

Profit and Organisational Legitimacy in an Emerging Market

Abstract

While there is common acknowledgement that the main aim of organisations is to maximise shareholder wealth, firms also have the obligation to manage the needs of a broader group of stakeholders as these firms are a product of social creation. In this study, we test the notion that the concept, profit, is fundamental to society's perception of the firm in an emerging market, and the need for a firm to legitimise a level of profit. We evaluate the relationship between the readability of various components of corporate annual reports and the level of profit, and we also take into account the nature of disclosure (mandatory and non-mandatory), the size of the firm and the nature of setup (public enterprises and publicly listed companies). Our findings suggest that, as with developed markets, in emerging markets profit is indeed an important determinant of the nature of operations of a firm, and that firms consider readability of their disclosures in attempting to legitimise a level of profit.

Key words: Legitimacy Theory; Mandatory Disclosures; Non-Mandatory Disclosures; Profit, Public Enterprises; Publicly Listed Companies

JEL classification: M14, M41

1. Introduction

While there is common acknowledgement that the main aim of organisations is to maximise shareholder wealth, there is also the emergent belief within frameworks like triple bottom line reporting that organisations have to satisfy a broader group of stakeholders. Corporations are a product of social creation, and their survival in a society depends upon the society's willingness to continue to allow them to operate (O'Donovan, 2002). This implied social contract means that businesses have a moral obligation to act in a responsible manner and justify their outcomes, actions, and activities to the greater stakeholders. Such justification would be an attempt of legitimacy of their current state of health.

The legitimacy in relation to the existence of a firm in an economic sector of a developing nation is primarily through political authority, with firms having a mandate from state to fulfill the needs of the nation. Owing to the political nature of this setting, specific groups may act in ways not in the best interest of the nation or expectation of the society. The subsequent sense of the adverse shift in the perceptions of the society of how an organisation is operating would mean attempts by the organisation to "manage" this shift. This perception management could be achieved in many ways (Dowling and Pfeffer, 1975), but it is generally agreed that perceptions are best managed by disclosures (Cormier and Gordon, 2001; Deegan, 2002; O'Donovan, 2002).

Prior studies on organisational legitimacy have largely been driven by social and environmental issues in developed economies (see for example, Deegan and Rankin, 1996; O'Donovan, 2002; Wilmshurst and Frost, 2000). While it has been established, to some extent, that firms in developed economies legitimise their actions in relation to social and environmental issues (Deegan and Rankin, 1996), this issue has received very little attention in developing countries. The existence of a near monopoly environment and some government protection means for organisations that profit may not be perceived

to result from their efficiency. Even if greater profit is through efficiency, there is the expectation from the society to share the benefits of this profit through lower costs of services. Therefore, in this paper, we suggest that as with mature economies, in developing economies, the concept of profit is fundamental to the society's perception of the firm, and thus the need for the firm to justify a level of profit. Second, prior studies on organisational legitimacy, largely in relation to social and environmental issues, are event-driven, and the extent of organisational legitimacy is studied ex-post. We believe that changing focus from "what is disclosed" to "how it is disclosed" may add an important dimension to our understanding of how organisations legitimise their existence and outcomes to the greater society. Thus, in this study we suggest that readability of corporate disclosures is an important indicator of organisational legitimacy. Third, we believe that comparing this readability in relation to different forms of disclosure will provide richer insights into the nature of firms' legitimising activities.

The aim of this paper is then to investigate the relationship between the level of profit and the choice of a 'how' legitimisation tool – the readability of mandatory and non-mandatory disclosures in annual reports in a developing economy. This paper is organised as follows. The next section provides a literature review on organisational legitimacy and readability research followed by discussion of the theoretical framework. Then, we present our methods and results. In the final section, we discuss the results, limitations, and provide directions for future research.

