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The Durable Corporation

Strategies for Sustainable Development

Güler Aras and David Crowther

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Strategies for Sustainable Development

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Foreword

Recently such issues as climate change have come to the fore, not just in public life and not just in business life but for society generally. This is true throughout the world – everyone is noticing these changes and accepting that global warming is taking place and causing such change. And climate change is a topic of conversation all over the world. This popular acknowledgement has only happened in the last couple of years. At the same time there has been a general recognition of the idea of sustainability and that this is an issue which needs to be addressed – at a societal level, at a local level, at a personal level and – more significantly in terms of the focus of this book – at a business level. Thus the term sustainability has become ubiquitous both within the discourse of globalisation and within the discourse of corporate performance. Sustainability is, of course, a controversial issue and there are many definitions of what is meant by the term, something which we need to address early in this book.

A simple definition of sustainability is that life will just carry on unchanged. This is a comfortable definition which enables those of us who accept it to make as little effort as possible to change our way of life. It may be comfortable but plainly it is unrealistic – things are changed even by us carrying on in an unchanged manner! At the opposite end of the spectrum is the deep green approach of returning to the illusory *golden age* prior to industrial development – a kind of mass adoption of the Amish[1] way of life, with a cosy but unquestioned assumption that life was simpler and therefore happier then. This, too, is unrealistic. We certainly do not wish to return to that way of life – without the computers to enable us to write this book and the printing technology to enable it to be produced so that you can read it – and we do not know anyone else who wants this option either. So plainly another sort of sustainability must be sought.

Another approach to sustainability, which is common for many people, is that sustainability is concerned with the use of environmental resources – and so we must make sure that we do not print out emails and that we recycle

1 The Amish are a religious sect based in eastern USA who have steadfastedly maintained a way of life from the seventeenth century – at least according to popular belief and the Harrison Ford film! An investigation readily shows this to be untrue.

our bottles and the problem has been addressed. This may be slightly facile but this approach to sustainability implies that society must use no more of a resource than can be regenerated. This can be defined in terms of the carrying capacity of the ecosystem and described with input-output models of resource consumption. Viewing an organisation as part of a wider social and economic system implies that these effects must be taken into account, not just for the measurement of costs and value created in the present but also for the future of the business itself. Such concerns are pertinent at a macro level of society as a whole, or at the level of the nation state but are equally relevant at the micro level of the corporation, the aspect of sustainability with which we are concerned in this work.

As far as corporate activity is concerned then most analysis of sustainability only recognises a two-dimensional approach of the environmental and the social. A few writers recognise a third dimension which is related to organisation behaviour. We argue that restricting analysis to such dimensions is deficient. One problem is the fact that the dominant assumption by researchers is based upon the incompatibility of optimising both financial performance and social/environmental performance. In other words, financial performance and social/environmental performance are seen as being in conflict with each other through this dichotomisation. Consequently most work in the area of corporate sustainability does not recognise the need for acknowledging the importance of financial performance as an essential aspect of sustainability and therefore fails to undertake financial analysis alongside – and integrated with – other forms of analysis for this research. This, too, is based on an unrealistic understanding which obscures a full debate.

We can see, therefore, that there are many issues which are currently subject to debate within the discourse of sustainability. It is our opinion, however, that these are often neither addressed in a rigorous manner nor expressed in a way in which the practical implications are apparent. The aim of this book is to address these limitations. Moreover, although there are numerous books concerned with sustainability, the majority of them are concerned with either environmental issues or with an aspect of the concept of sustainable development. Our approach is based upon rigorous analysis but is applied to corporate behaviour in order to provide a practical aspect to our analysis, and to offer an approach to corporations seeking to improve their sustainability.

When we started to work in this area we were vaguely dissatisfied with what was being said about sustainability without being quite certain why. Like most people we tended to just accept the standard definition of sustainability being about not affecting the choices available to future generations, as developed by the Brundtland Commission over 20 years ago. Now we realise that this is plainly ridiculous; not just is it flawed in its definition but the acceptance of it as the starting point has actually prevented discussion and analysis based upon an alternative and more useful approach – or even from developing such an approach. As we have worked through our analysis of sustainability as applied to corporate activity we have come to realise what the problems are with analysis based upon Brundtland and its descendants – such as the notion of the triple bottom line. We have also come to realise what the key issues are and to build them into our analysis. The end result of our analysis is this book, where we have explained the issues, analysed the strategies and from this have developed our own view and proposed some different strategies which we believe will actually address the issue of sustainability. Indeed we consider that our approach also encapsulates the factors involved in sustainable development – which is not synonymous with sustainability – and provides the basis for developing some realistic strategies for corporations to engage in sustainable development.

Naturally we consider that our analysis is useful and provides some realistic and practical proposals to enable corporate managers to develop appropriate strategies. The feedback we have received when we have presented our ideas and analysis at conferences and seminars around the world, over the last couple of years, suggests to us that others also see merit in our work. Now that it appears all together in this book we hope that you, the reader, also find it equally relevant and practical – and more importantly helpful in the development of corporate strategies to enable sustainable development.

Güler Aras and David Crowther

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1

Introduction: Why Sustainability Matters

Introduction

Most corporations in the world are currently trying to distance themselves from the excesses and misbehaviours which have been manifest in recent years by those corporations which have been symbolised as *rogue* corporations.[1] Many would consider that these corporations have, however, behaved no differently to most others and have merely been found out in their misdeeds. Nevertheless, the distancing of the rogues from the rest has led to a tremendous resurgence of interest in behaviour which has been classified as corporate social responsibility (CSR). So, corporations have been busy repackaging their behaviour as CSR and redesignating their spinmasters as Directors of CSR, for many people would say that there is much evidence that little has changed in corporate behaviour except for this repackaging – the power of the semiotic being far more potent in the modern world that the power of actual action, and also obviating the need for such action. In this book we do not take this position, holding a view that all corporations are a mixture of good and bad practice just as much as all people are – so cataloguing the bad might be easy and entertaining but hardly constructive.

Crowther and Rayman-Bacchus (2004a) have argued that the corporate excesses, which are starting to become disclosed and which are affecting large numbers of people, have raised an awareness of the social behaviours of corporations. This is one reason why the issue of CSR has become a much more prominent feature of the corporate landscape. There are other factors which have helped raise this issue to prominence and Topal and Crowther

1 Enron is, of course, the best known of these but there are many more examples of corporations exhibiting bad behaviour, although probably not quite on the same enormous scale. There are many examples from many countries – too many to try to catalogue.

(2004) maintain that a concern with the effects of bioengineering and genetic modifications of nature is also an issue which is arousing general concern. At a different level of analysis, Crowther (2000a, 2002a, 2002b) has argued that the availability of the World Wide Web has facilitated the dissemination of information and has enabled more pressure to be brought upon corporations by their various stakeholders. But, Wheeler and Elkington (2001: 1) talk about the end of the corporate environmental report due to the fact that historically this report has not engaged stakeholders and it appears to be:

> *'the development of truly interactive (cybernetic) corporate sustainability and communications delivered via the internet and other channels.'*

Another point of view, about the diffusion of information and its impact,[2] was presented by Unerman and Bennette (2004), who explain the difficulties in identifying all stakeholders that are affected by a corporation's activity. All these perspectives, therefore, raise the question as to what exactly is CSR and how can it manifest and to what exactly can be considered to be CSR. According to the EU (2001: 8):

> *'… CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.'*

From these various writings about CSR we can infer that the idea of the corporation as a social enterprise is not new and has resonance with earlier ideas such as those of Dahl (1972: 18), who stated:

> *'… every large corporation should be thought of as a social enterprise; that is an entity whose existence and decisions can be justified insofar as they serve public or social purposes.'*

Shaw (2004: 196) explains that the principal characteristics of a social enterprise are:

(i) the orientation, *'… directly involved in producing goods and providing services to the market, making an operating surplus …'*

2 Unerman and Bennette (2004: 702) explain the interactive ways that the financial report could exist. For them:

> *'… it is not possible to ascertain from the web forum (i.e., it is a mechanism to ensure movement towards inter subjective acceptance by all stakeholders of the corporate responsibilities recognised) the extent to which postings have actually affected corporate decisions.'*

(ii) the aim, *'… explicit social aims (job creation, training or provision of local services), strong social values and mission (commitment to local capacity building), accountable to their members and wider community for their social, environmental and economic impact.*[3] *The profits are to their stakeholders or for benefit the community.'*

(iii) and the ownership, *'… autonomous organizations with loose governance and participation of stakeholders in the ownership structure.'*

All definitions – and there are many – seem to have a commonality in that they are based upon a concern with more than just profitability and returns to shareholders. Indeed, involving other stakeholders and considering them in decision-making is a central platform of CSR. The broadest definition of CSR is concerned with what is – or should be – the relationship between the global corporation, governments of countries and individual citizens. For example, the Organization for Economic Cooperation and Development (OECD) has studied investment in weak governance zones.[4] More locally, the concept of CSR is concerned with the relationship between a corporation and the local community in which it resides or operates. One such case was Timberland, which recorded 44,000 community service hours during a three-year period and received US recognition[5] for its commitment to social responsibility (Austin et al. 2004). Another concept of CSR is concerned with the relationship between a corporation and its stakeholders. In this situation, activity could be focused on employees (see Parker 1977). The corporation develops its codes of conduct that could make some progress in improving labour rules and process, but the scope are limited and it is unclear if they can make a significant impact without the help of governments with law enforcement. These efforts are likely to benefit only a small segment of the target workforce.[6]

3 An empirical study concerning the operational reporting of corporate natural assets (i.e., habitats, fauna and flora) can be seen in Jones (2003).

4 Following the external inputs invitation of 28 February 2005, the concept has been developed as:

> *'… in some investment environments, public authorities are unwilling or unable to protect rights (including property rights) and to provide basic public services (e.g. social programmes, infrastructure development and prudential surveillance). These "government failures" lead to broader failures in political, economic and civic institutions that the project refers to as "weak governance".'* (OECD 2005).

5 Recognition included a corporate conscience award from the council on economic priorities and public accolades from Presidents Bush and Clinton (Austin et al. 2004).

6 See, for example, OECD (2000a, 2000b) and Scherrer and Greven (2001).

For the authors all of these definitions are pertinent and represent dimensions of the issues. At the same time a parallel debate is taking place in the arena of ethics as to whether corporations should be controlled through increased regulation or whether the ethical base of citizenship has been lost and needs replacing before socially responsible behaviour will ensue. For example, Fülöp et al. (2000) state that people in Hungary often comment that ethics in the Hungarian economic life is a delusion rather than a reality.[7] However this debate is represented it seems that it is concerned with some sort of social contract between corporations and society.

For corporations however, within the broad concept of CSR there are three real issues which focus their attention at the moment: sustainability, corporate governance and the harmonisation of accounting standards. All are issues which are global in their impact and must be considered in the context of globalisation. Probably the most important – and certainly what we will be focusing on in this book – is the issue of sustainability. This is something which is addressed by every corporation, and most governments and NGOs, all over the world. It is also the topic of this book and so we need to start by considering why it has become such an important issue.

Global Warming

The changes to the weather systems around the world is apparent to most people and is being manifest in such extreme weather as excessive rain or snow, droughts, heatwaves and hurricanes which have been affecting many parts of the world. Indeed most of us remember, for example, Hurricane Katrina which devastated New Orleans. Global warming and climate change, its most noticeable effect, is a subject of discussion all over the world and it is generally, although by no means universally, accepted that global warming is taking place and therefore that climate change will continue to happen. Opinion is divided, however, as to whether the climate change which has taken place can be reversed or not. Some think that it cannot be reversed. Thus, according to Lovelock (2006) climate change is inevitable with its consequences upon the environment and therefore upon human life and economic activity. He remains, however, positive that it is possible to adapt and is thereby more positive than some other commentators.[8] In this book we take the position that it is an

7 Similarly an Islamic perspective on CSR can be found in Rizk (2005) and on business ethics in Pomezanz (2004).

8 See, for example, Reay (2005).

established fact that climate change is taking place and consider what can be done about it in terms of corporate activity. Whether or not it is reversible is not the issue for us as we feel obliged to attempt to – at least – mitigate its effects through changes in corporate behaviour.

Although there are many factors which are contributing to the global warming which is taking place, it is clear that commercial and economic activity plays a significant part in this global warming. Indeed many people talk about 'greenhouse gases', with carbon dioxide being the main one, as a direct consequence of economic activity. Consequently many people see the reduction in the emission of such gases as being fundamental to any attempt to combat climate change. This of course requires a change in behaviour – of people and of organisations. Such a perceived need for change is one of the factors which has caused the current concern with sustainability.

Footprinting

Another factor which is occupying the minds of people in general is that of their ecological footprint – the amount of physical area of the earth needed to provide for each person. Ecological footprint analysis compares human demand on nature with the biosphere's ability to regenerate resources and provide services. It does this by assessing the biologically productive land and marine area required to produce the resources a population consumes and absorb the corresponding waste, using prevailing technology. This approach can also be applied to an activity such as the manufacturing of a product or driving of a car. A possibly more fashionable term at the moment however is that of carbon footprinting.

A carbon footprint can be considered to be the total amount of carbon dioxide (CO_2) and other greenhouse gases emitted over the full life cycle of a product or service. Normally a carbon footprint is usually expressed as a CO_2 equivalent (usually in kilogrammes or tonnes), which accounts for the same global warming effects of different greenhouse gases (UK Parliamentary Office of Science and Technology POST 2006). There are a number of ways of calculating this footprint and a number of online resources to assist, at least as far as individuals are concerned. For a corporation it is more problematic as it involves both life cycle analysis[9] and a detailed understanding of all stages in the supply chain.

For an individual the definition of carbon footprint is the total amount of carbon dioxide attributable to the actions of that individual (mainly through their energy use) over a period of one year. This definition underlies the personal carbon calculators that are widely used. The term owes its origins to the idea that a footprint is what has been left behind as a result of the individual's activities. Carbon footprints can either consider only direct emissions (typically from energy used in the home and in transport, including travel by cars, aeroplanes, rail and other transport), or can also include indirect emissions (including carbon dioxide emissions as a result of goods and services consumed). Bottom-up calculations sum attributable such emissions from individual actions; top-down calculations take total emissions from a country (or other high-level entity) and divide these emissions among the residents (or other participants in that entity). A number of studies have calculated the carbon footprint of organisations and nations. One such UK (2007) study examined age-related carbon emissions based on expenditure and consumption. The study found that on average people aged 50–65 years have a higher carbon footprint than any other age group. Individuals aged 50–65 years old have a carbon footprint of approximately 13.5 tonnes/capita per year compared to the UK average of 12 tonnes.

9 Life cycle analysis is concerned with all the effects of an activity over the whole life. It recognises that any activity involves expenditure in the acquisition of the basis of activity but also involves a commitment to future impact in its use. It is important to recognise this and to incorporate both acquisition and operating effects into the evaluation. Thus, for example, a product which has a high production cost but low operating costs may be more ecological than one which has a low acquisition cost but high operating costs. An evaluation solely on operating effects will not take this into account and the most effective decision may not be made. The costs incurred over the full life cycle of a product are the following:

- production or manufacturing costs – including research and development, resource consumption, energy consumption, etc;
- operating costs – for example, maintenance, energy, spares, training;
- ongoing capital costs – for example, equipment upgrades, modifications;
- disposal costs – for example, removal and disposal of noxious substances, salvage, storage, reclamation, etc.

The objective of life cycle analysis is to measure the full range of environmental effects assignable to products and services, so as to be able to choose the least burdensome one. The term life cycle refers to the notion that a fair, complete assessment requires the assessment of raw material, production, manufacture, distribution, use and disposal including all intervening transportation steps necessary or caused by the product's existence. The sum of all those steps – or phases – is the life cycle of the product. The concept also can be used to optimise the environmental performance of a single product or to optimise the environmental performance of a company. As indicated, however, in the preceding paragraph this measurement and comparison takes place in terms of cost.

It is claimed that the carbon footprint so calculated can be effectively reduced by some of the following steps:

- Life Cycle Assessment (LCA) to accurately determine the current carbon footprint.

- Identification of hot-spots in terms of energy consumption and associated carbon dioxide emissions.

- Optimisation of energy efficiency and, thus, reduction of CO_2 emissions and reduction of other GHG emissions contributed from production processes.

- Identification of solutions to neutralise the CO_2 emissions that cannot be eliminated by energy saving measures. This includes such things as carbon offsetting and investment in projects that aim at reducing carbon dioxide emissions, such as tree planting.

It is commonly understood that the carbon dioxide emissions (and the emissions of other greenhouse gases) are almost exclusively associated with the conversion of energy carriers such as wood burning, natural gas, coal and oil. The carbon content released during the energy conversion process reaches the atmosphere and is deemed to be responsible for global warming, and therefore climate change.[10] Nevertheless, general concern has been expressed worldwide and this has led to the Kyoto Protocol.[11] The Kyoto Protocol defines legally binding targets and timetables for cutting the greenhouse-gas emissions of industrialised countries that ratified the Protocol.[12] Accordingly, from an economic or market perspective, one has to distinguish between a *mandatory market* and a *voluntary market*. Typical for both markets is the trade in emission certificates.

In contrast to the strict rules set out for the mandatory market, the voluntary market provides companies with different options to acquire emissions

10 This is, of course, overly simplistic, if not completely wrong. Thus people (and animals) produce carbon dioxide when breathing, cows (and other ruminants) produce methane and the process by which vegetation produces, captures and subsequently releases carbon dioxide is complex and not fully understood (see Lomborg 2001).

11 This was agreed in 1997 and came into effect in 2005.

12 In late 2007, Australia ratified the Protocol, leaving only one large developed country which has not done so. This country is however the USA, probably the largest producer of such greenhouse gases.

reductions. A solution, comparable with those developed for the mandatory market, has been developed for the voluntary market, the verified emission reductions (VER). This measure has the great advantage that the projects/activities are managed according to the quality standards set out for CDM/JI projects but the certificates provided are not registered by the governments of the host countries or the Executive Board of the UNO. As such, high quality VERs can be acquired at lower costs for the same project quality. However, at present VERs can not be used in the mandatory market.

The voluntary market in North America is divided between members of the Chicago Climate Exchange and the over the counter (OTC) market. The Chicago Climate Exchange is a voluntary yet legally binding cap-and-trade emission scheme whereby members commit to the capped emission reductions and must purchase allowances from other members or offset excess emissions. The OTC market does not involve a legally binding scheme and a wide array of buyers from the public and private spheres, as well as special events that want to go carbon neutral. There are project developers, wholesalers, brokers and retailers, as well as carbon funds, in the voluntary market. Some businesses and nonprofits in the voluntary market encompass more than just one of the activities listed above. A report by Ecosystem Marketplace shows that carbon offset prices increase as it moves along the supply chain – from project developer to retailer.

While some mandatory emission reduction schemes exclude forest projects, these projects flourish in the voluntary markets. A major criticism concerns the imprecise nature of greenhouse gas sequestration quantification methodologies for forestry projects. However, others note the community co-benefits that forestry projects foster. Project types in the voluntary market range from avoided deforestation, aforestation/reforestation, industrial gas sequestration, increased energy efficiency, fuel switching, methane capture from coal plants and livestock, and even renewable energy. Renewable energy certificates (RECs) sold on the voluntary market are quite controversial due to additional concerns. Industrial gas projects receive criticism because such projects only apply to large industrial plants that already have high fixed costs. Siphoning off industrial gas for sequestration is considered picking the low hanging fruit; which is why credits generated from industrial gas projects are the cheapest in the voluntary market. The size and activity of the voluntary carbon market is difficult to measure. The most comprehensive report on the voluntary carbon markets to date was released by Ecosystem Marketplace and New Carbon Finance in July of 2007.

There has been a considerable volume of criticism of the concept of a carbon footprint. All is based on disagreement with one or more of the assumptions underlying the calculation of a carbon footprint:

- that carbon emissions are a significant cause of global warming;
- that human activity is a significant cause of these emissions;
- that it is possible to attribute all or most emissions to particular individuals;
- that individual initiative is necessary because market forces or legislation will not be powerful and timely enough;
- that each individual should therefore calculate and attempt to reduce his share of carbon emissions;
- sometimes, that each person should be given as a target an equal share of emissions, or some other share.

Criticisms derived from the rejection of these assumptions therefore include:

- that other gases, such as methane, are more significant than carbon dioxide;[13]
- that human activity is not as significant a cause as natural processes such as volcanic activity;
- that many emissions cannot reasonably be attributed to any individual. Thus is it reasonable to decide that the emissions from commuting, for example, are attributable to commuters or should they be attributed to the consumers of the final produce which they produce or service that they consume?
- that human activity will be changed, given sufficient time, by market forces or by political interventions;
- that population growth invalidates the calculations;

13 This is one of the arguments made in Europe by the low cost flight air transport industry.

- that one cannot limit everyone to equal emissions: for example those in urbanised societies may be unable to avoid some emissions, while less-developed countries may not have the technology to mitigate others.

Although scientific opinion has more or less reached a consensus that global warming is taking place and therefore that climate change is happening, there are still a considerable number of sceptics and people who deny that it is happening.[14] There are others who argue that the human contribution to global warming is negligible: they argue, therefore, that it is useless or even harmful to concentrate on individual contributions.

Resource Depletion

Obviously the resources of the planet are finite and this is a limiting factor to growth and development which we will consider to a considerable extent in this book. The depletion of the resources of the planet, however, is one of the actors which has helped create the current interest in sustainability. Of particular concern is the extractive industries and such things as aluminium are becoming in short supply. In the UK, the mineral resources such as tin and lead have been fully extracted long ago and the thriving industries based around them are long gone. As other resources – such as coal – are extracted in total then the companies based upon them disappear, as do the jobs in those industries. This is an obvious source of concern for people.

Of particular concern is the extinguishing of supplies of oil, because much economic activity is fuelled by the energy created by the use of oil. Indeed many would argue that the wars in the Middle East,[15] particularly the problems in Iraq and Iran, are caused by oil shortages, actual or impending, and the problems thereby caused, rather than by any concern for political issues. Most people have now heard of Hubert's Peak[16] and engaged with the debate as to whether or not it has been reached. Certainly it has in parts of the world

14 The European consensus is by no means worldwide in this respect.

15 And most probably any other parts of the world also – it would be instructive to correlate the presence of oil with conflicts.

16 In 1956 Dr King Hubert, a geologist working for Shell Oil developed his theory about the depletion of finite resources like fossil fuels. Now commonly known as Hubert's Peak, his theory explains that production rates of oil and gas will increase to a peak and then rapidly taper off as reserves are depleted. He developed his theory to explain the coming reduction in production of oil in the USA and it is generally accepted that his theory was correct about this.

such as the USA and the North Sea but it is less certain if it has been reached for the world as a whole. Nevertheless the whole crux of sustainability – and sustainable development – is based upon the need for energy and there are insufficient alternative sources of energy to compensate for the elimination of oil as a source of fuel. Consequently, resource depletion, real or imagined, and particularly energy resources, is one of the most significant causes of the current interest in sustainability.

Competition

As resources become more obviously finite then the competition for the use of them necessarily increases. Globalisation, of course, necessarily increases the scale of the competition which has become worldwide rather than local. The drive for growth, of course, exacerbates this as each company thereby requires more of the finite resources, and competition therefore increases. The advent of China into the global economy with its double digit growth rate has highlighted this issue about the increased competition for finite resources. These are all issues which we will return to at various times in this book because they are very significant for any analysis of sustainability. They are also all things with which most people are familiar and therefore are some of the factors which have caused the current interest in sustainability and the possibilities or limitations for sustainable development.

The Gaia Hypothesis

Named after the Greek earth goddess, the Gaia hypothesis was created by James Lovelock (Lovelock 1979). In this hypothesis he posited a different model of the planet Earth; in his model the whole of the ecosphere, and all living matter therein, was co-dependent upon its various facets and formed a complete system. According to this hypothesis, this complete system, and all components of the system, was interdependent and equally necessary for maintaining the Earth as a planet capable of sustaining life. This Gaia hypothesis was a radical departure from classical liberal theory,[17] which maintained that each entity was independent and could therefore concentrate upon seeking satisfaction for its own wants, without regard to other entities. This classical liberal view of the world forms the basis of economic organisation, provides a justification for the existence of firms as organs of economic activity and provides the rationale

17 See the discussion of Utilitarianism later in this chapter for details of classical liberal theory.

behind the model of accounting adopted by society. The Gaia hypothesis, however, implied that interdependence, and a consequent recognition of the effect of one's actions upon others, was a facet of life. This consequently necessitates a different interpretation of accountability in terms of individual and organisational behaviour, activity and reporting.

Given the current constitution of the economic activity of the world into profit seeking firms, each acting in isolation and concerned solely with profit maximisation, justified according to classical liberalism, it is inevitable that accounting developed as organisation-centric,[18] seeking merely to measure and report upon the activities of the firm insofar as they affected the firm itself. Any actions of the firm which had consequences external to the firm – as almost all do in one way or another – were held not to be the concern of the firm. Indeed enshrined within classical liberalism, alongside the sanctity of the individual to pursue his own course of action, was the notion that the operation of the free market mechanism would mediate between these individuals to allow for an equilibrium based upon the interaction of these freely acting individuals and that this equilibrium was an inevitable consequence of this interaction.[19] As a consequence, any concern by the firm with the effect of its actions upon externalities was considered to be irrelevant and not therefore a proper concern for its accounting.

The Gaia hypothesis stated that all organisms were interdependent[20] and that it was necessary to recognise that the actions of one organism affected other organisms and hence inevitably affected itself in ways which were not necessarily directly related to its actions – in other words all actions may well have unintended consequences.[21] Thus, the actions of an organism upon its

18 We will return to this issue later in the book, as it is very relevant to an understanding of sustainability.

19 This assumption of course ignores the imbalances in power between the various parties seeking to enact transaction through the market.

20 In actual fact Lovelock claimed in his hypothesis that the earth and all its constituent parts were interdependent. It is merely an extension of this hypothesis to claim the interrelationship of human activity whether enacted through organisations or not.

21 This can be considered to be related to the ideas of chaos theory. Gleick (1988) contends that Western science is founded on the idea that very small influences can be ignored, approximately accurate inputs will result in approximately accurate outputs. This is because these small influences remain small and do not escalate into much larger effects. However, since the 1960s, this foundation has been questioned as there has been a realisation that in certain circumstances this is not the case. This leads to one of the cornerstones of chaos theory which considers systems which demonstrate a sensitive dependence upon initial conditions. Also it has become apparent that in certain instances this dependence is of such importance that the causal relationships are lost. A definition of chaos theory, which is appropriate for the confines of this paper, was provided by Kellert (1993) as 'the qualitative study of unstable

environment and upon externalities was a matter of consequence for every organism, as everything is interdependent. This is true for humans as much as for any other living matter upon the planet. It is possible to extend this analogy to a consideration of the organisation of economic activity taking place in modern society and to consider the implications both for the organisation of that activity and the accounting for that activity. As far as profit seeking organisations are concerned therefore the logical conclusion from this is that the effect of the organisation's activities upon externalities is a matter of

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aperiodic behaviour in deterministic non-linear dynamical systems.' (1993: 27). Therefore, the systems which will show this chaotic behaviour are those which encompass non-linear feedback loops.

Parker and Stacey (1995) identify non-linear feedback systems in nature as those which exist at the boundary of stability and instability. As a result these systems produce a continuously creative and innovative behaviour. They argue that as 'human systems, including business organisations and economies, are non-linear feedback systems, the lessons from chaos theory are profound.' (1995: 101). Phelan (1995) suggests that organisations operating in a competitive environment are actually in a complex adaptive system, while Vriend (1994) described a complex system as one where there are many agents which are interacting with each other and that it is adaptive if the agents' actions alter as a result of these interactions. Complex systems appear to evolve into a state of complexity at the edge of chaos (Phelan 1995), a situation which incorporates stability whilst still permitting change, which is consistent with the position of organisations as identified by Parker and Stacey (1995). Chaos theory and complexity theory are often considered to be synonymous (Hayles 1991) and have both been used to describe the environment within which modern organisations operate. Both are essentially concerned with the elimination of uncertainty from the environment and the representation of the future as certain, based upon the predictive ability of the theory. In this respect these theories can be likened to accounting theory in that they are concerned with the elimination of uncertainty in the prediction of the future, albeit each starts from a different base and works with a different set of assumptions.

As organisations exist within a system which is complex and adaptive, the role of accounting in prediction needs to be reconsidered. First, within all financial models there are likely to be errors within the data which is input. Also we should remember Lorenz, one of the instigators of chaos theory, who led us to what is known as the butterfly effect, which as Gleick (1988) explains is the notion that a 'butterfly stirring the air today in Peking can transform storm systems next month in New York.' (1988: 35). Therefore, even factors which appear irrelevant can have crucial implications for future predictions. An accountant preparing a plan or budget for an organisation can never be sure that all relevant factors have been included; indeed it is unlikely that this will be the case. Added to this is the admission in the accounting literature that external factors with quite obvious implications for the organisation are ignored, or considered to be stable and predictable, and therefore irrelevant to the analysis. On this basis, therefore, the validity of the financial plans of an organisation prepared under these assumptions would appear questionable. However, the omission of small influences may not be as important in the shorter term, as it takes a period of time for these small influences to be amplified. It is therefore argued that accounting theory can benefit from the use of the assumptions which underpin chaos theory and a combination of the two can enhance the predictive capability of the combined theory in predicting the future as far as individual organisations working in uncertain environments are concerned. Accounting can therefore be advanced through a consideration of chaos theory and an acknowledgement that in order to predict the future either only short time periods should be considered or for longer term purposes a more detailed specification of the initial conditions would be required.

concern to the organisation, and hence a proper subject for accounting in terms of organisational activity.

