Social accountability and the finance sector: the case of Equator Principles (EP) institutionalisation
O'Sullivan, N.A.

Citation for published version (APA):

General rights
It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations
If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: http://uba.uva.nl/en/contact, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.

UvA-DARE is a service provided by the library of the University of Amsterdam (http://dare.uva.nl)
CHAPTER 2: LITERATURE REVIEW

“Banks have an important role to play in financing economic activity yet have received comparatively little attention in the social accounting literature to date.” (Thompson and Cowton, 2004, p.216)

2.1 Introduction

This chapter is divided into two parts. Firstly, it provides a brief overview of some of the existing literature within the broad “sustainable” finance field, highlighting the key topics that have been addressed within this literature. This is done in order to portray the context within which this particular research is placed, and in doing so highlights the unique contributions that it aims to make to this literature. It then continues by introducing some of the extant literature on the Equator Principles (EP) per se, from a wide range of academic disciplines, in order to provide an overview of how the Principles have already been studied, and how this research will contribute to and advance this body of literature.

Secondly, part two of this chapter conducts a review of, what will be termed, the “theoretical” literature. This is further divided into two parts. The first section is concerned with the concepts of accountability and legitimacy. It begins with an explanation of how accountability is defined, understood and used in the existing literature; and how it is interpreted in this research. This is important as one of the main aims of this research is to investigate whether the EP institutionalisation process affected the social accountability of adopting Equator Principles Financial Institutions (EPFIs) between 2003 and 2008 (see Section 1.2). It then explores the interconnection between the notions of accountability and legitimacy, and briefly introduces how they are interrelated with institutional theory in this research. This is relevant as part of this research examines why and how NGO demands for financial sector accountability/legitimacy played an instrumental role in the initiation and development of the EP institutionalisation process. The second section then provides an overview of institutional theory and its evolution and critique in the literature. This acts as the foundation for a more in-depth consideration of institutionalisation processes, and the explanation of the Dillard et al. (2004) framework on institutionalisation, in Chapter Three.
2.2 PART 1: Sustainable Finance Literature in Review

Research in the broad field of “sustainable” (environmental and social) finance/corporate social responsibility (CSR) and the finance sector (UNEP FI, 1997; Bouma et al., 2001) focuses on a wide range of topics related to both credit (debt) and investment (equity) activities.

Firstly on the credit side, the majority of work has tended to centre around the notion of risk. Here, much work has been done on the integration and analysis of environmental risks (and “sustainability” criteria) into commercial bank credit risk management policies and processes (e.g. Coulson and Dixon, 1995; Weber et al., 2008; Weber et al., 2010). In addition, lender fear of reputational risk due to, for example, an association with polluters, has also been explored (Coulson and Monks, 1999).

Coulson (2001) provides further in-depth analysis of these risks and sustainable finance through a case study of Lloyds TSB Group. She focuses on the development and use of environmental assessment techniques within the bank’s commercial and business lending function, and observes how environmental risk assessment was becoming part of the day-to-day reality for the bank’s lending officers and borrowers. In doing so she stresses how lending officers should not be considered environmental experts, yet also outlines how their perceptions of environmental risk could potentially influence the level of financial support made available for both economic development and environmental protection. In general, Coulson (2001) emphasises that sharing lending experiences and developing lending frameworks based on industry, customer and regional expertise, can greatly contribute to improved levels of corporate environmental risk assessment.

In terms of a broader focus on risk, Thompson (1998) examines a sample of UK bank environmental lending policies, and concludes that, at the time, while banks were focusing on environmental risk management regarding corporate lending, there was little evidence of them harnessing the opportunities related to the “greening” of industry. In addition, Soppe (2004) compares the concept of sustainable corporate finance with traditional and behavioural finance, and concludes that finance as a discipline needs a multifaceted approach instead of the extant one-dimensional risk and return focus.
Some scholars have considered what role banks could play in encouraging the protection of the natural environment, beyond their direct, in-house impacts (Lundgren and Catasus, 2000), and how the financial sector can act as a driver for CSR overall (Scholtens, 2006). In doing so, Scholtens (2006) mentions the EP as one medium in which banks may influence the environmental and social (E&S) behaviour and performance of borrowers and their projects. Broader still, Simpson and Kohers (2002) analyse the relationship between corporate social performance and financial performance in the banking sector and find a positive link between both.

Other scholars have studied the banking sector and reporting/accountability issues, investigating the environmental information used or desired by banks when making lending decisions (Thompson and Cowton, 2004; Coulson, 2007), and conducting an analysis of E&S reporting in web-based financial and corporate social reports of five UK Banks (Coupland, 2006). Also, a number of regional studies have been undertaken, including an analysis of the social performance of the main financial companies in Spain (Cuesta-Gonzalez et al., 2006), and the examination of consumer awareness and understanding of Australian banking sector CSR activities (Pomering and Dolnicar, 2009).

In addition, a range of “benchmarking” or status reports on the variety of sustainability activities of banks and financial service organisations have been produced (Weber, 2005; Coulson, 2007). Scholtens (2009) extends this by developing a framework to assess CSR within international banks, finding differences amongst banks, countries and regions as well as a significant increase in banks’ CSR between 2000 and 2005.