2. Literature Review

Prior research on organisational legitimacy has mainly focused on the volume and content of corporate social responsibility disclosures in the corporate annual reports (Cho and Patten, 2007; Healy and Krishna, 2001). Most of these studies are based on the legitimacy theoretical perspective. While prior studies on social and environmental reporting did not provide much support for the legitimacy theory

due to data limitations (for example, Guthrie and Parker, 1989), subsequent studies, more often than not, have found links between corporate social and environmental disclosures and organisations legitimising intentions (see for example, Brown and Deegan, 1998; Cho and Patten, 2007; Deegan and Gordon, 1996; Deegan and Rankin, 1996; Deegan *et al.*, 2002; Mobus, 2005; O'Donovan, 2002; Patten, 1992). Patten (1992) and Deegan and Rankin (1996) found that organisations respond to specific environmental performance threats to legitimacy through the expanded use of voluntary corporate social reporting. Managers are also found to convey legitimising messages to relevant audiences (Adams, 2002; O'Donovan, 2002). Tilt (1994) found that financial and other relevant stakeholders desire and place importance on corporate social reporting.

The literature reveals the dynamics of corporate social reporting, and how the audience may become receptive targets of information disclosed by corporate managers to convey legitimising impressions. However, understanding the extent of the disclosure may mean the disclosures may be de-coupled from the actual event, resulting in potentially misleading communication. Hence, understanding how the information is disclosed, by way of readability of the disclosures may provide a better understanding on the intentions of such disclosures, and their effects on organisational legitimacy dynamics.

Research in corporate disclosure readability and usefulness has been mostly conducted in developed economies. The results of the readability studies provide evidence that there is a mismatch between the level of comprehension used by the preparers of narrative disclosures and the readers of the annual reports (see for example, Courtis, 1986; Courtis, 1995; Courtis, 1997; Courtis, 2004; Jones, 1994; Li, 2008). Using alternative readability measurement tools (e.g. Flesch, Fog and Lix), these studies have revealed reading ease-level to be difficult to very difficult, thus suggesting a mismatch in ease of reading narrative disclosures between the preparers of those disclosures and their readers. Evidence

from this body of research has also indicated that the degree of reading ease-level in the corporate annual reports is consistent with a reader having attained at least an undergraduate degree. In most countries, this circumstance would mean that almost 90 percent of the population is excluded from comprehending easily at least some of the annual report message in its present form (Courtis, 1995).

Initially, studies attempted to assess the readability of components of the annual reports. Studies in the United States revealed that the reading ease-level was lower in the Chairman's address compared to the Footnotes (Jones and Shoemaker, 1994). Similar results were also seen in studies conducted in Hong Kong and Canada. The studies conducted in U.K. revealed lower reading ease-level compared to other countries (Jones and Shoemaker, 1994). Studies conducted in New Zealand showed average reading ease-level based on Flesch score to be moderate compared to other countries (Healy, 1977).

There have also been some atheoretical studies that examine the association between readability and other variables, including corporate profitability (Courtis, 1986; Subramanian *et al.*, 1993). These studies had inconclusive results as, Courtis (1986) did not find a strong correlation between readability and net profits, and Subramanian *et al.*, (1993) found that the annual reports of profitable firms are significantly easier to read than those of poor performers. In this study, we provide a theoretical basis for the relationship between readability and profitability, namely legitimacy theory, which we discuss next.

3. Legitimacy Theory, Corporate Legitimacy, and Profit

Legitimacy theory is considered to be a systems-oriented theory that permits us to focus on role of information and disclosure in the relationship between organisations, the State, individuals and groups (Gray *et al.*, 1996). Sourced from the broader political economy theory, legitimacy theory indicates that

organisations are not considered to have any rights to resources. (Deegan, 2002). Rather, organisations exist to the extent that a particular society considers that they are legitimate, and if this is the case, the society confers upon the organisation the state of legitimacy. Legitimacy theory, from a managerial perspective focuses on various strategies management may adopt to legitimise their actions or status (Deegan, 2002; Deegan and Rankin, 1996; O'Donovan, 2002). Conceptualised from organisational legitimacy, legitimacy theory is:

....a condition or status, which exists when an entity's value system is congruent with the value system of the larger social system of which the entity is a part. When a disparity, actual or potential exists between the two value systems, there is a threat to the entity's legitimacy (Dowling and Pfeffer, 1975).