While it is not realistic to claim that the development of the Gaia theory had a significant impact upon organisational behaviour, it seems certain that there is some relationship, albeit indirect, as it seems that a social concern among business managers developed at the same time that this theory was being propounded. It is perhaps that both are symptomatic of other factors which caused a re-examination of the structures and organisation of society. Nevertheless, organisational theory has, from the 1970s, become more concerned with all the stakeholders of an organisation, whether or not such stakeholders have any legal status with respect to that organisation. At the same time within the discourse and practice of accounting there has been a growth in concern with accounting for externalities and for the effects of the actions of the firm upon those externalities. One externality of particular concern is that of the environment; in this context the environment has been defined to include the complete ecosphere, rather than merely the human part of that ecosphere. These concepts form part of the foundations of a concern with sustainability.

Population

According to the pronouncements of the United States Census Bureau, the world population had increased to 6.5 billion on 25 January 2006. This was only a few years after 12 October 1999, which had been designated by the United Nations Population Fund as the approximate day on which world population reached 6 billion. This in turn was only about 12 years after the world population had reached 5 billion, in 1987. It must be noted, however, that the population of some countries, such as Nigeria or Brazil, is not even known to the nearest million, and so it can be seen that there is a considerable margin of error in such estimates. Nevertheless, it is certain that the population of the world is continuing to grow, and at as quick a rate as at present. Thus, the United Nations Population Division has recently projected that the world population will be likely to exceed 9 billion by 2050. There are a number of reasons why there has been such a rapid increase in population in the last century. One factor of course is that of the medical advances which have been made, in preventing child death and in extending the life of old people. Another factor is rising prosperity, coupled with a substantial increase in agricultural productivity, particularly in the period 1960 to 1995, which has enabled people to live healthier and more productively.

An increasing population of course increases the requirements for goods to consume – raising a question about sustainability. This is particularly pertinent as far as the need for agricultural production to supply food in increasing quantities. When coupled with climate change and the consequent expected disruption to agriculture this has been a cause for concern for many people, particularly in the context of sustainability. This in turn has caused Malthus and his theories to be re-examined for current relevance. Malthus, of course, was an eighteenth-century economist who developed his views primarily as a reaction to the optimistic opinions of his father and of his father's associates, notably Rousseau.[22] In his famous 'An Essay on the Principle of Populations', first published in 1798, he made his well-known prediction that food shortages would occur because population would increase at a faster rate than food supply could be increased – leading to mass starvation. He stated:

> *'The power of population is so superior to the power of the earth to produce subsistence for man, that premature death must in some shape or other visit the human race. The vices of mankind are active and able ministers of depopulation. They are the precursors in the great army of destruction, and often finish the dreadful work themselves. But should they fail in this war of extermination, sickly seasons, epidemics, pestilence, and plague advance in terrific array, and sweep off their thousands and tens of thousands. Should success be still incomplete, gigantic inevitable famine stalks in the rear, and with one mighty blow levels the population with the food of the world.'*

His argument is based on his Principle of Population. This states that population, if unchecked by such things as war or plague, increases at a geometric rate while the production of food will only grow at an arithmetic rate. In the optimistic years of the mid-twentieth century this argument was viewed as quaint and outdated. In recent years it has come back into vogue somewhat and people are wondering if his ideas have current relevance.

At the same time, many people are wondering about population control. This is presently happening in China with their one child per family regulation, which has met with limited success and considerable evasion. Population control was attempted in India and was such a disaster that it is not possible politically to attempt it again. In most countries population control is not politically possible and in quite a number the ethos is to increase population

22 Malthus's essay also constituted a response to the views of the Marquis de Condorcet (1743–1794).

rather then limit or reduce it. Indeed many religions[23] advocate actions which make population growth inevitable. Population, therefore, is another reason for the current concern with sustainability.

The Global Compact

The Global Compact is an initiative developed by the United Nations with the objective of encouraging businesses worldwide to adopt policies regarding sustainable and socially responsible behaviour and to use a common framework to report on them. The Global Compact was first announced by United Nations Secretary-General Kofi Annan in his speech to the World Economic Forum on 31 January 1999. It was officially launched at the UN headquarters in New York on 26 July 2000. The Global Compact is not a regulatory instrument, but rather a forum for discussion and a network for communication including governments, companies and labour, whose actions it seeks to influence; and NGOs and civil society organisations, representing its stakeholders.

The Compact itself says that once companies are part of the Compact, 'This does not mean that the Global Compact recognizes or certifies that these companies have fulfilled the Compact's principles.' The Compact's goals are intentionally flexible and vague, but it distinguishes the following channels through which it provides facilitation and encourages dialogue: *policy dialogues*, *learning*, *local networks* and *projects*. The compact is based on 10 principles.

THE 10 PRINCIPLES[24]

The Global Compact's 10 principles in the areas of human rights, labour, the environment and anti-corruption enjoy universal consensus and are derived from:

The Universal Declaration of Human Rights.

The International Labour Organisation's Declaration on Fundamental Principles and Rights at Work.

The Rio Declaration on Environment and Development.

23 For example the Roman Catholic version of Christianity prohibits birth control and advocates procreation regardless of circumstances and ability to raise children.

24 www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html.

The United Nations Convention Against Corruption.

The Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment, and anti-corruption:

Human Rights

Principle 1: businesses should support and respect the protection of internationally proclaimed human rights; and

Principle 2: make sure that they are not complicit in human rights abuses.

Labour Standards

Principle 3: businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4: the elimination of all forms of forced and compulsory labour;

Principle 5: the effective abolition of child labour; and

Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

Principle 7: businesses should support a precautionary approach to environmental challenges;

Principle 8: undertake initiatives to promote greater environmental responsibility; and

Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

Principle 10: businesses should work against corruption in all its forms, including extortion and bribery.

The Global Compact sets a standard for socially responsible behaviour for business on a worldwide basis and this is important to aid comparability as well as to set the agenda for what can be considered to be social responsibility. What is less certain, however, is whether the Compact has raised public awareness of the social responsibility agenda and helped to create any concern, or whether the Compact is merely a reflection of already existing public concern. Certainly many people were concerned with these issues before the announcement of the Compact by Kofi Annan so its issue has not created public awareness although it has probably heightened it.

The Advent of Utilitarianism

Often neglected from a concern with such things as sustainability is the role played by political philosophy. In this book we want to concentrate upon the philosophy of Utilitarianism, as propounded by such people as John Stuart Mill and Jeremy Bentham. Utilitarianism must be considered to be the foundation stone of the capitalist system but it is trite to regard the definition of it *as the greatest good of the greatest number*. Rather the argument is for maximising societal utility through a summative process. Inevitably, therefore, it is possible to arrive at a situation whereby a large increase in utility for a small number of people offsets the small reduction in utility for a very large number of people to show a net increase in utility for society, although all the benefit is accrued to the few. Indeed the power imbalances prevalent in society – but ignored in any Utilitarian analysis – make this inevitable and represent one of the major flaws with the capitalist system.

It is impossible to consider Utilitarianism without a recognition of the place of Bentham in its development (Crowther 2001). He can be considered to be the first systematic Utilitarian thinker, and 'Introduction to the Principles of Morals and Legislation' (1789) his most significant book. In it he argues that human beings desire pleasure above all and that what is good for the individual is that which produces pleasure or happiness. He describes the concept of utility and argues that the pursuit of utility, as an individually defined concept, is the fundamental motivation of each person, and that there is no basis for moral belief other than from this motivation of individuals. Mill extended the Benthamite concept of Utilitarianism through his recognition that the net benefit to society cannot be achieved through a simple summation of individual utilities. Indeed he argues that the power of forgoing happiness is a necessary social virtue. Thus society is more than an aggregate of individuals and Utilitarianism is thereby expanded into a moral system of ethics in which he places liberty at the centre. In doing so he places the rights of the individual in a dominant position and argues that these give each person a claim upon society, thereby creating a role for society, as well as for individuals, within Utilitarian theory.

Sidgwick rejects the argument of Mill regarding quality in welfare and argues that the Utilitarian goal is the maximisation of total welfare in quantitative terms. Thus he argues that it is better for a society to give average happiness to a large number rather than maximum happiness to a small number, with total happiness being summative. He holds that some intuition is necessary to support Utilitarianism and that we should only praise conduct which needs to be stimulated. He also argues for the keeping secret of some aspects of Utilitarianism, particularly applied in the context of communication between the rulers of society and the ruled. Similarly Rawls argues that equality of opportunity should be available to all and that inequality can only be defended if it is of advantage to the worst off. In doing so he is critical of Utilitarianism and argues that the maximising of total utility should not be pursued when it imposes unfair disadvantages upon the less skilled or less powerful within society. He therefore rejects the summative aspect of Utilitarianism. His aim is to develop a just society based upon rights and hence based upon inputs rather than the outcomes of Utilitarianism.

Sustainability

As we can see there are a lot of factors which have contributed to the current interest in, and concern for, sustainability. Discussions of sustainability occur regularly and a variety of issues are discussed and a variety of meanings are attached to the term. We will be discussing these meanings and their consequences, of course, throughout this book. Here we will start by stating that sustainability is of course merely the latest concept to be adopted by corporate managers in their reporting/publicity – the two are often indistinguishable (see Crowther 2002c). Prior to this then the term corporate responsibility – or corporate social responsibility) had been in vogue and before this terms such as the triple bottom line, business process re-engineering can be used to trace the concepts back through the idea of the balanced scorecard to the early days of TQM. The question that arises, therefore, is concerning whether these are truly new techniques or refinements of existing management techniques. In this book we will argue that business excellence (as described by Peters and Waterman 1982) has four facets: profitability; sustainability; corporate reputation and good governance. These can be combined and described in terms of the model below (Figure 1.1), all aspects of which are equally necessary to arrive at any kind of sustainable competitive advantage.

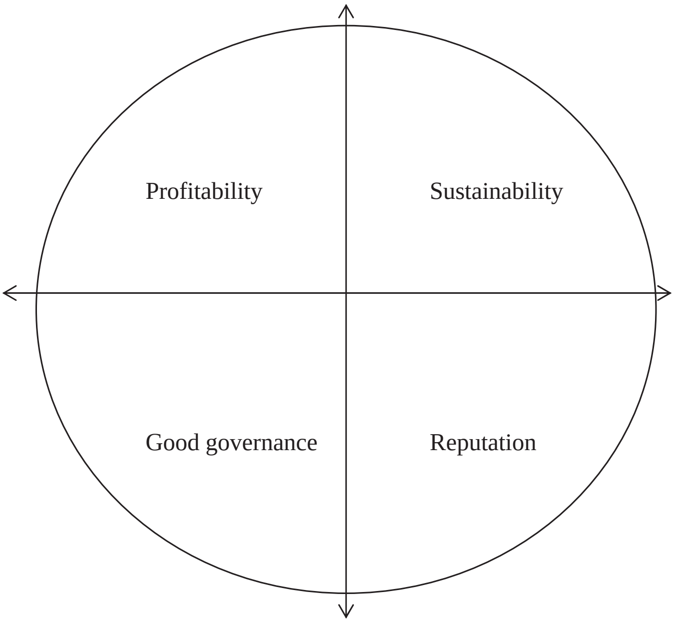

Figure 1.1 The components of sustainable excellence

We will consider each of these, and their combination in this book.

Profitability

Profit is, of course, essential to business survival and maintaining economic activity must be the central *raison d'etre* of corporate activity and the principal reason for organising corporate activity. Equally it is possible to define profitability in terms of an adequate return for the level of risk undertaken. Or it can be considered to be a reward for entrepreneurship and an outcome of the transformations process depicted in Figure 1.2. This concept is very significant for our analysis and we will return to it, and develop it, several times during the course of the book.

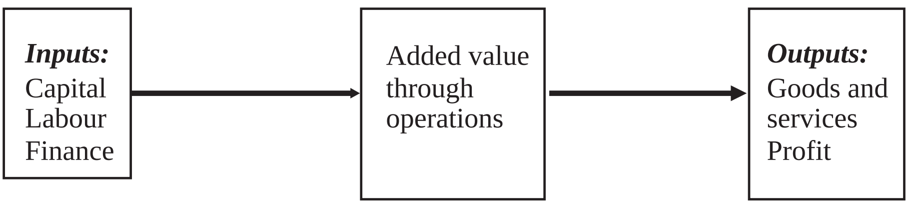

Figure 1.2 The transformational process

Often profitability is omitted from any analysis when considering the sustainability of business activity and certainly the other aspects of excellence with which we are concerned in this analysis. There is an assumption that profit is ‘not quite nice’, possibly as a reaction to the maximising shareholder value focus of a decade ago. In actual fact, of course, profitability is absolutely essential and must be one focus of any analysis. Indeed our concern in this book is about making profitability sustainable and a central part of ensuring sustainable business activity.

Conclusions

As we can see, therefore, there are a number of factors which in combination have caused the current interest in sustainability. For many people sustainability is about environmental issues; these are, of course, very important but sustainability is about much more than this. Equally, many businesses seem to regard sustainability as just continuing to exist: equally sustainability is about much more than this. In actual fact it is a complex issue with a variety of factors involved and a variety of actions being necessary to ensure sustainability. A consideration of sustainable development – a term which is often considered to be synonymous with sustainability – makes this even more complex. We will outline the factors involved but a starting point must be to outline what is mean by the term sustainability, and this will be the subject of the next chapter.

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Defining Sustainability

Introduction

A growing number of writers over the last several decades have overtly recognised that the activities of an organisation impact upon the external environment and have suggested that such an organisation should therefore be accountable to a wider audience than simply its shareholders. Such a suggestion probably first arose in the 1970s[1] and a concern with a wider view of company performance is taken by some writers who evince concern with the social performance of a business, as a member of society at large. This concern was stated by Ackerman (1975) who argued that big business was recognising the need to adapt to a new social climate of community accountability, but that the orientation of business to financial results was inhibiting social responsiveness. Equally McDonald and Puxty (1979) maintain that companies are no longer the instruments of shareholders alone but exist within society and so therefore have responsibilities to all of that society, and that there is therefore a shift towards the greater accountability of companies to all participants. Implicit in this concern with the effects of the actions of an organisation on its external environment is the recognition that it is not just the owners of the organisation who have a concern with the activities of that organisation. Additionally there are a wide variety of other stakeholders who justifiably have a concern with those activities, and are affected by those activities. Those other stakeholders have not just an interest in the activities of the firm but also a degree of influence over the shaping of those activities. This influence is so significant that it can be argued that the power and influence of these stakeholders is such that it amounts to quasi-ownership of the organisation. Indeed Gray, Owen and Maunders (1987) challenge the traditional role of accounting in reporting results and consider that, rather than an ownership approach to accountability, a stakeholder approach, recognising the wide stakeholder community, is

1 Although philosophers such as Robert Owen were expounding those views more than a century earlier.

needed.[2] Moreover Rubenstein (1992) goes further and argues that there is a need for a new social contract between a business and its stakeholders.

Central to this social contract is a concern for the future which has become manifest through use of the term sustainability. This term of sustainability has become ubiquitous both within the discourse of globalisation and within the discourse of corporate performance. Sustainability is of course a controversial issue and there are many definitions of what is meant by the term. At the broadest definitions sustainability is concerned with the effect which action taken in the present has upon the options available in the future (Crowther 2002c). If resources are utilised in the present then they are no longer available for use in the future, and this is of particular concern if the resources are finite in quantity. Thus raw materials of an extractive nature, such as coal, iron or oil, are finite in quantity and once used are not available for future use. At some point in the future therefore alternatives will be needed to fulfil the functions currently provided by these resources. This may be at some point in the relatively distant future but of more immediate concern is the fact that as resources become depleted then the cost of acquiring the remaining resources tends to increase, and hence the operational costs of organisations tend to increase.[3] Thus, regardless of replaceability, the cost structure of business inevitably changes[4] and this has implications for sustainability.

Defining Sustainability

It is this concern with the depletion of natural resources, and in particular with the impending shortage of fuel in the form of the fossil fuels of coal, oil and gas, that provides one reason which has led to the current concern with sustainability. This has been considered to be of particularly pressing importance because the continuing existence of individual firms and even the whole basis of national economies and of the economic system is predicated in the ability to continue growing. Without the necessary fuel then the growth of economic activity becomes problematic and this has created an added urgency to the debate. Thus

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2 The benefits of incorporating stakeholders into a model of performance measurement and accountability have however been extensively criticised. See, for example, Freedman and Reed (1983), Sternberg (1997, 1998) and Hutton (1997) for details of this ongoing discourse.

3 Similarly, once an animal or plant species becomes extinct then the benefits of that species to the environment can no longer be accrued. In view of the fact that many pharmaceuticals are currently being developed from plant species still being discovered this may be significant for the future.

4 At the present time (2008) this has become very manifest in the dramatic rise in the price of oil, and the consequences for the world economy.

the term sustainability has been widely used by corporations and in the media and everyone assumes a knowledge of what the term means without anyone every actually expressing that meaning. Any analysis of the term however, and its implications cannot be undertaken without a precise understanding of its meaning, and this is where we must start our analysis.

Thus, as we will see, one of the most used words relating to corporate activity at present is the word sustainability. Indeed it can be argued that it has been so heavily overused, and with so many different meanings applied to it, that it is effectively meaningless. For example, according to Marrewijk and Were (2003) there is no specific definition of corporate sustainability and each organisation needs to devise its own definition to suit its purpose and objectives, although they seem to assume that corporate sustainability and corporate social responsibility (CSR) are synonymous and based upon voluntary activity which includes environmental and social concern, implicitly thereby adopting the EU approach.[5]

Thus the term sustainability currently has a high profile within the lexicon of corporate endeavour. Indeed it is frequently mentioned as central to corporate activity without any attempt to define exactly what sustainable activity entails. This is understandable as the concept is problematic and subject to many varying definitions – ranging from platitudes concerning sustainable development to the deep green concept of returning to the 'golden era' before industrialisation – although often it is used by corporations merely to signify that they intend to continue their existence into the future.

Sustainability of course is a term which has become ubiquitous also in the political world. Similarly, at the same time, the concept of globalisation[6] has come into common parlance. Naturally both are concepts which are highly pertinent to corporate activity in the modern environment and have a lot of implications for such activity but both are vague concepts with uncertain meaning. Alongside the concept of sustainability there is also the term sustainable development and most people consider the two to be synonymous. The term sustainable development, and a general understanding of its meaning, is based upon that in the Brundtland Report and so we must therefore continue by considering what is meant by the terms in this Report.

5 The European Commission has firmly rejected a regulatory approach to CSR – and therefore by implication to developing sustainability – which it considers *'is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis'* (EC, 2002: 5).

6 We will consider globalisation and its implications for sustainability in detail in Chapter 9.

The Brundtland Report

In 1983, the United Nations established the World Commission on Environment and Development (WCED) under the chairmanship of Gro Harlem Brundtland. It subsequently became known as the Brundtland Commission and its report, Our Common Future, is normally known as the Brundtland Report. The Commission was created to address a growing concern 'about the accelerating deterioration of the human environment and natural resources and the consequences of that deterioration for economic and social development'. In establishing the Commission, the UN General Assembly recognised that environmental problems were global in nature and determined that it was in the common interest of all nations to establish policies for sustainable development. It is important to note that it was unquestioned that sustainable development was both desirable and possible and this has been a source of one of the problems with the Report to which we will return.

In 1983 the UN General Assembly passed the Resolution 38/161, 'Process of Preparation of the Environmental Perspective to the Year 2000 and Beyond' establishing the Commission. In A/RES/38/161, the General Assembly:

> '8. *Suggests that the Special Commission, when established, should focus mainly on the following terms of reference for its work:*
>
> (a) *To propose long-term environmental strategies for achieving sustainable development to the year 2000 and beyond;*
> (b) *To recommend ways in which concern for the environment may be translated into greater co-operation among developing countries and between countries at different stages of economic and social development and lead to the achievement of common and mutually supportive objectives which take account of the interrelationships between people, resources, environment and development;*
> (c) *To consider ways and means by which the international community can deal more effectively with environmental concerns, in the light of the other recommendations in its report;*
> (d) *To help to define shared perceptions of long-term environmental issues and of the appropriate efforts needed to deal successfully with the problems of protecting and enhancing the environment, a long-term agenda for action during the coming decades, and aspirational goals for the world community, taking into account the relevant resolutions of the session of a special character of the Governing Council in 1982.*'

The Brundtland Report was published by Oxford University Press in 1987. The Report deals primarily with sustainable development and the change of politics needed for achieving that. The definition of this term in the Report is very well known and often cited:[7]

> *'Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.'*

The Report highlighted the urgency of making progress toward economic development that could be sustained without depleting natural resources or harming the environment and thereby raised the profile of a concern for sustainability which had previously only been expressed by some NGOs. It was primarily concerned with securing global equity, and with redistributing resources towards poorer nations whilst encouraging their economic growth. The Report suggested that equity, growth and environmental maintenance – the triple bottom line, which we will refer to later – are simultaneously possible and that each country is capable of achieving its full economic potential whilst at the same time enhancing its resource base. The Report also recognised that achieving this equity and sustainable growth would require technological and social change. In addition, a key contribution of the Report to the concept of sustainable development included the recognition that the many crises facing the planet are interrelated and can be considered as part of a single crisis of the whole world[8] and of the vital need for the active participation of all sectors of society in consultation and decisions relating to sustainable development.

It is normally assumed that Brundtland was only concerned with environmental issues and considered sustainability only in those terms. Indeed this is still a common interpretation of sustainability and sustainable development. In actual fact the Report highlighted three fundamental components to sustainable development: environmental protection, economic growth and social equity. It stated that the environment should be conserved and our resource base enhanced, by gradually changing the ways in which we develop and use technologies. Moreover it was clear that developing nations must be allowed to meet their basic needs of employment, food, water, energy and sanitation. It raised the issue that if this were to be done in a sustainable manner, then there would be a definite need for a sustainable level of population rather than unchecked growth – something we mentioned in the last chapter.

7 Indeed we use this definition as our starting point in this book.
8 See Chapter 1 regarding the Gaia Hypothesis.

For economic growth then the Report stated that this should be revived and that developing nations should be allowed a growth of equal quality to the developed nations. These three aspects of sustainable development – environmental protection, economic growth and social equity – have been related to the concept of the triple bottom line as a means of measuring the effects of corporate activity.

Even though it is now 20 years since this Report was produced it still continues to dominate the sustainability debate. Indeed all current definitions of sustainability refer back, at least implicitly, to Brundtland and the importance of not reducing the choices available to future generations. It is our view – which we will explain in this book – that this obsession with the Brundtland Report has clouded the real issues and prevented serious debate about the true issues upon which sustainability must be based. Thus Brundtland – unintentionally – has done a great disservice to sustainability.

It is generally accepted that sustainable development is a process which aims to fulfil human needs while also maintaining the quality of the natural environment on an indefinite basis. It is often thought that such development was first recognised by Brundtland but actually the link between environment and development was globally recognised in 1980, when the International Union for the Conservation of Nature published its report, World Conservation Strategy, in which it made use of the term sustainable development. Admittedly, however, the term came into general usage following the publication of the Brundtland Report.

As we have already seen, sustainable development does not focus solely on environmental issues. More broadly, sustainable development policies encompass three general policy areas: economic, environmental and social. In support of this, several United Nations texts, including recently the 2005 World Summit Outcome Document, refer to the 'interdependent and mutually reinforcing pillars' of sustainable development as economic development, social development and environmental protection. Thus, for example, The Universal Declaration on Cultural Diversity[9] (UNESCO 2001) elaborates further the concept by stating that '... cultural diversity is as necessary for humankind as biodiversity is for nature'. It is described as 'one of the roots of development understood not simply in terms of economic growth, but also as a means to achieve a more satisfactory intellectual, emotional, moral and spiritual existence'. In this vision, cultural diversity is the fourth policy area of sustainable development.

9 See also Chapter 1 for details of this declaration.

The Rio Summit resulted in the following documents:

- The Rio Declaration on Environment and Development.
- Agenda 21.
- The Convention on Biological Diversity.
- Forest principles.
- Framework Convention on Climate Change.

Both the Convention on Biological Diversity and the Framework Convention on Climate Change were set as legally binding agreements. Critics, however, have argued that many of the agreements made in Rio have not been enacted, particularly with regard to such fundamental issues as reducing poverty and preventing further environmental damage and degradation – issues which still arouse considerable feeling.

The Brundtland Legacy

A direct outcome of the Brundtland Report was a conference which was held five years later in 1992 in Rio de Janeiro. This was the United Nations Conference on Environment and Development, better known as the Earth Summit. There were representatives of 172 governments who participated, with 108 considering it important enough to send their heads of state or government. In addition, over 2,000 representatives of NGOs attended, with around 15,000 other people at the parallel NGO Forum; these people had what was known as Consultative Status. The issues addressed in the conference included:

- a scrutiny of patterns of production – particularly production with hazardous components or waste, such as lead in petrol or poisonous waste from other products;
- alternative sources of energy to replace fossil fuels which had already been linked to global climate change;

- a reliance on public transport systems in order to reduce vehicle emissions, congestion in cities and the health problems caused by polluted air and smog;
- the growing scarcity of water as a resource in various parts of the world.

An important achievement of the Conference was an agreement on the Climate Change Convention which in turn led to the Kyoto Protocol.[10] Another was agreement to 'not carry out any activities on the lands of indigenous peoples that would cause environmental degradation or that would be culturally inappropriate'. The Convention on Biological Diversity was opened for signature at the Summit, and made a start towards redefinition of money supply measures that did not inherently encourage destruction of natural ecology or encourage uneconomic growth.

Another outcome was Agenda 21 which is a programme related to sustainable development. It is a comprehensive blueprint of action to be taken globally, nationally and locally by organisations of the UN, governments and major groups in every area in which we impact on the environment. The number 21 refers to the 21st century, clearly showing its forward looking and long-term intentions. It specifically identified information, integration and participation as key building blocks to help countries achieve sustainable development that incorporates these interdependent pillars. It emphasised that for sustainable development everyone is a user and provider of information and also stressed the need to change from old sector-centred ways of doing business to new approaches that involve cross-sectoral coordination and the integration of environmental and social concerns into all development processes. Additionally, it emphasised that broad public participation in decision-making is a fundamental prerequisite for achieving sustainable development.

The full text of Agenda 21 was announced at the Earth Summit; the final text was of course the result of drafting, consultation and negotiation, beginning in 1989 and finishing at the Conference. There are 40 chapters in

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10 The Kyoto Protocol is an agreement made under the United Nations Framework Convention on Climate Change. Countries that ratify this Protocol have committed themselves to reducing their emissions of carbon dioxide and five other greenhouse gases, or to engage in emissions trading if they maintain their emissions of these gases, or do not reduce them to the extent agreed. As present the USA and Kazakhstan are the only signatory countries which have not ratified the Protocol.

Agenda 21, divided into four sections. In all, the document was over 900 pages and consisted of:

Section I: Social and Economic Dimensions

The main items included:

- combating poverty;
- changing consumption patterns;
- population and demographic dynamics;
- promoting health;
- promoting sustainable settlement patterns;
- integrating environment and development into decision-making.

Section II: Conservation and Management of Resources for Development

The main items included:

- atmosphere protection;
- combating deforestation;
- protecting fragile environments;
- conservation of biological diversity;
- control of pollution.

Section III: Strengthening the Role of Major Groups

The main items included:

- the roles of children and youth, women, NGOs, local authorities, business and workers.

Section IV: Means of Implementation

The main items included:

- science and technology transfer;
- education;
- international institutions and mechanisms and financial mechanisms.

Being Green

Green development – particularly of the deep green variety – is something which is generally differentiated from sustainable development in that green development prioritises what its proponents consider to be environmental sustainability over economic and cultural considerations. Proponents of sustainable development argue that it provides a context in which to improve overall sustainability where technological advances green development is unattainable. For example, a leading edge treatment plant with extremely high maintenance costs may not be sustainable in regions of the world with less financial resources. An environmentally ideal plant that is shut down due to bankruptcy is obviously less sustainable than one that is maintainable by the indigenous community, even if it is somewhat less effective from an environmental standpoint.[11]

Some research activities start from this definition to argue that the environment is a combination of nature and culture. For example the Ring of Peace[12] is one such organisation which seeks to integrate multidisciplinary capacities and which interprets cultural diversity as a key element of a new strategy for sustainable development. Other researchers view environmental and social challenges as opportunities for development action. This is particularly true in the concept of sustainable enterprise that frames these global needs as opportunities for private enterprise to provide innovative and entrepreneurial solutions. This view is now being taught at many business schools around the world.[13]

11 This is, of course, the message which Schumacher was promoting over 30 years ago – see Schumacher (1973, 1977); McRobie (1981). The groundbreaking 'Small is Beautiful' promoted the use of intermediate technology in developing countries.

12 http://www.ringofpeace.org.

13 This naturally includes the universities of which we are members.

On the twentieth anniversary of the release of the Brundtland Report, the World Business Council on Sustainable Development (WBCSD) produced a report of its own – Then and Now: Celebrating the 20th Anniversary of the Brundtland Report – which provided an update on the progress made in the intervening years. The WBCSD Report gives an account of the Brundtland Report but focuses particularly on how the WBCSD has developed itself as the business voice in the sustainable development arena and what actions they had taken towards the future. Thus, although it is primarily about self-promotion, this Report does show that the WBCSD has made some positive efforts over the years since Brundtland. Nevertheless, it also highlights that over 20 years after the original Report, almost everything in the original Report is still relevant today, including the warning about climate change. There is some cause for optimism though as climate change is now more of an accepted fact and global warming has entered popular consciousness as a cause for concern. So perhaps pressure from individuals will lead to the action which has been largely missing for the last 20 years.

