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Compromising strategy and legitimacy gap in environmental performance reporting: A case study at the Rajawali company

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ABSTRACT

This article aims to analyze how companies strive to understand their social environment expectations. Environmental performance reporting is used as the phenomenon in this article to better understand the dynamics of social relations and their effect on company legitimacy. This article employs a theoretical framework consisting of legitimacy theory as the main framework supported by other social system-oriented theories such as PET, institutional theory, and stakeholder theory as parts of the legitimacy theory framework. This study uses an interpretive qualitative method for data collection and analysis. This article shows that it is not easy for companies to gain legitimacy from stakeholders. Legitimacy is highly subjective depending on the party observing companies. In addition, different understanding on environmental performance reports as an external communication tool often occurs. Consequently, a very detrimental legitimacy gap for companies occurs as well. Therefore, the identification process of stakeholder expectations plays an important role in bridging the gap. This article explains the strategies used by the Rajawali company in minimizing different understandings with the government in terms of environmental performance reports.

Introduction

Rajawali is a Cement company owned by the Indonesian government. The main activity of the Rajawali Company is to manufacture Cement products processed from limestone and clay as the main materials. In its internal business process, the Rajawali company always strives to pay attention to environmental aspects in accordance with the applicable legislative provisions for the time being in force. The Rajawali company has the Environmental Impact Assessment/EIA (Analisis Mengenai Dampak Lingkungan/AMDAL) document as the guideline and routinely prepares periodic EIA reports to the government. The company can meet almost all assessment criteria for EIA Reports. In 2002, the government set new criteria for companies' environmental performance assessment. The new assessment criteria are more dynamic than EIA because, in addition to a more complex performance evaluation process, the assessment process is more emphasized on companies' benchmarking against the industry. Since the enactment of the new environmental performance assessment criteria, the legitimacy of the Rajawali company has been very dynamic and fluctuating. It takes a long time for Rajawali to improve its internal structure to be aligned with the expected values in new environmental performance reports.

The phenomenon of environmental performance reporting is generally explained by legitimacy theory or stakeholder theory. These two theories have been used widely but separately as if it implies that environmental performance reporting can be viewed from a different perspective, i.e., the perspective of legitimacy theory or the perspective of stakeholder theory. In substance, these two theories examine environmental performance reporting within the same perspective, causing the legitimacy and stakeholder theories cannot be separated because they are two overlapping theories (Chen & Roberts, 2010; Gray, Kouhy, & Lavers, 1995). In other words, these theories explain and unravel the phenomenon of the complex relationship between organizations and their social environment. Likewise, other theories, such as political economy theory, are frequently employed in discussing environmental performance reporting. The political economy theory is generally used separately with legitimacy theory. Meanwhile, ideas in legitimacy theory and stakeholder theory originate from political economy theory (Gray, 2002). This argument is in accordance with the reality that complex business activities cannot be separated from other important aspects, i.e., social, political, and economic aspects (Loh, Deegan, & Inglis, n.d.; Lohmann, 2009).

Social and political aspects are so important in supporting companies' economic success that companies need to identify the relevant social environment having the highest power by Buhr (1998). The form of the social environment having power, in general, is institutions. Institutions play a very important role in defining the social scope targeted by companies. Institutions become the unit of social activity by Scapens,(1994). Institutions have a clear social scope with rules, norms, and concrete institutional elements. Therefore, the discussion about the phenomenon of environmental performance reporting cannot be separated from the institutional and institutionalization concepts, which become the reporting framework. There are many parties with interests in companies and each party has conflicting interests by Freeman, Wicks, & Parmar(2004). Moreover, the interests are unstable and tend to change, causing an effect on company legitimacy.

Understanding the relevant stakeholders' expectations for companies greatly influences company legitimacy. This understanding plays an important role considering company legitimacy is highly subjective and depending on the opinion of the party giving an assessment to companies. In addition, understanding stakeholder desires are also important to minimize the companies' misperception toward stakeholder hopes and expectations. Therefore, because it is important for companies to understand the relevant stakeholders' expectations, this article aims to analyze how companies strive to understand their social environment expectations. This article also answers Deegan's (2002) and Chen & Robert's (2010) request regarding the inability of legitimacy theory to specifically explain how companies minimize the risk of subjectivity in gaining legitimacy.