Secondly, with regard to the investment side of financial activities, a wide variety of studies have also been published. These have ranged from an examination of shareholder activism for CSR (O’Rourke, 2003), to an exploration of socially responsible investment (SRI) funds and their ability to achieve their desired E&S outcomes (Haigh and Hazeltom, 2004), to the study of public pension funds’ need to invest in socially responsible companies (Sethi, 2005). These have also included an examination of the methods in which mutual funds select and apply social considerations in their investment activities (Haigh, 2006a), an analysis of the financial and social performance of SRI in the Netherlands (Scholtens, 2007),
and SRI-screened corporate pension plans in Spain (Albareda Vivo and Balaguer Franch, 2009).

Additionally, more specific accountability issues have also emerged within this body of literature, concerned with, for example: the interrelationship between E&S disclosure, investment decisions and market performance (Murray et al., 2006); the importance and fusion of public and private sustainability disclosure between investee companies and institutional investors (Solomon and Solomon, 2006); plus mandatory reporting requirements for institutional investors regarding the extent to which social considerations are employed in their portfolio construction (Haigh, 2006b).

Finally, in terms of the relationship between non-governmental organisation (NGO) stakeholders and sustainable finance, while the literature has supported many studies related to the influence of, and relationship between, stakeholders and corporate organisations regarding their sustainability activities and/or accountability (e.g. Tilt, 1994; Lounsbury et al., 2003; Delmas and Toffel, 2004; Deegan and Blomquist, 2006), there has been very little academic work specifically focused on the influence of NGO stakeholders on financial sector sustainability or social accountability.

It might be argued that Coulson (2009) indirectly contributes to this niche, through the consideration of what commercial banks’ role could be in the governance of the environment. She explores the notion of such governance beginning from a position of “precaution”, whereby a bank’s interpretation of precautionary action in environmentally challenging projects may be opposed to NGO notions of the precautionary veto of, for example, lending or investing in such harmful projects. As a result, she argues that a contested understanding of what constitutes “harmful”, between both parties, and how a bank may thus contribute to the governance of the environment, arises. Coulson acknowledges however, that the dichotomy between “action” or “veto” is not so straightforward due to the variety and complexity of both bank and NGO positions and practices regarding this. Furthermore, she highlights how a bank’s power to govern the environment is both enabled and constrained by their economic position. They are enabled in that they have the capacity to influence the types of projects that are financed through their lending policies or investment streams, and constrained due to anti-monopoly and
competition regulation; limiting their ability to respond collectively to environmental challenges. Despite this however, she suggests that “banks are being forced to act in unison to find solutions on environmental governance and defend their market position” (Coulson, 2009, p.155) and refers to the EP as an example of this. She concludes by reiterating that a major barrier to environmental governance is incorrectly generalising bank behaviour; and that it is more important to recognise banks’ interpretation of a “precautionary approach” as a useful starting point from which to progress the environmental governance agenda.

However, of what little academic work has been published in this NGO-financial sector domain, Waygood (2006) has, arguably, produced the most comprehensive account to date of the impact of NGO “capital market campaigns” on corporate companies, shareholders and reputational risk. Waygood documents the history of these (predominantly UK) NGO campaigns, analyses the evolving effectiveness of NGO strategies and tactics, examines their implications for company risk management and shareholder value, and provides an overview of some “best practice” responses by companies and investors to such campaigns. In doing so, Waygood inter alia refers to the EP and states that “not only was capital market campaigning one reason why the original ten banks created the Equator Principles in the first place, but also the ongoing threat of being targeted by campaigners has been a major incentive for other banks to subsequently sign up” (p. 5).

In a similar vein, Spitzeck’s (2007) working paper focuses on the public discourses that captured the “contentious” relationship between Citigroup and the Rainforest Action Network (RAN), between 2000 and 2004. Here, Spitzeck argues that RAN’s criticism of the banks’ irresponsible behaviour triggered E&S innovation by Citigroup; of which involvement in the development of the EP was one example. Spitzeck suggests that RANs campaigns forced Citigroup to consider the moral nature of their operations and criticisms against them; and to learn how to integrate this into their decision-making structures in an attempt to become a responsible organisation. In general, Spitzeck posits that: companies which understand the underlying moral nature of doing business will experience fewer “legitimacy” struggles with stakeholders, and position themselves as more “authentic” corporate citizens.

A review of the extant literature on the EP is now conducted in the following section.
2.2.1 The Equator Principles (EP)

While there is a lot of NGO (e.g. BankTrack, 2003; 2004b; 2005b; 2006a; Missbach, 2004); media (e.g. Phillips and Pacelle, 2003; Financial Times, 2006; Sevastopulo, 2006a; 2006b; Scott, 2007; Ethical Corporation, 2008); financial sector popular press (e.g. Nelthorpe, 2003; Thomas, 2004; Deri, 2005; Monahan, 2005; The Banker, 2006; Gaskin, 2007); as well as legal (e.g. Freshfields Bruckhaus Deringer, 2005; Allens Arthur Robinson, 2006; Watchman and Baines, 2007; Watchman et al., 2007); consultancy (e.g. Bailey et al., 2006; Lawrence, 2009; Siddy, 2007) and rating agency (e.g. EIRIS, 2006) work on the EP; there has been little academic work on the Principles to date. Furthermore, while the EP have been referred to in some social accounting publications (see Coulson, 2007), no prior work specifically focused on the Principles, the accountability debates surrounding them or their institutionalisation, has been conducted within the accounting discipline to date.