Consequently, the general notion of legitimacy is the extent to which a firm conforms to the general expectation of the society in which it operates (Davisdon, 1996). Firms would like to achieve a congruence between their actions and achievements, and the expectations of the society, and firms will present their actions in favourable ways and concealing or justifying information that is less glorious (McGuire, 1997). This result is because legitimacy is conferred by outsiders to the firm (Buhr, 1998; Dowling and Pfeffer, 1975; Elsbach, 1994), but controlled by the firm itself. For an organisation, an understanding of how legitimacy can be gained, maintained, and lost is important. Wartick and Mohan (1994) suggest the following may result in a legitimacy gap:

- Corporate performance changes while a societal expectation of the corporate performance remains the same.
- Societal expectations of the corporation changes while the corporate performance remains the same; and
- Both corporate performance and the societal expectations change, but either move in different directions, or they move in the same direction, but with a time lag.

If an organisation can position itself on this scale of expectation mismatch, they may identify important manageable means to confer and withdraw legitimacy in their organisation.

Profit is the key indicator of a firm's health, and it is subject to numerous societal emotions. Thus, it is at the heart of legitimacy controversies (Breton and Côté, 2006). Societal perceptions of the firm and the level of profit depend upon the conditions within which the firm operates. While the for-profit firm's core responsibility is to make profit, an organisation is perceived to be excessively greedy on the quest for profit when it is tainted by its business practices. However, there is a shift towards social responsibility, owing to stakeholder theory, which suggests that the firm has a greater responsibility to a relevant public (Buhr, 1998; Neu *et al.*, 1998). In the lens of the stakeholder concept, the firm is part of the social structure, vested with the responsibility of production of goods and services by using the community resources. Consequently, in a market, under the social contract, firms are allowed to make a certain level of profit. When a firm exceeds this arbitrary profit limit, there is a perception by a segment of society that the firm is manipulating the given resources to increase its profits unduly, and it is in breach of the social contract that is the basis of any legitimacy (Patten, 1992). In a developing market, the near monopolistic nature of businesses is implicitly created by society and controlled by the government for the benefit of the society. Thus, these businesses are permitted to make 'acceptable profit' while providing goods and services to the society at a reasonable cost. Any justification for increased profit should be complemented with a better quality of service, or service at a lower cost. Profit is perceived as being necessary, but excessive if it reaches a certain level. If profit is made beyond a "reasonable" level, then the goal of the firm is to show that this excessive profit is resulting from comprehensive strategy (O'Donovan, 2002). Therefore, profit is the most important and widely disclosed notion about firms, and a major component of the legitimacy system (Breton and Côté, 2006).

Consistent with the legitimacy argument that profit is the most widely disclosed notion about firms, it is expected that the more profitable firms in emerging markets will make attempts to communicate more clearly to their stakeholders to justify the basis of increased profit. Therefore we propose:

P1: There will be a positive direct relationship between the levels of profit of firms and the reading ease of their corporate annual reports.

Prior studies have revealed that organisations respond to specific environmental performance threats to legitimacy through expanded use of voluntary reporting (see for example, Deegan and Rankin, 1996; Patten, 1992; Warsame *et al.*, 2002). The use of voluntary reporting provides management with greater freedom in the way in which they communicate their legitimacy. Thus, in addition to improving the volume of their legitimacy disclosure, firms may also take advantage of the flexibility, and improve on how such information is disclosed. In contrast, structured mandatory reporting may leave management with little freedom to manipulate the way in which they want their information to be disclosed. Despite the adoption of principle-based accounting standards in most developing countries, regulatory requirements provide management with few avenues to manipulate information disclosure. Therefore, we propose that:

P2: The relationship between the levels of profit of firms and the readability of disclosures in their corporate annual reports will be greater in non-mandatory disclosures than mandatory disclosures.

There is also evidence suggesting that managerial objectives for undertaking legitimising actions are contingent upon different contexts which influence the level of public exposure and public responsibility attached to a firm. Clarke and Gibson-Sweet (1999) argue that corporate disclosure policies are better described as ongoing means of reinforcing corporate legitimacy, rather than as a crisis management tool. They showed empirically that managers of bigger firms in sectors with a high public presence were additionally inclined to use their annual reports to capitalise on their investments

in the community and the environment by making more disclosures. Further, Toms (2002) showed empirically that the larger the organisational size and the more controversial the sector in which the organisation operates, the higher the quality of information disclosed. Therefore, we propose,

P3a: There will be a significant positive relationship between the size of the firm and the readability of disclosures in their corporate annual reports.

P3b: The relationship between the levels of profit of firms and the readability of disclosures in their corporate annual reports will be greater in public enterprises than in publicly listed companies.