Redefining Sustainability

Sustainability therefore implies that society must use no more of a resource than can be regenerated. This can be defined in terms of the carrying capacity of the ecosystem (Hawken 1993) and described with input–output models of resource consumption. Thus the paper industry, for example, has a policy of replanting trees to replace those harvested and this has the effect of retaining costs in the present rather than temporally externalising them. Similarly motor vehicle manufacturers such as Volkswagen have a policy of making their cars almost totally recyclable. Viewing an organisation as part of a wider social and economic system implies that these effects must be taken into account, not just for the measurement of costs and value created in the present but also for the future of the business itself.

Such concerns are pertinent at a macro level of society as a whole, or at the level of the nation state but are equally relevant at the micro level of the corporation, the aspect of sustainability with which we are concerned in this work. At this level, measures of sustainability would consider the rate at which resources are consumed by the organisation in relation to the rate at which resources can be regenerated. Unsustainable operations can be accommodated for either by developing sustainable operations or by planning for a future lacking in resources currently required. In practice, organisations mostly tend to aim towards less unsustainability by increasing efficiency in the way in which resources are utilised. An example would be an energy efficiency programme.

Sustainability is a controversial topic because it means different things to different people. Nevertheless there is a growing awareness (or diminishing naivety) that one is, indeed, involved in a serious debate about what sustainability means and, crucially, the extent (if at all) it can be delivered by MNCs in the easy manner they promise (United Nations Commission on Environment and Development – Schmidheiny, 1992). The starting point must be taken as the Brundtland Report (WCED 1987) because there is explicit agreement with that Report and because the definition of sustainability in there is pertinent and widely accepted. Equally, the Brundtland Report is part of a policy landscape being explicitly fought over by the United Nations, Nation States and big business through the vehicles of the WBCSD and ICC, (see, for example, Beder 1997; Mayhew 1997; Gray and Bebbington 2001).

There is a further confusion surrounding the concept of sustainability: for the purist sustainability implies nothing more than stasis – the ability to continue in an unchanged manner – but often it is taken to imply development in a sustainable manner (Marsden 2000; Hart and Milstein 2003) and the terms sustainability and sustainable development are for many viewed as synonymous. Ever since the Bruntland Report was produced by the World Commission on Environment and Development in 1987 there has been a continual debate concerning development (Chambers 1994; Pretty 1995) and this has added to the confusion between sustainability and sustainable development. For us we take the definition as being concerned with stasis; at the corporate level if development is possible without jeopardising that stasis then this is a bonus rather than a constituent part of that sustainability.

Most analysis of sustainability (for example, Dyllick and Hockerts 2002) only recognises a two-dimensional approach of the environmental and the social.[14] A few (for example, Spangenberg 2004) recognise a third dimension which is related to organisation behaviour. We argue that restricting analysis to such dimensions is deficient. One problem is the fact that the dominant assumption by researchers is based upon the incompatibility of optimising, for a corporation, both financial performance and social/environmental performance. In other words, financial performance and social/environmental performance are seen as being in conflict

14 In the main the economic aspect, which was present in the Brundtland Report and is a central pillar of the triple bottom line, has been omitted from the subsequent analysis of sustainability.

with each other through this dichotomisation (see Crowther 2002c, 2002d). Consequently most work in the area of corporate sustainability does not recognise the need for acknowledging the importance of financial performance as an essential aspect of sustainability and therefore fails to undertake financial analysis alongside – and integrated with – other forms of analysis for this research.[15] We argue that this is an essential aspect of corporate sustainability and therefore adds a further dimension to the analysis of sustainability. Furthermore we argue that the third dimension sometimes recognised as organisational behaviour needs to actually comprise a much broader concept of corporate culture. There are therefore four aspects of sustainability which need to be recognised and analysed, namely:

- ***societal influence***, which we define as a measure of the impact that society makes upon the corporation in terms of the social contract and stakeholder influence;

- ***environmental impact***, which we define as the effect of the actions of the corporation upon its geophysical environment;

- ***organisational culture***, which we define as the relationship between the corporation and its internal stakeholders, particularly employees, and all aspects of that relationship; and

- ***finance***, which we define in terms of an adequate return for the level of risk undertaken.

These four must be considered as the key dimensions of sustainability, all of which are equally important. Our analysis is therefore considerably broader – and more complete – than that of others. Furthermore we consider that these four aspects can be resolved into a two-dimensional matrix along the polarities of internal focus v external focus and short-term focus v long-term focus, which together represent a complete representation of organisational performance. This can be represented as shown in Figure 2.1.

This model provides both a representation of organisation performance and a basis for any evaluation of corporate sustainability.

15 Of course the fact that many researchers do not have the skills to undertake such detailed financial analysis even if they considered it to be important might be a significant reason for this.

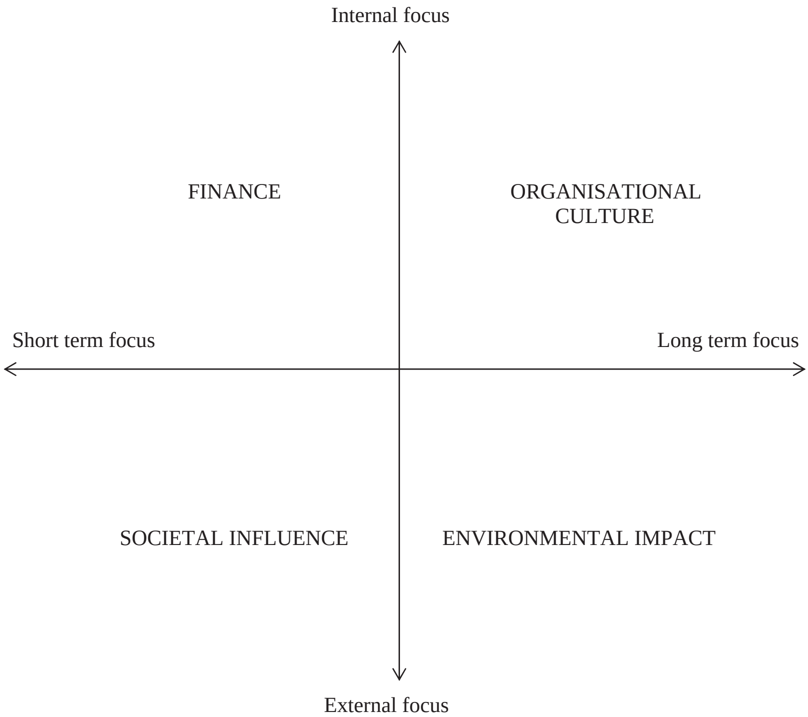

Figure 2.1 Model for evaluating sustainability

In order to achieve sustainable development[16] it is first necessary to achieve sustainability and there are a number of elements to this. What is important for sustainability is not just addressing each of these elements individually but also paying attention to maintaining the balance between them. It is the maintenance of this balance which is the most challenging – but also the most essential – aspect of managing sustainability. There are a number of elements which must be addressed but these can be grouped together into four major elements, which map exactly onto the model for evaluating sustainability outlined earlier. These four major elements of sustainability therefore are:

- Maintaining economic activity, which must be the central *raison d'etre* of corporate activity and the principal reason for organising corporate activity. This of course maps onto the finance aspect.

16 Many authors continue to assume both the possibility and desirability of sustainable development, hence our mentioning of it. For us, however, the achievement of sustainability is both a necessary precondition and sufficient in itself.

- Conservation of the environment, which is essential for maintaining the options available to future generations. This maps onto the environmental impact aspect.

- Ensuring social justice, which will include such activities as the elimination of poverty, the ensuring of human rights, the promotion of universal education and the facilitation of world peace. This maps onto the societal influence aspect.

- Developing spiritual and cultural values, which is where corporate and societal values align in the individual and where all of the other elements are promoted or negated; sadly at present they are mostly negated (see Davila Gomez and Crowther 2007; Crowther and Davila-Gomez 2006a, 2006b, 2006c). This maps onto the organisational culture aspect.

Often theorists attempt to prioritise these but our argument is that it is the balancing of them equitably which is essential to developing sustainability, and hence we maintain that most considerations of the concept are unworkably simplistic. It can therefore be seen that the representation of corporate activity is considerably more complex than simply managing the stakeholder v shareholder dichotomisation which is ever present in organisational theory.

It is our argument therefore that sustainability is predicated upon addressing all of these aspects and that this cannot be done simply through the enaction of contracts, nor through considering the firm as comprising merely a nexus of treaties. Of crucial importance are not just these negotiated contracts but also the psychological contract which comprises an essential part of the social contract, as well as providing a basis for operation of the negotiated contract. And, of course, this only operates in an environment of trust – this cannot be written into the contract and equally cannot be ignored. Trust enables transactions to be negotiated. It also enables contracts to be implemented which are flexible enough to enable the organisation to react to changing circumstances. More significantly it facilitates power inequalities being removed from the negotiation and thereby overcomes some of the deficiencies outlined above. There has been a trend to claim rationality through the negotiation of any need for trust out of any contract and it is our argument that this merely leads to the elimination of sustainability.

The Conflation of Financial, Social and Environmental Performance

One view of good corporate performance is that of stewardship and thus just as the management of an organisation is concerned with the stewardship of the financial resources of the organisation, so, too, would management of the organisation be concerned with the stewardship of environmental resources. The difference however is that environmental resources are mostly located externally to the organisation. Stewardship in this context therefore is concerned with the resources of society as well as the resources of the organisation. As far as stewardship of external environmental resources is concerned then the central tenet of such stewardship is that of ensuring sustainability. Sustainability is focused on the future and is concerned with ensuring that the choices of resource utilisation in the future are not constrained by decisions taken in the present. This necessarily implies such concepts as generating and utilising renewable resources, minimising pollution and using new techniques of manufacture and distribution. It also implies the acceptance of any costs involved in the present as an investment for the future.

Not only does such sustainable activity, however, impact upon society in the future; it also impacts upon the organisation itself in the future. Thus, good environmental performance by an organisation in the present is in reality an investment in the future of the organisation itself. This is achieved through the ensuring of supplies and production techniques which will enable the organisation to operate in the future in a similar way to its operations in the present and so to undertake value creation activity in the future much as it does in the present. Financial management also, however, is concerned with the management of the organisation's resources in the present so that management will be possible in a value creation way in the future. Thus, the internal management of the firm, from a financial perspective, and its external environmental management coincide in this common concern for management for the future. Good performance in the financial dimension leads to good future performance in the environmental dimension and vice versa. Thus there is no dichotomy (Crowther 2002c) between environmental performance and financial performance and the two concepts conflate into one concern. This concern is of course the management of the future as far as the firm is concerned.[17] The role of social and environmental accounting and reporting

17 Financial reporting is, of course, premised upon the continuing of the company – the going concern principle.

and the role of financial accounting and reporting therefore can be seen to be coincidental. Thus, the work required needs be concerned not with arguments about resource distribution but rather with the development of measures which truly reflect the activities of the organisation upon its environment. These techniques of measurement, and consequently of reporting, are a necessary precursor to the concern with the management for the future – and hence with sustainability.

Similarly the creation of value within the firm is followed by the distribution of value to the stakeholders of that firm, whether these stakeholders are shareholders or others. Value, however, must be taken in its widest definition to include more than economic value as it is possible that economic value can be created at the expense of other constituent components of welfare such as spiritual or emotional welfare.[18] This creation of value by the firm adds to welfare for society at large, although this welfare is targeted at particular members of society rather than treating all as equals. This has led to arguments by Tinker (1988), Herremans et al. (1992) and Gray (1992), amongst others, concerning the distribution of value created and to whether value is created for one set of stakeholders at the expense of others. Nevertheless if, when summed, value is created then this adds to welfare for society at large, however distributed – the standard Utilitarian argument. Similarly good environmental performance leads to increased welfare for society at large, although this will tend to be expressed in emotional and community terms rather than being capable of being expressed in quantitative terms. This will be expressed in a feeling of wellbeing, which will of course lead to increased motivation. Such increased motivation will inevitably lead to increased productivity, some of which will benefit the organisations, and also a desire to maintain the pleasant environment which will in turn lead to a further enhanced environment, a further increase in welfare and the reduction of destructive aspects of societal engagement by individuals.

Thus, increased welfare leads to its own self-perpetuation. In the context of welfare also, therefore, financial performance and environmental performance conflate into a general concern with an increase in welfare.

18 See, for example, Mishan (1967), Ormerod (1994) and Crowther, Davies and Cooper (1998). This can be equated to the concept of utility from the discourse of classical liberalism.

Operationalising Sustainability

Central to corporate activity is the concept of the social contract[19] (see Aras and Crowther 2008a) and within this is a concern for the future which has become manifest through the term sustainability. This term sustainability, as we have explained, has become ubiquitous both within the discourse of globalisation and within the discourse of corporate performance. Sustainability is of course a controversial issue and there are many definitions of what is meant by the term. At the broadest definitions sustainability is concerned with the effect which action taken in the present has upon the options available in the future (Crowther 2002c). If resources are utilised in the present then they are no longer available for use in the future, and this is of particular concern if the resources are finite in quantity. Thus raw materials of an extractive nature, such as coal, iron or oil, are finite in quantity and once used are not available for future use. At some point in the future, therefore, alternatives will be needed to fulfil the functions currently provided by these resources. This may be at some point in the relatively distant future but of more immediate concern is the fact that as resources become depleted then the cost of acquiring the remaining resources tends to increase, and hence the operational costs of organisations tend to increase.

There seem, therefore, to be two commonly held assumptions which permeate the discourse of corporate sustainability. The first is that sustainability is synonymous with sustainable development. The second is that a sustainable company will exist merely by recognising environmental and social issues and incorporating them into its strategic planning. As already mentioned, according to Marrewijk and Were (2003) there is no specific definition of corporate sustainability. Most analysis of sustainability (for example, Dyllick and Hockerts 2002; Spangenberg 2004) do not recognise financial performance as an integral part of sustainability. One problem is the fact that the dominant assumption by researchers is based upon the incompatibility of optimising, for a corporation, both financial performance and social/environmental performance. In other words, financial performance and social/environmental performance are seen as being in conflict with each other through this dichotomisation (see Crowther 2002c). Consequently, most work in the area of corporate sustainability does not recognise the need for acknowledging the importance of financial performance as an essential aspect of sustainability and therefore fails to undertake financial analysis alongside – and integrated with – other forms of analysis for this

19 As an extension of Rousseau's concept into the corporate arena.

research. We argue that this is an essential aspect of corporate sustainability and therefore adds a further dimension to the analysis of sustainability.

The four aspects outlined earlier must be considered as the key dimensions of sustainability, all of which are equally important. Our analysis is therefore considerably broader – and more complete – than that of others. Furthermore we consider that these four aspects can be resolved into a two-dimensional matrix along the polarities of internal focus v external focus and short-term focus v long-term focus, which together represent a complete representation of organisational performance. It is essential to recognise the realities of the global environment (see Aras and Crowther 2007a, 2007b) insofar as the company is firmly embedded into a global environment which necessarily takes into account the past and the future as well as the present. This effectively makes a stakeholder out of everything and everybody both in the present and in the future. Sustainability therefore requires a distribution of effects – positive and negative – in a way which eliminates conflict between all of these and pays attention to the future as well as the present. Thus, a short-term approach is no longer acceptable for sustainability and Figure 2.2 represents such an approach to sustainability and sustainable development.

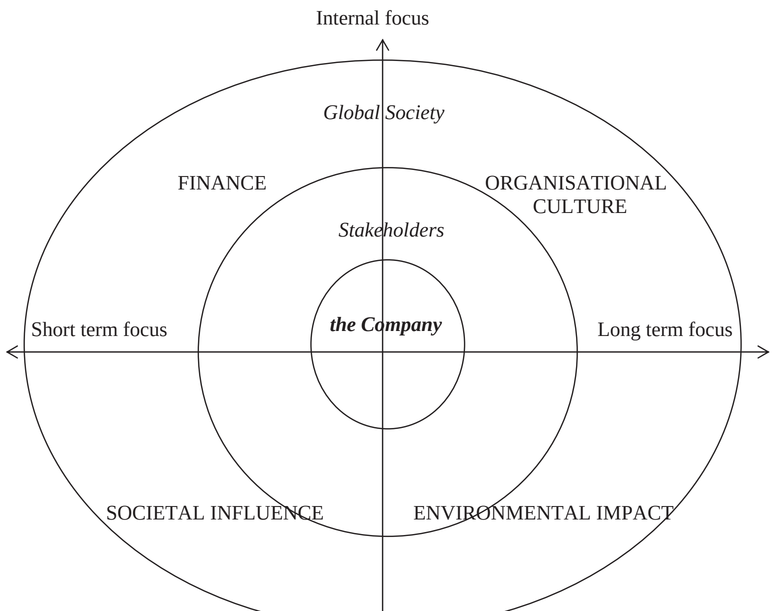

Figure 2.2 Model of sustainable development

Conclusions

There are many issues involved in sustainability which extend far beyond a concern for the environment. All aspects of society are involved and all aspects of corporate activity. Indeed for corporations we have extended the concern for sustainability beyond the three pillars of the triple bottom line to incorporate corporate culture also. We will be considering the implications of these four aspects for corporate behaviour as we progress through this book. As might be expected there are many implications which permeate all aspects of corporate activity.

We have also seen that sustainable development is not the same as sustainability and there are different implications. Many people, NGOs and pressure groups advocate calling a halt to development, claiming that the term sustainable development is an oxymoron. Equally many corporations simply accept that sustainable development is possible and will happen merely by their firm continuing to exist. We reject both of these views as being overly simplistic. Instead we maintain that both sustainability and sustainable development are possible but need some thought and actions to achieve. The focus of the rest of the book is to outline just how this can be achieved.

3

Managing Risk

Introduction

It is almost 20 years since Ulrich Beck introduced the concept of the risk society (Beck 1992). Since then the concept of risk and the management of that risk has permeated every aspect of society. Indeed risk management is so important that it has spawned its own specialist organisations. It is apparent that managerial decision-making involves deciding between alternative courses of action, and managers do this by forecasting the outcomes from each of the alternatives available to them and then deciding upon the appropriate course of action to follow. Thus, decision-making involves forecasting the future effects of a present decision and there is, therefore, an element of uncertainty involved in the forecast, and a level of risk attached to any decision made. A manager's job is to reduce the level of risk and uncertainty involved in decision-making in order that the forecasting of outcomes provides as reliable basis as possible for making these decision.

A theoretical distinction is normally made between risk and uncertainty, and the two are defined as follows:

> **Risk**
> This term is used to apply to a situation where there are several possible outcomes but past experience, or research, enables statistical evidence to be produced which enables the prediction of possible outcomes.
>
> **Uncertainty**
> This term is used to apply to a situation where there is no evidence to enable the possible outcomes to be predicted.

In his seminal work *Risk, Uncertainty, and Profit*, Knight (1921) established the distinction between risk and uncertainty when he stated that:

> *'… Uncertainty must be taken in a sense radically distinct from the familiar notion of Risk, from which it has never been properly separated. The term "risk," as loosely used in everyday speech and in economic discussion, really covers two things which, functionally at least, in their causal relations to the phenomena of economic organisation, are categorically different. … The essential fact is that "risk" means in some cases a quantity susceptible of measurement, while at other times it is something distinctly not of this character; and there are far-reaching and crucial differences in the bearings of the phenomenon depending on which of the two is really present and operating. … It will appear that a measurable uncertainty, or "risk" proper, as we shall use the term, is so far different from an unmeasurable one that it is not in effect an uncertainty at all. We … accordingly restrict the term "uncertainty" to cases of the non-quantitive type.'*

In decision-making it is desirable to reduce uncertainty surrounding the decision and thus enable the forecasting of outcomes to be more reliable. This suggests that the more information that is available the more likely is the uncertainty surrounding a decision to be reduced. Information, therefore, has a value, as we have seen previously. There is also a cost involved in obtaining that information, and to be of benefit the value of the information obtained must exceed the costs of obtaining it. Later in this chapter we will look at ways of quantifying this value of information in order to decide whether or not it is beneficial to obtain additional information. Reducing uncertainty, however, can be achieved not just through the acquiring of additional information. It can also be achieved through the quantification of existing information, and the converting of it into expected outcomes. This is achieved through the use of statistical techniques based upon probability theory.

A Typology of Risk

There are a variety of pressures acting upon organisations in terms of risk to which they are subject, and these can be viewed as representing different dimensions of risk. In order to consider the way in which the various aspects of risk affect an organisation and its behaviour in relation to sustainability, it is possible to construct a typology of environmental pressures:

Global risk
As the world has become more integrated – a facet of the globalisation which we considered in the last chapter – the risk from global competition has naturally increased. Consequently, both the nature of the risks and the scale of the risk has increased.

Environmental risk
An organisation affects its environment and this includes not just the physical environment, in geophysical terms, but also the local environment though such things as pollution, noise or traffic congestion.

Social risk
A firm is, of course, part of society and reacts with that society, both positively and negatively. Risk naturally arises from this interaction.

Cultural risk
Much has been written[1] about the relationship between a firm and its employees, which is often negative in nature. This relationship is a source of risk which is particularly significant when the relationship breaks down and litigation or industrial action ensues.

Financial risk
All corporate activity has financial implications. Indeed the nature of a corporation requires the undertaking of financial risk and the acceptance of the consequences. Ideally these will result in financial rewards which are commensurate with the level of risk[2] undertaken but sometimes small rewards lead to a high level of exposure to risk.[3] We will deal with this in detail in a later chapter.

Long-term/short-term risk
Often consequences of corporate activity become manifest in the long term and all decisions are subject to both long- as well as short-term risks. This is of particular significance as some of the long-term risks might not

1 See, for example, Davila Gomez and Crowther (2007).
2 This is, of course, the basis upon which financial management is based.
3 Consider, for example, the financial consequences for Barings of their focus upon short-term financial success.

be apparent[4] when decisions are taken and action is commenced. Some risk, therefore, might exist which cannot even be recognised.

Stakeholder/shareholder
The power and influence of various stakeholder groups is increasing – something to which we will return – and this might increase the level of risk brought about by conflicts of interest between shareholders and other stakeholders, or between different groups of stakeholders.

Technical risk
Developments take place for all corporations and these include product or service development and mechanisms for delivery. We will return to this later as this is very significant for our consideration of sustainability. At this point, however, we must recognise that developments have associated risks.

Environmental Issues and their Effects

When an organisation undertakes an activity which impacts upon the external environment then this affects that environment in ways which are not necessarily recognised in the planning and performance monitoring processes of that organisation. The environment can be affected either positively, through for example a landscaping project, or negatively, through for example the creation of spoil heaps (of waste material) from a mining operation. These actions of an organisation impose costs and benefits upon the external environment. These costs and benefits are imposed by the organisation without consultation, and in reality form part of the operational activities of the organisation. These actions are, however, excluded from traditional planning of the firm,[5] and by implication from its area of responsibility. Thus we can say that such costs and benefits have been externalised. The concept of externality, therefore, is concerned with the way in which these costs and benefits are externalised from the organisation and imposed upon others.

Such externalised costs and benefits have traditionally been considered to be not the concern of the organisation, and its managers, and hence have been excluded from its accounting. It must be recognised, however, that the

4 The consequences of the use of asbestos, for example, were not known about in the 1960s when this material was considered beneficial for commercial use.

5 They are, of course, included in the costs of the firm's activities and thereby in its accounting but all the costs and benefits resulting from such action are not fully recognised through traditional accounting.

quantification of the effect of such externalisation, particularly from a financial viewpoint, is problematical and not easy to measure, and this is perhaps one reason for the exclusion of such effects from the organisation's accounting. It is probably fair to state, however, that more costs have been externalised by organisations than benefits. Hence, a typical organisation has gained from such externalisation and the reported value creation of such an organisation has been overstated by this failure to account for all costs and benefits. This is achieved by restricting the accounting evaluation of the organisation to the internal effects. Indeed one way in which an organisation can report, through its accounting, the creation of value is by an externalisation of costs, which are thereby excluded from the accounting of the organisation's activities.

As far as the externalisation of costs is concerned it is important to recognise that these can be externalised both spatially and temporally. Spatial externalisation describes the way in which costs can be transferred to other entities in the current time period. Examples of such spatial externalisation include:

- environmental degradation though unsightly waste piles or through increased traffic imposes costs upon the local community through reduced quality of life;
- causing pollution – chemical or noise – imposes costs upon society at large;
- waste disposal problems impose costs upon whoever is tasked with such disposal;
- removing staff from shops imposes costs upon customers who must queue for service;
- just in time manufacturing imposes costs upon suppliers by transferring stockholding costs to them.

In an increasingly global market then, one favourite way of externalising costs is through transfer of those costs to a third world country. This can be effected by a transfer of operational activities, or at least those with environmental impacts, to such a country where the regulatory regime is less exacting. In this respect it should be noted that the arguments regarding reducing labour costs are generally used for such a transfer of operational activities but at the same time less exacting regulatory regimes also exist.

The temporal externalisation of costs describes the way in which costs are transferred from the current time period into another – the future. This thereby enables reported value creation, through accounting, to be recorded in the present. Examples of temporal externalisation include:

- deferring investment to a future time period and so increasing reported value in the present;
- failing to provide for asset disposal costs in capital investment appraisal and leaving such costs for future owners to incur;
- failure to dispose of waste material as it originates and leaving this as a problem for the future;
- causing pollution which must then be cleaned up in the future;
- depletion of finite natural resources or failure to provide renewable sources of raw material will cause problems for the future viability of the organisation;
- lack of research and development and product development will also cause problems for the future viability of the organisation;
- eliminating staff training may save costs in the present at the expense of future competitiveness.

It can be seen that such actions have the effect of deferring the dealing with problems into the future but not of alleviating the need to deal with such problems. In this respect it must be recognised that it is not always apparent in the present that such costs are being temporally externalised, as they may not be recognised as a problem at the present time. For example, the widespread use of asbestos, referred to earlier, in the 1930s to 1960s was considered to be beneficial at the time and was only later found to be problematic. This temporal externalisation of costs, through causing the clean-up problems and costs of a later time period, was therefore incurred unintentionally. Equally, such costs may at the present time be in the course of being transferred into the future through actions taken in the present which will have unanticipated consequences in the future. Nevertheless it is reasonable to suggest that such actions may be taken in the present for cost minimisation purposes with little regard for possible future costs. At the present time there is a concern with the increased production of carbon dioxide which is leading to climate change and global warming. Many so-called solutions to this problem are to capture the CO_2 and store by some method – leaving it to the future to deal with the problem: not dealing with the problem but merely temporarily externalising it.

Many organisations can be seen to be becoming more proactive in the setting of their own agendas for environmental performance improvement because of the perceived benefits from such a course of action. Much criticism has, however, been levelled at the internal drivers of environmental performance, both from environmental pressure groups and from academics. Common criticisms have been concerned with the following:

- many companies are driven by the need to comply with existing or anticipated legislation rather than by any real concern with the environment;

- much corporate environmental action is concerned with publicity and a concern with image rather than any concern with the environment, and is therefore little more than a public relations exercise;

- internal motivations for environmental improvement are often prevented or diluted by budgetary and other business constraints which prevent significant action being taken; consequently external compulsion, through legislation or regulation, is necessary to bring about effective action by a company;

- measures of environmental performance tend to be selectively chosen to demonstrate improvement rather than to provide a balanced picture of environmental performance (Aras and Crowther 2008a);

- a concern with measurement and quantification can, in itself, be symptomatic of a managerialist discourse which seeks to impose its own limits on the environmental debate and thereby to effectively silence alternative points of view.

While any action by companies is open to such interpretation, and there is an element of truth in such interpretations, there is nevertheless sufficient evidence to show that companies are to a large extent genuinely concerned with their environmental performance. This is not just because such companies recognise their social duties as corporate citizens but also that they recognise the business benefits which can follow an improving environmental performance. These business benefits inevitably feed through into the bottom line performance of the organisation.

Attitudes to Risk

In practice, statistical techniques for evaluating alternatives can help to reduce uncertainty but they cannot eliminate the risk associated with any particular decision. The decision is, therefore, ultimately dependent upon managerial judgement, and people make decisions based upon their attitude to risk. In terms of their attitude to risk, people can be classified into three types:

Risk seeking
A risk seeker is a person who will value a positive outcome more highly than a negative outcome. When faced with two equal possibilities of a profit or a loss arising from a particular decision, a risk seeking person will choose to proceed because of the possibility of profit.

Risk averse
A risk averter would value the negative outcome more highly than the positive and in the same situation would choose not to proceed because of the possibility of a loss.

Risk neutral
A risk neutral person would value both outcomes equally and would be indifferent about whether to proceed or not in this situation.

Different people have different attitudes to risk and this influences their decision-making and how they value possible outcomes. Research has shown, however, that for important business decisions, such as capital expenditure appraisal, managers tend to be risk averse in their decision-making. They therefore tend to choose decisions which might have lower expected values than other decisions but which have less risk associated with them. Managers of a business have responsibilities to the owners of that business (that is, the shareholders) and one of these responsibilities is to act as stewards of that business and to maintain the value of the business and its future viability. This duty will tend to lead managers towards less risky decisions, which they are making on behalf of the owners of the business, than they may perhaps make on their own behalf.

Portfolio Theory

Given that all decisions involve an element of risk, and that this cannot be accurately quantified, one way to optimise the performance of a business is through portfolio analysis. This is based upon the premise that decisions are not made in isolation but that a manager has a continuing stream of decisions to make. Risk averse decision-making will tend to lead to a lower level of performance than might otherwise be obtained through accepting a higher level of risk. Portfolio theory assumes that the best outcome will be obtained on some occasions while the worst will be obtained on others, but with a spread of outcomes between these two extremes on most occasions. Optimum performance can therefore be achieved through managing the level of risk accepted by the business. Thus, risk averse decisions will be made on some occasions but risk seeking decision on others. The theory states that spreading risk in this manner and making a mixture of risky and less risky decisions will lead to better overall performance than always seeking risk averse decisions.