Nevertheless, the wide-ranging CSR and sustainable finance literature currently displays a variety of ways in which the EP have been researched. Firstly, within the broad CSR literature, the EP are often mentioned as examples of voluntary corporate initiatives which “pressurise” companies to be more responsible (e.g. Waddock, 2008). The EP have also been cited as examples of how industry self-regulation has moved from national to global levels, and how tough accountability mechanisms and transparency policies need to be adopted by participating organisations if industry self-regulation is to be an effective alternative to transnational governmental regulation (Hemphill, 2004). Secondly, there is an emerging array of research directly focused on the EP, and the following is a chronological overview of the diversity of these studies and publications.

Amalric (2005) presents a preliminary economic analysis of the EP and proposes some potential impacts and routes of evolution of the Principles. He questions: (1) why banks are interested in participating in such self-regulation if their overarching aim is to maximise firm value; and (2) what the consequences of this could be on social welfare. He hypothesises that companies that promote and/or adopt the Principles do so because they believe it will enhance firm value, and that the EP can bring banks one step closer to aligning their interests with that of sustainability. However, he also states that if projects are successfully screened against E&S risks that this does not necessarily mean they will
positively contribute to sustainable development. He argues that the EP can only develop into an effective sustainable development device through closer cooperation between EP banks\textsuperscript{12} and NGOs.

Richardson (2005) evaluates the EP from a legal perspective. He explains what the Principles demand of lenders, assess their implementation and examines their adequacy for the promotion of environmentally sustainable finance. He believes that the EP are a step in the right direction but that in their original form (Equator Principles I, 2003), are not adequate for nurturing a commitment to environmentally sustainable development. He suggests that while the EP may change the way project financing decisions are made, publicly accountable and transparent decision-making is needed to engender meaningful change; and greater due diligence by project sponsors is also necessary. He believes this is important if the EP, as a voluntary mechanism, are to be an adequate tool for promoting “sustainable” finance in the future, as opposed to enabling mere “window-dressing”.

Hansen (2006),\textsuperscript{13} also writing from a legal perspective, investigates the potential avenues for legal action against EPFIs. He suggests that, in applying the Principles, EPFIs may increase their lender liability with regard to: (1) environmental damage caused by the projects they finance; and (2) violations of the social and economic rights of project affected communities. He therefore warns that it is in the best interest of EPFIs to take responsible E&S practices seriously as this can mitigate potential liability risk.

One of the most widely cited academic papers on the EP is Wright and Rwabizambuga (2006). Wright and Rwabizambuga focus on the EP as a voluntary code of conduct and explore how institutional pressures and the maintenance of firm reputation act as catalysts to EP adoption. In general, they observe that EP adoption is greater in geographical regions where large commercial banks are headquartered and more “exposed” to NGO campaigns (i.e. Europe and North America). As this study has some broad parallels with aspects of this research it will be discussed further in Chapter Three, Section 3.2.1a.

\textsuperscript{12} Prior to 2006 EP adoptees were generally referred to as EP banks. The term Equator Principles Financial Institutions (EPFIs) was then adopted to more accurately represent the range of financial institution adoptees.

\textsuperscript{13} This is an unpublished Masters thesis.
Later, Wright (2009) also examines the role of the International Finance Corporation (IFC) in the development of the EP. He considers how the IFC influenced the drafting of the EP and why its standards were chosen by commercial banks as a blueprint for the Principles. Wright argues that the IFC’s convening power in the run up to the development of the EP played an instrumental role in bringing competing banks together to draft the Principles. He also contends that the participation of the IFC in the drafting stages of the EP convinced the banks that the IFC’s (then) Safeguard Policies were the most effective blueprint for mitigating the E&S risks associated with project finance. Wright suggests that widespread support for the EP has made the IFC a “de facto standard-setter” in the global project finance market. However, he also states that the IFC’s influence in the development of the EP should not be overestimated, and without the voluntary commitment and endorsement of the banks involved (spurred on by the reputational risks of NGO campaigns), the EP would not have materialised. In closing he states that to instil public confidence in the voluntary Principles, banks, notwithstanding commercial and legal constraints, need to disclose how the EP are applied to controversial projects.

Bertens (2006)\(^{14}\) investigates whether, three years after their inception, the EP have met their objective of achieving: a common industry standard, improved E&S risk management and continuous engagement with locally affected communities. Based on her research of five Dutch EPFIs, she deduces that at an organisation level, the implementation of the EP has been “fairly effective”, with banks integrating the EP into their credit policies and procedures, staff training and public reporting. However, at an industry and project level she believes many challenges remain regarding EP governance and social expertise.