4. Methodology

4.1 The Case of Fiji Islands - An Emerging Market

Our sample contains publicly listed and public enterprises in Fiji, a good candidate as an emerging market. The publicly listed companies have institutional and private shareholders, with the Board of Directors appointed by these shareholders. The public enterprises have majority Government shareholding, with the Board of Directors appointed by the Government. Fiji has a free capital market which, however, operates in a blocked shareholding environment. While the proportion of institutional and individual shareholders differ within listed companies, on average, about 80% of the shares on the publicly listed companies are held by institutional shareholders (South Pacific Stock Exchange, 2006). The capital market regulator, the Capital Markets Development Authority (CMDA) was formed in 1996 through the CMDA Act 1996 and facilitates the trading of shares through the South Pacific Stock Exchange (SPSE) (Capital Markets Development Authority, 2006). The CMDA records and releases current trading data on equities and bonds traded during SPSE call market sessions. At present, only a selected number of securities are issued and traded. These are shares, government and statutory authority bonds, government treasury bills, statutory authority promissory notes, corporate bonds, Reserve Bank of Fiji notes (issued for monetary policy purposes) and tradable term deposits.

4.2 *Measures of Readability*

Understanding financial information depends upon factors like style, content and format of disclosures. Consideration of style is one of the most common measures of readability (Courtis, 1995), and word and sentence length has been extensively used to measure the style dimension of readability of narrative disclosures in corporate annual reports (Courtis, 1995; Courtis, 1997). Effective communication of narrative accounting information depends upon the degree of synchronisation between the ability of the users to understand and the reading difficulty of the text. Word length is a good indicator of speed of recognition and sentence length determines memory span. The readability formulae are an appropriate tool to measure readability of narrative disclosures and they help in determining the level of synchronisation between the ability of users and the reading difficulty of text.

In this study, we use Flesch, Fog and Lix as measures of readability. Despite various reported limitations of the use of the readability formula as a measure of the level of synchronisation between the ability of users and the reading difficulty of text (see for example, Dreyer, 1994; Jones and Shoemaker, 1994; Sydserff and Weetman, 1999), this technique has been justified through an examination of validity data, i.e. the relationship between formula scores and estimates of readability arrived at from independent comprehensive testing (Courtis, 1995). The Flesch and Fog index were found to have correlation coefficients of 0.70 and 0.59 respectively with the McCall-Crabbs Standard Test Results in Reading (Courtis, 1995). The Lix measure, which is new in measuring readability in accounting reports, has been found to improve the speed and reliability of calculation and it is a reliable measure in five languages making it ideal to measure readability of narrative disclosures in annual reports (Courtis, 1986; Courtis, 1987).

Flesch is a reading ease score developed by a linguist, Rudolf Flesch, as a way of evaluating the readability of text. Flesch based his score on an algorithm that looks at the length of the words and sentences. The Flesch Reading formula is:

$$\text{Flesch Index} = 206.835 - 84.6 * \text{sylla}/\text{words} - 1.015 * \text{words}/\text{sent}$$

Where "sylla" is the number of syllables, "words" is the number of words, and "sent" is the number of sentences. The notion is text that includes many long sentences and big words will make things harder for the reader. Flesch scores range from 1 (near impossible) to 100 (as easy as it gets). A Flesch score of about 60 is considered normal, everyday English. The Gunning Fog index, developed by Robert Gunning, an American businessman is one of the simplest and most effective manual tools for analysing readability. Gunning defines hard words as those with more than two syllables. It is relatively easy to calculate and accurate within one grade level. The ideal score for readability with the Fog index is 7 or 8; anything above 12 is too hard for most people to read. The Bible, Shakespeare and Mark Twain all have Fog Indexes of about 6. Time, Newsweek, and the Wall St. Journal average about 11. The Laesbarhedsindex (Lix) measure considers the average number of words per sentence and the percentage of words of seven or more letters. The formula for calculating Lix is:

$$LIX = W/S + (100 * LW)/W \text{ where}$$

LIX = LIX index score

W = Number of words

LW = Number of long words (7+ characters)

S = Number of sentences

A low Lix score is consistent with a high level of readability.