Agency Theory and Asymmetric Power

Agency Theory argues that managers merely act as custodians of the organisation and its operational activities[6] and places upon them the burden of managing in the best interest of the owners of that business.[7] According to Agency Theory all other stakeholders of the business are largely irrelevant and if they benefit from the business then this is coincidental to the activities of management in running the business to serve shareholders.[8] This focus upon shareholders alone as the intended beneficiaries of a business has been questioned considerably from many perspectives, which argue that it is either not the way in which a business is actually run or that it is a view which does not meet the needs of society in general. Conversely, stakeholder theory argues that there are a whole variety of stakeholders involved in the organisation and each deserves some return for their involvement. According to stakeholder theory, therefore, benefit is maximised if the business is operated by its management on behalf of all stakeholders and returns are divided appropriately amongst those stakeholders, in some way which is acceptable to all. Unfortunately a mechanism for dividing returns amongst all stakeholders[9] which has universal

6 See, for example, Emmanuel et al. (1985).
7 Such owners are, of course, the legal owners of the business, that is the shareholders.
8 See the VBM discourse considered by Cooper et al. (2001).
9 For example, the discourse surrounding social accounting and the problems of actually measuring the benefit to be distributed.

acceptance does not exist, and stakeholder theory is significantly lacking in suggestions in this respect. Nevertheless this theory has some acceptance and is based upon the premise that operating a business in this manner achieves as one of its outcomes the maximisation of returns to shareholders, as part of the process of maximising returns to all other stakeholders. This maximisation of returns is achieved in the long run through the optimisation of performance for the business to achieve maximal returns to all stakeholders.[10] Consequently, the role of management is to optimise the long-term performance of the business in order to achieve this end and thereby reward all stakeholders, including themselves as one stakeholder community, appropriately.

These two theories can be regarded as competing explanations of the operations of a firm, which lead to different operational foci and to different implications for the measurement, and reporting of performance. It is significant, however, that both theories have one feature in common. This is that the management of the firm is believed to be acting on behalf of others, either shareholders or stakeholders more generally. They do so, not because they are the kind of people who behave altruistically, but because they are rewarded appropriately and much effort is therefore devoted to the creation of reward schemes which motivate these managers to achieve the desired ends. Similarly, much literature is devoted to the consideration of the effects of reward schemes on managerial behaviour (see Briers and Hirst 1990; Child 1974, 1975; Coates et al. 1993; Fitzgerald et al. 1991) and suggestion for improvements.

The simplest model of Agency Theory assumes one principle and one agent (see Crowther 2004) and a modernist view of the world merely assumes that the addition of more principles and more agents makes for a more complex model without negating any of the assumptions. In the corporate world, this is problematic as the theory depends upon a relationship between the parties and a shared understanding of the context in which agreements are made. With one principle and one agent, this is not a problem, as the two parties know each other. In the corporate world, the principles are equated to the shareholders of the company. For any large corporation, however, those shareholders are an amorphous mass of people who are unknown to the managers of the business. Indeed, there is no requirement, or even expectation, that anyone will remain a shareholder for an extended period of time. Thus, there can be no relationship between shareholders – as principles – and managers – as agents – as the principles are merely those holding the shares – as property being invested in – at a particular point in time. So, shareholders do not invest in a company and in

10 See Rappaport (1986, 1992).

the future of that company; rather they invest for capital growth and/or a future dividend stream, and shares are just one way of doing this which can be moved into or out of at will. This problem is exacerbated, particularly in the UK, by the fact that a significant proportion of shares are actually bought and sold by fund managers of financial institutions acting on behalf of their investors. These fund managers are rewarded according to the growth (or otherwise) of the value of the fund. Thus, shares are bought and sold as commodities rather than as part ownership of a business enterprise. In another perspective of the same problem, as Scherrer and Greven (2001) explain, almost 10 per cent of the total value of the commodities in the world market are produced in violation of the fundamental rights of workers. Consequently, Agency Theory fails as a mechanism for directing managerial behaviour (see Crowther and Ortiz Martinez 2007).

The Cost of Capital

It is recognised in the financial world that the cost of capital which any company incurs is related to the perceived risk associated with investing in that company – in other words, there is a direct correlation between the risk involved in an investment and the rewards which are expected to accrue from a successful investment. Therefore it is generally recognised that the larger, more established companies are a more certain investment and therefore have a lower cost of capital. This is all established fact as far as finance theory is concerned and is recognised in the operating of the financial markets around the world. Naturally a company which is sustainable will be less risky than one which is not. Consequently, most large companies in their reporting mention sustainability and frequently it features prominently. Indeed it is noticeable that extractive industries – which by their very nature cannot be sustainable in the long term – make sustainability a very prominent issue. The prime example of this can be seen with oil companies – BP being a very good example – which make much of sustainability and are busy redesignating themselves from oil companies to energy companies with a feature being made of renewable energy, even though this is a very small part[11] of their actual operations.

Just as a company which is sustainable is less risky, then one which can claim to be undertaking sustainable development is even less risky and many companies simply mention this concept and therefore merely imply that it relates

11 It needs a very careful reading of the annual report to discover this and that the investment in R&D for this type of energy is around 1 per cent of the total R&D.

to their operations. Such a company has a rosy future of continued growth,[12] with the expectation of a concomitant continued growth in profitability. An investigation of the FTSE100, for example, shows that 70 per cent make a feature of sustainability while 15 per cent make a feature of sustainable development. So the cost of capital becomes lower as the certainty of returns becomes higher. We have shown, therefore, in this chapter that the concept of sustainability is complex and problematic and that the idea of sustainable development is even more problematic. It is our argument that companies are not really addressing these issues but are merely creating an image of sustainability.[13] The language of the statements made by corporations tends, therefore, to be used as a device for corrupting thought (Orwell 1970) by being used as an instrument to prevent thought about the various alternative realities of organisational reality. Significantly it creates an image of safety for investors and thereby reduces the cost of capital for such corporations. Such language must be considered semiotically (Barthes 1973) as a way of creating the impression of actual sustainability. Using such analysis then the signification is about inclusion within the selected audience for the corporate reports on the assumption that those included understand the signification in a common way with the authors. This is based upon an assumed understanding of the code of signification used in describing corporate activity in this way. As Sapir (1949: 554) states:

> *'… we respond to gestures with an extreme alertness and, one might almost say, in accordance with an elaborate and secret code that is written nowhere, known by none and understood by all.'*

It is a part of our argument that the methodologies for the evaluation of risk are deceived by this rhetoric and are deficient in their evaluation of risk – particularly environmental risk. In order to fully recognise and incorporate environmental costs and benefits into the investment analysis process the starting point needs to be the identification of the types of costs and revenues which need to be incorporated into the evaluation process. Once these types of costs have been identified then it becomes possible to quantify such costs and to incorporate qualitative data concerning those less tangible benefits which are not easily subject to quantification. The completion of an environmental audit will enhance the understanding of the processes involved and will make this easier. In considering environmental benefits, as distinct from financial benefits, it is important that an appropriate time horizon is selected which will enable

12 At least this is the assumption made by the company and assumed to be shared by investors and potential investors.

13 See Crowther (2002a) for a full discussion of image creating in corporate reporting.

those benefits to be recognised and accrued. This may imply a very different time horizon from one which is determined purely by the needs of financial analysis.

The Firm as a Going Concern

One of the fundamental principles of accounting is the concept of the firm as a going concern. This of course means that the accounts and the balance sheet of a company must reflect the value of that company as if it were to remain in existence for the foreseeable future. As International GAAP[14] states:

> *'financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations.'*
>
> Para 23 of the Conceptual Framework

The going concern principle is among the most important accounting, and therefore business, principles. Nevertheless, despite the definition of the principle seeming to be relatively straightforward, the application of it can be fraught with difficulties. Accountants and lawyers spend much time debating the application of this concept in practice. What is missing from their discussions, however, is any attempt to apply the principles of sustainability to the company; instead they merely assume that an unchanged external environment will enable the firm to carry on in an unchanged manner. Firms themselves, in their publicity and annual reporting also assume this – merely that the going concern principle applies to the activities of the firm, but with the prospect of development being sustainable on the same basis.

International GAAP however also has other things to say about the firm and its reporting. For example one such statement is that:

> *'The objective of general purpose external financial reporting is to provide information that is useful to present and potential investors and creditors and others in making investment, credit, and similar resource allocation decisions.'*
>
> Section 5.2.1

14 GAAP is the mnemonic for generally accepted accounting principles – the basis of all accounting practice.

Furthermore the meaning of the phrase 'information that is useful' is further clarified as follows:

> *'financial reporting should provide information to help present and potential investors and creditors and others to assess the amounts, timing, and uncertainty of the entity's future cash inflows and outflows (the entity's future cash flows). That information is essential in assessing an entity's ability to generate net cash inflows and thus to provide returns to investors and creditors.'*
>
> Section 5.2.1

Accounting is clearly about the provision of information to enable the assessment of future returns on investment. But we have attempted to show that although this has been interpreted as sustainability in the discourse of firms and their reporting it is clearly at odds with the discourse of sustainability within both the academic community and the environmental community. Our argument is that, although these two discourses are seemingly incompatible, they are both incomplete, and that their completion brings about their reconciliation.

The Efficiency of Accounting

Accounting, from its inception, has been harnessed generally to dominant political interests and ideological views. They have been part of hegemonic discourses and have aroused controversy and public debate. The development of accounting in the early twentieth century worked hand in glove with early management theory, designed to order the workplace in such a way as to maximise management control and to minimise the power of the workforce both in terms of decision-making, and expertise and discretion regarding the work. Accounting has also been used to legitimate the corporate values of performance over others values such as truth or ethics, and has been co-opted to manipulate figures in favour of large-scale fraud, as has been revealed in recent years.

Management accounting principles and techniques supported Frederick Taylor's ideas of scientific job design (specialisation) and productivity in terms of reducing work criteria to those that could be measured and that would produce higher productivity in terms of profit and/or cost, and dispensing with the unwanted humanistic considerations altogether. Similarly, classical management's emphasis on hierarchical chains of command, and rules and procedures were supported by kindred ideas regarding the practice of management accounting

(Covaleski and Aiken 1986). Concepts of discipline and surveillance, taken much further by Foucault in his analysis of organisations, are also made more acceptable through reference to accounting techniques. Accounting has been used as a form of *dressage* or control, through its emphasis on precision, rules, measurement and on material, as opposed to psychological or humanistic outcomes (Jackson and Carter 1998) to legitimate the increasing control exerted particularly over employees in the workplace.

Accounting techniques have been used to promote efficiency – in both financial and operational terms – in bringing about structural and cultural change in industries undergoing privatisation. Thus Ogden and Anderson (1999) have shown how delegation of work was introduced into newly privatised water companies in such a way as to make the new managers strictly accountable while at the same time suggesting that they were being 'empowered' – which some managers accepted as part of the corporate values while others realised that their newly gained power was limited to operational boundaries and was being subjected to tight financial constraints. Accounting was also used in the privatisation of the electricity industry as a means of shifting power and status from professional electricians to managers (Carter and Crowther 2000b). In both cases values changed from those of professional standards of maintenance and safety to market criteria of high profits and low costs.

One of the roles of accounting is, of course, to exercise control through the measurement of performance. The inadequacy of accounting has been recognised by many, such as Johnson and Kaplan (1987) who argue that the role of accounting has changed so that it is no longer relevant to managerial needs. It has also been argued (Crowther 2002d) that although one aspect of managerial need is that of internal control of organisational activity and resource allocation, this is not in fact the prime need for accounting information which is used for the semiotic purpose of creating the desired impression of an organisation.

Cost accounting, the precursor of management accounting, appeared relatively late in the evolution of accounting systems but, just as financial accounting developed in response to the needs of its environment, so too did cost accounting emerge in order to satisfy different needs of business. Whereas financial accounting can be seen as concerned with controlling, recording and reporting upon transactions with, and to, stakeholders in the enterprise's external environment (primarily shareholders and other investors), cost accounting has traditionally been seen as an internal control mechanism. Johnson and Kaplan (1987) suggest that the development of cost management was influenced by the decision of nineteenth-century entrepreneurs to arrange for processes, which had previously been organised and priced in the market, to be brought within the control of one organisation. For example, the process outputs for a textile business include spinning, weaving and finishing. In the past each of these activities had been carried out by separate craftsmen operating in their own right and with their process outputs being exchanged in the market via merchants. Entrepreneurs believed that bringing the various processes associated with a single activity, such as textiles, within the control of one centrally organised hierarchy would result in greater profits. In so doing, however, a need was created to control the efficiency of the processes when combined and to attach an internal price, or more precisely a cost, to the processes now performed within the hierarchy. These systems thus provided quasi-market metrics that enabled managers to gauge the efficiency of the economic activity taking place within the organisation.

This ability to measure efficiency was predicated in the certainty arising from the Cartesian view of the world with its essential certainties which could be measured. This point was argued by Sombert (1915) who stated:

> *'Thought in economic activities then becomes more definite and conscious, in other words, more rational, and modern science has tended to make it so. But it has also helped to make it more exact and punctual, by providing the necessary machinery for measuring time.'*

This was of particular importance for the development of management accounting as early cost management systems emphasised the need to control the level of input resources consumed per output unit. This was particularly true of labour, as a unit of resource consumed, because labour normally comprised the greatest factor cost of production in any nineteenth-century industrial organisation. Different industries developed control measures to serve their own particular requirements: thus, for example, railways used cost per ton-mile while distributors/retailers used gross margins and stock turnover. Johnson and Kaplan describe how other organisational and procedural changes that were occurring in the late nineteenth and early twentieth century spawned cost accounting developments to serve the needs created by these changes. Procedural changes included the emergence of scientific management, which gave rise to F.W. Taylor's notion of 'one best way' of utilising labour and material resources, measured in terms of physical units. Henry Ford's factory, which began the mass production of the Model T in 1913, marked the triumph of scientific management. The exacting temporal practices of scientific management (see Clark 1987) were resonant with key features of management accounting, and the natural evolution of this concept was to ascertain the standard cost of a process and the concomitant comparison of variances between actual and standard performance. The first description of a system of standard costing and variance analysis is generally ascribed to G. Charter Harrison. Organisational changes in the form of vertically integrated, and later divisionalised, businesses also led to the development of innovative forms of accounting. Thus, for example, return on investment (ROI) was developed in order to be used centrally in vertically integrated firms to guide decisions on capital allocation between various activities. At a later date, when divisionalised businesses delegated the responsibility for using capital efficiently to managers, ROI also came to be used to judge local performance. Similarly flexible budgets were developed to assess and control business units subject to variations in output.

Every business will develop a number of performance measures that it considers are key indicators of operational success and these tend to be tailored to the particular firm. Accordingly, each firm will develop various performance metrics targeted at the perceived critical variables. Whilst there is a degree of variability in these operational measures there is far more uniformity in the use of financial performance metrics. Most companies, and where appropriate their divisions, use the level of profits earned as a measure of performance. Whilst the level of profit is important, on its own it is poor indicator of performance. Instead, profit adequacy requires expression in relation to the amount of capital resource utilised in the generation of that profit. The most common method of achieving this evaluation is through the measure of return on capital employed (ROCE). This is determined by the result of the firm's or division's net earnings before tax (NEBT) divided by the capital employed in the economic unit. The widespread use of ROCE reflects the fact that the measure has many positive features. Specifically, it uses routinely collected accounting data, and as such it benefits from having low data collection cost and having the objectivity that is inherent in financial accounting numbers. In addition, ROCE makes possible performance comparisons across divisions of different size and business activity.

One of the purposes of accounting, therefore, is to enable the evaluation of performance and thereby allow decisions to be made regarding the future of the business. Thus measures such as ROI and ROCE have been developed for this purpose. Sadly though these accounting measures equate efficiency with effectiveness and ally them to cost reduction – something to which we will return later in the chapter. So producing for less cost is considered to be desirable and is assumed to lead to sustainable competitive advantage. And, of course, the prime ways of reducing costs include both their externalisation and reducing the variable cost of labour by getting rid of people.

The evaluation of performance is partly concerned with the measurement of performance and partly with the reporting of that performance, and with the greater importance being given to social accountability the changing reporting needs of an organisation are also being recognised. Thus, Birnbeg (1980) states that accounting is attempting to supply various diverse groups, with different needs for information, and that there is a need for several distinct types of accounting to perform such a function. Similarly Gray (1992) considers the limitations of the traditional economic base for accounting and questions some of its premises such as: the desirability of growth; the existence of rational economic man; the exclusion of altruism; and the ignoring of the way in which wealth is distributed. He argues that there is a need for a new paradigm with the environment being considered as part of the firm rather than as an externality and with sustainability and the use of primary resources being given increased weighting. Rubenstein (1992) goes further and argues that there is a need for a new social contract between a business and the stakeholders to which it is accountable, and a business mission which recognises that some things go beyond accounting.

Corporate Sustainability

Sustainability is a fashionable concept for corporations and their reporting previously described as environmental reporting and then corporate social responsibility (CSR) reporting is now often described as sustainability reporting (Aras and Crowther 2007c). Corporate websites also tend to discuss sustainability. But it is apparent that sustainability and sustainable development are used as interchangeable terms. It is equally apparent that all corporations claim to have engaged with sustainability and solved the attendant problems.[15] It is apparent, therefore, that a very powerful semiotic (Guiraud 1975; Kim 1996) of sustainable activity has been created – conveniently as Fish (1985) shows that truth and belief are synonymous for all practical purposes. It has been argued elsewhere (Aras and Crowther 2008a) that this is a deliberate ploy as one of the effects of persuading people that corporate activity is sustainable is that the cost of capital for the firm is reduced as investors are misled into thinking that the level of risk involved in their investment is lower than it actually is.

15 See Aras and Crowther (2008d). The claim regarding all corporations engaging with sustainability is based on their research regarding all firms in the FTSE100.

Traditional accounting theory and practice assumes that value is created in the business through the transformation process and that distribution is merely concerned with how much of the resultant profit is given to the investors in the business now and how much is retained in order to generate future profits and hence future returns to investors. This is of course overly simplistic for a number of reasons. Even in traditional accounting theory it is recognised that some of the retained profit is needed merely to replace worn out capital – and hence to ensure sustainability in its narrowest sense. Accounting, of course, only attempts to record actions taking place within this transformational process, and even in doing so regards all costs as things leading to profit for distribution.

This traditional view of accounting is that the only activities with which the organisation should be concerned are those which take place within the organisation;[16] consequently it is considered that these are the only activities for which a role for accounting exists. Here, therefore, is located the essential dialectic of accounting – that some results of actions taken are significant and need to be recorded while others are irrelevant and need to be ignored. This view of accounting places the organisation at the centre of its world and the only interfaces with the external world take place at the beginning and end of its value chain. It is apparent, however, that any actions which an organisation undertakes will have an effect not just upon itself but also upon the external environment within which that organisation resides. In considering the effect of the organisation upon its external environment it must be recognised that this environment includes both the business environment in which the firm is operating, the local societal environment in which the organisation is located and the wider global environment.

The discourse of accounting can therefore be seen to be concerned solely with the operational performance of the organisation. Contrasting views of the role of accounting in the production process might therefore be epitomised as either providing a system of measurement to enable a reasonable market mediation in the resource allocation problem or as providing a mechanism for the expropriation of surplus value from the labour component of the transformational process. Both strands of the discourse, however, tend to view that labour as a homogeneous entity and consider the effect of organisational activity upon that entity. Labour is, of course, composed of individual people; moreover these individual people have a lifetime of availability for employment and different needs at different points during their life cycle. The depersonalisation of people through the use of the term labour, however, provides a mechanism for the treatment of labour as an entity

16 Essentially the only purpose of traditional accounting is to record the effects of actions upon the organisation itself.

without any recognition of these personal needs. Thus it is possible to restrict the discourse to that of the organisation and its components – labour, capital, etc, – and to theorise accordingly. The use of the term labour is a convenient euphemism which disguises the fact that labour consists of people, while the treatment of people as a variable cost effectively commodifies these people in the production process – something to which we will return later as it is central to our argument.

In order to create value in the transformational process[17] of an organisation then commodities need to be used efficiently, and this efficient use of such commodities is measured through the accounting of the organisation. When this commodity consists of people then this implies using them in such a way that the maximum surplus value can be extracted from them. The way in which this can be achieved is through the employment of young fit people who can work hard and then be replaced by more young fit people. In this way surplus value (in Marxian terms) can be transferred from the future of the person and extracted in the present. As people have been constituted as a commodified variable cost then they become merely a factor of production which can be exchanged for another factor of production, as the costs determined through the use of accounting legitimate. Thus it is reasonable, through an accounting analysis, to replace people with machinery if more value (profit) can be extracted in doing so, and this has provided the imperative for the Industrial Revolution which has continued up until the present. Accounting is only concerned with the effect of the actions of an organisation upon itself and so the effect of mechanisation upon people need not be taken into account. Thus if mechanisation results in people becoming unemployed (or possibly unemployable) then this is of no concern – except to the people themselves.

Conclusions

Risk, and the management of risk, is an important part of organisational life because of the potential implications of the consequences of organisational activity. The consequences of corporate activity can be very significant to that corporation and to its stakeholders and might not become apparent until far into the future. Thus the management of risk is of such consequence. This applies to all aspects of corporate activity but when we consider sustainability the level of risk does not necessarily increase but the consequences of the effects of activity do – to such an extent that the future viability of the firm is potentially placed in jeopardy. This is, therefore, something to which we will return in future chapters.

17 See Figure 1.2 in Chapter 1, p. 20.

4

Governance and Sustainable Performance

Introduction

In the risk minimising environment which epitomises the current era then every time society faces a new problem or threat then a new legislative process of some sort is introduced which tries to protect that society from a future reoccurrence (Romano 2004). Recently we have seen a wide range of problems with corporate behaviour, which we have argued has led to prominence being given to corporate social responsibility (CSR) (see, for example, Boele, Fabig and Wheeler 2001). Part of this effect is to recognise the concerns of all stakeholders to an organisation, and this has been researched by many people (for example, Johnson and Greening 1999; Knox and Maklan 2004) with inconclusive findings. Accordingly, therefore, corporations, with their increased level of responsibility and accountability to their stakeholders, have felt that there is a need to develop a code for corporate governance so as to guide them towards appropriate stakeholder relations.

A great deal of concern has been expressed all over the world about shortcomings in the systems of corporate governance in operation: Britain, Australia, most other Anglo-Saxon and English speaking countries, and many other countries, have a similar system of governance. Conversely Germany is a good example of the Continental approach where the distance between ownership and control is much less than in the United States, while Japan's system of corporate governance is in some ways in between Germany and the United States, and in other ways different from both (Shleifer and Vishny 1997). By contrast, in India the corporate governance system in the public sector may be characterised as a transient system, with the key players (that is, politicians, bureaucrats and managers) taking a myopic view of the system of governance. Such international comparisons illustrate different approaches to the problem of corporate governance and the problem of ensuring that managers act in their shareholders' interest. Recently, of course, much attention to this issue has been paid by institutional investors (Cox, Brammer and Millington 2004).

Many people have commented upon the current[1] financial crisis, its causes and consequences and there have been many attempts to theorise the problem in terms of market failure or governance failure. For some it is even the failure of capitalism. These people tend to advocate a change to the system – generally to another of their personal preference. Others have been more concerned to allocate blame – to the banks, the financial markets, the regulators or to governments – again according to their personal prejudices. Still others would say that it is an inevitable consequence of greed, ignorance and irresponsibility. One thing which is apparent is that the current financial crisis, much as previous ones, has highlighted failures in governance and failures in regulation. Indeed some writers, in their desire for scapegoating, have argued that the regulators are more guilty even than the perpetrators and should be sanctioned accordingly. There is a problem with managing the prevention of future financial crisis concerned with the problem of globalisation, to which we will return.

Good governance is, of course, important in every sphere of the society whether it be the corporate environment or general society or the political environment. Good governance levels can, for example, improve public faith and confidence in the political environment. When the resources are too limited to meet the minimum expectations of the people, it is a good governance level that can help to promote the welfare of society. And, of course, a concern with governance is at least as prevalent in the corporate world (Durnev and Kim 2005).

Corporate governance can be considered as an environment of trust, ethics, moral values and confidence – as a synergic effort of all the constituents of society – that is the stakeholders, including government; the general public, etc.; professional/service providers – and the corporate sector. One of the consequences of a concern with the actions of an organisation, and the consequences of those actions, has been an increasing concern with corporate governance (Hermalin 2005). Corporate governance is therefore a current buzzword the world over. It has gained tremendous importance in recent years. Two of the main reasons for this upsurge in interest are the economic liberalisation and deregulation of industry and business and the demand for new corporate ethos and stricter compliance with the law of the land. One more factor that has been responsible for the sudden exposure of the corporate

1 Current as at the time of writing in late 2008.

sector to a new paradigm for corporate governance that is in tune with the changing times is the demand for greater accountability of companies to their shareholders and customers (Bushman and Smith 2001).

Corporate Governance

One of the main issues, therefore, which has been exercising the minds of business managers, accountants and auditors, investment managers and government officials – again all over the world – is that of corporate governance. Often a company's main target is to become global – while at the same time remaining sustainable – as a means to gain competitive power. But the most important question is concerned with what will be a firm's route to becoming global and what will be necessary in order to get global competitive power. There is more than one answer to this question and there are a variety of routes for a company to achieve this.

Probably since the mid-1980s, corporate governance has attracted a great deal of attention. The early impetus was provided by Anglo-American codes of good corporate governance.[2] Stimulated by institutional investors, other countries in the developed, as well as in emerging, markets established or adapted version of these codes for their own companies. Supra-national authorities like the OECD and the World Bank did not remain passive and developed their own set of standard principles and recommendations. This type of self-regulation was chosen above a set of legal standards (Van den Barghe 2001). After the recent big corporate scandals, corporate governance has become central to most companies. It is understandable that investors' protection has become a much more important issue for all financial markets after the tremendous, high-profile firm failures and scandals. Investors are demanding that companies implement rigorous corporate governance principles in order to achieve better returns on their investment and to reduce agency costs. Most of the times investors are ready to pay more for companies to have good governance standards (Beiner et al. 2004). Similarly, a company's corporate governance report is one of the main tools for investor decisions. Because of these reasons companies cannot ignore the pressure for good governance from shareholders, potential investors and other market actors.

At the same time, banking credit risk measurement regulations are requiring new rules for a company's credit evaluations. New international bank capital adequacy assessment methods (Basel II) necessitate that credit evaluation rules

2 An example is the Cadbury Report in the UK, probably the earliest such code of governance.

are elaborately concerned with operational risk which covers, inter alia, corporate governance principles (Aras 2007a, 2007b). In this respect corporate governance will be one of the most important indicators for measuring risk. Another issue is related to firm credibility and riskiness. If the firm needs a high rating score then it will have to be pay attention to the principles of corporate governance rules also. Credit rating agencies analyse corporate governance practices along with other corporate indicators.[3] Even though corporate governance principles have always been important for getting good rating scores for large and publicly-held companies, they are also becoming much more important for investors, potential investors, creditors and governments. Because of all of these factors, corporate governance receives high priority on the agenda of policymakers, financial institutions, investors, companies and academics. This is one of the main indicators that the link between corporate governance and actual performance is still open for discussion. In the literature a number of studies have sought to investigate the relation between corporate governance mechanisms and performance (for example, Agrawal and Knoeber 1996; Loderer and Martin 1997; Dalton and others 1998; Cho 1998; Bhagart 1999; Choles 2001; Gompers, Ishii and Metrick 2001; Patterson 2002; Heracleous 2001; Demsetz and Villalonga 2002; Bhagat and Jefferis 2002; Becht et al. 2002; Millstein and MacAvoy 2003; Bøhren and Ødegaard 2004). Most of the studies have shown mixed results without a clear-cut relationship. Based on these results, it seems that corporate governance matters significantly to a company's performance, market value and credibility, and therefore that every company has to apply corporate governance principles. But the most important point is that corporate governance is the only means for companies to achieve corporate goals and strategies. Therefore companies have to improve their strategy and effective route to the implementation of governance principles. So, companies have to investigate what their corporate governance policy and practice needs to be.

The Purpose of Corporate Reporting

At the start of the twentieth century it was generally accepted that accounting served the purpose of facilitating the agency relationship between managers and owners of a business, through its reporting function, but that the general public had no right to such information (Murphy 1979). Thus as far as the UK is concerned, but paralleled in many other countries throughout the world (Crowther 2000a),

3 The ratings of these agencies have been shown to be particularly problematic in the current crisis. A probable consequence is that corporate governance practice will become weighted even more highly.

the Companies Act 1906 stated that there was no requirement for companies to produce financial statements, although the Companies (Consolidations) Act 1908 amended this to require the production of a profit and loss account and balance sheet. This was further amended by the Companies Act 1929 which required the production of these, together with a directors' report and an auditors' report for the AGM. Subsequent legislation has extended the reporting requirements of companies to the format seen today.