Hadfield-Hill (2007), writing from a geographical perspective, explores the links between banks and their E&S responsibilities. She questions whether “Equator banks” can contribute to sustainability and argues that when conforming to the Principles, banks can make, and have made, responsible E&S lending decisions. Yet, she also highlights the need for consistent EP compliance, transparency and accountability by Equator banks, and suggests that further collaboration, compromise and trust between banks and NGOs is needed if responsible lending and sustainable development are to be achieved.

\(^{14}\) This is an unpublished Masters thesis.
Schaper (2007) investigates the power dynamics and relationships surrounding the EP. He focuses on a range of financial institutions (FIs), including export credit agencies (ECAs), that have adopted the Principles. He observes that FIs build upon their structural (economic) power to “green” clients’ projects, and highlights how both state and civil society actors have leveraged this power to encourage businesses to implement environmental policies and procedures. As a result he argues this has transformed NGOs’ relatively weak discursive power base into a more instrumental form of power.

Scholten and Dam (2007) analyse the performance of banks that have adopted the EP. They investigate whether these behave in a significantly different manner with regard to their environmental, social and ethical policies than non-adopters, and whether financial markets assess them differently. They find the policies of adopting banks (mainly large FIs) differ significantly from non-adopters. They also find that reputation is a major concern for larger banks with the more responsible ones signalling their responsibility by adopting the EP. Their analysis shows that shareholders do not respond in a significant manner to banks’ announcement of EP adoption, implying that shareholders feel adhering to the EP does not affect shareholder value. Scholten and Dam find no evidence to support the view that the adoption of the EP is just “window dressing”, as “there is at least some costs involved and there are many project finance banks that do not adopt the Principles” (p.1308). They posit that the benefits of EP adoption, i.e. reduced risk, outweigh any costs involved.

2.2.2 Summary

Sections 2.2 and 2.2.1 have provided an overview of the broad sustainable finance and EP literature. In general, this focused on the integration of E&S issues into the lending and investment policies, procedures and reporting of the financial services industry; and how the EP are playing a role in the same. This discussion highlighted the existing gaps in the literature with regard to: 1) more in-depth research into EP social accountability debates; 2) stakeholder perspectives on the development and evolution of the EP; and 3) EP institutionalisation processes. The next section now turns to a review of relevant theoretical literature for this research.
2.3 PART 2: A Review of the Theoretical Literature

2.3.1 Accountability

“Accountability will be enhanced by recognizing the multiple ways in which accountability is experienced.” (Sinclair, 1995, p.216)

As this thesis is concerned with social accountability and the finance sector, it is necessary to consider what the concept of accountability entails and how (aspects of) it will be applied to this study. The following discussion thus considers some of the ways in which accountability, as well as the relationship between accountability and legitimacy, are conceptualised within the literature and why this is of importance to this research.

The literature repeatedly reminds us that accountability is a rather elusive, multi-faceted and even “murky” term, lacking precise definition (Sinclair, 1995; Shearer, 2002; Cooper and Owen, 2007). As Cooper and Owen (2007, p.651) point out “not only does it have discipline specific meanings, but even within the accounting domain there is a distinct lack of consensus as to what being held accountable actually entails”. However, despite the fact that the notion of accountability may thus be recognised as “subjectively constructed and chang[ing] with context” (Sinclair, 1995, p.219), there still appears to be some general consensus regarding its basic attributes. For example, the extent to which some of the following definitions have been (re)used throughout the social accounting literature is testament to this.

We have been told that the concept of accountability “in its broadest sense simply refers to the giving and demanding of reasons of conduct” (Roberts and Scapens, 1985, p.447). More specifically, accountability is said to entail “identifying what one is responsible for and then providing information about that responsibility to those who have rights to that information” (Gray, 2001, p.11). Accordingly, accountability is seen as dependent upon “the free flow of appropriate information and on effective forums for discussion and cross-examination” (Mulgan, 2000, p.8). Being called to account for one’s actions “requires one to explain and justify what was done” (Ibid, p.9), while “the question of whom to hold to account for what raises immediate issues of personal responsibility and internal values” (Ibid, p.10). Thus, according to Roberts (1991, p.365) “at the heart of accountability is a
social acknowledgement and insistence that one’s actions make a difference both to self and others”. It is this “intersubjectivity” (Shearer, 2002), or interdependence, between self and others that leads some authors to consider accountability “as a moral phenomenon that both can and should be subject to ethical reflection” (Shearer, 2002, p.545; Schweiker, 1993). Hence, they claim that it is the notion of “moral responsibility that grounds the accountability of the entity with respect to [a] community” (Shearer, 2002, p.543).

While the literature often refers to responsibility and accountability collectively as “accountability” (e.g. Roberts 1991), some authors distinguish between them. For example, Lindkvist and Llewellyn (2003, p.252) argue “accountability tends to connote instrumentality and external controls, whereas responsibility to a greater extent connotes morality and inner controls”. Similarly, Ebrahim (2003, p.194) views accountability as “the means through which individuals and organisations are held externally to account for their actions and […] take internal responsibility for continuously shaping and scrutinising organisational mission, goals and performance”. While Fry (1995) states “an individual can only be accountable for that which he or she publicly promises to do for or with another” (p.189); hence actors are said to “feel” responsible for what they promise to be accountable for.

