regard to environmental, social, and employee-related matters, as well as human rights, anti-corruption, bribery, and the diversity of the boards of directors.

## **2 Previous literature and used methodology**

Non-financial reporting represents the result of companies’ thoughts on what CSR is, its importance, and on how it can be shared with the stakeholders (Perrini, 2006). The shift in thinking of professional investors to greater detail for nonfinancial and governance information is confirmed by many researchers (Cohen et al., 2015, Khan et al., 2016, Chen L. et al., 2016 and others). Ex ante analysis of the envisaged reaction of Polish and Romanian companies to the induction of this EU Directive was performed by Dumitru, Dyduch, Gușe and Krasodomska (2017). This study has provided an analysis of special conditions in two transitional economies.

Issues of reporting, including those related to competition aspects, are provided by MacGregor Pelikánová (2017). The link to legitimacy was previously analysed by Beelitz and Merkl-Davies (2012), looking into the nuclear energy sector. A study of reporting in several groups of controversial companies listed on DAX 30, in Germany, was performed by Kilian and Hennigs (2014), who used a combination of content analysis and econometric methods.

The basic idea of our methodology is to use content analysis. With regards to coding, we adopted the approach of Kilian and Hennigs (2014), however, the format of the analysis differs as we concentrate on one company and use case study methodology. Therefore, we go

deeper into the features of the company and do not perform statistical analysis using econometric data. We have divided our sample of investigation in two periods – years 2011, 2012 and 2013 –i.e. period before the EU directive on non-financial reporting was published, and subsequently years 2014, 2015 and 2016 –after it was published. The regulation was supposed to come into force in 2017, but we assume that corporations envisaging the implementations of such norm started preparations for the new requirements earlier than 2017, which should be reflected in their reporting. An additional argument for more timely preparation in our particular case was that the parent company, Philip Morris, started its preparation in 2011. Furthermore, the parent company is a well-known American industrial company operating in a sensitive sector with over 120 years of history. Thus, it can be assumed that the legitimacy aspects of CSR reporting will be even more stressed.

### 3 Empirical analysis and findings

Results of our content analysis are summarized in Table 1 for the first period and in Table 2 for the second period).

**Tab. 1: Codings from the first period - Philip Morris, Annual Reports 2011 – 2013**

Main category	First subcategory	Coding example	No of codings	Rank
Stated philosophy towards CSR	Environmental responsibility (2011- 2; 2012- 0; 2013- 2) <i>4 codings</i>	“At PMI, we focus our environmental sustainability efforts in three key areas, as shown below, and have set measurable goals for each that will help us reduce our impact on the world around us.” (2013,p.7)	<b>4</b>	
	Social responsibility (2011- 2; 2012- 1; 2013- 2) <i>5 codings</i>	“We support programs that help make a difference in communities where our employees live and work, as well as in farming communities where we source tobacco.” (2012, p.17) - (“Contributions”: 2011 – p.13; 2012 – p.17; 2013 – p.7)	<b>5</b>	
CSR motives	Performance-driven (2011- 1) <i>1 coding</i>	“Reducing our impact on the environment in a sustainable manner and protecting our workforce are not only the right things to do, but may also contribute positively to our future business performance.” (2011, p.5)	<b>1</b>	
	Stakeholder-driven	N/A		
	Value-driven <i>1 coding</i>	“Contributing to the community is part of our culture.” (2011, p.13)	<b>1</b>	

