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Strategic Drivers of Sustainable Financial Performance: A Legitimacy Theory Perspective on Aligning Strategy with Sustainability and Profitability

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ABSTRACT

This research examines how corporate social responsibility (CSR) influences sustainable financial performance (SFP) through frugal innovation and ambidextrous innovation as mediators. In this research, primary data was gathered from 318 CEOs, CFOs, and finance managers of Palestinian listed companies. The results were analysed using Smart-PLS software. It was found that CSR activities had a significant positive effect on the SFP of Palestinian listed companies. Moreover, innovation ambidexterity mediates the relationship between CSR and SFP, whereas frugal innovation does not. This study reveals that companies aligning their CSR activities with society's expectations will see an increase in SFP through the lens of legitimacy theory. In addition, companies adopting an ambidextrous approach to innovativeness can attract investors and increase their SFPs.

Keywords: CSR activities, frugal innovation, innovation ambidexterity, sustainable financial performance

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INTRODUCTION

The COVID-19 pandemic exposed financial weaknesses across companies at all levels, especially in developing or conflict-affected areas such as Palestine (Midões & Seré, 2022). Companies in these regions face far greater financial hardship than those in stable, developed parts of the world (Iram et al., 2023). Publicly listed companies in conflict zones also face challenges

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in maintaining operations, leading to significant cost reductions through cuts in CSR investments to maintain profitability (Nave & Ferreira, 2019). Publicly listed companies are under pressure from their stakeholders to maintain financial stability during periods of uncertainty; therefore, publicly listed companies will need to create new structures and optimise their business processes (Awa et al., 2024).

Cutting back on CSR spending during hard financial times erodes the trust of both investors and stakeholders and creates an environment that threatens the company's very existence. Biggeri et al. (2023) revealed that companies that properly followed sustainable practices over the last 10 years achieved an 8.1% return, while those that did not achieved only a 4.7% return. Companies that have committed to investing in financial sustainability benefit from lower capital costs and operational risk, which usually translate into strong long-term financial performance and increased survival during economic downturns (Shan et al., 2024). Additionally, a financial advisory company reported that businesses in the top quartile for CSR spending experienced a 21% lower cost of debt and a 49% lower stock return volatility compared to those in the bottom quartile (Voinea et al., 2020).

As Saeed and Riaz (2021) found, if publicly listed companies want to continue to thrive, they must be able to effectively navigate an uncertain economic environment and respond to stakeholders' social and environmental concerns. For example, 67% of consumers are inclined to support businesses with a proven commitment to addressing environmental and social concerns. Furthermore, over 60% of the 500 largest companies globally now require reporting of their expenditure on social and environmental challenges (Alfalih, 2023). Additionally, Huang (2022) found that 88% of institutional investors consider environmental, social, and governance (ESG) criteria when making investment decisions. Similarly, Badwan and Atta (2021) report that high levels of investment inflows improve sustainable performance. In another study, however, Tabbaa (2020) noted the need for an additional research into developing and unstable economies such as Palestine. There is also a dearth of literature linking CSR activities to the establishment of trust amongst investors and other stakeholders, thereby facilitating public investors' investment in listed companies cand enhancing their SFP in difficult-to-operate locations. This leads to the first research question:

RQ 1 : Do CSR activities increase the SFP?

Frugal innovation reduces resource use, waste, and costs while offering sustainable, affordable products or services (Niroumand et al., 2020). It has the potential to reduce operational costs for companies and enhance their access to capital, leading to sustainable development. Iqbal, Ahmad and Li (2021) also shown that frugal innovation can reduce capital expenditure and operational risks for companies, thereby enhancing profitability and competitiveness in the marketplace. Hossain et al. (2023) has employed the concept of frugal innovation to illustrate how to generate greater value with fewer resources, thereby promoting environmental sustainability, aiding local communities, and fostering economic development. Al Masud et al. (2025) showed that companies focusing on cost-effective, innovative strategies for customer well-being can achieve financial success while also fostering positive social and environmental effects. Nevertheless, further investigation is necessary to determine how to effectively apply and expand frugal innovation across various industries and contexts. Additionally, the concept of frugal innovation remains relatively novel among publicly traded companies in developing and unstable nations such as Palestine (Dima et al., 2022). Additionally, we must explore how frugal innovation can enable listed companies to gain the trust of investors and stakeholders in fulfilling CSR responsibilities and attract investments to secure SFP. So, this leads to the second research question:

RQ 2 : Does frugal innovation act as a mediator between CSR initiatives and SFP?