Such corporate reporting has, however, been extended to encompass more things in addition to satisfying legislative requirements. Thus the period up to the Second World War[4] saw an increasing use of accounting information for analysis purposes but with an emphasis upon the income statement. This period also saw the extension of the directors' report to contain information about the company which was not to be found in the financial statements. This information was, however, primarily concerning the past actions of the company as corporate reporting as the emphasis in this period remained firmly upon the reporting of past actions as part of the relationship between the ownership and management of the firm. It is only in the post-war period that this emphasis changed from backward looking to forward looking and from inward looking to outward looking. Gilmore and Willmott (1992) have argued that this was a reflection of the changing nature of such reporting to a focus upon investment decision-making and the need to attract investment into the company in this period of expansion. The emphasis remained firmly upon the needs of the company, however, and only the emphasis had changed from informing existing investors to attracting new investors and so Jordan (1970: 39) was able to claim that:

> *'The purpose of accounting is to communicate economic messages on the results of business decisions and events, insofar as they can be expressed in terms of quantifiable financial data, in such a way as to achieve maximum understanding by the user and correspondence of the message with economic reality.'*

At this time the users of such corporate reports have increased so that they are no longer only the shareholders of the company and its managers, but all were, however, still considered to be a restricted set of the population, having specialist knowledge of and interest in such reporting. The identification of such specialists had however been extended to include both the accounting

4 From 1939–45.

profession and investment professionals. Thus Cyert and Ijira (1974: 29) were able to claim that:

> *'Financial statements are not just statements reporting on the financial activities and status of a corporation. They are a product of mutual interactions of three parties: corporations, users of financial statements, and the accounting profession.'*

While Leach (1975) stated that:

> *'In recent years there have been enormous changes in public interest in and understanding of financial statements. The informed user of accounts today is no longer solely the individual shareholder but equally the trained professional acting for institutional investors and the financial news media.'*

Thus there was at this time a general acceptance that corporate reporting should be provided for the knowledgeable professional rather than the individual investor or potential investor, who was assumed to be financially naive (Mauntz and Sharif 1961), and in order to satisfy the needs of these professionals corporate reports became more extensive in content with greater disclosure of financial and other information. This pressure for greater disclosure was not, however, new and Mitchell (1906) argued that the accounts produced did not give an adequate basis for shareholder judgement. All that has changed is the perception of who the reporting should be aimed at with a widening of the perceived intended audience from managers and shareholders to include other professionals. There was at this time little questioning of the assumed knowledge that the financial information is the most important part of the corporate report. The importance of the financial information contained in the reports has changed, however, and Lee and Tweedie (1977) claimed that the most important financial information contained in the report was details concerning profits, earnings and dividends. They equally claimed that the economic prospects of the firm are the most important information contained in the report (Lee and Tweedie 1975) but were dismissive of the private shareholder in recording (Lee and Tweedie 1977) that the majority read the chairman's report but nothing else.

This focus upon the development of the financial reporting aspects of corporate reporting of course ignores the development of the semiotic of such reporting and the changing nature of this semiotic. This lack of recognition is despite the acceptance that such reporting had changed over time to become more forward looking, to include more non-financial information including the chairman's report, and to become used by a wider range of people. It has been argued (Crowther 2002d; Crowther, Carter and Cooper 2006) that this semiotic of corporate reporting is the most important use of such reporting and the prime vehicle for developing an understanding of such reporting and the changed nature of the reporting itself. Indeed the function of the semiotic is to aid social construction of corporate activity in a way which is mediated through the semiotic (Vygotsky and Luria 1994) in such a way that the interpretation of the reader is controlled from without by the creators of the semiotic.[5] It is further argued that the lack of recognition of the semiotic of corporate reporting has also led to a lack of exploration of the dialectics inherent in such reporting.

The most recent stage in the development of reporting is epitomised by the most dramatic changes in corporate reporting. No longer is the firm seeking to communicate internally – to members or potential members – but rather the focus is upon the external environment. Indeed no longer do results matter, although still contained in the report but relegated to semi-obscurity, and it is only prospects that matter. Thus the report now becomes predominantly forward looking and, perhaps more significantly, the forward orientation is not upon the economic prospects of the firm but upon the prospects for the shareholder community in terms of rewards – both dividends and share price increases. Additionally the report now acknowledges the rest of the stakeholder community and seeks to demonstrate corporate citizenship by commenting upon relationship with, and benefits accruing to, employees, society, customers and the local community. Indeed the report has tended to become not a communication medium but rather a mechanism for self promotion. Thus the actual results of the firm's past performance no longer matter but rather the image of the firm is what matters and the production of the report is the event itself, rather then merely a communication mechanism. And, of course, the availability of this reporting has increased dramatically as all companies[6] now show their reports via the internet as well as via paper, thereby making them potentially accessible to everyone. Inevitably alongside that greater accessibility of corporate reporting has gone an interest in corporate activity

5 Indeed the parceling up of dubious investments into mixed packages of doubtful value which are then bought by investment managers without understanding what they have bought – a feature of the current crisis – is a prime example of the power of the semiotic.

6 It is accepted that not all companies throughout the world yet do this but the number of companies which do not report via the internet is shrinking rapidly. Moreover it is a requirement in an increasing number of countries.

and this has raised the importance of governance for corporations and their stakeholders alike.

Good Governance and Corporate Behaviour

Good governance is, of course, important in every sphere of the society whether it be the corporate environment or general society or the political environment. Good governance levels can, for example, improve public faith and confidence in the political environment. When the resources are too limited to meet the minimum expectations of the people, it is a good governance level that can help to promote the welfare of society. And, of course, a concern with governance is at least as prevalent in the corporate world.

Good governance is essential for good corporate performance and one view of good corporate performance is that of stewardship and thus just as the management of an organisation is concerned with the stewardship of the financial resources of the organisation so too would management of the organisation be concerned with the stewardship of environmental resources. The difference however is that environmental resources are mostly located externally to the organisation. Stewardship in this context therefore is concerned with the resources of society as well as the resources of the organisation. As far as stewardship of external environmental resources is concerned then the central tenet of such stewardship is that of ensuring sustainability. Sustainability is focused on the future and is concerned with ensuring that the choices of resource utilisation in the future are not constrained by decisions taken in the present. This necessarily implies such concepts as generating and utilising renewable resources, minimising pollution and using new techniques of manufacture and distribution. It also implies the acceptance of any costs involved in the present as an investment for the future.

Corporate governance can be considered as a synergic effort of all the constituents of society – that is the stakeholders, including government; the general public, etc.; professional/service providers – and the corporate sector. One of the consequences of a concern with the actions of an organisation, and the consequences of those actions, has been an increasing concern with corporate governance. Corporate governance is therefore a current buzzword the world over. It has gained tremendous importance in recent years. There is a considerable body of literature which considers the components of a good system of governance (for example, Bhagat and Black 1999; Coles et al. 2001;

Patterson 2002; Bhagat and Jefferies, 2002) and a variety of frameworks exist or have been proposed. Aras and Crowther (2008e, 2009b) have examined and evaluated these frameworks while also outlining the cultural context of systems of governance. Their argument is that corporate governance is a complex issue which cannot be related to merely the Anglo-Saxon approach to business; indeed it cannot be understood without taking geographical, cultural and historical factors into account in order to understand the similarities, differences and concerns relating to people of different parts of the world.

As we have seen a great deal of concern has been expressed all over the world about shortcomings in the systems of corporate governance in operation and its organisation has been a subject of much debate among business leaders, academics and government officials all over the world. Often companies' main target is to become global – while at the same time remaining sustainable – as a means to get competitive power. But the most important question is concerned with what will be a firm's route to becoming global and what will be necessary in order to get global competitive power. There is more then one answer to this question and there are a variety of routes for a company to achieve this. Corporate governance can be considered as an environment of trust, ethics, moral values and confidence – as a synergic effort of all the constituents of society – that is the stakeholders, including government; the general public, etc.; professional/service providers – and the corporate sector.

Of equal concern is the question of CSR – what this means and how it can be operationalised. Although there is an accepted link between good corporate governance and CSR the relationship between the two is not clearly defined and understood. Thus many firms reporting on the London Stock Exchange consider that their governance is adequate because they comply with The Combined Code on Corporate Governance, which came into effect in 2003.[7] Of course all firms reporting on the London Stock Exchange are required to comply with this Code, and so these firms are doing no more than meeting their regulatory obligations. Many companies regard corporate governance as simply a part of investor relationships and do nothing more regarding such governance except to identify that it is important to investors/potential investors and to flag up that they have such governance policies. The more enlightened recognise that there is a clear link between governance and CSR and make efforts to link the two. Often this is no more than making a claim that good governance is a part of their CSR policy as well as a part of their relationship with shareholders.

7 This code was amended in 2006 and may well be amended again.

Corporate Governance Principles

Since corporate governance can be highly influential for firm performance, firms must know what the corporate governance principles are and how it will improve their strategic planning to apply these principles. In practice there are four principles of good corporate governance, which are:

- Transparency;
- Accountability;
- Responsibility;
- Fairness.

All these principles are related with the firm's CSR. Corporate governance principles, therefore, are important for a firm but the real issue is concerned with what corporate governance actually is.

Management can be interpreted as managing a firm for the purpose of creating and maintaining value for shareholders. Corporate governance procedures determine every aspect of the role for management of the firm and try to keep in balance and to develop control mechanisms in order to increase both shareholder value and the satisfaction of other stakeholders. In other words, corporate governance is concerned with creating a balance between the economic and social goals of a company including such aspects as the efficient use of resources, accountability in the use of its power and the behaviour of the corporation in its social environment.

The definition and measurement of good corporate governance is still subject to debate. However, good corporate governance will address such points as creating sustainable value, achieving the firm's goals and keeping a balance between economic and social benefit. Also, of course, good governance offers some long-term benefits for a firm, such as reducing risk and attracting new investors, shareholders and more equity.

Corporate Reputation

One concept which is of growing importance for business management, and also for academics, is that of corporate reputation. The beginning of the twenty-first century creates a new challenge for corporations – realising the potential of their corporate brands (Papasolomou 2005). In today's markets, organisations focus on intangible factors in order to compete and differentiate their services/products in an environment which is characterised by rapid changes. The reputation of the corporation is often the most important factor in gaining a competitive advantage as well as building financial and social success. Corporations are realising that possessing a well-known name such as Johnson & Johnson, can help them secure a good position in the marketplace. Businesses are not only faced with sophisticated and informed stakeholders but also by rigorous regulation and evolving standards as well as by independent associations and agencies that act as watchdogs guarding the interests of their publics. Kitchen and Lawrence (2003) stipulate that even though corporations have always valued corporate reputation it is only in the latter part of the twentieth century that it became a topic of major importance.

There are many benefits claimed for being perceived as having a good corporate reputation. One of the main ones is concerned with the fact that it improves shareholder value; a strong corporate reputation inspires confidence in investors, which in turn leads to a higher stock price for a company. The Opinion Research Corporation (ORC), which conducts 'Corperceptions', a periodic survey of more than 4,000 business executives in several of the world's major markets concludes that the better the corporate reputation, the higher the stock price (Morley 2002). It brings increased customer loyalty to the products of the company because a positive customer perception of a company extends to its products. Equally a strong corporate reputation is an influential factor for forming partnerships and strategic alliances as the partner company has the potential to improve its own reputation by association. Similarly a company with a solid reputation is more influential on legislative and regulatory governmental decision-making. Employee morale and commitment are higher at corporations with a good corporate reputation. At a time of a crisis a good corporate reputation can shield the company from criticism and even blame, and can help it communicate its own point of view more easily to audiences that are willing to listen to its point of view. A good example is the Pepsi Cola tampering case according to which products on sale were found to contain hypodermic syringes. Pepsi dealt effectively with the crisis by defusing public alarm with a public relations campaign that highlighted the integrity of its manufacturing process and its corporate credibility (Morley 2002). Kitchen and Lawrence (2003) show that corporate reputation underlines the need for corporate branding and the effective management of corporate brand reputation.

A positive image that people share about an organisation can yield positive influence on the quality of the relationships between that organisation and its stakeholders. Thus Chajet (1989) postulates that a company with a good image can more easily attract audiences that influence the success of the organisation such as: investors, partners, employees and customers. Similarly Mackiewicz (1993) shows that research studies indicate that 90 per cent of consumers use the reputation of an organisation in order to decide which product or service they will buy from among those that are available at a similar price and quality, while Poiesz (1986) stipulates that without the existence of images, it will not be easy for consumers to decide which products to buy and Bernstein (1986) claims that image affects attitudes, which in turn affect behaviour. The Reputation Institute indicated that the best corporate reputations in the USA – the world's major market – also perform significantly better than others in terms of market share and share value (*Wall St. Journal* 1999). The reputation of a company needs to be protected as it can ensure the growth and long-term survival of the company. Building and maintaining a strong positive reputation depends on establishing strong relationships with the corporate stakeholders.

The Relationship Between Financial, Social and Environmental Performance

In a previous chapter we dismissed the concept of the triple bottom line, and later we will propose our own alternative approach. We must state, however, that we do not reject a concern for financial, social and environmental performance as essential elements of corporate behaviour; indeed these are key aspects of sustainability – necessary but not sufficient. We maintain, however, that these are not separate aspects of corporate performance but inevitably interrelated as dimensions of a single performance; thus all together are a part of sustainable performance.

It will be appreciated that not only does sustainable activity impact upon society in the future but it also impacts upon the organisation itself in the future. So good performance in the present is essential for the future of the company, along all dimensions of that performance. We can therefore state that good environmental performance by an organisation in the present makes sound strategic sense as it is in reality an investment in the future of the organisation itself. One way to achieve this is to ensure that supplies of raw materials and the design of production techniques will enable the organisation to operate in the future in a similar way to its operations in the present[8] and so to undertake its value creating activities in the future in much the same way as it does in the present. We can see therefore that the internal management of the firm, from a financial perspective, and its external environmental management coincide in this common concern for management for the future. Good performance in the financial dimension leads to good future performance in the environmental dimension and vice versa (Crowther 2002c). This concern is of course the management of the future as far as the firm is concerned.[9] The role of social and environmental accounting and reporting and the role of financial accounting and reporting therefore can be seen to coincide and therefore the work required needs be concerned not with arguments about resource distribution but rather with the development of measures which truly reflect the activities of the organisation upon its environment. These techniques of measurement, and consequently of reporting, are a necessary precursor to the concern with the management for the future – and hence with sustainability.

All actions of the company have effects both within the company and outside the company. Consequently the firm distributes effects from its activities which are far wider than simply the profit resulting from its activities being distributed to shareholders. Value is distributed to all of the stakeholders and this value can be either positive or negative with the complete distribution including both positive effects and negative effect. Value in this context must be taken as its widest definition to include more than economic value; it is probable that economic value can be created at the expense of other constituent components of welfare[10] such as spiritual or emotional welfare.[11] This creation of value by the firm adds to welfare for society at large, although this welfare is targeted at particular members of society rather than treating all as equals. This of course has led to arguments – which have become more prominent and probably also strengthened by the financial crisis of 2008 – that value is created for one set of stakeholders at the expense of others, and that value redistribution has been deceitfully described as value creation. In this context we can see that good environmental performance leads to increased welfare for society at large, which will be expressed in a feeling of wellbeing. This will of course

8 This is an important point which we will return to many times in the context of the transformational process – see Figure 1.1, p. 20.

9 Financial reporting is of course premised upon the continuing of the company – the going concern principle.

10 This is of course an integral part of our sustainability model – see Figure 2.2, p. 41.

11 See, for example, Mishan (1967), Ormerod (1994) and Crowther, Davies and Cooper (1998). This can be equated to the concept of utility from the discourse of classical liberalism, and from Benthamite economics.

lead to increased motivation. Such increased motivation will inevitably lead to increased productivity, some of which will benefit the organisations, and also a desire to maintain the pleasant environment which will in turn lead to a further enhanced environment, a further increase in welfare and the reduction of destructive aspects of societal engagement by individuals.

An increase in welfare leads to its own self-perpetuation, and vice versa. Consequently it is apparent that financial performance and environmental performance conflate into a general concern with an increase in welfare.

Good Governance and Sustainability

It is clear that all these long-term benefits are also directly related to the sustainability of a firm and that firm's success. We can evaluate corporate governance from different perspectives, such as that of the general economy; the company itself; private and institutional investors; or banking and other financial institutions. Some research results show that the quality of the corporate governance system of an economy may be an important determinant of its competitive conditions (Fulghieri and Suominen 2005). Authors suggest the existence of a reverse causality between corporate governance and competition and also examined the role of competition in the production of good corporate governance. Van de Berghe and Levrau (2003) on the other hand investigated from the perspective of companies, investors and banks, arguing that from the company's perspective, it can no longer ignore the pressure for good corporate governance from the investor community. Installing proper governance mechanisms may provide a company with a competitive advantage in attracting investors who are prepared to pay a premium for well-governed companies. From an investor's perspective, corporate governance has become an important factor in investment decisions as it is recognised to have an impact on the financial risks of their portfolios. Institutional investors put issues of corporate governance on a par with financial indicators when evaluating investment decisions. From the creditor's perspective, there is a plea for increased attention for corporate governance in a bank's risk measurement methods: a plea which is supported by the new requirements put in place by Basel II.

Bøhren, and Ødegaard (2004) also showed that corporate governance matters for economic performance; insider ownership matters the most while outside ownership concentration destroys market value; direct ownership is superior to indirect; and that performance decreases with increasing board size, leverage, dividend payout, and the fraction of non-voting shares. Black et al. (2005) investigated the relationship between governance and firm value. They found evidence that better governed firms pay higher dividends, but no evidence that they report higher accounting profits.

It is clear that all these long-term benefits are also directly related to the sustainability of a firm and that firm's success. It would seem apparent, therefore, that there should be some attention paid to sustainability within the corporate governance of a corporation. It therefore becomes imperative to conduct an investigation as to what exactly is mentioned about sustainability within such corporate governance. It is to be expected that good corporate governance will foster sustainability in general and will deal specifically with all four elements of sustainability outlined earlier. It therefore becomes possible to state the following hypotheses:

1. Good corporate governance will address the issue of sustainability.

   and

2. Good corporate governance will address the societal influence aspect of sustainability.

3. Good corporate governance will address the environmental impact aspect of sustainability.

4. Good corporate governance will address the organisational culture aspect of sustainability.

5. Good corporate governance will address the finance aspect of sustainability.

There has been much work undertaken which investigates the failures of corporate governance and the ensuing problems which arise and this could be adapted to a consideration of our concern with the relationship between corporate governance and sustainability. We argue however that this approach – akin to Popper's (1959) falsification theory – is not an appropriate methodology for this research, rather our starting assumption is that effective corporate governance will be largely unnoticed and the relationship assumed in our hypotheses will be manifest in examples of good practice rather than in the exceptional instances of poor practice. Our investigation, therefore, is based on exploring corporate governance in the FTSE100 companies which are generally accepted to be examples of good practice in this respect.

The further assumption we make in conducting this research is that the reporting of corporate activity through the corporate website is more complete that that contained in the statutory reporting. In other words everything which can be found in the statutory reporting can also be found on the corporate website, along with much more information. Our methodology, therefore, is based on investigating the information about the various aspects of corporate governance with which we are concerned by an evaluation of these corporate websites. And our analysis is primarily qualitative with some simple descriptive statistics.

Relating Sustainability with Governance: the Evidence

Although there is a clear link between good corporate governance and all aspects of a firm's performance, which will ultimately affect the sustainability of that firm's activity our research does not show that this is at all clearly understood by many firms. Of the firms in the FTSE100 it is clear that a majority do not understand this relationship – or do not think that it is important. Thus 30 per cent of the firms consider that their governance is adequate because they comply with The Combined Code on Corporate Governance, which came into effect in 2003. Of course all firms reporting on the London Stock Exchange are required to comply with this Code, and so these firms are doing no more than meeting their regulatory obligations and the other 70 per cent also comply with the Code. A further 24 per cent regard corporate governance as simply a part of investor relationships and do nothing more regarding such governance except to identify that it is important to investors/potential investors and to flag up that they have such governance policies.

This therefore leaves only 46 per cent who recognise that there is a relationship between governance and other aspects of corporate activity. Thus 27 per cent of firms recognise that there is a clear link between governance and CSR[12] and make efforts to link the two. Often this is no more than making a claim that good governance is a part of their CSR policy as well as a part of their relationship with shareholders. And of course there are a lot of vague comments about firms

12 The terms used include corporate social responsibility and corporate responsibility.

doing their best[13] to behave sustainably, without any precise indications of what is meant by such a claim. Some firms do however go further then this and make clear links to specific action. Thus 5 per cent recognise the relationship to financial sustainability through an understanding of the relationship between governance and risk. Similarly 2 per cent relate governance to community relations; 4 per cent to ethical behaviour towards employees; 3 per cent to environmental policy and behaviour; and 1 per cent to their commitment to sustainable growth. Despite these seemingly dispiritingly small numbers though it is encouraging that 7 per cent of firms recognise the relationship to all the aspects of sustainability which we have identified and clearly spell out their relationship in their corporate activity.

This can all be summarised in the following table (Table 4.1):

Table 4.1 The relationship between corporate governance and sustainability

Type of relationship recognised/action undertaken/commitment made	Firms recognising the relationship (%)
Comply with Code only	30
Related to investor relations only	24
Related to CSR policy	27
Community relations	2
Ethics	4
Environmental policy	3
Sustainable growth	1
Risk	5
Full connection to sustainability	7

It is tempting to try to undertake some analysis of sectoral differences in the approaches taken concerning governance practice, and from the evidence in the research there certainly are some differences. But we need to be realistic and state that, as we have only looked at the FTSE 100, our sample is too small (and probably unrepresentative) to undertake some reliable analysis of this nature. We therefore flag up this as further analysis to be undertaken in our project. So we simply turn to a consideration of what conclusions we can draw from this research.

13 Often the phrase used includes something like 'within reason' or 'in the light of circumstance' as a way of obviating any real commitment to any particular sort of action.

Conclusions

With respect to the hypotheses proposed then the sort of research which we have undertaken has been qualitative and therefore has not been sufficient to either prove or disprove these hypotheses. So it is not possible to say that good corporate governance will address these issues. What it is possible to state though is that a firm which has a more complete understanding of both sustainability and of corporate governance will address these issues more completely. By implication a more complete understanding of the interrelationships will lead to better corporate governance, thereby implying the validity of these hypotheses.

The other tentative conclusion from this research is concerned with the extent of disclosure manifest through the reporting of such things as corporate governance and sustainability, and is more in the nature of a prognosis. Crowther (2000a) traces an archaeology of corporate reporting which shows that, over time, the amount of information provided – first to shareholders, then to potential investors (Gilmore and Willmott 1992), then to other stakeholders – has gradually increased throughout the last century, as firms recognised the benefit in providing increased disclosure. Similarly the amount of disclosure regarding CSR activity has been increasing rapidly over the last decade as firms have recognised the commercial benefits of increased transparency. Therefore it is reasonable to argue – as we are doing – that the amount of information regarding the relationship between governance and sustainability will also increase, not just as firms gain a clearer understanding of that relationship but also as they understand the benefits of greater disclosure in this respect. Thus we conclude that the validity of our hypotheses will become more apparent over time.

It can therefore be seen that corporate governance is an important issue which is inevitably related to corporate performance and therefore also to sustainability and sustainable performance. A lot of attention has bee directed to the establishment of codes of corporate governance and recently it has been recognised that this must necessarily extend beyond simply investor relations and into the arena of all stakeholder relations. It is clear, therefore, that the definition of corporate governance has extended considerably beyond investor relations and encompasses relations with all stakeholders – including the environment. This is essential for the longer term survival of a firm and is therefore a key component of sustainability. There is evidence that some firms understand this but they are in a minority. So it is possible to say that good corporate governance will address this but that not all firms recognise this. It is equally possible to state that a firm which has a more complete understanding of the relationship between social responsibility, sustainability and corporate governance will address these issues more completely. By implication a more complete understanding of the interrelationships will lead to better corporate governance, and therefore to better economic performance.

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5

Implications of the Size and Sector of a Firm

Introduction

We have seen that the context in which a firm operates is important, not just for its financial performance but also for its approach to, and chances of, achieving sustainability. In other words, the external environment is important to a company. So, too, is the internal environment within the company itself. This, of course, is in accordance with our definition of the aspects on sustainability outlined in Chapter 2. At this point in our analysis, therefore, it is opportune to investigate more rigorously what the relationship is by undertaking some quantitative analysis. In undertaking our analysis we have paid attention to three factors and investigated the differences, if any, which these make to the sustainability of the firm. First, we have looked at the country in which the firm is domiciled; then we have looked at the sector in which is it active; then, we have looked in detail at its size and profitability. From this analysis we have drawn some useful conclusions which will assist our further analysis in the rest of the book.

Country and Sectoral Analysis

Although there are many ways to consider a country analysis, the most common method is to compare two different countries and very often this is based upon the comparison of a developed country with a developing country. The implication of this is that the developing country is aspiring to become a developed country and so will inevitably assume the same characteristics. There may be some truth in this but much of the underlying assumptions seem to be fallacious because of the many different geopolitical and cultural factors at play. We have, therefore, explicitly not made this assumption. Nevertheless, we have started with a comparison between developed and developing countries.

Our starting point for analysis has been the Dow Jones Sustainability Index (DJSI) on the basis that this Index is composed of companies which have chosen to be included and, therefore, have a concern for sustainability, even if they do not necessarily understand its implications. We can illustrate this through the following selected quotations from their annual reports.

Thus, Shell[1] expresses a concern for sustainability in terms of the triple bottom line when stating:

> *'The companies of the Royal Dutch/Shell Group have an integrated vision of sustainability built on three pillars: economic progress, social development and environmental improvement. The Shell commitment to sustainable development is being incorporated into strategic planning and the daily conduct of the business.'*

One the other hand, BP provides a good illustration of the confusion between sustainability and mere continued existence, by stating in its 2006 report:[2]

> *'That is why we care about the sustainability of our activities and why, throughout the company, we work to ensure that the things we do and the way we do them are genuinely sustainable.'*

While later in the same report (on the same page even) is stated:

> *'BP has now sustained itself as a company for almost 100 years through periods of dramatic economic, social, political, technological and commercial change.'*

There are over 2,500 companies included in the DJSI, the vast majority (around 95 per cent), of course, being domiciled in developed countries. Of these, around 40 per cent are domiciled in the USA and 8 per cent in the UK. In terms of the sectors included this is shown in Figure 5.1.

This can then be broken down between developed and developing countries as shown in Figures 5.2 and 5.3.

Alternatively, a comparison between OECD and non-OECD countries can be made, this is illustrated in Figures 5.4 and 5.5.

1 From http://www.shell.com/home/content/mediaen/news_and_library/speeches/1998/shelland sustain_10171340.html accessed on 21 August 2007.

2 www.bp.com.

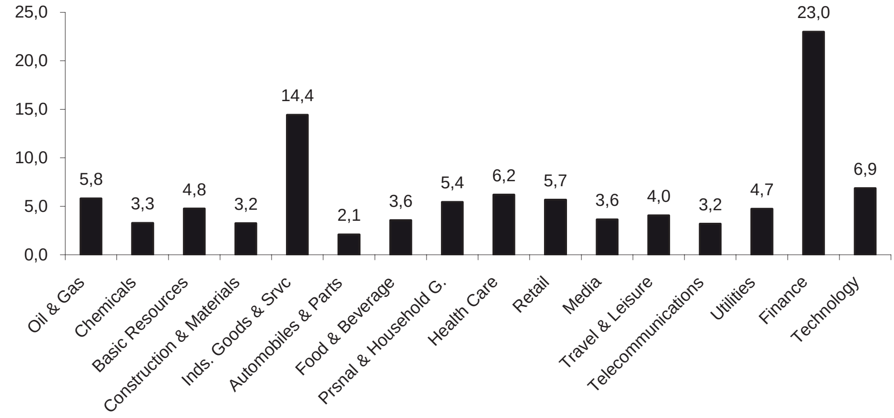

Figure 5.1 Developed countries sectoral distribution

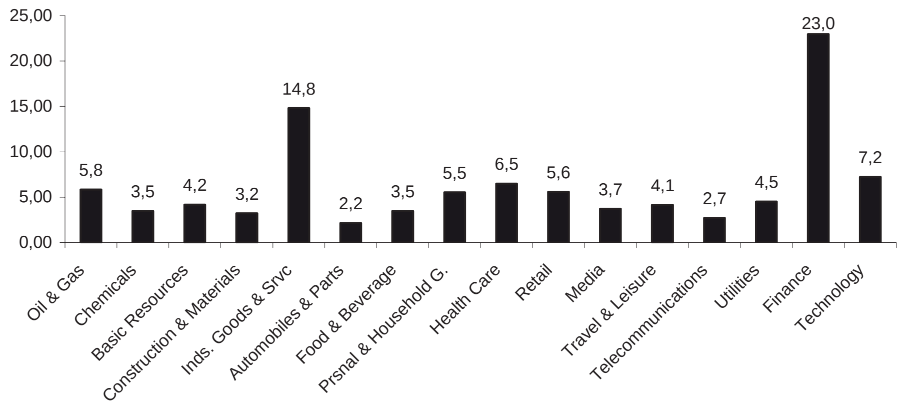

Figure 5.2 Developed countries sectoral distribution

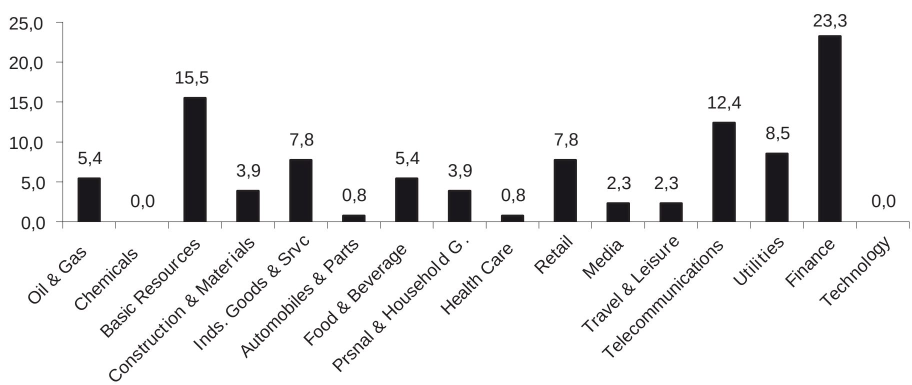

Figure 5.3 Developed countries sectoral distribution

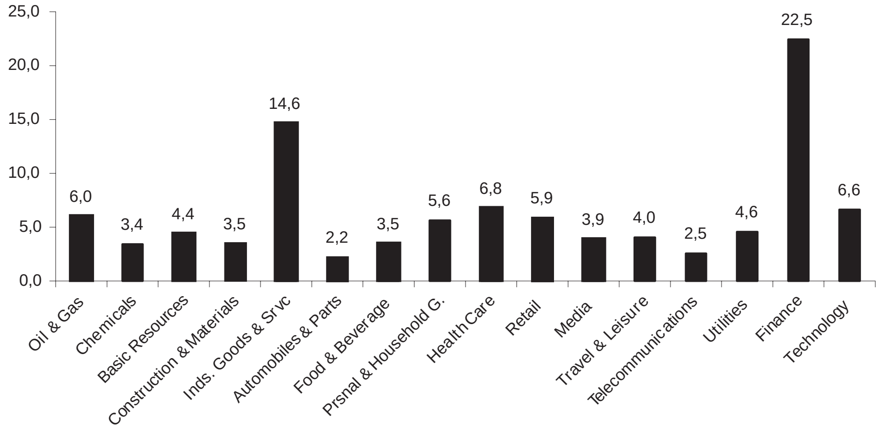

Figure 5.4 OECD countries

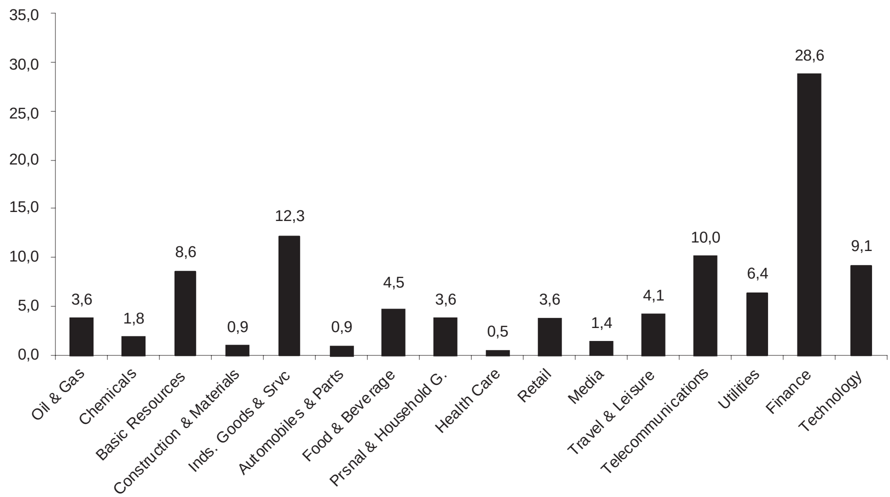

Figure 5.5 Non-OECD countries

The essential point of this analysis is to illustrate that there is a great deal of similarity between developed and developing countries and no reason to assume the developing countries will necessarily change in characteristics as they develop. We therefore argue that there is no need for a comparison, interesting as it may be, between a developed country and a developing country and we therefore turn our attention to a consideration of firms themselves and the relationship between sustainability and size and profitability.