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CSR-related internal activities	Organizational activities (2011- 1; 2012- 1; 2013- 1) <i>3 codings</i>	“To this end, in 2011 we initiated the rollout of our Agricultural Labor Practices code to improve conditions for workers on farms where tobacco is purchased for PMI products.” (2011, p.4)	<b>3</b>	
	Products & production (2011- 1; 2012- 1; 2013- 1) <i>3 codings</i>	“One of the top priorities of our research efforts is the development of a portfolio of innovative Next Generation Products (NGPs) that have the potential to reduce the risk of smoking-related diseases in comparison to conventional cigarettes.”(2011, p.6)	<b>3</b>	
	Activities in HR management (2011- 3; 2012- 2; 2013- 4) <i>9 codings</i>	“This includes setting additional principles and standards for working conditions on tobacco farms, tailored training programs and regular external assessments to monitor the progress we, our suppliers, and farmers make.”(2012, p.35)	<b>9</b>	<b>4</b>
CSR-related activities towards suppliers	Guidelines (2011- 2; 2012-1; 2013- 0) <i>3 codings</i>	“Implementation of our GAP guidelines is compulsory for all our tobacco suppliers and includes labor policies preventing child labor or forced labor.” (2011, p.4)	<b>3</b>	
	Others	<b>N/A</b>		
CSR-related activities towards society	CSR-related reports	<b>N/A</b>		
	Neighborhood projects (2011- 6; 2012- 6; 2013- 3) <i>15 codings</i>	“The integrated efforts of our contributions, sustainable tobacco production programs and labor initiatives serve to improve the livelihoods of communities around the world.”(2013, p.7)	<b>15</b>	<b>3</b>
Corporate donations, sponsoring and charitables	Education & research (2011- 3; 2012- 3; 2013- 0) <i>6 codings</i>	Programs range from building and renovating schools to scholarships and training for teachers.” (2012, p.17)	<b>6</b>	
	Sports & culture	<b>N/A</b>		
	Social issues (2011- 9; 2012- 10; 2013- 2) <i>21 codings</i>	“Domestic violence has a significant impact on families and communities around the world and has been one of our main giving areas for several decades.” (2012, p.17)	<b>21</b>	<b>2</b>
	Environmental issues (2011- 2; 2012- 2; 2013- 1) <i>5 codings</i>	“These include a variety of innovative programs to protect and enhance natural resources, such as reforestation of the land, providing clean water and ensuring food security for families.” (2012, p.17)	<b>5</b>	

CSR-related cooperations	With other companies	N/A		
	With non-profit organizations (2011- 9; 2012- 9; 2013- 4) <i>22 codings</i>	“We continue to work with the American Chamber Foundation Philippines Inc. and local non-governmental organizations such as the Philippine Red Cross to help restore livelihoods and rebuild the affected areas.” (2013, p.7)	22	1
Total no of codings			98	

Source: Own findings organized according to Kilian and Hennigs (2014)

According to our findings, most of the attention was devoted to CSR-related co-operations, in terms of work with non-profit organizations (22 codings), followed by Social issues within the Corporate donations, sponsoring and “charitables” section (21 codings). Ranking third, with 15 codings, are CSR-related activities towards society, specifically Neighbourhood projects, and, finally, CSR-related internal activities, in particular activities in HR management have 9 codings. The company is seemingly concerned with projecting a positive picture to its stakeholders with regards to external and internal working environments.

**Tab. 2: Codings from the second period of investigation - Annual Reports 2014 – 2016**

Main category	First subcategory	Coding example	No of codings	Rank
Stated philosophy towards CSR	Environmental responsibility (2014- 1; 2015- 1; 2016- 1) <i>3 codings</i>	“We will continue to manage our environmental performance responsibly and reduce the impact that we have on the environment.” (2014, p.7)	3	
	Social responsibility (2014- 2; 2015- 0; 2016- 0) <i>2 codings</i>	“PMI is committed to addressing critical societal issues around the world.” (2014, p.7)	2	
CSR motives	Performance-driven	N/A		
	Stakeholder-driven	N/A		
	Value-driven	N/A		
CSR-related internal activities	Organizational activities (2014- 2; 2015- 1; 2016- 1) <i>4 codings</i>	“We also continued the implementation of our Agricultural Labor Practices Program to eliminate child labor and other labor and human rights abuses in our tobacco-growing supply chain.” (2015, p.5)	4	2