Innovation ambidexterity refers to a firm's ability to pursue both exploration and exploitation, thus achieving sustainable competitive advantage. Prior research indicates that companies that manage their exploratory and exploitative innovation activities—innovation ambidexterity—are better equipped to allocate resources to new and existing products and services, adapt to market changes, and achieve improved financial performance results (Ceptureanu et al., 2022). Firms with cultures of continuous improvement, risk and uncertainty management, and execution capability are more likely to achieve innovation ambidexterity and stronger organisational financial performance. Firms that engage in innovation ambidexterity can successfully implement CSR practices into their overall financial strategy (Khan, Chen, & Hung, 2021). However, due to conflicting priorities, limited resources, and resistance to change stemming from unstable and unpredictable circumstances, many firms struggle to balance exploration and exploitation (Litrico & Lee, 2008). Additionally, the current literature does not address how innovation ambidexterity can enhance CSR initiatives among publicly listed companies while maintaining long-term financial stability. This leads to the third research question:

RQ 3 : How does innovation ambidexterity mediate between CSR activities and SFP?

THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

Theoretical Framework

Legitimacy theory is key to understanding corporate behaviour. It also offers valuable insights into the actions of corporate firms.

A company is considered resilient in terms of its survival when its stakeholders and community members regard it as a legitimate entity. Kähkönen et al. (2021) revealed that companies can swiftly lose the public's trust, and it may lead to failure. To sustain legitimacy, a key approach is to engage in CSR activities. When a listed firm takes initiatives for societal and environmental well-being, it is considered to enhance its legitimacy. It can be argued that listed firms that implement their CSR activities efficiently and effectively, using various strategies and innovative techniques, can gain a more positive image than firms that do not. So, publicly listed companies that implement innovative strategies such as frugal innovation or ambidexterity in their CSR efforts can improve efficiency and reduce operational costs. Berry et al. (2025) make a compelling case that when companies are committed to addressing their societal needs in an efficient and responsible way, their first goal is to create financial value, and their second goal is to boost their legitimacy. In this way, they achieve long-term financial success. Such an approach, adopted by listed companies, develops a well-connected framework that ties together the ideas of legitimacy, CSR, and innovation. So, this connection contributes to increasing the companies' financial performance.

Hypothesis Development

Sustainable Financial Performance

SFP is basically a company's ability to be profitable and stay financially viable for long-term survival. Previous researchers have pointed out various studies. For example, Zeng et al. (2024) point to environmental sustainability. They argued that, factors like waste reduction or green energy production can lead to significant cost savings. On a different tack, Habtoor et al. (2024) looked inward at governance. They found that structures such as an independent board or strong shareholder ownership can boost firm performance. Schäper et al. (2023) investigated role of innovative activities. They revealed that, how innovation capabilities can fuel financial performance in developed nations. Despite this research, we have found a glaring gap. Scholars seem less inclined to investigate SFP in contexts like Palestine. This context has unique environment due to political instability, economic volatility, and real scarcity of resources. Our literature is filled with stable environments, but how SFP is achieved under such duress is a wide-open question.

Corporate Social Responsibility

CSR denotes a company's dedication to conducting its operations ethically and with social responsibility, taking into account its effects on society and the environment (Tamvada, 2020). Previous studies have examined the effects of CSR on various aspects influencing company performance. Dela et al. (2024) systematic review revealed that CSR activities influence the company's financial performance, customer satisfaction, employee satisfaction, and digital innovative performance.

Wang et al. (2021) have also investigated CSR's influence on a company's reputation, brand image, and stakeholder perceptions.

However, the literature still lacks consensus on the effect of CSR practices on achieving SFP in developing countries like Palestine, where access to resources is limited, and challenges are unique. Chen et al. (2019) found that governance structures and companies' innovation capabilities positively influence the financial performance of companies in developed countries. Companies engaged in environmentally sustainable practices, such as waste reduction and energy efficiency, can save on financial resources. Moreover, Al-Matari (2019) found that the presence of an independent board of directors and higher levels of shareholder ownership were positively associated with improved financial performance. The legitimacy theory also holds that listed firms actively engaged in CSR are more likely to gain legitimacy and reputation among stakeholders. Thus, they can attract investment capital, foster customer loyalty, and gain financial benefits. The literature indicates a link between CSR activities and a company's financial performance in both developed and developing countries. How listed companies practicing CSR in turbulent regions like Palestine can meet SFP requirements warrants investigation. So, it leads to a hypothesis:

H1 : CSR practices have a positive link with the SFP.