4.3 Data

We collected data from the annual reports of all fifteen listed companies and fifteen public enterprises, including, government commercial companies, commercial statutory authorities, and statutory authorities for a period of five years (2001- 2005), thus considering the whole population. We used the

Chairman's report, and notes to the accounts separately for measuring the readability of narrative mandatory disclosures. Managing Director's/Chief Executive's report was considered for readability of non-mandatory disclosures. Three, hundred-word passages were randomly selected from each of these disclosures. Flesch, Fog and Lix readability scores were calculated using readability software for each of these sections for the five years. We use return on assets as a measure of firm profitability. Total assets are used as proxy for firm size.

5. Results

5.1 Descriptive Statistics

Table 1
Descriptive Statistics (N = 150)

	Minimum	Maximum	Mean	Standard Deviation	Kurtosis	Skewness
Chairman's Report						
Flesch	16.96	73.50	47.37	13.00	-0.68	-0.25
Fog	8.20	26.35	15.93	4.53	-0.76	0.27
Lix	46.00	110.00	64.21	11.79	0.98	0.80
Chief Executives Report						
Flesch	20.31	74.72	48.95	13.29	-0.82	-0.26
Fog	6.86	24.99	15.54	3.83	-0.03	0.13
Lix	46.00	100.00	61.59	9.26	2.83	1.18
Notes to Accounts						
Flesch	16.73	72.86	42.15	8.32	2.01	0.38
Fog	11.35	21.68	16.43	1.88	0.83	-0.09
Lix	53.00	79.00	64.87	4.95	0.30	0.19
Return on Assets	-10.55	59.64	10.76	13.97	2.38	1.33
Total Assets (000)	1180	494197	104435	137776	0.47	1.32

Table 1 presents the descriptive statistics for the independent variables and the dependent variables in relation to Directors Report, Chief Executives Report, and Notes to Accounts. The Flesch scores range between 16.96 and 20.31 at the lower end and between 72.86 to 74.72 at the upper end. Similarly, the minimum and maximum Fog scores range from 6.86 to 11.35 and 21.68 to 26.35 respectively. The Lix scores also follow a similar pattern. The maximum kurtosis is 2.38, with the skewness ranging from -

0.09 to 1.34. Total assets range from 1 million to 494 million with an average of around 103 million. The return on assets range from -10.55% to 59.64%, with an average of 10.76%.

5.2 Diagnostic Checks

We performed several diagnostic checks to ensure that assumptions of the analysis were not violated. We captured the residuals to test for normality using Kolmogorov-Smirnov test, and p-values did not indicate violation of the normality assumption. We also checked for heteroscedasticity using White’s test and did not see any issues. The Durbin-Watson statistic did not indicate any problem of serial correlation in the estimation. Finally, we tested for multicollinearity, and the Variance Inflation Factors (VIF) were below the threshold value of 10, suggesting multicollinearity was not an issue.

5.3 Profit and Overall Organisational Legitimacy

Table 2 provides the regression result of the relationship between profit and readability. Overall 8.6% of the variance in profit is explained by the readability scores. This result supports proposition 1. The relationship between the Flesch scores and profit is favourable (in the hypothesised direction), whereas the relationship between the Fog and Lix scores and profit is unfavorable.

Table 2
Readability Measures and Profitability (N=150)

Variable	Anticipated Direction	β	Sig	VIF
Flesch	+	0.499***	.000	3.094
Fog	-	0.292***	.000	4.123
Lix	-	0.057***	.000	3.094
R²		0.086	.000	
Adjusted R ²		0.075		
***p<0.01	**p<0.05		*P<0.10	(All tests are two tailed)

5.4 Profit, Readability, Mandatory and Non Mandatory Disclosures

Table 3 provides the regression results of the relationship between readability in Chairman’s Report, Notes to Accounts, and CEO Report and profitability. In the Chairman’s Report, 6.4% of the variance in profit is explained by readability of its report, which is also statistically insignificant (sig. 0.143). The Flesch and the Lix scores are favourably related to profit, but the relationship between Lix score and profit is statistically insignificant. In Notes to accounts, 21.6% of the variance in profit is explained by its readability.