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	Products & production (2014- 2; 2015- 1; 2016- 1) 4 codings	“Reduced-Risk Products (RRPs) is the term the company uses to refer to products with the potential to reduce individual risk and population harm in comparison to smoking cigarettes.” (2015, p.1)	<b>4</b>	<b>2</b>
	Activities in HR management (2014- 1; 2015- 1; 2016- 1) 3 codings	While we still have more to do, our ambition to improve gender diversity is yielding positive results, with the percentage of women hired and promoted by PMI increasing in 2016.” (2016, p.3)	<b>3</b>	
CSR-related activities towards suppliers	Guidelines	<b>N/A</b>		
	Others	<b>N/A</b>		
CSR-related activities towards society	CSR-related reports (2016- 2) 2 codings	“Last year, we published our first communication on progress to the United Nations Global Compact, reporting comprehensively on our sustainability practices across human rights, labor rights, environment and anti-corruption.” (2016, p.3)	<b>2</b>	
	Neighbourhood projects (2014- 3) 3 codings	“PMI is committed to addressing critical societal issues around the world. Our programs primarily focus on access to education, providing economic opportunity, empowering women and disaster relief.” (2014, p.7)	<b>3</b>	
Corporate donations, sponsoring and charitables	Education & research (2014- 3) 3 codings	“PMI partnered with Nocetum Social Cooperative in Milan to provide the training and skills that help empower immigrant women in vulnerable situations to become self-sufficient.” (2014, p.7)	<b>3</b>	
	Sports & culture	<b>N/A</b>		
	Social issues (2014- 3) 3 codings	“We have an almost 60-year history of supporting communities where we do business, and our commitment has never been stronger than it is today. In 2014, we gave a total of approximately \$31 million to more than 210 non-profit organizations around the world.” (2014, p.7)	<b>3</b>	
	Environmental issues (2014- 2) 2 codings	Disaster relief, clean water (2014, p.7)	<b>2</b>	
CSR-related cooperations	With other companies	<b>N/A</b>		
	With non-profit	“In 2009, our Colombian subsidiaries entered into	<b>11</b>	<b>1</b>

	organizations (2014- 6; 2015- 3; 2016- 2)  <i>11 codings</i>	an Investment and Cooperation Agreement with the national and regional governments of Colombia to promote investment in, and cooperation on, anti-contraband and anti- counterfeit efforts.” (2016, p.40)		
Total no of codings			<b>40</b>	

*Source: Own findings organized according to Kilian and Hennigs (2014)*

Even though one might expect a higher level of codings because of the approaching legal enforcement of the EU directive 2014/95/EU, surprisingly, there are fewer codings in the second period (40 in contrast to 98 in the first period). The most concentrated issue remains to be the cooperation with non-profit related organizations (11 codings). CSR-related internal activities, in terms of Organizational activities and Products & production activities are in second place (4 codings each). Third place, with 3 codings, is jointly occupied by five different subcategories, including Social issues, Education & research, Neighbourhood projects, and others.

#### **4 Discussion**

The two periods are distinct because of the shifting accents on reported corporate responsibility.

One of the more significant changes in Annual Reports started in 2015, when the section called “Contributions” was removed. This was the section most dedicated to the company’s CSR-related activities, and is, subsequently, the primary reason the second half of the annual reports has fewer codings.

However, since 2016, Philip Morris prepares and publishes a standalone Sustainability Report, covering many more aspects, which would be worth a deeper investigation. On a general level, it covers issues such as approach to sustainability, ambition for a smoke-free future and acting with integrity. In regard to structure, the report deals with (1) Own approach to sustainability in the introduction (10 pages); (2) Need for business transformation (20 pages), and (3) Strengthening sustainability fundamentals (67 pages). Additional information is provided on Cautionary Statements, Business Transformation Metrics – Independent Assurance Report (69 pages).

#### **5 Conclusion and implications**

The analysis of the published annual reports of Philip Morris shows features of pragmatic legitimacy which attempt to convince stakeholders that the company’s behaviour is in line

with current levels of common social norms and usual behavioural patterns. Our study contributes to the research stream of non-financial reporting analyses in Central and Eastern Europe. The biggest limitation of our study stems principally from the used method. Although narrative statements possess wealthy informational content, their analysis can be very biased – with the subjective opinion of the researcher, in terms of data codings and identification of examined features, potentially skewing results. Misspecification in coding may bring in error in whole measurement process and distort interpretation of results.

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