Frugal Innovation

Designing affordable and accessible goods, services, or processes that fulfil customers' needs with minimal resources (Mogaji et al., 2021) is one of the main objectives of resource-constrained developing nations' embrace of frugal innovation. This is a growing area of research, with studies examining how such innovations affect product quality, customer satisfaction, market share, and financial results (Cuevas-Vargas et al., 2022). Other researchers Soomro et al. (2025) examined various factors influencing frugal innovation: resource scarcity, technological potential, and market dynamics. However, there is an urgent need for research on the relationships between CSR practices and the SFP of public companies.

Knizkov and Arlinghaus (2021) revealed that frugal innovation can help lower operational costs for companies while increasing their efficiency and therefore provides high returns on investment. Also, companies that use frugal innovation can create a positive image to attract investors seeking socially responsible investments. Iqbal, Ahmad and Halim (2021) revealed that companies using frugal innovations can sustain performance. Literature shows a positive link between CSR and financial performance but little research on frugal innovation's mediating role. Furthermore, firms listed on the stock exchange that are utilising frugal innovations convey a commitment to social and environmental issues through their operations. By doing so, they build trust among stakeholders, gain a competitive advantage by offering low-cost products, and positively influence revenue growth and sustainability. Based on this, we propose our hypothesis:

H2 : Frugal innovation mediates between CSR activities and the SFP.

Innovation Ambidexterity

Innovation ambidexterity refers to a company's capacity to explore new opportunities while leveraging existing capabilities (Ceptureanu & Ceptureanu, 2021). X. Zhao et al. (2021) suggests that innovation ambidexterity is crucial for firms that face rapid technological change and intense competition. Other studies have explored the antecedents and outcomes of innovation ambidexterity, including organisational culture, leadership style, and company performance (Muhammad et al., 2021). However, a research gap exists on how innovation ambidexterity influences SFP and relates to CSR in Palestinian listed companies.

Buccieri et al. (2020) revealed that innovation ambidexterity contributes to an organisation's performance by enabling it to respond to changing market conditions, maintain a competitive advantage, and develop a culture of continuous innovation. W. Zhao et al. (2021) further supported by demonstrating that firms that exhibit high levels of innovation ambidexterity achieve greater financial returns, an increase in market share, and demonstrate improved overall competitive advantage. Khan, Chen, Suanpong, et al. (2021) demonstrated that companies practicing social responsibility are typically more innovative and agile, which aligns with the innovation ambidexterity concept.

CSR initiatives enable organisations to meet societal expectations, reflect their ethical behaviour and environmental responsibility, and thereby increase their legitimacy with stakeholders (Ellemers & Chopova, 2021). Concurrently, innovation ambidexterity, the ability to explore new possibilities and exploit current resources, allows organisations to exploit CSR initiatives as a means of achieving a competitive advantage and creating innovation (Broadstock et al., 2020). An organisation’s strategic approach to innovation will enable it to develop new products, processes, and business models, while simultaneously optimising its current capabilities to enhance operational efficiency and strengthen its relationships with stakeholders.

H3 : The role of innovation ambidexterity as a mediator linking CSR activities and sustainable financial performance.

Figure 1 shows the conceptual framework for hypothesis development.

RESEARCH METHODOLOGY

Materials and Methods

This research employed a cross-sectional study design and utilised a purposive sampling technique to gather primary data from the Chief Executive Officers (CEOs),