Literature Review

Institutional theory focuses on the power of social control in changing corporate behavior patterns. Institutional theory argues that social control has power because institutions are unit with binding institutional values and norms. Institutional social ties can provide support and strength to the institutional members in facing business competition. However, social support and strength can be obtained as long as companies, as the institutional members, institutionalize social values and norms that have become institutional agreements. In other words, institutional theory explains that the social environment has the power to drive companies to institutionalize social values and patterns requested by institutions. Institutionalization performed by companies is motivated by company desire to obtain support and social acceptance in maintaining their existence and survival. Thus, it can be concluded that institutional theory is a part of legitimacy theory framework in more specifically explaining company motivation in accepting social rules and norms as well as implementing these social norms through alignment of internal structure with external rules and norms.

Stakeholder theory posits that companies must provide value added not only to shareholders and stakeholders. Companies must respond to the interests of the parties that have an effect on or get an effect from company activities. Meanwhile, there are many parties with interests on the effect of company activities and these interests are contradictory and always changing or dynamic. Therefore, it is important for companies to identify the relevant and most representative stakeholder group on company effect.

Relevant stakeholder identification helps companies focus on designing strategies in responding to stakeholder expectations. Generally, relevant stakeholders are a group having higher power than other groups (Chelly et al, 2014; Burh, 1998). The companies' main objective is to minimize conflicts of interest between stakeholders. Social hierarchy in stakeholder groups also determines the direction to whom companies must be socially responsible. Social responsibility is a company mechanism in communicating their activities and actions that meet social expectations. Thus, it can be concluded that the environmental performance reporting mechanism as a communication tool to society can help companies gain legitimacy and acceptance within the social environment. In other words, stakeholder theory is a part of legitimacy theory framework in more detail explaining company strategy in minimizing conflicts of interest between stakeholders and responding to relevant stakeholder interests to gain legitimacy.

Compromise Strategy as a solution for the gap of the relations between companies and the social environment. It is not easy to build and maintain social relations because those who have power are difficult toidentify. Different socio-political conditions will bring up powerful parties with different interests (Tinker, 1980). Meanwhile, the rapidly changing external environment makes it difficult for companies to adjust to these changes. Because legitimacy is very subjective and highly depending on the opinions of the relevant parties having the highest power in the social system, it is important for companies to understand social party expectations from an external perspective. It aims to avoid the companies' misperception in interpreting external desires (Ashford and Gibbs, 1990). Chen and Robert (2010) offer the compromise concept to explain company behavior in their efforts to understand and meet social expectations. Compromise can be interpreted as company efforts to understand stakeholder interests and strive to find the suitability between stakeholder interests and company interests. Prepared environmental performance reports are frequently only understood by companies, while external parties do not understand the purpose of the reports (Freeman, 1984). Environmental performance reporting serves as a communication tool and compromise is the essence of communication (Chen and Robert, 2010). Therefore, the understanding gap between companies and stakeholders can be minimized by applying the compromise concept.

Methods

To answer the purpose of this article on how companies strive to understand their social environment expectations, this article employs a qualitative method for data collection and data processing. This article uses an interpretive approach as a perspective in analyzing the obtained data. The theoretical framework used is legitimacy theory as the main framework and PET (Political Economy Theory), stakeholder theory, and institutional theory as parts of legitimacy theory framework. PET, stakeholder theory, and institutional theory provide some emphasis on legitimacy theory in explaining the phenomenon of the new environmental performance reporting version from the government. Data were collected through observations and interviews conducted on the directly responsible sections for controlling the environmental effect in the Rajawali company. Interviews were carried out with Head of emission control section, Head of work safety and environment section, the drafting team for environmental performance reports, and management representative section.

Results

Changing and contradictory stakeholder expectations. The environmental performance assessment program is very enthusiastically welcomed by companies and other organizations in the industry environment. The program is coercive and puts environmental issues as an aspect companies should not ignore anymore. It drives very high company desires to join and enter into the institutional environment although companies realize that they must meet consequences and obligations as part of the institutional members. However, the value added of social and environmental acceptance has a higher value benefit for companies.

The environmental performance assessment criteria from the government are clearly in favor of environmental and social interests, causing company interests to seem to be not represented in these criteria. However, social relations between companies and the government are capital having similar importance with production efficiency capital. In fact, social relations and production efficiency are two types of capital that cannot be separated in the economic distribution hierarchy (Tinker, 1998). This is the reason for the Rajawali company to improve its internal processes to meet the environmental performance assessment criteria from the government. Therefore, proper development is indeed very enthusiastic from year to year, the other companies have rapid development. Looking at the data from the Ministry of Environment and Forestry, the number of participants is increasing, and according to public relations, the previous score we got is different from the present score. So, other companies also compete to get a higher score. (The drafting team for environmental performance reports)

It is not easy for companies to meet external expectations, even when the assessment criteria have been outlined in writing in the form of government regulations. In addition, stakeholder expectations are always changing and the results of performance assessments are considered highly subjective. However, the Rajawali company acknowledged that these limitations do not make them stop doing their best efforts. There were times when their environmental performance reports could convey information in line with the evaluation team expectations, and conversely, there were times when their environmental performance reports did not have enough quality considered by the evaluators to meet certain criteria. Therefore, the environmental performance reporting mechanism requires internal creativity, so stakeholders can comprehend the purpose and substance of the prepared environmental performance reports annd the new environmental performance assessment is very dynamic, sometimes we can achieve a gold award but sometimes we can't, depending on what we present. And the recent development of other companies is also remarkable. (The drafting team for environmental performance reports).