Table 3
Readability Measures and Profitability for Mandatory and Non-Mandatory Disclosures (N=150)

Variable	Chairman’s Report (Mandatory)			Notes to Accounts (Mandatory)			CEO Report (Non-Mandatory)		
	β	Sig	VIF	β	Sig	VIF	β	Sig	VIF
Flesch (+)	0.477**	0.043	4.635	0.272**	0.038	1.724	0.760***	0.000	3.458
Fog (-)	0.573**	0.026	5.555	-0.529**	0.004	3.200	0.422*	0.055	4.391
Lix (-)	-0.058	0.732	2.428	0.486**	0.004	2.774	0.044	0.818	3.723
R²	0.064	0.143		0.216***	0.000		0.238***	0.000	
Adjusted R ²	0.03			0.187			0.199		
***p<0.01 **p<0.05 *P<0.10 (All tests are two tailed)									

The Flesch and the Fog scores are favourably associated to profit, which are also statistically significant. The notes to the account are in the middle-range of mandatory and non-mandatory disclosures. The magnitude of the relationship with profit is greater with the Fog index ($\beta = -0.529$) than the Flesch score ($\beta = 0.272$). Overall, a greater degree of variance in profit is explained by the readability scores from the Notes to the Accounts (21.6%) than from Chairman’s Report (6.4%). In the non-mandatory report, the CEO report, 23.8% of the variance in profit is explained by its readability

scores. The relationship between Flesch score and profit is favourable and significant ($\beta = 0.760$), while the Fog score share a marginally significant but unfavourable ($\beta = 0.422$) and the Lix scores share an unfavourable and statistically insignificant ($\beta = 0.044$) relationship with profit. Overall the readability scores of the non-mandatory disclosures explain a greater degree of variance in profit (23.8%) than the scores of the mandatory reports (6.4% and 21.6%). The results support proposition 2.

5.5 Profit, Readability, and Size of the Firm

Table 4
Readability Measures and Size of the Firm (Total Assets) (N=150)

Variable	Overall			Chairman's Report (Mandatory)			Notes to Accounts (Mandatory)			CEO Report (Non-Mandatory)		
	β	Sig	VIF	β	Sig	VIF	β	Sig	VIF	β	Sig	VIF
Flesch (+)	-0.588 ***	0.000	3.094	-0.827 ***	0.000	4.635	-0.267 *	0.059	1.724	-0.843	0.123	3.448
Fog (-)	-0.142	0.234	4.123	-0.404 *	0.090	5.555	0.208	0.277	3.200	-0.231 *	0.063	4.391
Lix (-)	-0.376 ***	0.000	2.798	-0.380 *	0.007	2.428	-0.341 *	0.057	2.744	-0.534 ***	0.000	3.723
R²	0.141 ***	0.000		0.190 **	0.001		0.086 *	0.062		0.226 ***	0.000	
Adjusted R ²	0.130			0.160			0.052			0.198		

***p<0.01, **p<0.05, *P<0.10, (All tests are two tailed)

Table 4 provides the regression results of the relationship between readability in the Chairman's report, notes to accounts, CEO report, and size of the firm (total assets). Overall, there is a significant positive fit of the model to the observed data ($R^2 = 0.141$, $p < 0.01$). However, only the Lix score has a favourable and statistically significant relationship ($\beta = -0.376$). With the individual reports, the readability scores of the CEO report (non-mandatory) explain the greatest variation in total assets (a proxy for size of the firm) ($R^2 = 0.226$, $p < 0.01$). Both the Lix and the Fog scores have a favourable and statistically significant relationship with total assets ($\beta = -0.231$ and -0.534) for the CEO report. Of the mandatory reports, the readability scores of the Chairman's report explain a greater variance in total

assets ($R^2 = 0.190$) with both the Lix and Fog scores having a favourable and significant relationship with total assets ($\beta = -0.404$ and -0.380). The readability score of the Notes to Accounts explain 8.6% variation in total assets. Only the Fog index had a favourable and statistically significant relationship with total assets ($\beta = -0.341$) Overall, the results support proposition 3a.

5.6 *Profit, Readability, and Type of Firm*

Table 5 (Panel A and B) presents the regression result of the relationship between readability of reports in annual reports and profit for publically listed companies and public enterprises. In PANEL A, overall, the results show that the readability score in reports of the publically listed companies explain 7.7% variance in profit, and in PANEL B, the readability scores reports of the public enterprises explain 17.3% variance in profit. This supports proposition 3b. In both types of firms, readability scores of the Notes of Accounts and CEO report explain the most variance in profit ($R^2 = 0.209$ and 0.201 , and 0.286 and 0.255 respectively). In both firm types, the Flesch scores share a favourable and statistically significant relationship with profit ($\beta = 0.486$ and 0.523).