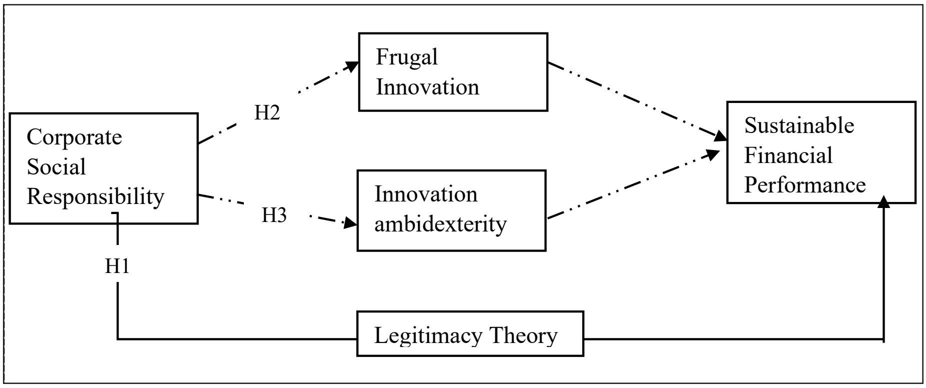

Figure 1. Conceptual Framework

Chief Financial Officers (CFOs), and finance managers of publicly listed companies in Palestine. This study used a purposive sampling technique because the selected respondents hold decision-making roles, possess the requisite knowledge, influence corporate strategies and financial decisions, and have experience relevant to the research questions. The data were collected face-to-face and through WhatsApp. We distributed 500 questionnaires and received 362. After going through the security phase, 318 questionnaires were finalised for data analysis. This study selected companies based on their market capitalisation, total assets, and financial performance such as profitability and revenue growth. The rationale for this criterion is that larger, more financially stable firms may have more established governance practices and greater capacity for innovation. Moreover, firms with more than five years of operational history are listed on the Palestinian Stock Exchange.

The research utilised published validated scales from high-quality academic sources. The survey used a 5-point Likert scale to assess responses from the CEOs, CFOs, and finance managers of publicly held companies located in Palestine. The use of the Likert scale facilitates measuring how people feel toward different issues. The Likert-type scale ranged from one (1) being Strongly Disagree to five (5) being Strongly Agree. The CSR scale (Harrison et al., 2020), with a total of nine (9) items, was used. A 7-item unidimensional frugal innovation scale was utilised from (Rossetto et al., 2023). A four (4)-item SFP scale was utilised from (Carson & Westerman, 2023). Finally, an 8-item innovation ambidexterity scale was utilised from (Le et al., 2023).

RESULTS AND DISCUSSION

After performing assessments for inner model and meeting the outer model requirements, we performed bootstrapping with 5,000 subsamples to test hypotheses and evaluate structural model in Smart-PLS. We also performed a two-tailed test at the 0.05 significance level to assess significance of the path coefficients (beta values), t-values, and R^2 values.

The outcomes of direct paths are displayed in Table 1. According to the direct path results, the listed businesses' SFP is significantly improved by CSR actions (H1: $\beta = 0.417$, $p = 0.001$, $t = 13.62$).

Table 2 depicts how frugal innovation and innovative ambidexterity work as mediators between CSR efforts and SFP. Table 2 indicates that frugal innovation (H2: $\beta = 0.012$, $p = 0.254$, $t = 1.061$) does not mediate the connection, whereas innovative ambidexterity (H3: $\beta = 0.368$, $p = 0.002$, $t = 13.175$) does.

The results of three hypotheses were examined in relation to legitimacy theory. The findings revealed a positive and significant relationship between CSR initiatives and SFP among listed companies; therefore, H1 has been confirmed. This is consistent with (Song & Rimmel, 2021), who suggested that firms that implement CSR measures tend to have better financial performance overall. Legitimacy theory states that CSR measures help firms meet social norms of legitimacy and attract investors, customers, and regulators. Palestinian-listed firms fulfil their societal obligations by investing in their local communities, pursuing environmental sustainability goals, and maintaining ethical business conduct; in turn, they improve their reputation and build credibility for socially responsible performance.

H2 results reveal that the mediational effect of frugal innovation does not exist for SFP and CSR initiatives. H2 was rejected. Previous research Algarni et al. (2023) also found that cutting innovative activities might not yield a competitive advantage or positive revenue. This is consistent with legitimacy theory, which holds that CSR efforts by publicly listed companies do not inherently confer legitimacy or yield financial gains through frugal innovation, especially in Palestinian businesses and amid their unique challenges. Although

Table 1
Direct path analysis

Hypothesis	Direct Path	Co-efficient	t-value	p-value	Decision
H1	CSR→SFP	0.417	13.62	0.001	Accept

Note. SFP = Sustainable Financial Performance; CSR= Corporate Social Responsibility
Source: Author's calculation

Table 2
Mediating path analysis

Hypothesis	Mediating Path	Co-efficient	t-values	p-value	Decision	BCI-LL	BCI-UL
H2	CSR→FI→SFP	0.012	1.061	0.254	Reject	-0.021	0.053
H3	CSR→IA →SFP	0.368	13.175	0.002	Accept	0.331	0.448

Note. FI = Frugal Innovation; CSR = Corporate Social Responsibility; IA = Innovation Ambidexterity; SFP = Sustainable Financial Performance
Source: Author's calculation

organisations may achieve legitimacy and gain stakeholder trust through CSR initiatives, the role of frugal innovation in achieving SFP appears limited in this case.