Sustainability and Financial Performance

As we have seen, there is no agreed upon definition of exactly what constitutes either corporate social responsibility (CSR) (Ortiz, Martinez and Crowther 2005) or sustainability (Aras and Crowther 2007c) and therefore no agreed upon basis for measuring that activity and relating it to the various dimensions of corporate performance, although Kristensen and Westlund (2004) argue that financial and non-financial measures need to be integrated for sustainability measures. Nevertheless, both academics and practitioners point to Howard Bowen's Social Responsibilities of the Businessman (1953) as the initial attempt to thoroughly examine and analyse the relationship between corporations and society (see, for example, Carroll 1979; Wartick and Cochran 1985). Other approaches have been adopted and, for example van den Brink and van der Woerd (2004) propose industry-specific measures for sustainability.

There have been many theoretical and empirical debates about the relationship between corporate social performance and firm financial performance (see, for example, Aras and Crowther 2007a). There have been no empirical studies concerning the relationship between sustainability and financial performance, at least using our definition; conversely, the relationship between CSR and financial performance has been empirically examined by 127 published studies between 1972 and 2002 with different measurement methods (Margolis and Walsh 2003). We base our analysis on these studies on the basis that there is considerable similarity in the terms of investigation. In these studies, basically two types of financial performance measures have been used in order to investigate the link between different aspects of firm performance and CSR. The first one is the accounting based financial performance measures but this method has certain drawbacks. It only shows historical firm performance, can be affected by the manipulation of the managers and produces incomparable results between firms because of the different accounting procedures applied. The characteristic of different sectors and the risk associated with them should also be taken into consideration when using accounting based measures. To deal with the stated shortcomings, stock market-based measures can be used to analyse firm financial performance. The benefits associated with this second type of measure are that they are less dependent on varying accounting measures applied by firms and managerial manipulations. This type of measure is also successful at attaining the companies' future economic earnings rather than past performance. However, the shortcoming of this method is that the investors' perception of the company may not be enough to gauge firm financial performance (McGuire et al. 1988; Ullmann 1985).

Some of these studies have seen a positive relationship between CSR and financial performance, whereas others have not. According to modern stakeholder theory and Agency Theory there is expected to be a positive relationship between CSR and financial performance. Contrarily and probably the most important point is that what the stakeholders are concerned about or interested in developing/ emerging economies is financial performance. Investors are easily able to get excess returns in emerging markets and so they do not take into account long-term sustainability and corporate responsibility in these markets. Thus, it is not possible to find the link between CSR and financial performance. The second important point is concerned with how CSR and financial performance are measured. Three methods have mainly been used by prior studies for the measurement of CSR (McGuire et al. 1988). The first method is the expert evaluation of corporate policies. The accuracy of this method depends on the access of the investigator to full scope of activities of the firm and the expertise of the investigator (Abbott and Monsen 1979). The second method is the content analysis of annual reports and other corporate documents. Weber (1990) defines content analysis as 'a set of procedures to make valid inferences from text'. Krippendorff (2004: 18) states that 'content analysis is a research technique for making replicable and valid inferences from texts (or other meaningful matter) to the contexts of their use'. The performance of companies in controlling pollution as a proxy measure is the third method for the measurement of CSR (McGuire et al. 1988). Chen and Metcalf (1980) and Spicer (1978) used pollution control in their studies for the measurement of CSR. However, the usage of pollution control as a proxy measure can bias the results where there are differences between industries in terms of pollution and it also emphasises only one dimension of social responsibility. All these different measurement methods and approaches give different results. The last important point related to CSR and financial performance measurement is data collection and reliability of the sample. Mostly CSR data relies on the company reporting an activity, which can be manipulated and/or misreported. So data collection and reliability testing is always problematic in these studies.

CSR and sustainability are, of course, inevitably related and we therefore argue that the same methodology is equally applicable. Our study therefore examines and investigates the relationship between sustainability and size and financial performance of Turkish publicly held companies. The sample employed in this study consists of the companies listed in Istanbul Stock Exchange (ISE) 100 for the consecutive four years until 31 December 2006. Thus, the annual reports of 40 companies were selected after removing the companies in the financial sector and two companies in the automobile sector because of the fact that their annual reports varied greatly from those of the remaining sample.

There is one further point which we should make. In our definition of sustainability (see Chapter 2), we identified four factors – societal influence, environmental impact, organisational culture and finance – and argued that it was the balance between them which is important to achieve sustainability. In this chapter, however, we are taking a slightly different approach and relaxing that argument. Because we are comparing financial performance with sustainable performance we have excluded finance from the sustainability factors and are concentrating upon the other three. This is, of course, essential to compare sustainability with financial performance and is, therefore, also logical when comparing with firm size also.

Methodology Used in the Analysis

This research uses the content analysis method which was first used by Bowman and Haire (1975). Other studies on social and environmental disclosures have also employed this approach (see, for example, Abbott and Monsen 1979; Hughes et al. 2001; Hackston and Milne 1996; Ingram 1978; Anderson and Frankle 1980). The disclosure related to sustainability is derived from the 2006 annual reports of the 40 companies constituting the sample as is the case with prior studies (Hackston and Milne 1996; Hughes et al. 2001; Gray et al. 1995a; Hall 2002). The usage of the annual reports for the medium of such disclosures has been supported by Hughes, Anderson and Golden (2001) because of their easy reach and the fact that they are tools that enable companies to get across with the shareholders.

The content analysis of social and environmental disclosures consists of two processes which are the development of a categorisation scheme and determination of the rules to be used as a guide for the decision of what and how to code (Milne and Adler 1999). The method of categorisation used in this study is based on the study of Ng (1985) who further developed this comprehensive checklist from the work of Ernst and Ernst 1978.

The number of the sentences related to the aspects of sustainability disclosed in the companies' annual reports, is the unit of analysis used in this study to determine the degree of sustainability, based on the work of Hackston and Milne (1996). Using sentences as a medium for the basis of coding is far more reliable than any other unit of analysis because unreliability is increased when words or areas of a page are used instead (Milne and Adler 1999). Ng (1985) used number of words because of his criticism of the portion of pages which could distort the results related to the differences in print, column and page sizes of the annual reports. However, number of words also is not a precise measurement because of the subjectivity in deciding which individual word is related to any aspect (Crowther 2002c). Thus, it can be argued that number of sentences solves the problem of standardisation of words (Hackston and Milne 1996). This instrument enables the researcher to record the amount of CSR in various categories and has four dimensions which are listed below:

- theme: environment, societal and culture, and employee;
- evidence: monetary quantification, non-monetary quantification and declaration;
- news type: good, bad and neutral news;
- amount: number of sentences.

Table 5.1 Definitions of evidence

Term	Definition
Monetary	Financial definition in currency
Non-Monetary (quantitative)	Disclosure in quantified terms, but not in currency (that is, measures of weight, mass, volume or size), can be in absolute terms or percentages
Declarative	If not one of the above

Tilt (1998)

Table 5.2 Definitions of news type

Term	Definition
Neutral News	statement of policy or intent within statutory minimum with no details of what or how; statement of facts whose credit/discredit to the company is not obvious – which are unaccompanied by editorialising.
Good News	statements beyond the minimum which include (for example) specific details where these details have a creditable or neutral reflection on the company; any statements which reflect credit on the company; upbeat analysis/discussion/statements
Bad News	any statement which reflects/might reflect discredit on the company. Include, for example, numbers made redundant (if redundancy is spoken of as a human rather than an economic act), and any increase in accidents.

Gray et al. (1995b)

The Reliability and Measurement of Content Analysis

The problem of reliability exists for the content analysis just like any quantitative technique. The disagreement between the coders will distort the significance of the analysis (Janis et al. 1943).

Three types of reliability have been defined by Krippendorff (2004): stability, reproducibility and accuracy. Stability, which is the weakest form of reliability, is measured as the degree that a coder reaches the same results while analysing the data over time. Reproducibility, which is a stronger form of reliability than stability measures the repeatability of the data by multiple coders. The strongest form of reliability is named as accuracy and it measures the performance of coding against the performance of a method that has been applied by experts and regarded as being correct.

In this study, the annual reports were read by two coders who are academicians familiar with social and environmental disclosure research. In order to capture the degree of the stability of the data, the annual reports that have been read once by a coder were read a second time after two weeks. It has been seen that no significant difference existed between the two readings. To analyse the degree of reproducibility, the two coders read the annual reports independently applying the same set of dimensions and decision rules for coding. Again, no significant difference has been noted between the two coders. To achieve accuracy, Hackston and Milne's coding approach, which has been cited by many academic studies, was undertaken.

In this study, Krippendorff's α was calculated to measure the degree of inter-coder agreement that occurs above chance on the decision of 'is this sentence a social disclosure, yes or no?' A pre-testing was conducted on 10 per cent of the sample and Krippendorff's α was measured to be 0.9793 as a result of the reliability tests. Krippendorff's α theoretically ranges between the values of +1.0 (perfect agreement) and -1.0 (perfect disagreement). The result of 0.9793 shows a high degree of reliability in this study.

Control Variables

Previous studies have employed company size, risk, research and development intensity as control variables. Different studies used different variables as a proxy for size. Net log of sales was used in the study of Belkaoui and Karpik

(1989), while Chen and Metcalf (1980) employed total assets. Waddock and Graves (1997) used total assets, total sales and number of employees. Stanwick and Stanwick (1998) used annual sales of the firm in their study. The study of Orlitzky et al. (2003) summarised the predictors of size used in prior studies some of which are number of employees, number of shareholders, Fortune rank, total assets, total sales, owners' equity, net worth, lines of business, ln of average revenues and log of sales. Waddock and Graves (1997) also defined size as a significant variable since the socially responsible behaviour disclosed by larger firms tend to be more than those disclosed by smaller firms. In our study, we used three measures to control for size which are ln of sales, ln of assets and ln of market capitalisation.

Profitability

EPS growth, stock price change, price per share change, ROE, average ROE, P/E ratio, net income, net profit margin, operating earnings/assets, operating earnings/sales were determined as some of the variables of economic performance (Ullman 1985). McGuire, Sundgren, and Schneeweis (1988) used both accounting and stock market-based measures. The accounting based measures employed by these studies were ROA, total assets, sales growth, asset growth and operating income growth. Profitability was measured by Hackston and Milne (1996) by average ROE and average ROA. In order to capture financial performance we used accounting based measures of ROE, ROA and ROS.

Analysis

Table 5.3 depicts the descriptive statistics for social disclosure measures in ISE 100 companies. The issues related to theme, evidence and news type are reported in four different perspectives, that is, disclosed sentences as a percentage of all disclosed sentences shown in the fourth column. Disclosing the figures in terms of percentages makes one get a clearer understanding of the situation. For example, 77.5 per cent of companies constituting the sample make disclosures in the theme of societal influence in their annual reports. However, the theme of societal influence makes up only 14.3 per cent of all disclosed sentences which shows that these companies disclose a small amount in this particular theme.

Table 5.3 Descriptive statistics for sustainability measures in ISE 100 companies

	Disclosing companies (making at least one disclosure)	Disclosing companies as a percentage of total sample (incidence)	Number of disclosed sentences (amount)	Disclosed sentences as a percentage of all disclosed sentences
Theme				
Environment	24	60.00	531	9.04
Societal Influence	31	77.50	840	14.30
Culture and Employee	40	100.00	1.567	26.67
Sustainability	40	100.00	2.938	50.00
Total			5.876	100.00
Evidence				
Monetary	23	57.50	178	3.03
Non-monetary	36	90.00	1.302	22.16
Declarative	40	100.00	4.396	74.81
Total			5.876	100.00
News				
Good	38	95.00	4.624	78.69
Bad	5	12.50	12	0.20
Neutral	36	90.00	1.240	21.10
Total			5.876	100.00

If only focusing on the incidence figures in the second column, one might think that non-monetary and declarative disclosures are almost equally presented. However, when disclosed sentences as a percentage of all disclosed sentences is considered, it can easily be seen that declarative disclosures are far more than non-monetary disclosures with 74.81 per cent and 22.16 per cent respectively.

The total number of sentences disclosed by the 40 companies is 5,876, with an average of 147 sentences.

Table 5.4 provides the descriptive statistics for the measures of size, profitability and CSR themes of environment, societal influence, corporate culture and employee, and sustainability.

Table 5.4 Descriptive statistics for the variables

	N	Min.	Max.	Mean	S.D.
Measures of Size					
lnsales	40	17.24	23.72	20.64	1.459
lnasset	40	18.77	22.89	20.69	1.251
lnmarcap	40	18.32	23.48	20.36	1.210
Measures of Profitability					
ROE	40	-1.04	.64	.10	.247
ROA	40	-.09	.58	.08	.118
ROS	40	-.18	.79	.10	.169
CSR Themes					
NofEnvironment	40	.00	101.00	13.27	19.636
NofSocietalInfluence	40	.00	131.00	21.00	31.229
NofCulture&employee	40	5.00	146.00	39.17	27.425
NofSustainability	40	5.00	212.00	73.45	53.358
Valid N (listwise)	40				

Our Findings

In our study and based on the preceeding analysis and argument, we have developed the hypotheses stated below:

H_{01}:There is no relationship between size and environment.
H_{11}: There is a relationship between size and environment.

H_{02}: There is no relationship between size and societal influence.
H_{12}: There is a relationship between size and societal influence.

H_{03}: There is no relationship between size and corporate culture and employee.
H_{13}: There is a relationship between size and corporate culture and employee.

And, therefore:

H_{04}: There is no relationship between size and sustainability.
H_{14}: There is a relationship between size and sustainability.

And, separately:

H_{05}: There is no relationship between financial performance and sustainability.
H_{15}: There is a relationship between financial performance and sustainability.

In order to test our hypothesis 1; we first employed correlation analysis using the indicator of company size (lnmcap, lnsales, lnasset) and the social responsibility of the company in terms of the theme of environment. The natural logarithm to the base is used for the variables of size as denoted by ln. The correlation results for the first hypothesis are given below in Table 5.5(a). As can be seen from the table, there is a positive and significant relationship at 0.01 level with the indicator of ln market capitalisation, and the social responsibility of the company in terms of the theme of environment.

For the same hypothesis, we then employed regression analysis, using environment as the dependent variable and the company size in terms of lnmcap, lnasset and lnsales as the independent variable. As a result of the regression analysis, a significant and positive relationship between company size and environment has been found (see Table 5.5(b)).

Table 5.5(a) Pearson correlations matrix for ISE 100 companies

This Table reports the correlations among 2006 company size and 2006 sustainability of the firm in terms of the theme of environment.

	lnmcap	lnsales	lnasset	Nofenvironment
lnmcap	1	.662**	.822**	.544**
lnsales		1	.870**	.502**
lnasset			1	.534**
Nofenvironment				1

**Statistically significant at 1% level.

* Statistically significant at 5% level.

Table 5.5(b) Regression results for predictive variables (2006)

This Table reports the regression results for 2006 using environment as the dependent variable and the company size.

Dependent Variable: Environment	Model
Independent Variable: lnmcap	**8.829****
lnsales	
lnasset	
R	.544
R2	.296
Adj. R2	.278
F	15.992**
Excluded variables: lnsales, lnasset	

**Statistically significant at 1% level.

In hypothesis 2, we first employed correlation analysis using the indicator of company size (lnmcap, lnasset, lnsales), and the social responsibility of the company in terms of the theme of societal influence. The correlation results for the second hypothesis are given below in Table 5.6(a). As can be seen from the table, there is a positive and significant relationship at 0.05 level between lnsales and the sustainability of the company in the theme of societal influence.

For the same hypothesis we employed regression analysis, using number of societal influence disclosures as the dependent variable and the company size in terms of lnmcap, lnasset and lnsales as the independent variable. As a

Table 5.6(a) Pearson Correlations Matrix for ISE 100 companies

This Table reports the correlations among 2006 company size and 2006 sustainability of the firm in terms of the theme of social influence.

	lnmcap	lnsales	lnasset	Nofsocietal Influence
lnmcap	1	.662**	.822**	.310
lnsales		1	.870**	.373*
lnasset			1	.279
NofSocietal Influence				1

**Statistically significant at 1% level.
* Statistically significant at 5% level.

result of the regression analysis, a significant and positive relationship between company size in terms of lnsales and number of societal influence has been found (see Table 5.6(b)).

Table 5.6(b) Regression results for predictive variables (2006)

This Table reports the regression results for 2006 using social influence as the dependent variable and the company size.

Dependent Variable: Number of Social Influence	**Model**
Independent Variable: lnmcap	
lnsales	**7.983***
lnasset	
R	.373
R2	.139
Adj. R2	.116
F	6.143*
Excluded variables: lnmcap, lnasset	

* Statistically significant at 5% level.

In hypothesis 3, we first employed correlation analysis using the indicators of company size (lnmcap, lnasset, lnsales) and the social responsibility of the company in terms of the theme of corporate culture and employee. The correlation results for the third hypothesis are given in Table 5.7(a). As can be seen from the table, there is a positive and significant relationship at 0.05 level with ln market capital and the sustainability of the company in the theme of corporate culture and employee.

For the same hypothesis we then employed regression analysis, using environment as the dependent variable and the company size in terms of lnmcap, lnasset and lnsales as the independent variable. As a result of the regression analysis, a significant and positive relationship between company size in terms of lnmcap and number of corporate culture has been found (see Table 5.7(b)).

In hypothesis 4, we first employed correlation analysis using the indicators of company size (lnmcap, lnasset, lnsales) and the social responsibility of the company in terms of the theme of sustainability.

Table 5.7(a) Pearson Correlations Matrix for ISE 100 companies

This Table reports the correlations among 2006 company size and 2006 sustainability of the firm in terms of the theme of corporate culture and employee.

	lnmcap	lnsales	lnasset	Nofcorporateculture&employee
lnmcap	1	.662**	.822**	.367*
lnsales		1	.870**	.280
lnassets			1	.348*
Nofcorporate culture&emp loyee				1

**Statistically significant at 1% level.

*Statistically significant at 5% level.

Table 5.7(b) Regression results for predictive variables (2006)

This Table reports the regression results for 2006 using corporate culture as the dependent variable and the company size.

Dependent Variable: Number of Corporate Culture	Model
Independent Variable: lnmcap	**8.308***
lnsales	
lnasset	
R	.367
R2	.134
Adj. R2	.112
F	5.904*
Excluded variables: lnsales, lnasset	

* Statistically significant at 5% level.

The correlation results for the fourth hypothesis are given below in Table 5.8(a). As can be seen from the table, there is a positive and significant relationship at 0.01 level with ln marketcap and the size of the company in the theme of sustainability.

For the same hypothesis we then employed regression analysis, using number of sustainability disclosures as the dependent variable and the company size in terms of lnmcap, lnasset and lnsales as the independent variable. As a result of the regression analysis, a significant and positive relationship between company size in terms of lnmcap and the sustainability of the company has been found (see Table 5.8(b)).

Table 5.8(a) Pearson Correlations Matrix for ISE 100 companies

This Table reports the correlations among 2006 financial data and 2006 size of the firm in terms of the theme of sustainability.

	lnmcap	lnsales	lnasset	Sustainability
lnmcap	1	.662**	.822**	.570**
lnsales		1	.870**	.547**
lnassets			1	.538**
Sustainability				1

**Statistically significant at 1% level.

*Statistically significant at 5% level.

Table 5.8(b) Regression results for predictive variables (2006)

This Table reports the regression results for 2006 using sustainability as the dependent variable and the company size.

Dependent Variable: Number of Sustainability	Model
Independent Variable: lnmcap	**25.142****
lnsales	
lnasset	
R	.570
R2	.325
Adj. R2	.308
F	18.324**
Excluded variables: lnsales, lnasset	

**Statistically significant at 1% level

All of these show significant relationships and we can, therefore, be fairly certain that there is a distinct relationship between firm size and sustainability. Indeed we can state this more positively as follows:

Large firms are more sustainable that small firms.

When we look at profitability, however, we see a different story. In hypothesis 5, we employed correlation analysis using the indicators of firm financial performance (ROA, ROE, ROS) and the social responsibility of the company in terms of the theme of sustainability. However, no significant relationship between number of sustainability diclosures and financial performance of the firm has been found. We also employed regression analysis, using sustainability disclosures as the dependent variable and financial performance indicators as the independent variable. The stepwise regression method was used and all of the variables were found to be excluded. Thus we can state the following:

Sustainability is not influenced by financial performance.

Implications of the Analysis

These finding are interesting in their own right and have some obvious implications. For example, it would not be sensible for a firm to focus upon financial performance as a way of becoming more sustainable, even though we have identified finance as one aspect of our definition of sustainability. This implication in effect contradicts the received wisdom from economics and from finance theory that profitability is the key to long-term success. Although some profit is obviously necessary for survival, the route to long-term success (or even long-term existence) is not to be achieved through growth in profit. Strategic planning needs to recognise this and the strategies developed by the managers of firms will inevitable need to be different. This is important and we will return to this during the course of our analysis; it is also important for the development of strategies for sustainable development which are an outcome of our analysis.

Probably even more significant is our finding of the relationship between size and sustainability and the implications which stem from that. This would imply that sustainable development is both desirable and realistic. Moreover, it does not seem to matter if that growth is in terms of asset base or of turnover – both increase the sustainability of the company. Indeed it would seem that the route to becoming more sustainable is for a company to grow. This, too, is important: we have rejected the Brundtland assumption that sustainable development is both desirable and possible while also saying that growth (i.e., development) is desirable. It is therefore necessary to undertake further analysis in order to establish the circumstances in which that growth can take place and how development becomes sustainable. We shall be returning to this also a number of times during our analysis in the subsequent chapters.

Conclusion

The conclusions to our analysis in this study might be regarded as somewhat surprising in the way that they show relationship between the factors we investigated. Certainly they were initially a little surprising for us but upon reflection are more obvious. Thus we have investigated the relationship between different themes of sustainability and company performance and size in firms reporting on the ISE National 100 index of Turkey. Furthermore, we have argued that we can expect this to be reasonably representative of firms in other locations; in other words, we maintain that there is no particular difference in different parts of the world and there is no particular difference between developing and developed countries. In order to analyse the five hypotheses in the study, both correlation and regression analyses were applied. As a result of the analysis which has been used, the first four hypotheses which investigate the relationship between company size and sustainability have been accepted. However, the last hypothesis which investigates the relationship between financial performance and sustainability has been rejected. We can simplify our findings therefore to state that size matters but the profit does not.[3] Our discussion of the implications of the findings has set the scene for much of the analysis which follows.

3 Within the normal limits of profit being required to continue trading; in other words profit maximisation is not a sustainable goal.

6

Satisfying Stakeholders: Distributing Effects

Introduction

It is normal to consider that the outputs from corporate activity are goods or services and a surplus resulting from their production and sale. From corporate activity, therefore, it is normal to consider distribution in terms of this resultant profit from the operations of an organisation being either distributed to shareholders in the form of dividend or retained in the business for future developments, and hence for future distribution. It is assumed that all other stakeholders are satisfied along the way and not therefore concerned with distributional problems. In this chapter we intend to take a radically different view and argue that for a sustainable business all stakeholders must be satisfied through the distributional process.

Social Issues and their Effects and Implications

The growing concern with the effects of the actions of an organisation on its external environment is based upon a recognition that it is not just the owners of the organisation who have a concern with the activities of that organisation. There are also a wide variety of other stakeholders who have a concern with those activities, and are affected by those activities. Indeed those other stakeholders have not just an interest in the activities of the firm but also a degree of influence over the shaping of those activities. Indeed it has been argued that the power and influence of these stakeholders is such that it amounts to quasi-ownership of the organisation. Based upon this there has been, by some people, something of a challenging of the traditional role of accounting in reporting results. Such a challenge considers that, rather than an ownership approach to accountability, a stakeholder approach, recognising the wide stakeholder community, is needed.

Over time, however, the performance of businesses in a wider arena than the stock market and its value to shareholders has become of increasing concern. This concern led initially to the development of social accounting during the 1970s:

> *'Social accounting is an approach to reporting a firm's activities which stresses the need for the identification of socially relevant behaviour, the determination of those to whom the company is accountable for its social performance and the development of appropriate measures and reporting techniques.'*
>
> (Fetyko 1975)

> *'Social accounting recognises that different aspects of performance are of interest to different stakeholder groupings; it distinguishes, for example, between investors, community relations and philanthropy as areas of concern for accounting. It also considers various areas for measurement, including consumer surplus, rent, environmental impact and non-monetary values.'*
>
> (Klein 1977)

These writers consider, by implication, that measuring social performance is important without giving reasons for believing so. Indeed, one of the origins of social accounting is based upon ideological grounds. Other reasons exist and as far as the business itself is concerned, the reasons for objectively measuring objectively its social performance include:

- to aid rational decision-making and, therefore, improved performance;
- as a defensive measure.

Social accounting is generally concerned with involving stakeholders and recognition of the rights of all stakeholders; the duty of a business to be accountable in this wider context, therefore, has been largely a relatively recent phenomenon. Generally, its origins are considered to be in the 1970s. it can also be considered to be a way of combating the corporate tendency to externalise costs – that is, to pass them outside of the corporation and, therefore, of its remit.

In an increasingly global market, then one favourite way of externalising costs is through transfer of those costs to a third world country. This can be effected by a transfer of operational activities, or at least those with environmental impacts, to such a country where the regulatory regime is less exacting. In this respect it should be noted that the arguments regarding reducing labour costs are generally used for such a transfer of operational activities but at the same time less exacting regulatory regimes also exist.

As we have considered previously, the temporal externalisation of costs describes the way in which costs are transferred from the current time period into another – the future – thereby enabling the creation of value in the present. Examples of temporal externalisation include:

- not undertaking capital investment transfers costs to the future, when it will need to be incurred;
- not considering asset disposal costs in capital investment appraisal leaves the risk of significant costs in the future;
- burning off gas at oil extraction plants wastes energy and leaves a potential shortage in the future as well as contributing to global warming;
- excessive packaging may reduce transportation and storage costs but creates disposal costs in the future;
- causing pollution incurs future clean-up costs;
- saving research and development expenditure risks a lack of future competitiveness and therefore the future viability of the organisation;
- reducing staff development expenditure may save costs in the present at the expense of future competitiveness.

Although it is simple to avoid dealing with problems in the present this does not mean that they are avoided – they will need to be dealt with in the future instead. Arguably the problems of global warming in the present have been caused by not dealing with energy supply problems in the past, or dealing with them in a way which minimised costs at the time. Often however such problems might not be recognised at the time. For example tobacco smoking was thought to be therapeutic for many years; later it became a fashionable thing to do. It is only relatively recently that the enormous costs to health have been recognised. Similarly chewing gum was considered acceptable in the UK but recently it has been recognised that this causes pollutions problems and large amounts of money need to be spent in cleaning up the detritus. It is of course possible that actions being taken in the present will have unforeseen consequences and costs in the future. Nevertheless much temporal externalisation of cost is designed to minimise present costs without any regard for the future sustainability of the business.