The Role of Compromise in Social Relations. Direct interaction and dialogue are tactics to bridge misunderstandings between companies and external parties. With direct interaction and dialogue, companies can understand the expectations and desires of external parties. In addition, direct interaction can form a two-way understanding between companies and external parties. This balance is very important in the company social relations concept. Balance in social relations is an important capital in maintaining company survival. For example, the Rajawali company considered that it has carried out the reporting activities of environmental programs conducted in a long period of time and not designed impromptu. However, because there was no two-way understanding, the Rajawali company was disadvantaged in this case.

The Ministry of Environment and Forestry has stated that they do not want programs designed impromptu. Although, for example, the policy has actually been implemented for a long time, we feel "ah, we don't need that ..." (Head of emission control section). The small issues starting to be addressed by companies to their environmental programs, new culture, norms, and values are formed. This internal reform is a strategy to get social acceptance and legitimacy. Therefore, inaccurate internal perceptions of external expectations can be bridged through the "compromise" concept. The previous procedure paying more attention to technical production efficiency in detail and ignoring the relationship between company social relations and the environment begins to shift. Social relations prioritizing compromise aspect are now as important as technical efficiency and organizational productivity aspects. The company acknowledged that it strives to learn to "pack up" environmental performance reports to be easily understood by external parties. "Packing up" reports according to what external parties want to understand is as important as creating profit and efficient production processes for investor interests so the new environmental performance assessment is very detailed and as time goes by the company

is good at packing it up. We are also just learning that because currently, other companies have already packed it up more appealing and easier to understand, the steps we previously took are not suitable for now. (Management Representative Section)

Efforts to establish compromise are not only carried out by companies. External parties, in this case, environmental regulators, also try to minimize company misperception in implementing the environmental performance criteria from the government. Understanding the importance of compromise in social relations to increase legitimacy has become an institutional norm. As explained by Mrs. Lieke that at the time the compromise is formed, internal parties who initially are closed to changes in norms and culture related to organizational environmental aspects become increasingly open and accepting. This understanding can facilitate and accelerate the institutionalization of environmental values expected by regulators. Previous habits can change through a "compromise" approach. This greatly benefits organizations because it is not easy to understand the purposes and expectations of external parties appropriately. It is due to social expectations, and acceptance is basically highly subjective and always changing according to the level of established social relations. Therefore, the opportunity to discuss with regulators is an important moment for organizations to increase opportunities in gaining legitimacy.

It seems that these programs have become a culture too. So yesterday, the colleagues here were invited to discuss with the Ministry of Environment and Forestry. The Ministry of Environment and Forestry explained and even gave an example from another company, "see, this is how they present it." Automatically, the colleagues here were somewhat getting out of their comfort zone after seeing from a general perspective. We as the committee also felt, "oh yeah, we are so used to the company habits who think that everyone understands the cement industry." So, in our assessment, we had a fertilizer company, an oil company, and of course, the assessment team didn't understand when we wrote about some tool modification. (Management Representative Section)

Compromise and Changes in Company Behavior. Changes in internal organizational processes towards values and norms desired by external parties provide benefits and competitive position for companies. Manifestations of internal changes in the value and norm institutionalization process are reflected in internal structure and system changes. In other words, external social structures are implemented in the companies' internal structures and systems. Thus, the new designed internal structures and systems become the indicator that companies understand external desires and perform internal functions more specifically to meet the external party criteria. "Oh, it turns out there are systems we must implement". It is a good lesson, so in 2015 we already performed a rapid development, because we were already full. (Head of work safety and environment section)

Companies' understanding of the "desires" of external parties accelerates the adoption and adaptation process of the environmental performance assessment criteria from the government. Internal action plans become more directed, effective, and efficient. "Compromise" makes social values and norms to be entered easily and quickly and helps companies in communicating with external parties that companies act on external purposes in a proper attitude and manner.