Notions of responsibility and accountability raise some conceptual challenges for how organisations are perceived and “whom” exactly is being held responsible and to account. In other words is the organisation recognised as an “entity” or a “collective of individuals”? Shearer (2002), suggests that “since economic entities are not individuals and do not possess a consciousness, any attempt to ascribe moral responsibility to collectivities must locate the source of this moral agency elsewhere than in the self-realizing ‘soul’ of the individual subject” (p.543). Instead, she believes that “economic entities become members of a moral community by virtue of the accounts that such entities render of themselves” (Ibid, emphasis added). Hence, the act of “accounting for” their moral (E&S) responsibilities is arguably a means by which organisations, as entities, may represent the collective “soul” or voice of individual actors therein.

Furthermore, as Ahrens (1996, p.168) suggests “a defining feature of organisational processes of accountability is the alignment of organisational rhetoric and practice with
wider public discourses”. Accordingly, the social accounting literature is dominated by research on why and how organisations attempt to “evidence” their accountability, and at the same time gain societal legitimacy, through the production of E&S, or sustainability, reports (O’Donovan, 2002; O’Dwyer, 2002; Deegan and Gordon, 1996; Deegan, 2002; Deegan et al., 2002; Deegan, 2007; Gray et al., 1995; Hogner, 1982; Milne and Patten, 2002; Patten, 1992). This interrelationship between accountability and legitimacy will be discussed further in the following section.

In terms of this research, accountability is interpreted as “identifying what one is responsible for and then providing information about that responsibility to those who have rights to that information” (Gray, 2001, p.11). Hence, responsibility (for one’s self, one’s actions, and to others) is recognised as a fundamental aspect of accountability, even if “accountability” may, in the majority of cases, be used as the collective term to denote both responsibility and accountability throughout this thesis. In addition, “social accountability” is used in this study to refer collectively to environmental and social accountability.

In this research, the relevant publics/stakeholders “holding to account” are largely campaigning NGOs, while those being “held accountable” are commercial banks/EPFIs that developed and adopted the EP. Furthermore, the demarcation between organisations as entities or collectives of individuals is quite “fluid” in this research. This is because, as the ensuing case narrative (Chapters Six to Nine) will illustrate, NGOs target EPFI organisations as “entities” while seeking to influence the “moral” conscience of the individuals therein.

The next section will now discuss how accountability and legitimacy are interrelated and introduce why this is of relevance to this research.

2.3.1a Accountability and Legitimacy

From an organisational perspective, the concept of accountability is aligned with that of legitimacy as both concepts are concerned with societal values and expectations of organisations. With regard to organisational legitimacy, Dowling and Pfeffer (1975, p. 122) note that organisations aim to establish equivalence between the social values associated with or implied by their operations and the social norms of acceptable behaviour in the
larger social system or environment they inhabit. Consequently, the extent to which these two value systems are congruent determines organisational legitimacy.

Organisational legitimacy is not seen as “an abstract measure of the ‘rightness’ of the [organisation] but rather a measure of the societal perceptions of the adequacy of [organisational] behaviour” (Deegan, 2007, p. 128). It is recognised as a social construct, conferred upon organisations by “relevant publics” (Buhr, 1998; Neu et al., 1998), and changing over time and place depending on these societal perceptions, desires or demands (Deegan, 2007). Thus, in many respects it is based on the concept of a “social contract” (Gray et al., 1988) or “social licence to operate” between organisations and broader society. Organisations are therefore said to adopt legitimisation strategies focused on repairing, maintaining or gaining legitimacy (Suchman, 1995) in order to conform with, or endeavour to change social perceptions, expectations or values (Lindblom, 1994; Gray et al., 1995).

Here, Ashforth and Gibbs (1990) contrast symbolic and substantive organisational approaches to legitimation. A symbolic approach portrays corporate behaviour as “appear[ing] consistent with social values and expectations” (p.180), whereas a substantive approach is reflective of “real, material change in organisational goals, structures and processes or socially institutional practices” (p.178). In addition, Deephouse (1996) argues that organisational legitimacy can be conceptualised as both a process and a state. A process of legitimisation (Ashforth and Gibbs, 1990; Suchman, 1995) may be undertaken by organisations that have experienced a “legitimacy gap” (Sethi, 1979) between their operations and societal perceptions of the same, in order to achieve a state of organisational legitimacy once more (Breton and Cote, 2006; Gray et al., 1995).

Suchman (1995) identifies three forms of legitimacy: moral, pragmatic and cognitive. Moral legitimacy “rests on judgements not about whether a given activity benefits the evaluator, but rather on judgements about whether the activity is ‘the right thing to do’” (Suchman, 1995, p.579). These judgements reflect beliefs about whether an “activity effectively promotes societal welfare, as defined by the audience’s socially constructed value system” (p.576). Pragmatic legitimacy “rests on the self-interested calculations of an organisation’s most immediate audiences” (p.578). These “audiences” are likely to become “constituencies, scrutinising organisational behaviour to determine the practical consequences, for them, of any given line of activity” (Ibid). In contrast, cognitive
legitimacy is based more on “comprehensibility” and “taken-for-grantedness” rather than “interest or evaluation” as in the other two forms (p.582). Here, legitimacy stems from “plausible explanations for the organisation and its endeavours” (Ibid), as well as a sense that “for things to be otherwise is literally unthinkable” (p.583). However, all three forms are said to co-exist in real world settings.