In the publically listed companies (PANEL A), the Fog score in the notes to accounts shares a favourable and statistically significant relationship with profit ($\beta = -0.536$). In the public enterprises, Fog scores in the notes to accounts shares a favourable and statistically significant relationship with profit ($\beta = -0.613$), and Lix score in the Chairman's report shares a favourable but statistically insignificant relationship with profit. Overall, the results also provide additional support for proposition 2.

Table 5
Readability Measures and Profit in Publically Listed and Public Enterprises

PANEL A			Publically Listed Companies (N = 75)									
Overall			Chairman's Report (Mandatory)			Notes to Accounts (Mandatory)			CEO Report (Non-Mandatory)			
Variable	β	Sig	VIF	β	Sig	VIF	β	Sig	VIF	β	Sig	VIF
Flesch (+)	0.486 ***	0.000	3.194	0.385 **	0.041	4.165	0.283 **	0.038	1.628	0.688 ***	0.000	3.368
Fog (-)	0.282 ***	0.000	4.163	0.563 **	0.018	5.268	-0.536 **	0.004	3.125	0.436 **	0.044	4.289
Lix (-)	0.063 ***	0.000	3.138	-0.049	0.786	2.095	0.466 **	0.004	2.856	0.041	0.798	3.658
R ²	0.077 ***	0.000		0.058	0.132		0.209 ***	0.000		0.201 ***	0.000	
Adjusted R ²	0.065			0.029			0.177			0.171		

PANEL B			Public Enterprises (N = 75)									
Overall			Chairman's Report (Mandatory)			Notes to Accounts (Mandatory)			CEO Report (Non-Mandatory)			
Variable	β	Sig	VIF	β	Sig	VIF	β	Sig	VIF	β	Sig	VIF
Flesch (+)	0.523 ***	0.000	3.125	0.322 ***	0.000	4.128	0.486 ***	0.000	1.258	0.829 ***	0.000	3.125
Fog (-)	0.365 ***	0.000	3.958	0.568	0.321	5.365	-0.613 ***	0.000	3.025	0.122 *	0.086	4.059
Lix (-)	0.109 ***	0.000	2.965	-0.113	0.732	2.312	0.212	0.135	2.125	0.013	0.913	3.259
R ²	0.173 ***	0.000		0.077 **	0.003		0.286 ***	0.000		0.255 ***	0.000	
Adjusted R ²	0.161			0.061			0.273			0.241		

***p<0.01, **p<0.05, *P<0.10, (All tests are two tailed)

6. Discussion

In addition to its shareholders, understanding organisations' obligation towards other stakeholders is important. While much is said about this in developed economies, little is known on whether firms recognise this obligation in developing countries. Using legitimacy theory as our theoretical basis for asserting profit as a trigger for legitimising activities, the overall result of this study indicates that there is a favourable significant association between the readability of reports in firms' corporate annual reports and their profit. The results also indicate that this relationship is greater in the non-mandatory reports than the mandatory reports. In addition, the results also indicate that there is a positive and

favourable relationship between the size of the firm and its readability of the reports, and the relationship between the readability of reports is more favourable in public enterprises than in publicly listed companies.

From a legitimacy theory lens, it can be asserted that firms in Fiji, an emerging market, in fact are cautious of the concerns of the society when communicating information in their corporate annual report. The positive association between the readability of components of their reports and their profit implies that they make attempts to legitimise the size of profit to the stakeholders. This implication is supported by the fact that firms have taken the legitimising opportunity, as the readability of their non-mandatory disclosures were better in comparison to the mandatory components of their reports. Further, when we looked at the two mandatory reports (Chairman's report and Notes to Accounts), greater variance shared between profit and readability of notes to accounts (a less rigid mandatory discourse) indicate that firms do take the opportunity provided, even in mandatory reporting, to explain their performance to stakeholders in an event of improved profitability.

We did not find favourable relationship between all measures of readability and the firms' profit levels. One possible explanation is that while firms may use readability as a tool to legitimise their level of profit, this benefit is not explored to its maximum. This could owe to the fact that while there is certainly a need to justify a particular profit level, the level of justification required may not what one would expect in developed market. There is a potential for future research to explore this through a comparative study.