Managing Managers – Agency Theory

Managers are in an unusual position in that they have both the ability to commit the organisation to whatever contracts and transactions they feel appropriate and a responsibility towards the owners of the business. There was a need to ensure that this responsibility took place. It is normally accepted that Agency Theory provides a platform upon which this can be ensured. Agency Theory suggests that the management of an organisation is undertaken on behalf of the owners of that organisation, in other words the shareholders. Consequently, the management of value created by the organisation is only pertinent insofar as that value accrues to the shareholders of the firm. Implicit within this view of the management of the firm, as espoused by Rappaport (1986) and Stewart (1991), amongst many others, is that society at large, and consequently all other stakeholders to the organisation, will also benefit as a result of managing the performance of the organisation in this manner. From this perspective, therefore, the concerns are focused upon how to manage performance for the shareholders and how to report upon that performance (Myners 1998).

This view of an organisation has, however, been extensively challenged by many writers,[1] who argue that the way to maximise performance for society at large is to both manage on behalf of all stakeholders and to ensure that the value thereby created is not appropriated by the shareholders but is distributed to all stakeholders. Others such as Kay (1998) argue that this debate is sterile and that organisations maximise value creation not by a concern with either shareholders or stakeholders but by focusing upon the operational objectives of the firm and assuming that value creation, and equitable distribution, will thereby follow.

1 See, for example, Herremans et al. (1992); Tinker (1985).

The shareholder theory of the firm is often also referred to as Agency Theory as the role of the management of a firm is to act as the agents of the shareholders (the principals). The separation of ownership and control that is apparent in large modern-day (joint stock) companies, presently the most common way for a business to be organised, is another significant change since the days of Smith and Mill. It is this separation that leads to what is known as the principal–agent relationship. It is also argued that within this role it is only appropriate for managers (the agents) to use the funds at their disposal for purposes authorised by shareholders (the principals) (Hasnas 1998; Smith and Hasnas 1999). Furthermore, shareholders normally invest in shares in order to maximise their own returns and consequently managers, as their agents, are obliged to target this end. In fact this is arguing that as an owner a shareholder has the right to expect his or her property to be used to his or her own benefit. Donaldson (1982, 1989) disagrees and suggests that it can be morally acceptable to use the shareholder's money in a different way if it is to further public interest. The ethical and moral acceptability of this suggestion is questionable and Smith and Hasnas (1999) point out that such an act would contravene Kant's (1804) principle. This principle states that a person should be treated as an end in his or her own right rather than as a means to an end. By using shareholders' money for the benefit of others it is argued that the shareholders are being used as a means to further others ends. This defence of shareholder theory is as ironic as it is compelling given that the exact same principle is often cited to defend stakeholder theory.

Also assumed within Agency Theory is a lack of goal congruence between the principal and agent and that it is costly or difficult to confirm the agent's actions (Eisenhardt 1989). In saying this it is suggested that, left to their own devices, the agents will prefer different options to those that would be chosen by the principals. The agents would make decisions and follow courses that further their own self-interest as opposed to that of the principal. This assumption that agents' behaviour will be driven by their own self-interest and nothing else has been criticised as being an overly simplistic conception of human behaviour (Williamson 1985). He argued that in addition to self-interested motives, other motives including altruism, irrationality, generosity and a genuine concern for others also characterise the multi-faceted reality of human behaviour. Sen (1987) agrees and actually states that 'to argue that anything other than maximising self-interest must be irrational seems altogether extraordinary'.

It has been argued that shareholders should have rights to determine how their property be used, as should an owner of any asset under private property rights. Etzioni (1998) suggests that this view of shareholders' property rights, which are both moral and legal, is 'widely embedded in the American political culture' and therefore needs no further introduction, but also notes that such property rights are a social construct, as opposed to natural or inalienable rights, and as such society has the opportunity and the ability to change them if it is considered necessary. A closer consideration of what is meant by private property, as it has been socially constructed in present day Western societies, has been undertaken by Donaldson and Preston (1995) who argue that the philosophy of property 'runs strongly counter to the conception that private property exclusively enshrines the interests of owners'. They specifically note the work of Pejovich (1990) as recognising that ownership does not entail unrestricted rights as they cannot be separated from human rights. Further, Honore (1961) suggests that the rights are restricted where the use would be harmful to others. Donaldson and Preston (1995) suggest that as property rights are restricted then they need to be founded on distributive justice. Interestingly, Sternberg (1998), a proponent of shareholder theory, because 'it alone respects the property rights that are so essential for protecting individual liberty', also suggests that ethical business must also be based on 'distributive justice' along with 'ordinary decency' (Sternberg 1994, 1998). Donaldson and Preston (1995) follow Becker's (1992) suggestion that the 'three main contending theories of distributive justice include Utilitarianism, Libertarianism and social contract theory'. Utilitarianism has already been commented upon as part of the historical roots – and concomitant problems – of the capitalist economic system.

Within the legal systems of the UK, the USA and most Western countries, the managers of a business have a fiduciary duty to the owners of that business. This duty to shareholders is wider than the regulatory or contractual responsibilities to other groups (Marens and Wicks 1999; Goodpaster 1991). These more general duties have also been used as a justification of the appropriateness of shareholder theories of the firm. The purpose and meaning of fiduciary duty were considered by Marens and Wicks (1999) who suggest that in actual fact this duty does not limit managers to a very narrow shareholder approach. They argue that the purpose of the fiduciary duty was originally designed to prevent managers undertaking expenditures that benefited themselves rather than the owners (Berle and Means 1933). Marens and Wicks (1999), on the other hand, suggest that fiduciary duties simply require that the fiduciary has an honest and open relationship with the owners and does not gain illegitimately from their office. Therefore the tension between fiduciary responsibility and the responsibility to other stakeholder groups, the stakeholder paradox (Goodpaster 1991), is not as apparent as is often assumed. Further support for this argument is provided from the US courts. When shareholders have challenged management's actions as being too generous to other stakeholder groups then the courts have usually upheld the right of management to manage.[2] The justification has normally been on rational business performance grounds, such as efficiency or productivity, and the accuracy of such claims is difficult to prove. This has led Marens and Wicks (1999) to suggest that 'virtually any act that does not financially threaten the survival of the business could be construed as in the long-term best interest of shareholders'.

Thus, Agency Theory argues that managers merely act as custodians of the organisation and its operational activities,[3] and places upon them the burden of managing in the best interest of the owners of that business.[4] According to Agency Theory, all other stakeholders of the business are largely irrelevant and if they benefit from the business then this is coincidental to the activities of management in running the business to serve shareholders. This focus upon shareholders alone as the intended beneficiaries of a business has been questioned considerably from many perspectives, which argue that it is either not the way in which a business is actually run or that it is a view which does not meet the needs of society in general. Conversely, stakeholder theory argues that there are a whole variety of stakeholders involved in the organisation and each deserves some return for their involvement. According to stakeholder theory, therefore, benefit is maximised if the business is operated by its management on behalf of all stakeholders and returns are divided appropriately amongst those stakeholders, in some way which is acceptable to all. Unfortunately a mechanism for dividing returns amongst all stakeholders which has universal acceptance does not exist, and stakeholder theory is significantly lacking in suggestions in this respect. Nevertheless this theory has some acceptance and is based upon the premise that operating a business in this manner achieves as one of its outcomes the maximisation of returns to shareholders, as part of the process of maximising returns to all other stakeholders. This maximisation of returns is achieved in the long run through the optimisation of performance for the business to achieve maximal returns to all stakeholders.[5] Consequently, the role of management is to optimise the long-term performance of the business in order to achieve this end and thereby reward all stakeholders, including themselves as one stakeholder community, appropriately.

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2 Although different decisions have been made more recently, requiring managers to act in the best interests of the shareholders – and interpreting best interest as being synonymous with short-term interest – a legacy of the Bush era. It is by no means certain, however, that this view would be equally held throughout Europe and other parts of the world where cultures and legal systems differ from the American model.

3 See, for example, Emmanuel, Otley and Merchant (1985).

4 Such owners are, of course, the legal owners of the business, that is, the shareholders.

5 See, for example, Rappaport (1986).

These two theories can be regarded as competing explanations of the operations of a firm which lead to different operational foci and to different implications for the measurement and reporting of performance. It is significant, however, that both theories have one feature in common. This is that the management of the firm is believed to be acting on behalf of others, either shareholders or stakeholders more generally. They do so, not because they are the kind of people who behave altruistically, but because they are rewarded appropriately and much effort is therefore devoted to the creation of reward schemes which motivate these managers to achieve the desired ends. Similarly, much literature is devoted to the consideration of the effects of reward schemes on managerial behaviour (see, for example, Briers and Hirst 1990; Child 1974, 1975; Coates, Davis, Longden, Stacey and Emmanuel 1993; Fitzgerald, Johnston, Brignall, Silvestro and Voss 1991) and suggestion for improvements.

The simplest model of Agency Theory assumes one principle and one agent and a modernist view of the world merely assumes that the addition of more principles and more agents makes for a more complex model without negating any of the assumptions. In the corporate world this is problematic as the theory depends upon a relationship between the parties and a shared understanding of the context in which agreements are made. With one principle and one agent this is not a problem as the two parties know each other. In the corporate world, however, the principles are equated to the shareholders of the company. For any large corporation, however, those shareholders are an amorphous mass of people who are unknown to the managers of the business. Indeed there is no requirement, or even expectation, that anyone will remain a shareholder for an extended period of time. Thus there can be no relationship between shareholders – as principles – and managers – as agents – as the principles are merely those holding the shares – as property being invested in – at a particular point in time. So shareholders do not invest in a company and in the future of that company; rather they invest for capital growth and/or a future dividend stream and shares are just one way of doing this which can be moved into or out of at will. This problem is exacerbated, particularly in the UK, by the fact that a significant proportion of shares are actually bought and sold by fund managers of financial institutions acting on behalf of their investors. These fund managers are rewarded according to the growth (or otherwise) of the value of the fund. Thus, shares are bought and sold as commodities rather than as part ownership of a business enterprise.

Distributional Problems

Traditional accounting theory and practice assumes that value is created in the business through the transformation process and that distribution is merely concerned with how much of the resultant profit is given to the investors in the business now and how much is retained in order to generate future profits and hence future returns to investors. This is, of course, overly simplistic for a number of reasons. Even in traditional accounting theory it is recognised that some of the retained profit is needed merely to replace worn-out capital – and hence to ensure sustainability in its narrowest sense. Accounting, of course, only attempts to record actions taking place within this transformational process, and even in doing so regards all costs as things leading to profit for distribution.

This traditional view of accounting is that the only activities with which the organisation should be concerned are those which take place within the organisation;[6] consequently, it is considered that these are the only activities for which a role for accounting exists. Here, therefore, is located the essential dialectic of accounting – that some results of actions taken are significant and need to be recorded while others are irrelevant and need to be ignored. This view of accounting places the organisation at the centre of its world and the only interfaces with the external world take place at the beginning and end of its value chain. It is apparent, however, that any actions which an organisation undertakes will have an effect not just upon itself but also upon the external environment within which that organisation resides. In considering the effect of the organisation upon its external environment, it must be recognised that this environment includes both the business environment in which the firm is operating, the local societal environment in which the organisation is located and the wider global environment.

The discourse of accounting can, therefore, be seen to be concerned solely with the operational performance of the organisation. Contrasting views of the role of accounting in the production process might, therefore, be epitomised as either providing a system of measurement to enable a reasonable market mediation in the resource allocation problem or as providing a mechanism for the expropriation of surplus value from the labour component of the transformational process. Both strands of the discourse, however, tend to view that labour as a homogeneous entity and consider the effect of organisational

6 Essentially, the only purpose of traditional accounting is to record the effects of actions upon the organisation itself.

activity upon that entity. Labour is, of course, composed of individual people; moreover, these individual people have a lifetime of availability for employment and different needs at different points during their life cycle. The depersonalisation of people through the use of the term labour, however, provides a mechanism for the treatment of labour as an entity without any recognition of these personal needs. Thus, it is possible to restrict the discourse to that of the organisation and its components – labour, capital, etc. – and to theorise accordingly. The use of the term labour is a convenient euphemism which disguises the fact that labour consists of people, while the treatment of people as a variable cost effectively commodifies these people in the production process. In order to create value in the transformational process of an organisation then, commodities need to be used efficiently, and this efficient use of such commodities is measured through the accounting of the organisation. When this commodity consists of people then this implies using them in such a way that the maximum surplus value can be extracted from them. The way in which this can be achieved is through the employment of young fit people who can work hard and then be replaced by more young fit people. In this way surplus value (in Marxian terms) can be transferred from the future of the person and extracted in the present. As people have been constituted as a commodified variable cost then they become merely a factor of production which can be exchanged for another factor of production, as the costs determined through the use of accounting legitimate. Thus it is reasonable, through an accounting analysis, to replace people with machinery if more value (profit) can be extracted in doing so, and this has provided the imperative for the Industrial Revolution which has continued up until the present. Accounting is only concerned with the effect of the actions of an organisation upon itself and so the effect of mechanisation upon people need not be taken into account. Thus, if mechanisation results in people becoming unemployed (or possibly unemployable) then this is of no concern – except to the people themselves.

The Social Contract

It has been widely recognised that the activities of an organisation impact upon its external environment and, therefore, it has been suggested that such an organisation should be accountable to a wider audience than simply its shareholders. Such a suggestion probably first arose in the 1970s and a concern with a wider view of company performance is taken by some writers who evince concern with the social performance of a business, as a member of society at large. This concern was stated by Ackerman (1975) who argued that big business was recognising the need to adapt to a new social climate of community accountability, but that the orientation of business to financial results was inhibiting social responsiveness. McDonald and Puxty (1979) on the other hand maintain that companies are no longer the instruments of shareholders alone but exist within society and so, therefore, have responsibilities to that society, and that there is, therefore, a shift towards the greater accountability of companies to all participants.

Recognition of the rights of all stakeholders and the duty of a business to be accountable in this wider context, therefore, has been largely a relatively recent phenomenon.[7] The economic view of accountability only to owners has only recently, however, been subject to debate to any considerable extent. Some owners of businesses have, however, always recognised a responsibility to other stakeholders and this is evident from the early days of the Industrial Revolution. Implicit in this concern with the effects of the actions of an organisation on its external environment is the recognition that it is not just the owners of the organisation who have a concern with the activities of that organisation. Additionally, there are a wide variety of other stakeholders who justifiably have a concern with those activities, and are affected by those activities. Those other stakeholders have not just an interest in the activities of the firm but also a degree of influence over the shaping of those activities. This influence is so significant that it can be argued that the power and influence of these stakeholders is such that it amounts to quasi-ownership of the organisation. Indeed Gray, Owen and Maunders (1987) challenge the traditional role of accounting in reporting results and consider that, rather than an ownership approach to accountability, a stakeholder approach, recognising the wide stakeholder community, is needed.[8]

The desirability of considering the social performance of a business has not always, however, been accepted and has been the subject of extensive debate.[9] Nevertheless, the performance of businesses in a wider arena than the stock market and its value to shareholders has become of increasing concern. In many respects this can be considered to be a return to the notion of the social contract, which has been used to persuade business to accept their social responsibility.

7 Mathews (1997) traces its origins to the 1970s although arguments (see Crowther 2002c) show that such concerns can be traced back to the Industrial Revolution.

8 The benefits of incorporating stakeholders into a model of performance measurement and accountability have, however, been extensively criticised. See, for example, Freedman and Reed (1983), Sternberg (1997, 1998) and Hutton (1997) for details of this ongoing discourse.

9 See, for example, Hetherington (1973) and Dahl (1972)

Social contract theory is most often associated with the work of Hobbes (1651) and Rousseau (1762) where a contract, usually considered to be implied or hypothetical, is made between citizens for the organisation of the society and as a basis for legal and political power within that society. The idea is that for the legal and political system to be legitimate, it must be one that the members of society would have rationally contracted into. Social contract theory has been applied to the question of business in society in a similar fashion by considering 'what conditions would have to be met for the members of such a society to agree to allow corporations to be formed' (Smith and Hasnas 1999). The conclusions reached by the theorists include that the members of society would demand that the benefits outweigh the detriments implying a greater welfare for the society while remaining 'within the bounds of the general canons of justice' (Donaldson 1982). This can be summarised into three basic requirements that relate to social welfare and justice. Hasnas (1998) suggests that:

> *'… when fully specified, the social welfare term of the social contract requires that businesses act so as to 1) benefit consumers by increasing economic efficiency, stabilizing levels of output and channels of distribution, and increasing liability resources; 2) benefit employees by increasing their income potential, diffusing their personal liability, and facilitating their income allocation; while 3) minimizing pollution and depletion of natural resources, the destruction of personal accountability, the misuse of political power, as well as worker alienation, lack of control over working conditions, and dehumanization.'*

The justice term is less agreed upon but Hasnas suggests that one thing it should require as a minimum is that businesses do not 'systematically worsen the situation of a given group in society'. This obviously has a strong resonance with stakeholder ideas. Social contract theory has been criticised most usually because, as mentioned earlier, the contract is either argued to be implied or hypothetical. Therefore there is no actual contract (Kultgen 1987), that members of society have not given any formal consent to such a contract, and that they would be surprised to learn of its existence. Donaldson (1989) freely admits that the contract is a 'fiction' but continues that this does not undermine its underlying moral theory. Social contract theory is, therefore, grounded in moral theory, with a strong basis in ethics. In various chapters in this book contributors argue that there is a strong connection between corporate socially responsible behaviour and ethical behaviour.

An alternative to the attempts to explain, and regulate, relations between organisational stakeholders based upon the rationalities of economic theory, is the approach based upon the concept of the social contract. This social contract implies some form of altruistic behaviour – the converse of selfishness. Self-interest connotes selfishness, and since the Middle Ages has informed a number of important philosophical, political and economic propositions. Among these is Hobbes's world where unfettered self-interest is expected to lead to social devastation. A high degree of regulation is prescribed in order to avoid such a disastrous outcome, but in the process corporations sacrifice all the rights (human, labour, social) for others. Self-interest again raises its head in the Utilitarian perspective as championed by Bentham, Locke and John Stuart Mill (Titus and Smith 1974). The latter, for example, advocated as morally right the pursuit of the greatest happiness for the greatest number. This perception, as Phillips (2001: 51–2) describes, could imply that:

> *'… there is no longer serious market resistance to the market economy, understood as an arena in which firms compete and co-operate on the basis of free contractual arrangements. Applying market principles to the internal operations of firms is the next logical step …'*

Similarly, Adam Smith's free-market economics is predicated on competing self-interest. These influential ideas put interest of the individual above interest of the collective. Indeed, from this perspective, collective interests are best served through self-interest. At the same time this corporate self-interest has come to draw disapproval in modern times, as reflected in the current vogue for the tenets of corporate social responsibility (CSR). The moral value of individualism has all but vanished.

Crowther and Rayman Bacchus (2004b) suggest that the pendulum has swung too far towards encouraging corporate self-interest at the expense of the public interest. Indeed the continuing conversion of public service provision to market testing by many governments suggests a strengthening belief that the two interests are not in conflict. Self-interest and altruism (promoting the welfare of others over self) need not be in conflict. There is ample evidence that encouraging corporate self-interest (and risk taking) does indeed benefit society (albeit not necessarily to an equal extent). Some of that evidence is, however, contested, as in the case of genetically modified (GM) food (see Topal and Crowther, 2004). The European Union (EU) policies intend to pursue a high level of protection of human life and health, but differences between national laws, regulations and administrative provisions concerning the assessment and authorisation of GM food and feed may hinder their free movement, creating conditions of unequal and unfair competition (EU 2003). There is also abundant evidence to the contrary; that the pursuit of corporate self-interest continues to burden society with additional costs. In the agriculture area examples could be foot and mouth disease, with higher level of costs not very well estimated till now. Nevertheless, during the last two decades most of the world's nations have set about creating anew, or refining, (capitalist) economic and political institutions that encourage corporate self-interest.

Stakeholder Perspectives on the Contract

With the raising of CSR to its current prominence in society it is unsurprising that all companies have claimed to be concerned with a variety of stakeholders and take their needs into consideration in strategic decision making. For example, the research conducted by Cooper et al. (2001) in the UK shows that all organisations claim to consider certain stakeholders. These are shareholders, customers and employees, with suppliers and society and the environment also being considered important by the majority of companies. On the other hand, Heard and Bolce (1981: 248) explain that some pressure groups increase the influence of social reporting when they state that:

> *'… organizations have been instrumental in calling attention to issues such as product quality and safety, environmental protection (…) have had a substantial impact on the development of social measurement and social reporting.'*

Although CSR involves a concern with the various stakeholders to a business, there are several problems with this research in identifying socially responsible behaviour:

- the research shows that the concern is primarily with those stakeholders who have power to influence the organisation. Thus, organisations are most concerned with shareholders, less so with customers and employees, and very little with society and the environment;

- the research does not indicate the extent to which any action is taken and the extent to which this is voluntary;

- claiming a concern is very different to actually exhibiting that concern through actions taken (Crowther 2004a).

It therefore becomes imperative at this point to consider what is meant by any definition of CSR. There are three basic principles (Crowther 2002c; Schaltegger et al. 1996) which need to be considered: sustainability,[10] accountability and transparency. In this sense, Eccles et al. (2001: 163) presents the words of Delfgaauw, as Shell's vice president of sustainable development, who argues that 'new responsibilities bring new accountabilities. Sustainability is the substance, transparency the process'.

One theme which arises from any consideration of these principles is the extent to which it is possible to assess the accountability of organisations to a broader constituency by reference to an implicit or hypothetical social contract. In the process, it is attempted to show how social contract theory also helps bind the relationship between CSR and ethical behaviour. As Shaw (2004: 196) states, one of the characteristics of social entrepreneurs is being ethical as a way to 'ensure that public money is well used, that ideas are not corrupted by vested interests and that their full commitment is available for the project'.

This raises questions about the scope and depth of commitment among corporate leaders to social responsibility, a point which is central to this paper. Assessing this commitment is made difficult[11] given what appears to be a runaway free market ideology; a belief system that seems to be elevating the corporation above the nation state, and is being transmitted through corporate global expansion and with USA led government sponsorship. This can be developed in the context of the globalising process by considering the extent to which corporate and social exploitation of internet technology is helping both corporate bodies, and consumers and citizens transform our world into a global village (McLuhan and Fiore 1968) and then broadened to consider the broader relationship between technological innovation and social change. In examining this relationship it can be shown that technological development is underpinned by a Utilitarian perspective, and at the same time technological change is unavoidably bound up with making moral choices.

10 For an empirical perspective of creating a process-based model that structures existing indicators of sustainable development, see Isaksson and Garvare (2003).

11 See Crowther (2004b) for any argument that there is little such commitment; Crowther and Jatana (2005) for an exploration of this in the context of managerial egotism; and Andersson and Pearson (1999) for the argument concerning the incivility in the workplace and growing challenge of relationship mediated by high-tech, asynchronous and global interaction.

While governments and consumers alike look to business to continue delivering economic and social benefits, many observers remain concerned about corporate self-interest; a self-interest that is synonymous with those of the managers. Managerial self-interest is unavoidably driven by a combination of shareholder interests (backed up by markets for corporate control and managerial talent), and occupational rewards and career opportunity. The public interest is easily sacrificed on the altar of these managerial motivators (or constraints). So, as Jensen and Meckling (1994: 1) argue:

> *'… understanding human behaviour is fundamental to understanding how organizations function, whether they be profit-making firms in the private sector, non-profit enterprises or government agencies intended to serve the "public interest".'*

Moreover, public interest is not homogeneous and therefore cannot be simply represented. Public interest has become factionalised into constituencies and stakeholder groupings, each concerned with their particular interests. Consider, for example, the 'not-in-my-back-yard' protests over the building of recycling plants and mobile telephone masts, yet opinion polls support the former and sales of mobile phones demand more of the latter. Parkinson (2003) explains that in the continental European tradition, companies are regarded as partially public bodies, with constituencies that extend beyond the shareholders to include other groups, such as employees (with retirement plans and other benefits), trade unions (with strikes and public contest) and local communities (with social and economic needs).

It has often been noted, from a global perspective, which corporate self-interest seems to be associated with an unequal distribution of economic and social benefits. However, it seems unfair to lay the responsibility for such inequality solely at the door of the corporation. National and regional politics, religious conviction and differentiated moral values all play an immeasurable role in shaping a nation's life chances. Nevertheless, there is worldwide suspicion that corporate egoism is a significant (if not the most important) influence on economic and social development. For example, in an OECD (2003) study about anti-corruption management and reporting practices, the results show that corporations have different behaviour depending on their sector of operation. Most extractive industry corporations (eight out of the 12 oil and mining companies in the sample) publish lengthy anti-corruption statements. In contrast, only one out of 13 in the sample motor vehicle company publishes any material whatsoever.

Satisfying the Stakeholder Community

In this attempt to satisfy the necessities of the stakeholders there can appear other conflicts between the interests of the different groups included in the wider stakeholder community. Sometimes due to this conflict of interests and to the specific features of the company it tries to establish hierarchical levels between the stakeholders, paying more attention to those ones that are most powerful but, of course, their goals are not necessarily more socially responsible than others. In the end the hierarchy will depend on the other goals of the company, it will give an answer to those stakeholders that can threaten the attainment of the economic goals. The difficulties in measuring the social performance of a company are also due to their own concept. This is because the concept of CSR is really comprehensive. There are companies whose activities are very different but all of them have to bear in mind their social responsibility, and not only companies, but also people in whatever activity they do. Ethics, codes of conduct, human values, respect for the environment, respect for minorities and so on are values that have to be borne in mind and included in the social responsibility concept. The understanding of the concept can vary geographically depending on the country or the region, because some important problems linked to basic human values are more evident in some countries than in other ones. Equally the understanding can be culturally dependent and can vary from one culture to another. These social problems cannot be isolated because they have got an important relationship with the degree of development of the country or culture, so in the end it is the economy that pushes the world. Thus, capitalism allows for differences between people, but what is not so fair is that these differences are not only due to one's own effort or work but are also due to having taken advantage of someone else's previous effort. And this can be the case of multinational corporations, which sometimes abuse their power, closing factories in developed countries and moving them to developing countries because the wages are lower or, for example, because the security and health conditions are not so strict and so cheaper to maintain for the company. And then the same companies obtain big amounts of profits to use in philanthropic ways.

Development conditions of regions can determine the relationship between CSR and business success, as we have highlighted. If it is allowed in some developing countries to damage the environment or there are no appropriate labour unions and so on, because lack of requirements or governmental attention, the global players use these facilities to obtain a better economic performance although they can be aware of their damaging policies. But not only is the degree of development to do with CSR; countries or regions are deeply associated with human values through the education and the culture in the country. These values are so deeply embedded inside us that even it is said that people from different regions of the world who have shared the same education, for example, ethics courses at university, do not share the same human values, because they are marked by their origins (Aras and Crowther 2008b). Perhaps it should be understood as the inclusion of ethics courses in university degrees is of questionable value because in the end people will go on thinking what they thought at the beginning, depending on the values of their original culture. But everything is not so simple, because there have been proofs of situations where different values have been imported from another culture and accepted as one's own values without any problem (only point out the success of McDonalds food all over the world and even in the former communist countries, including a McDonalds restaurant in Red Square in Moscow). So, it shows that the questions related to CSR are complicated and not so simple as they can seem at a first glance.

This complexity can be argued as a disadvantage to take into account when speaking about the creation of global standards about companies and their socially responsible behaviour; there are so many different cases that to establish a general regulation may be really difficult. But at the same time this diversity can be argued to require this regulation, because there have been different initiatives, most of them private, and they have added diversity to the previous one and the subject requires a common effort to try to tackle the problem of its standards and principles. And continual examples of financial scandals have proved that it is not enough to rely on companies' own codes or human values, that it is necessary to reach an agreement to establish a homogeneous regulation at least at the level of global players, multinational corporations that play globally.

Accounting and Stewardship

As we have stated earlier, one view of good corporate performance is related to stewardship and thus just as the management of an organisation is concerned with the stewardship of the financial resources of the organisation so too would management of the organisation be concerned with the stewardship of environmental resources. The most significant difference is that environmental resources are mostly located outside of the company. Stewardship therefore must be concerned with the resources of society as well as the resources of the organisation as this relationship is indivisible. It therefore follows that stewardship of external environmental resources is concerned with the ensuring of sustainability. As we have seen, sustainability is focused on the future and is concerned with ensuring that the choices of resource utilisation in the future are not constrained by decisions taken in the present. This implies such things as recycling, using renewable resources and developing new production methods. It therefore becomes apparent that costs must be incurred in the present to minimise consequences in the future, and we will return to this later.

Action designed to be sustainable obviously has an effect upon society both now and in the future; equally it has an effect upon the company both now and in the future. Taking this perspective we can see that good performance by an organisation in the present is in reality an investment in the future of the organisation itself. We can also see that this is just as true of environmental performance as it is of financial performance despite this only being accepted very recently as true. So a concern with both financial and environmental performance is crucial to sustainability and this will involve a concern with both the supply of raw material s and with the development of production processes. Thus R&D must become more important for a company than it is sometimes treated and investment in the present is needed to safeguard the future. Slowly this is being recognised in the corporate world as the culture changes from externalising costs into the future – the Thatcherite – Reaganite approach – investing for the future. Even in the USA there are signs of this happening, partly of course as a result of the crisis in the financial world and partly as a result of the new president and his views.[12] From our perspective we simply wish to make the point here that financial and environmental performance are inter-related and that good performance in the financial dimension leads to good future performance in the environmental dimension and vice versa. Thus both must be of equal concern to managers.