It would appear that concerns about moral legitimacy predominate the social accounting literature. Here, many claim that “the disclosure of information to relevant publics is essential for influencing legitimacy” (Deegan, 2007, p.139), and that “organisations that lack acceptable legitimated accounts of their activities are more vulnerable to claims that they are negligent, irrational or unnecessary” (Meyer and Rowan, 1991, p. 50, cited in Suchman, 1995, p.575). In other words, to be deemed legitimate by relevant publics, organisations have to be – or at least be perceived to be – accountable. This is important as:

“[l]egitimacy itself can be threatened even when an organisation’s performance is not deviating from society’s expectations of appropriate performance. This might be because the organisation has failed to make disclosures that show it is complying with society’s expectations, which in themselves might be changing across time.” (Deegan, 2007, p. 135, emphasis added).

In general, the relationship between accountability and legitimacy is relevant for this research as one aim of this study is to illustrate how NGO campaigns for financial sector social accountability are recognised as simultaneous demands for financial sector legitimation, which in turn catalysed or “induced” (and continued to influence) the EP institutionalisation process. In so doing this will advance aspects of Lounsbury et al.’s (2003) examination of how social movements contribute to institutional change, but more specifically Den Hond and De Bakker’s (2007) study on how social activists’ demands for moral and pragmatic legitimacy influence institutionalisation processes.

In referring to the EP institutionalisation process however, it is first necessary to discuss institutional theory, from which concepts of institutionalisation derive. The next section therefore turns to an exploration of the institutional theory literature.

15 This is the form of legitimacy normally referred to in institutional theory. See Section 2.3.2.
2.3.2 Institutional Theory

“In general, the early development of neoinstitutional theory was extremely self-limiting.” (Lounsbury, 2008, p.352)

As this research focuses on the EP institutionalisation process, it is important to consider the evolution of institutional theory within the literature. The following sections therefore provide an overview of past and current critiques of institutional theory, and act as a foundation for more in-depth consideration and explanation of institutionalisation processes, especially the Dillard et al. (2004) framework on institutionalisation, in Chapter Three.

2.3.2a Types of Institutional Theory

Various types of institutional theory have been used in the literature in order to gain insights into organisational change. These include: new institutional economics (NIE), new institutional sociology (NIS) and old institutional economics (OIE). NIE is concerned with “the structures used to govern economic transactions” (Scapens, 2006, p.11). It adopts a traditional economics approach and uses the assumptions of economic rationality and markets to examine the governance of organisations. NIS is concerned with institutional (social and cultural) pressures and processes that shape organisations. In contrast to NIE and NIS, which (traditionally) focus on the impact of the external environment on organisations, OIE is “concerned with the institutions that shape the actions and thoughts of individual human agents” (Ibid) within the organisation. In so doing, it rejects the neoclassical economic approach and aims to explain the behaviour of economic agents with regard to their rules and routines (Scapens, 2006). This research uses a NIS/neoinstitutional, hereafter referred to as institutional theory, perspective.

2.3.3 The Evolution of (Neo) Institutional Theory

2.3.3a The Foundation

Institutional theory is concerned with how the pressures and processes of the institutional environment influence organisational structures and practices (Scott, 1995). Early institutionalists (e.g. Meyer and Rowan, 1977) distinguished between technical (“rational”)
and institutional ("non-rational") environments and claimed that both inflicted different pressures on organisations (Scott, 2008). Technical pressures relate to the need to ensure the economic/market efficiency of organisations, while institutional pressures refer to the need to meet social rules, norms and expectations (Burns and Scapens, 2000; Scapens, 2006). This dichotomy would later be challenged by the recognition of the inter-related nature of organisational behaviour to meet the economic and socio-cultural demands of their environments (Scott and Meyer, 1983; Scott and Meyer, 1991; Powell, 1991; Greenwood and Hinnings, 1996; Scapens 2006).

The starting point for neo-institutional enquiry was, traditionally, the question of why organisations appeared to be similar (Scapens, 2006). In response, Di Maggio and Powell (1983) developed the notions of coercive, mimetic and normative isomorphisms to describe the manner in which organisations conform to the expectations of their broader environment, and may appear “similar” as a result. Coercive isomorphism results from “both formal and informal pressures exerted on an organization by another party upon which it is dependent, and by expectations of the society within which it operates” (Dillard et al., 2004, p.509; Di Maggio and Powell, 1983). Mimetic isomorphism takes place “when an organization attempts to imitate a more successful referent organisation” (Ibid), and normative isomorphism stems from “professionalisation i.e. the collective struggle of members of an occupation to define the conditions and methods of work” (Ibid). These concepts were used to explain the “diffusion” (dispersal) of common values, norms and rules, or institutions, across organisations. Organisations had to comply with these institutions to be deemed “legitimate” in the eyes of their stakeholders and peers and to secure the “resources” necessary for survival (Di Maggio and Powell, 1983; Scapens, 2006). Organisations were often said to respond to institutional pressures through “ceremonial conformity”, a form of superficial adoption of institutions that were then “decoupled” from actual organisational practices (Meyer and Rowan, 1977; Scott, 2008). Hence, early studies emphasised the “homogeneous” nature of both institutional requirements and organisational responses to this, suggesting a form of “passive” reaction from organisations to their institutional obligations (Scott, 2008; Lounsbury, 2008).