From a theoretical perspective, the results are indicative of support of legitimacy theory in an emerging market context. While the magnitude of readability scores ability to explain variance in profitability is

not substantial, it is statistically significant. The legitimacy theory has shown to be a suitable framework to assessing and understanding whether and how firms in emerging markets legitimise their profits. The study has also provided support that legitimacy theory can not only be used to test the ex-post “what is reported” aspect of legitimacy, as shown by prior studies (for example, Deegan *et al.*, 2000), but “how” firms report in an attempt to legitimise. Similarly, it can be accorded that firms not only legitimise by increasing the volume of their reporting, but also by managing how they disclose their legitimising information.

Profit has shown to be an important aspect for firms and the society in an emerging market. Despite the existence of a near monopolistic market for both private and public service, and a relatively stagnant capital market, firms see the need to inform society of how profit is achieved. There is an implicit indication that firms are aware of the society’s concern for equitable provision of service, where there is a need for balance between the health of firms and level of service provided. In an event of improved profit, firms have taken the opportunity provided in their corporate annual report to communicate their operations in a way to legitimise this change in the profit. Larger firms are also aware of their capacity, and the society’s expectation on them in relation to their existence and profit, and have made better attempts to present their arguments relating to profit.

7. Limitations

This study has both strengths and limitations. First, the seemingly modest sample size of 30 firms might be a concern. However, the firms included in the study represent all the firms in the developing country and data is collected for five years, effectively creating 150 datasets. The firms represent a number of sectors, and because Fiji is the most successful of the developing countries within the South Pacific jurisdiction, we feel the firms are representative of those in the developing countries. However,

including other countries in future research should provide richer insights on the extent of profit legitimisation by firms in developing countries.

Second, even though the empirical analysis was conducted on the whole population, owing to a small number of firms in the respective sectors, making sector specific generalisations may be limited, and perhaps not feasible. Including more, similar companies may help in making such generalisations. Furthermore, because the methodology is cross-sectional, we only show association, not causality. The data shows that variance in profit is associated with certain measures of readability, and thus, readability as a tool is used by firms for legitimising purposes. Further study would be needed to show causality and the question of sustainability.

Finally, firms use numerous instruments to communicate to stakeholders. Our study has considered one instrument - the corporate annual report. Thus, it is also not feasible to generalise that firms use readability tools in all forms of communication to justify profit. However, the corporate annual report is the key corporate communication instrument, and a key source of information of firms' health.

8. Conclusion

This study used readability as a tool to understand the profit of a firm and its legitimacy efforts in an emerging market. The results indicate that firms perceive profit as an outcome that society has its concerns about, and therefore, make attempts to legitimise achieving a certain level of profit. This study also provides support for legitimacy theory in an emerging market context. Emerging markets, within themselves, differ in terms of proportion of local and international investment, the make-up of stakeholders, and societal and organisational culture. This study could be expanded to other emerging markets to obtain a broader understanding on the role of firm's profit and related legitimacy actions to

ensure firms have continued consent to operate in a society, and concurrently understand the legitimacy theory's capability in explaining this phenomenon.

This study considered the variability in the extent of profit legitimacy in publicly listed companies and public enterprises. Studying a number of emerging markets could allow for greater segmentation within the lines of industry, nature of service provided, market concentration, and the ownership nature of the firms. Such segmentation could provide more detailed and richer insights into the roles of profit for both the firms, and the society that permits the firms to operate in particular jurisdiction.

Firms use numerous ways to communicate information to relevant stakeholders. This study has considered the formal and perhaps the most important tool of corporate communication; the corporate annual report. Future studies may wish to expand this study to include other mediums that firms use, and understand the meaning of profit for both the firms and relevant stakeholders. Such mediums may include press releases, frequent reports, and formal executive speeches.

The pressures of a global economy mean that firms are facing the challenges of achieving a balance between earning profits for their continued survival and at the same time ensuring that their 'permission to operate' remains intact. The emerging markets of the developing economies are no different. Profit of a firm plays an important role in demonstrating the wealth of the firm and at the same time may let the society perceive that this wealth may have resulted from the misuse of resources vested to the firms. Evidence of some legitimising attempt are a positive sign, especially in an emerging market with near monopolistic environment, as it suggests that firms are considerate of their wider role in the society.

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