H3 supports the view that innovative ambidexterity mediates the association between CSR and SFP. Prior attempts Abbas (2024) find that firms who are socially responsible tend to be more innovative/agile, thus supporting the definition of innovative ambidexterity. The legitimacy company theory provides a basis for companies to develop future innovations from their CSR activities, motivating employees to pursue innovative ideas and to use current technology/resources to yield new products and services, as well as innovative cost savings from resource efficiencies, resulting in financial success.

Theoretical Implication

The present study has proposed a few theoretical implications. This study sheds light on how CSR initiatives, transparency, and innovation among listed companies operating in conflict zones such as Palestine can enhance their SFP. Firstly, listed companies engaged in CSR initiatives can increase their legitimacy. In this way, they win stakeholders' trust, encourage investment in their companies, and may subsequently achieve SFP. Second, listed companies that engage in CSR activities, explore new ones, and expand existing ones are involved in cost-effective, innovative activities. Such initiatives can help them to achieve SFP in conflict-ridden regions. It highlights that using CSR activities in innovative ways can promote a culture of innovation adoption. It can drive value addition in creativity and competitive advantage. Third, this study contributed to the literature by showing that propensity for innovation can mitigate the effects of political instability and economic uncertainty. It also increases the resilience of listed companies to attain SFP.

Practical Implications

The present study has practical implications for professionals and policymakers. Based on the results of this study, they can make informed decisions to use their resources efficiently and effectively in conflict zones like Palestine and achieve SFP. This study suggests that professionals should guide listed companies in reviewing their CSR strategies and aligning them with societal expectations. In addition, they should urge them to make communication transparent within listed companies. Listed companies should communicate their CSR efforts to their stakeholders. Enhancing a listed company's transparency practices can improve its legitimacy, trust, and financial performance, aligning with societal expectations.

Furthermore, policymakers need to create frameworks that require publicly listed companies to implement CSR initiatives and disclose how these initiatives contribute to sustainable development and social welfare in areas of conflict. Another point to note is that the current research did not show any impact of frugal innovation on the operations of listed companies; this may be due to these organisations' resource limitations. According to Tröster and Küblböck (2020), lack of local resources in developing countries is an impediment to innovation. To foster frugal innovation, policymakers need to create opportunities through CSR policies and transparency to advance the development of cost-effective, sustainable solutions. Companies that use CSR activities to promote frugal innovation and are transparent will develop a culture of innovation that creates value by improving productivity while fostering resilience and competitive advantage through effective resource use.

Lastly, listed companies should empower their employees to explore new ideas, optimise existing processes, and leverage CSR objectives and transparent communication practices to drive innovation ambidexterity. By integrating CSR, organisational transparency, and innovation into the strategic planning and decision-making process, listed companies can attain a strong competitive advantage, enhance stakeholder relationships, and achieve SFP in conflict zones similar to Palestine.

LIMITATION AND FUTURE RESEARCH

The limitations of this empirical study suggest that the results may lack generalisability or applicability. Data were collected by the researchers at a single time and location, which may have introduced common method bias; however, there was no such bias in this analysis. Future researchers may wish to employ longitudinal or experimental designs to reduce common method bias and establish causal relationships. The study focused on Palestinian companies in conflict zones with limited resources, which may limit the generalisability of these results to other settings. Future studies should determine the extent to which conflicted and non-conflicted areas can be compared to gain greater insights into this event.

CONCLUSION

Conclusively, this study emphasises the importance of CSR initiatives and innovative approaches to achieving SFP for companies listed in Palestine. This study revealed that companies prioritising CSR activities and demonstrating a commitment to societal responsibility can still achieve positive financial outcomes even during challenging economic and political circumstances. In addition, listed Palestinian firms engaged in frugal innovation activities do not play a significant role due to complex contexts, resource scarcity, and unrest. Furthermore, the findings suggest that listed companies can maximise the potential benefits of CSR initiatives and enhance their financial performance by adopting a balanced approach to innovation involving exploitative and explorative strategies. The study demonstrates how innovation ambidexterity mediates between CSR activity and SFP through innovation. Companies that are listed can engage in innovative activities, including frugal and ambidextrous forms of innovation, to achieve SFP by focusing on transparency in their CSR efforts.

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