These dynamics were seen to occur within an organisational field, which Di Maggio and Powell (1983) defined as: “those organizations that, in the aggregate, constitute a
recognised area of institutional life: key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products” (Di Maggio and Powell, 1983, p.143). This definition, as well as some other early interpretations of it (Scott and Meyer, 1983; Scott and Meyer, 1991; Scott, 1995), highlighted the “relational” (causal) and structural dimension of a field. This was elaborated and extended in future work incorporating for example: the symbolic (interpretation/meaning) and cultural elements of fields (e.g. Scott et al., 2000), the existence of conflict amongst contending factions (Di Maggio, 1991), and the formation of fields around issues as opposed to common products or markets (Hoffman, 1999). In general, the notion of an organisational field as well as “institutions” would become, and remain to be, a highly debated issue amongst institutionalists in the literature (this discussion will be expanded in Chapter Three).

Scott (2008) notes that: “although the founding works were seminal in calling attention to the reality and influence of the institutional environment on organizations, their initial formulations overstated the unity, coherence and independence of these frameworks” (p.431). Sebsequently, a number of re-evaluations and critiques of this pioneering work emerged. The following section discusses these critiques as they are of relevance to this research and the Dillard et al. (2004) framework on institutionalisation applied therein.

2.3.3b The Re-Evaluation

One of the first re-evaluations of institutional theory involved the realisation that many organisational fields are “fragmented or conflicted, containing competing requirements and prescriptions” (Scott, 2008, p.430). Studies began to examine the effects of such field complexity and ambiguity on organisational forms and processes (Scott, 2008), as well as the broader societal context (e.g. economy, state, religion, kinship), influencing field difference, conflict and change (Friedland and Alford, 1991). Heterogeneity as opposed to homogeneity of organisational field requirements and organisational responses to this became an emerging focus of enquiry. There was the realisation that the type, extent, and effects of “conformity” to institutional demands could vary across organisations. Hence, decoupling between “symbolic” conformance to institutional obligations and “substantive” organisational performance was no longer accepted as a “given”. For example, Scott (2008) states there has been emerging evidence that perceived “superficial” adoption of
institutional requirements could become more significant over time. While, Heugens and Lander (2009) suggest that organisations are likely to favour institutional “templates” that allow them “to reap substantive benefits in addition to social condonement” (p.61); and that conformity to such institutional norms “simultaneously improves the substantive performance of organizations” (p.77). All of this has drawn critical attention to the “traditional” depiction of “late adopters”- in a “two-dimensional diffusion process” of institutional practices - as engaging in “passive” mimicry or “mindless imitation” of early adopters’ actions (Lounsbury, 2008).

With this new focus on heterogeneity, research on the issue of “agency” also developed. Di Maggio (1988; 1991) initiated a re-examination of the role of agency in institutional theory, drawing attention to the “need to study power and the entrepreneurs who actually create institutions” (Lounsbury, 2008, p.352, emphasis added). In doing so he proposed a change of focus from extant institutions to that of the process of institutionalisation, as he believed studying the latter would show that:

“Institutionalization is a product of the political efforts of actors to accomplish their ends and that the success of an institutionalization project and the form that the resulting institutions takes depends on the relative power of the actors who support, oppose, or otherwise strive to influence it.”

(Di Maggio, 1988, p.13; Scott, 2008, p.431)

Di Maggio felt that such agency-affected processes were most visible during the construction of new fields, but other institutionalists, influenced by Giddens’ (1976, 1979, 1984) structuration theory, believed this construction process to be continuous, through the on-going interaction between social structures and actors over time (e.g. Barley and Tolbert, 1997; Dillard et al., 2004).

This reconsideration of actors within institutional arguments meant that the notion of institutional “rationality” (legitimation of behaviour) was also considered more broadly. In contrast to the “institutional” (or collective) form of rationality associated with organisational responses to institutional demands in early studies (Meyer and Rowan, 1977; Di Maggio and Powell, 1983), new forms of “instrumental/strategic” rationality (Lounsbury, 2008) emerged i.e. influencing purposive managerial action or responses to institutional pressures. For example, Oliver (1991) illustrates that, while conformity to institutional
pressures may be the most probable response by organisational actors, other responses, such as “compromise, avoidance, defiance, manipulation” (Scott, 2008, p.431) were also possible. Similarly, Delmas and Toffel (2004) focus on how organisations within the same organisational field pursue different strategies, despite experiencing the same “isomorphic” pressures from stakeholders (for environmental protection). They suggest it is managers’ perception of and reaction to these pressures that causes heterogeneity rather than homogeneity (of environmental strategies and practices) within an industry. In addition, Lounsbury (2008) advocates a more intent focus on actors and institutional rationality, in the form of multiple, competing logics, in order to move neoinstitutional research away from the study of isomorphism towards an understanding of organisational heterogeneity and practice variation.