This year is easier because we already managed it last year. The needs are already understandable. We know to whom we ask, how we ask, how the technique is. So now it's already systematic. The person who initially does not understand, when reading our plan for a month, begins to comprehend, "Oh, I see, this is what we need for the new environmental performance assessment" (Head of work safety and environment section). The company recognized that the external system and structure institutionalization is better than ceremonial adoption. This recognition is due to operational managers recognize the benefits of external structure and system implementation into the company. External structures implemented ceremonially will create an understanding gap between company environmental management section and other sections. This is due to the failure of the structures and systems to be in accordance with external expectations, thus affecting the quality of environmental performance reports due to incompatibility between information prepared by internal parties and those expected by external parties.

However, not everyone will understand, such as the colleagues in the field who do not deal with it every day. So, the colleagues at LITBANG really worked hard because they had to know what the data was. But consequently, the colleagues in the field also didn't understand whether the data was for government environmental performance assessments or for company reports because there was no discussion, only "okay, what kind of data do you have?". However, there was no understanding efforts provided for the colleagues in the field, such as "so, this is an example of government environmental performance assessments" try to participate, try to see things more generally, try to care more about the environment... so the colleagues were not only asked for something but didn't understand why they were asked for. They were only asked for raw data but never been involved. (Management Representative Section).

Based on interviews and analysis above, it can be concluded that gaining and maintaining legitimacy is not an easy thing for companies. Changes in external conditions, including changes in regulations and social norms, also automatically change company legitimacy. It happens because legitimacy is subjective and highly depending on the party giving an evaluation to companies for the time being. Therefore, companies always strive to understand the ever-changing environmental performance reporting guidelines within the government's perspective. However, the pattern as explained by stakeholder theory is one-way only, that is from companies to the government in which companies strive to understand stakeholder interests. Thus, the way legitimacy given to companies by the government cannot be fully explained within this theory perspective.

Complexity and dynamics of external changes encourage companies to identify relevant stakeholders. In the environmental reporting issue, companies focus on the Ministry of Environment (Kementerian Lingkungan Hidup, KLH) as a party having political power. At this stage, institutional theory explains the company change process in synchronizing their form with the external environment. Companies prepare environmental performance reports in communicating with the government about changes and activities that have been performed in line with the government's standard reporting criteria. When companies conduct the reporting, two-way communication between companies and the government is established. In other words, companies strive to understand the reporting criteria and prepare their reports according to the government standards; meanwhile, the government strives to understand the substance of company reports and provide legitimacy as a reward. When this institutionalization process occurs, companies simultaneously apply the compromise strategy with external parties. Companies strive to understand government expectations, and the government strives to understand institutional changes in companies. During the process, both parties have a new understanding (compromise) in unifying their perspectives on legitimacy received by companies or legitimacy provided by the government.

Conclusion

This article aims to analyze how companies strive to understand their social environment expectations. Environmental performance reporting is used as the phenomena in this article to better understand the dynamics of social relations and their effect on company legitimacy. This article employs a theoretical framework consisting of legitimacy theory as the main framework supported by other social system-oriented theories such as PET, institutional theory, and stakeholder theory as parts of the legitimacy theory framework. In other words, in explaining the relations between companies and their social environment, legitimacy theory cannot stand alone because there are overlaps between other theories oriented to the relations between companies and their social environment as well.

When the government set new criteria in the environmental performance assessment in 2002, the Rajawali company management showed its participation in implementing the environmental performance assessment. Rajawali's management decisions have implications for their involvement in the institutional environment. Rajawali management's involvement is considered as a strategy to get social support in business competitions. Rights and obligations are also attached to the Rajawali management as the institutional member. The expected benefit from institutional support is the increasing legitimacy of Rajawali in the environmental aspects amid society.

Although it does not directly contribute to production efficiency and financial performance, the Rajawali management realizes that in an imperfect business competition environment, social relations and support have a position as important as production efficiency. Therefore, the Rajawali management strives to meet the government's environmental performance assessment expectations as a form of support to institutions. Environmental performance reports become a tool that communicates Rajawali's environmental performance to the government. However, it is not easy to understand the purpose of government expectations in environmental performance standards. The Rajawali management considers a very subjective assessment in the evaluation process. It is understood by the management as a result of the different perceptions between the company's management and the government in understanding Rajawali's environmental performance reports. Therefore, the strategy the management employs to minimize the different perception is to conduct direct dialogue and interaction with the government as the stakeholder.

Dialogue and interaction are other forms of communication in which the essence of communication is to establish a compromise. Compromise then establishes understanding on the relations between companies and society. Furthermore, understanding will drive Rajawali's behavior changes in following the environmental performance expectations from the government. It happens because compromise allows companies to identify overlapping interest with external parties through communication. In other words, understanding can increase internal acceptance toward external changes. In addition, it can affect company legitimacy as well.

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