Relatedly, greater consideration of institutional “change” as opposed to “stability” or inertia also emerged in the literature. As the notion of institutions (norms, rules) tends to denote stability, early studies paid attention to convergent as opposed to divergent forms of change. Di Maggio’s (1991) study however was the first to investigate conflicting or contentious interactions that can lead to institutional change and field definition. In addition, early studies emphasised exogenous or external “jolts” (Meyer, 1982) that catalyse institutional change such as “social upheaval, technological disruptions, competitive discontinuities and regulatory change” (Greenwood and Suddaby, 2006, p.28). Yet, some later studies have focused on “endogenous” and deliberate sources of change, initiated by actors or “institutional entrepreneurs” (Di Maggio, 1988; Dacin et al., 2002; Greenwood and Suddaby, 2006; Reay et al., 2006). The concept of “embedded agency” or rather the “paradox of embedded agency” (Seo and Creed, 2002; Greenwood and Suddaby, 2006), has been central to these discussions. This notion suggests that if actors are “embedded” in institutional environments i.e. if their behaviour is shaped by “taken-for-granted” institutions, then “how can they envision and enact changes to the contexts in which they are embedded?” (Greenwood and Suddaby, 2006, p.27). Greenwood and Suddaby (2006) and Reay et al. (2006) demonstrate how embeddedness can actually provide agents with the foundation and opportunity for change as well as the legitimation of a new institution. They view key entrepreneurs/actors “not as embedded defenders of the status quo […] but as

---

16 With logics defined here as “cultural beliefs and rules that structure cognition and guide decision making in a field” (Lounsbury, 2008, p.350).
motivated agents of institutional change enabled, not constrained, by their structural position” (Greenwood and Suddaby, 2006, p.44, emphasis added).

In general, Scott (2008) suggests that early institutional work “carried with it some unfortunate intellectual baggage that has been difficult to discard [and] it has taken a good many years to reformulate some of the arguments and […] assumptions embedded in the founding studies” (p.428). Scott advocates renewed attention to change as well as longitudinal studies of organisations, organisational populations and organisational fields to assist in this “reformulation” process. Similarly, Lounsbury (2008) suggests the explanatory potential of institutional theory can be expanded through further exploration of the dynamic “between actor micro-processes and institutions” (p.351) at organisational and intra-organisational levels. He believes that a complete approach to such “multi-level” research on practice “requires attention to the broader cultural frameworks that are created and changed by field-level actors, as well as the lower-level activities of organizations and other actors that articulate with those frameworks” (Lounsbury, 2008, p.356). He feels that the “power” of more comprehensive approaches like this becomes evident “when probing the question of where new practices come from – an important, yet relatively unexplored question” (Ibid). The Dillard et al. (2004) model of institutionalisation applied to this study recognises such complex, political and “multi-layered” dynamics of institutionalisation processes, as occurring over socio-economic and political, organisational field and organisational levels. Some more recent studies have also advocated and adopted a multi-level (and structuration-based) approach to the study of institutional processes. For example, Purdy and Gray (2009) examine the evolution of a new population of organisations (state offices of dispute resolution in the US) in an emerging institutional as opposed to a mature field. Here, they focus on how entrepreneurial action interacts recursively with structural influences at multiple levels (organisational, population and field) to enable numerous logics, as opposed to one dominant logic, to diffuse and shape the process of institutionalisation in emerging fields.

The recent literature therefore appears to call for more research on the intricacies of institutional processes. And, as Heugens and Lander (2009) note:

“The processual dimension of isomorphism – how organizations experience isomorphic pressures, interpret them, and learn to manage them over time –
is rarely explored. Here qualitative process work…could make a profound contribution to scholars’ present understanding of institutional processes. Further opportunities exist at the field level. Researchers have only barely begun to understand the field-level mechanisms through which isomorphic pressures accelerate and coordinate collective organizational action.” (p.76)

This research which: adopts a qualitative approach and probes the “whys” and “hows” of the EP institutionalisation process, focuses on its complex, multi-level dynamics, and examines the variant levels of change it affected between 2003 and 2008, will address many of these recent demands in the institutional literature.

2.4 Chapter Summary

This chapter was divided into two parts. Firstly, it provided an overview of the broad sustainable finance and Equator Principles (EP) literature. This was done in order to portray the context within which this research is placed and to highlight the unique contributions that it aims to make to this literature.

Secondly, a review of the “theoretical” literature was undertaken and was further divided into two broad sections. The first section explained how the concepts of accountability and legitimacy are defined and understood in the literature, are interrelated, and are interpreted in this research. This is of relevance as part of this research examines why and how NGO demands for financial sector accountability/legitimacy played an instrumental role in the EP institutionalisation process, and how EP institutionalisation affected EPFI social accountability between 2003 and 2008. The second section conducted a review of institutional theory and its evolution and critique in the literature. This section provided the foundation for a more in-depth consideration of institutions, institutionalisation processes and the explanation of the Dillard et al. (2004) framework on institutionalisation, in the following chapter.