One thing that has become apparent to all as a result of the 2008 financial crisis is that this quickly metamorphoses into an economic crisis and that in the global world no country is immune from the effects. Effects therefore have a far wider effect than those involved and this is equally true for corporate activity. Consequently it is no longer acceptable to say that the firm undertakes its activities and the only result which matters is that profit ensues which is available for distribution to shareholders and investors – the conventional

12 At the time of writing it is too early to evaluate any actions taken by Obama and we restrict ourselves to observing that he talks of different and more sustainable behaviour. Time will tell.

view of the transformational process. What is apparent is that the creation of value within the firm – whether it is positive or negative – is followed by the distribution of value to the stakeholders of that firm, whether these stakeholders are shareholders or others. Value however must be taken in its widest definition to include more than economic value as it is possible that economic value can be created at the expense of other constituent components of welfare such as spiritual or emotional welfare.[13] This creation of value by the firm adds to welfare for society at large. Thus welfare must be regarded as the sum of economic, spiritual, environmental and societal effects of corporate activity and therefore refers to our definition of sustainability outlined in Chapter 2. Furthermore it becomes apparent that our concern must be not just with the creation (or destruction) of welfare but also its distribution among the stakeholder community, thereby extending the concerns of the traditional transformational process.

Distributional Conflicts

In binary opposition to shareholders, as far as value creation and distribution for an organisation are concerned, are all others interested in the performance of the organisation (Crowther 2000c), who are generally homogeneously described as 'the stakeholders'. This concept neatly distinguishes one stakeholder group, the shareholders, from all others and enables the discourse to treat amorphously all other stakeholders. It is important to remember, however, that this amorphous mass contains very discrete groupings such as employees, customers, society at large and possibly most significantly the future (see Cooper 2000). This future can be broadly encapsulated in the concept of the environment. In this separation of stakeholders into two distinct groupings a dialectic is created which establishes a violent hierarchy (Laclan 1990) between the two poles of a binary opposition by establishing the idea of a conflict of interests. The creation of this dialectic provides a legitimation for the privileging of shareholders over all other stakeholders, a task for which accounting is singularly well equipped.

At the same time, the creation of this dialectic implicitly creates two dimensions to the performance of an organisation – performance for shareholders and performance for other stakeholders, with an equally implicit assumption that maximising performance for one can only be at the expense

13 See, for example, Mishan (1967), Ormerod (1994) and Crowther, Davies and Cooper (1998). This can be equated to the concept of utility from the discourse of classical liberalism.

of the other. It is in this way that a dialogue is created to consider which pole of the binarism should be dominant in the managing of corporate performance because one of the essential features of the violent hierarchy of poles established in this dialectic is that one must be privileged over the other.

The nature of the discourse regarding the measurement and evaluation of corporate performance has bifurcated in recent years with the adoption of different perspectives and this has been reflected in the changing nature of corporate reporting. Thus Beaver (1989) states that there has been a shift from an economic view of corporate performance measurement to an informational perspective with a recognition of the social implications of an organisation's activities. Similarly Eccles (1991) states that there has been a shift from treating financial figures as the foundation of corporate performance measurement to treating them as part of a broader range of measures, while McDonald and Puxty (1979) maintain that companies are no longer the instruments of shareholders alone but exist within society and so have responsibilities to that society. Others (for example, Roslender 1996) argue for a changed basis for accounting to reflect these changes.

This part of the discourse, therefore, seems to have moved away from the concerns of shareholders in the firm and away from the economic rationale for accounting and towards a consideration of the wider stakeholder environment. At the same time, however, these shareholder concerns cannot be ignored and another part of the discourse has seen a return to economic values in assessing the performance of the firm. Thus, Rappaport (1986) recognises some of the problems with accounting but goes on to consider the concept of shareholder value and how this can be created and sustained. He develops a methodology of shareholder value based upon his previous work where he argues (1992) that a shareholder value approach is the correct way of evaluating alternative company strategies, stating that the ultimate test of a corporate plan is whether it creates value for the shareholders, and that this is the sole method of evaluating performance.

Adherents to each of these conflicting philosophies have a tendency to adopt different perspectives on the evaluation of performance. Thus good performance for one school of thought is assumed to be poor performance for the others. Thus performance maximising philosophies are polarised in the discourse and this leads to a polarisation of performance reporting and the creation of the dialectic considered earlier. Almost unquestioned within the discourse, however, is the assumption that good performance from one aspect necessitates the sacrificing of performance from the other, despite the ensuing distributional conflicts being hidden within the discourse. Indeed Kimberley et al. (1983) have argued that some areas of performance which are important to the future of the business are not even recognised, let alone evaluated. It is argued in this book that the future orientation of performance management necessitates the creation of value over the longer term for all stakeholders and moreover that this value creation must be manifest in the way in which the value created in the organisation is distributed among the various stakeholders. It is only in this way that the sustainability, and even the continuing temporal existence, of the organisation can be ensured.

It can be argued, therefore, that a clearer articulation of the needs of performance evaluation will not only facilitate a more meaningful evaluation of performance for all interested parties but will also lead to better performance for the organisation. This is not just because such an articulation of needs can be argued to lead to a reduction in tension within the organisational framework but also because it enables more clearly the identification of the factors which shape performance as far as meeting the objectives of the organisation is concerned, and the techniques of VBM[14] are designed for this purpose. It is further argued, however, that successful performance, in whatever terms deemed appropriate, is not just more likely to be achieved in this manner but also is more likely to be sustainable and so shape long-term performance rather than the short term performance of the organisation. The factors shaping performance in the long and short term are not necessarily the same and the viewpoint and time horizon of the organisation are therefore important to its approach to measurement and evaluation. An examination of this time horizon and its relationship both to the organisation's evaluation systems and its performance, both projected and actualised, is important, therefore, to an understanding of the operating of the organisation.

The Transformational Process

We have already referred to the transformational process and will refer to it again a number of times as it is crucial to the development of our understanding of sustainability. In order to develop this understanding we need to adapt and develop the conventional view of the transformational process in order to arrive at the correct view of this in the context of sustainable operations. Let us start, however, by looking again at the traditional view of this process

14 VBM = Value Based Management, a technique claimed to optimise decision-making for performance. See Cooper et al. (2001) for further details.

(as represented in Figure 6.1) in which the stakeholder with which we have been concerned in this chapter are merely part of the value adding operational process of the organisation. In this view distribution is solely to the owners of the business as a reward for their risk and entrepreneurial ability.

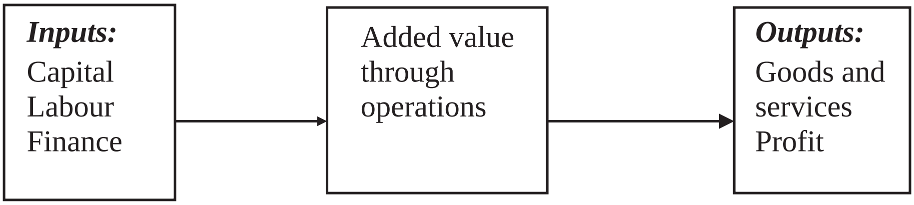

Figure 6.1 The traditional transformational process

This model assumes that inputs (of capital, labour and finance) are used to make goods and services through the employment of the operational factors of production – for example, employees, suppliers etc: also known as stakeholders – in order to make goods and services with a resultant profit. The implications of this conventional view of the transformational process are that the inputs can be freely acquired in the desired quantities and that the operational factors of production are commodified. This view of the process enables mediation through the market and is legitimated by the views of such as Spangenberg (2004) referred to earlier.

There are, however, two fundamental flaws with this form of analysis, from a sustainability perspective:

1. The input referred to as capital actually represents environmental resources and these are quite definitely finite in quantity (Daly 1996). Thus, the market cannot mediate adequately as the ensuing competitive bidding will raise the price but will not bring more of the resource into the market because there is no more in existence. Substitution can compensate for shortages only to a limited extent: it is difficult, for example, to see the extent to which more finance or labour can compensate for the absence of oil or any other fuel. We will return to this in subsequent chapters.

2. The factors of production are not actually commodities: rather they are stakeholders of the organisation. It may aid analysis to commodify them but they require benefits from the organisational activity. In particular, when resources are recognised to be finite,

> market mediation in this way does not satisfactorily accommodate the requirements of all stakeholders to the organisation. These stakeholders need to become a part of the output section of the transformational process.

The revised transformational process is therefore depicted as Figure 6.2.

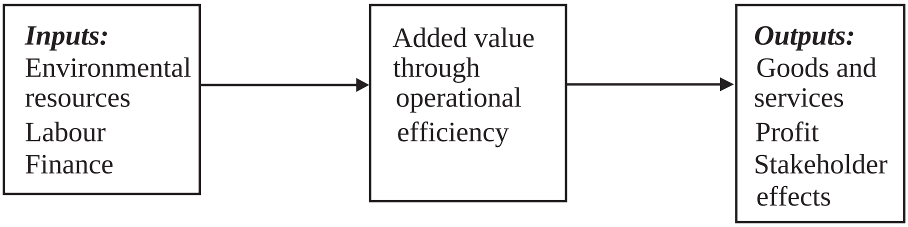

Figure 6.2 The revised transformational process

As far as inputs to the transformational process are concerned then it is apparent that environmental resources are finite and effectively fixed. Currently all the resources of the planet are in use (some would say overuse) and the resources for one corporation can only be increased by taking them from another through the process of competition in the market place. This highlights two alternative routes to development. The first is through the substitution of environmental resources with other inputs – of labour or finance. The second is through making better use of the available environmental resources – effectively doing more with less. Both require technological development in order to bring into effect and so sustainable development essentially requires technological development – also known as research and development – in order to be tenable. Technological development for sustainability requires the more efficient use of environmental resources whereas accounting efficiency requires the more effective use of financial resources. Sustainable development, therefore, requires greater use of human resources, particularly highly skilled people, in order to develop that technology, and this, of course, will incur additional cost. Accounting efficiency requires the replacement of people – particularly skilled and, therefore, expensive people – with relatively low cost techniques such as programmed change initiatives – business process re-engineering, etc. – and computer-based management systems. We therefore argue that the use of conventional accounting to a large extent is in direct opposition to the concept of sustainability – some we will return to again. At this point we wish to highlight that sustainability requires the adequate treatment of stakeholders so that the effects of organisational activity – both positive and negative – need to be distributed to all stakeholders, rather then merely to investors, in a way that is acceptable to all. Only such a form of distribution – as represented in Figure 6.3 – can be considered to be sustainable:

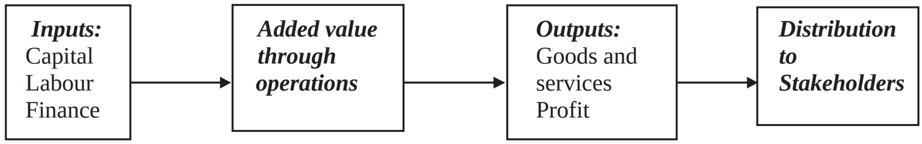

Figure 6.3 The sustainable distributional transformational process

We shall of course return again to this transformational process and develop our analysis further in the context of other factors – in later chapters.

Recycling and Stakeholders

The relationship between the company and its stakeholders is not of course unidirectional, with stakeholders merely being the passive recipients of the effects of corporate activity. Stakeholders have always made their opinion known – either actively through contacting the company or attending the AGM, or passively by ceasing a relationship with the company. Thus for example a customer who is not satisfied will make future purchases elsewhere. Similarly there have been many vociferous and high profile protests about corporate environmental activity. It is imperative therefore that a sustainable corporation needs to invest in all of its stakeholders in order to maintain and improve the relationships between the company and its stakeholders. Equally however it is apparent that this investment in stakeholder relations is returned to the company through being recycled as mutual benefit from a better relationship.

Conclusions

Distribution of effects is one of the key concepts of corporate sustainability and we have recognised in this chapter that the effects of corporate activity are wide and diverse but affect all stakeholders. We have framed our discussion in the context of the social contract which permeates much of the CSR discourse. In doing so we have extended our view of corporate activity beyond merely engaging in value adding in order to provide benefits to investors and have widened this to a consideration of the distribution of the effects of corporate activity to all stakeholders. This is part of the new discourse of sustainability which we will extend and refine in subsequent chapters.

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External Verification: Audit and Rating Systems

Introduction

An important aspect of sustainability activity by a corporation is its reporting – and, in particular, its conjunction with the other reporting of a corporation, which is, of course, primarily concerned with financial reporting. Such reporting needs to be verified in much the same way as financial reporting is verified, and this is the focus of this chapter. In order to set the scene, we need to consider briefly the history of the development of accounting. This shows that only certain effects of the actions of companies are generally considered to be the concern of the accounting of organisations. Anything else is considered to be irrelevant – and this includes the social and environmental effects of the actions of companies. As we have seen, this is not the case and we have shown that business performance can be improved by considering these effects. Social and environmental accounting is concerned with the measurement and reporting of these effects and the way they impact upon business performance.

All commercial enterprises have some form of accounting function. Indeed, accounting has become the universally adopted system of communicating economic information relating to an organisation and its activities – through the measurement and reporting of performance in financial terms. The notion of accounting, however, is far from being a new phenomenon. Accounting records dating back to ancient civilisations have been located, including building accounts for the Parthenon in Athens which have been found on marble tablets. Similarly, ancient Greek records exist illustrating an early form of stewardship accounting known as 'charge and discharge accounting': charge representing the amounts received and discharge being the amount expended. This system was further developed in Italy throughout the thirteenth and fourteenth centuries. The development included the practice of distinguishing between debit and credit entries and the use of two-sided accounting entries. The origins of a double entry bookkeeping system thus began to take form based upon the ideas of Paccioli. It is into this world that accounting was born on the basis that there was a need to record the actions of the individual, and the effects of those actions, as a basis for the planning of future action. This need was brought about by the separation of the public and private actions of an individual and the need to record, and account for, the public actions because of the involvement of others in these public actions. Thus the Medieval method of bookkeeping, with the indistinguishability of public from private actions was inappropriate to this modern world in which capitalist enterprise was beginning to arise.

Capitalism required the ability to precisely measure activities and this was the founding basis of management accounting. Indeed it has been argued that capitalism and the Industrial Revolution would not have been possible without the techniques of double entry bookkeeping and its subsequent metamorphosis into management accounting. This accounting provided the mechanism to make visible the activities of all involved in the capitalist enterprise and to both record the effects of past actions and the expected results of future actions. In so doing, however, a need was created to control the efficiency of the processes when combined and to attach an internal price, or more precisely a cost, to the processes now performed within the organisation. These systems thus provided quasi-market metrics that enabled managers to gauge the efficiency of the economic activity taking place within the organisation.

Stakeholder Influences on Accounting

Modern accounting came into being when firms became so large that ownership was necessarily divided and with external investment becoming necessary. The traditional view of accounting as far as an organisation is concerned is that the only activities with which the organisation should be concerned are those which take place within the organisation or between the organisation and its suppliers or customers – these are the only activities for which a role for accounting exists. Consequently it is considered, as far as traditional accounting is concerned, that these are the only activities which need to be taken into account as far as the accounting of an organisation is concerned. This view of accounting places the organisation at the centre of its world and the only interfaces with the external world are concerned with resources acquisition (raw materials, labour, capital, etc.) at the commencement of the organisation's processing cycle and selling its wares (goods or services and associated marketing costs) at the end of the processing cycle. This view of accounting is particularly pertinent for management accounting, which is essentially concerned with the transformational process within the organisation, and the management of that transformational process.

Here, therefore, is located the essential dichotomy of accounting – that some results of actions taken are significant and need to be recorded while others are irrelevant and need to be ignored. Social and environmental accounting, however, recognises that the organisation operates in a society in which its actions affect that society and its members. This accounting seeks to recognise the interrelationship between a business and society and to account for the activities of the business in such a way that both the business and society gain from the actions of the firm. Traditional accounting, however, remains focused upon the actions of the organisation and upon reporting the effect of those actions upon the organisation and its performance. In doing so it ignores the effects of the organisation upon its external environment.[1] A growing number of writers, however, have recognised that the activities of an organisation impact upon the external environment and have suggested that one of the roles of accounting is to report upon the impact of an organisation in this respect – in other words, the accounting of organisations should be more outward looking.

It is readily apparent that any actions which an organisation undertakes will have an effect not just upon the organisation itself but also upon the external environment of that organisation. In considering the effect of the organisation upon its external environment it must be recognised that this environment includes:

- the business environment in which the firm is operating;
- the local societal environment in which the organisation is located; and
- the wider global environment.

These effects of the organisation's activities can take many forms, such as:

- the utilisation of natural resources as a part of its production processes;

1 Indeed, this is consistent with financial accounting theory and its concern with the boundary of the organisation and with GAAP.

- the effects of competition between itself and other organisations in the same market;
- the enrichment of a local community through the creation of employment opportunities;
- transformation of the landscape due to raw material extraction or waste product storage;
- the distribution of wealth created within the firm to the owners of that firm (via dividends); and
- the workers of that firm (through wages) and the effect of this upon the welfare of individuals.

It can be seen, therefore, from these examples that an organisation can have a very significant effect upon its external environment and can actually change that environment through its activities. It can also be seen that these different effects can in some circumstances be viewed as beneficial and in other circumstances be viewed as detrimental to the environment. Indeed, the same actions can be viewed as beneficial by some people and detrimental by others. This is why planning inquiries or tribunals, which are considering the possible effects of the proposed actions by a firm, will find people who are in favour and people who are opposed. This is, of course, because the evaluation of the effects of the actions of an organisation upon its environment are viewed and evaluated differently by different people.

Environmental Issues and their Implications

As we have already seen, organisation activity has effects upon the external physical environment and these effects tend not to be reflected in the traditional accounting of that organisation. The external physical environment can be affected in many ways which are either positive, such as with conservation projects, or negative, such as through pollution caused by waste materials from a production process. Obviously these effects are unplanned but nevertheless affect the external environment and impose costs and benefits upon others. These unintended costs and benefits are imposed upon others – normally the local community, its citizens and society at large – by the organisation without consultation, and in reality form part of the operational activities of the organisation. These actions are however excluded from traditional accounting of the firm,[2] and by implication from its area of responsibility. Thus we can say that such costs and benefits have been externalised.

In the past it has been unquestioning that such externally imposed costs and benefits have been considered to be not the concern of the organisation, and its managers, and hence have been excluded from its accounting. Indeed accounting practices were designed without the facility to recognise them, having been designed in an era when the natural environment was considered to be simply a free resource to be used for the benefit of mankind. It is only through the development of environmental accounting that there has been any recognition of the need to recognise these effects and attempt to build them into the accounting of the organisation. Most people would agree that more costs have been imposed externally than benefits created and that therefore a typical organisation has gained from such externalisation and the reported value creation of such an organisation has been overstated by this failure to account for all costs and benefits. Indeed this is one way in which an organisation can report the creation of value.

We have already considered that it is possible to externalise costs both spatially and temporally. Temporally refers to the transferring of costs into the future whereas spatial externalisation describes the way in which costs can be transferred to others in the present. Examples of such spatial externalisation include:

- degradation of the environment through causing increased traffic and congestion in the local community and thereby reducing the quality of life;
- pollution of the atmosphere through emissions;
- the disposal of waste caused by excessive packaging and subsequently created litter;
- reducing the number of staff in shops and thereby imposing extra time costs upon customers;

2 They are of course included in the costs of the firm's activities and thereby in its accounting but all the costs and benefits resulting from such action are not fully recognised through traditional accounting.

- just in time processes which are designed to transfer costs to others earlier in the supply chain.

Regulation and its Implications

Although the disclosure of the actions of the firm in terms of their impact upon the external environment is essentially voluntary in nature, this does not necessarily mean that the actions themselves are always voluntary. Nor does it mean that all such disclosure is necessarily voluntary.[3] The regulatory regime which operates in most countries means that certain actions must be taken by firms which affect their influence upon the external environment. Equally, certain actions are prevented from being taken. These actions and prohibitions are controlled by means of regulation imposed by the government of the country – both the national government and local government. Equally, regulations govern the type of discharges which can be made by organisations, particularly when these are considered to cause pollution. Such regulations govern the way in which waste must be disposed of and the level of pollutants allowed for discharges into rivers, as well as restricting the amount of water which can be extracted from rivers.

The regulatory regime which operates in every country is continuing to change and become more restrictive as far as the actions of an organisation and its relationship with the external environment are concerned.[4] It seems reasonable to expect these changes to continue into the future and concern for the environmental impact of the activities of organisations to increase. These regulations tend to require reporting of the activities of organisations and such reporting also involves an accounting connotation. This accounting need is both to satisfy regulatory requirements but also to meet the internal needs of the organisation. This is because the managers of that organisation, in both controlling current operations and in planning future business activities, must have accounting data to help manage the organisational activities in this respect. The growth of environmental data, as part of the management information systems of organisations, therefore can be seen to be, at least in part, driven by the needs of society at large. In this way it is reflected in the regulations imposed upon the activities of organisations. As the extent of regulation of such activities can be expected to increase in the future, therefore,

3 This is particularly the case in countries which have more vigorous regulatory regimes.
4 In other words the extent of regulation in this area has increased in recent years and is continuing to increase.

the more forward looking and proactive organisations might be expected to have a tendency to extend their environmental impact reporting in anticipation of future regulation, rather than merely reacting to existing regulation.

It should not be thought, however, that the increase in stature and prominence accorded to socially responsible behaviour by organisations is driven entirely by present and anticipated regulations. To a large extent the external reporting of such environmental impact is not determined by regulations – these merely require reporting to the appropriate regulatory body. Nor can it be argued that the increasing multinational aspect of organisational activity, and the consequent need to satisfy regulatory regimes from different countries, has alone driven the increased importance of environmental accounting. Organisations which choose to report externally upon the impact of their activities on the external environment tend to do so voluntarily (Aras and Crowther 2008f). In doing so they expect to derive some benefit from this kind of accounting and reporting. The kind of benefits which organisations can expect to accrue through this kind of disclosure will be considered throughout this book. At this point, however, we should remember the influence of stakeholders upon the organisation and it can be suggested that increased disclosure of the activities of the organisation is a reflection of the growing power and influence of stakeholders, without any form of legal ownership, and the recognition of this influence by the organisation and its managers.

The Development of Social Accounting

Implicit in the development of social accounting is a recognition that the activities of an organisation have effects not just upon the organisation but also upon its wider environment. Thus social accounting shows a concern with the effects of the actions of an organisation on this external environment. This is based upon the recognition that it is not just the owners of the organisation who have a concern with the activities of that organisation. Additionally, there are a wide variety of other stakeholders who justifiably have a concern with those activities, and are affected by those activities. Indeed those other stakeholders have not just an interest in the activities of the firm but also a degree of influence over the shaping of those activities. Such stakeholders can include:

- suppliers of raw materials and other resources;
- customers for the organisation's products or services;
- employees;

- the local community;
- society at large;
- the government of the countries in which the organisation is based or conducts its activities.

This influence is so significant that it has been argued that the power and influence of these stakeholders is such that it amounts to quasi-ownership of the organisation. Indeed the traditional role of accounting in reporting results has been challenged. This challenge argues that accountability should be based upon a stakeholder approach, recognising the whole stakeholder community rather than an ownership approach. The benefits of incorporating stakeholders into a model of performance measurement and accountability have, however, been extensively criticised. Thus different schools of thought exist, however, as to whether there is any benefit in taking into account the needs of all stakeholders in the management of a company. Thus, for example, the techniques of value based management are based upon the premise that the way to maximise the performance of a company, for the ultimate benefit of all stakeholders, is by focusing upon the creation and maximisation of shareholder wealth. On the other hand, the stakeholder management school of thought disagrees and argues that performance for an organisation can only be maximised when the organisation addresses directly the needs of all stakeholders.

Social accounting first came to prominence during the 1970s when the performance of businesses in a wider arena than the stock market, and its value to shareholders, tended to become of increasing concern. This concern was first expressed through a concern with social accounting. This can be considered to be an approach to reporting a firm's activities which stresses the need for identification of socially relevant behaviour, the determination of those to whom the company is accountable for its social performance and the development of appropriate measures and reporting techniques. Thus, social accounting considers a wide range of aspects of corporate performance and encompasses a recognition that different aspects of performance are of interest to different stakeholder groupings. These aspects can include:

- the concerns of investors;
- a focus upon community relations;
- a concern with ecology.

Measuring performance in terms of these aspects will include, in addition to the traditional profit-based measures, such things as:

- consumer surplus;
- economic rent;
- environmental impact;
- non-monetary values.

Many writers consider, by implication, that measuring social performance is important without giving reasons for believing so. Solomons (1974), however, considered the reasons for measuring objectively the social performance of a business. He suggests that while one reason is to aid rational decision-making, another reason is of a defensive nature.

Unlike other writers, Solomons not only argued for the need to account for the activities of an organisation in terms of its social performance, but also suggests a model for doing this, in terms of a statement of social income. His model for the analysis of social performance is shown in Figure 7.1.

While Solomons proposes this model, which seems to provide a reasonable method of reporting upon the effects of the activities of an organisation on its external environment, he fails to provide any suggestions as to the

Analysis of Social Performance

		£
	Statement of Social Income:	
	Value generated by the productive process	xxx
+	unappropriable benefits	xxx
-	external costs imposed on the community	xxx
	Net social profit / loss	xxx

Figure 7.1 Analysis of social performance

actual measurement of external costs and benefits. Such measurement is much more problematic and this is one of the main problems of any form of social accounting – the fact that the measurement of effects external to the organisation is extremely difficult. Indeed, it can be argued that this difficulty in measurement is one reason why organisations have concentrated upon the measurement through accounting for their internal activities, which are much more susceptible to measurement. Social accounting is an attempt to redress this balance through a recognition that a firm affects, through its actions, its external environment (both positively and negatively) and should, therefore, account for these affects as part of its overall accounting for its actions.

The Measurement and Reporting of Performance

The evaluation of the performance of an organisation is partly concerned with the measurement of performance and partly with the reporting of that performance. If a greater importance is given to social accountability then changing measurement and reporting needs of an organisation must also be recognised. Social accounting is an attempt to measure and report upon organisational performance from a variety of perspectives, and hence to supply various diverse groups, with different needs for information. Thus it has been argued that there is a need for several distinct types of accounting to perform such a function. This argument is based upon a consideration of the limitations of the traditional economic base for accounting; it questions some of the premises of this economic base, such as:

- the desirability of continuing economic growth;
- the existence of rational economic man, making rational economic decisions;
- the exclusion of altruism from any decision-making process;
- the exclusion from consideration of the way in which wealth is distributed.

These factors are argued to be such that there is a need for a new paradigm. In this new paradigm the environment is considered as part of the firm rather than as an externality. Thus, the concept of sustainability, together with a consideration of the use of primary resources, is given increased weighting as far as accounting for the actions of a firm is concerned. Indeed some writers go further and argue that there is a need for a new social contract between a business and the stakeholders to which it is accountable, and a business mission which recognises that some things go beyond accounting.

Accountability and Social Activity

It is generally recognised that power is an essential component of accountability and that greater accountability is recognised towards those stakeholders that have more power. In this respect, organisations can be considered as externalising machines suited to self preservation. Thus, when faced with conflicting pressures a company will act in the interests of self preservation with smaller risk but less benefit being chosen. It is also argued that the power of businesses is increasingly being consolidated into the hands of the executives, rather than owners, as it is they who have the expertise to assess this risk. One of the problems with this concern with power is that society at large, and the environment in particular, tend not to be powerful stakeholders. It is perhaps for this reason that social accountability tends not to be a feature of organisations.

Research has, however, been undertaken with regard to the relationship between managers and employees and the use made of accounting information in this respect. This research has been concerned with the disclosure of accounting information to trade unions. Different conceptualisations of the relationship between management and employees can generate different conclusions regarding the disclosure of accounting information during industrial relations bargaining. Findings from such research demonstrate that increased disclosure can lead to reduced opposition from employees, greater commitment and loyalty, and increased legitimacy for intended action. This evidence therefore seems to suggest that greater disclosure of information can actually bring about benefits to the organisation as well as to the stakeholders involved. This is in line with the concepts of social and environmental accounting which are concerned with greater disclosure of the activities of an organisation but with an emphasis upon disclosure of actions and the way in which they impact upon the external environment.

Much of this research and argument is undertaken by people who start from the presumption that such accountability, and consequent reporting, is desirable without giving any reasons why this should be so. The benefits which ensue therefore go to the various stakeholders who benefit without any discernible benefit to the organisations themselves. One way to achieve this is through legislation and this is the approach taken by various countries around the world, with mixed results.

Another approach, however, is to demonstrate the benefits to an organisation itself from such social responsibility. These benefits can take place in the short term or in the long term. Generally speaking they can be in any of the following forms:

- increased information for decision-making;
- reduced operational costs or increased revenue;
- more accurate product or service costing;
- improved strategic decision-making;
- improved image;
- market development opportunities.

The Measurement of Environmental Impact

The techniques of social, environmental and accounting have been subject to continual development over the years. Growth in the techniques offered for measuring environmental impact, and reporting thereon, has also continued throughout the last 25 years during which the concept of such accounting has existed. However, the ability to discuss the fact that firms, through their actions, affect their external environment and that this should be accounted for has often exceeded any practical suggestions for measuring such impact. For example, it has been suggested that the concept of social overhead be offset against reported results from traditional measures of income, without suggesting how this might be calculated. Equally a model for such accounting, based entirely upon non-financial quantification, has been suggested. Other suggestions include a conceptual model for the categorisation of various forms of socially oriented disclosure which included the separation of socially responsible accounting from total impact accounting. Various models for sustainability accounting have also been suggested.

At the same time as the technical implementation of environmental accounting and reporting has been developing, the philosophical basis for such accounting has also been developed. Thus the extent to which accountants should be involved in environmental accounting has been the subject of considerable discussion. Similarly it has been argued that such accounting can be justified by means of the social contract as benefiting society at large. Some have argued that sustainability is the cornerstone of environmental accounting while others have stated that environmental auditing should be given prominence.

Environmental accounting can be seen to be a topical issue from a variety of perspectives but to be useful in measuring and reporting upon the impact of the actions of the firm it must necessarily be absorbed into the repertoire of accounting practitioners and into the systems of organisational control and reporting, rather than remaining as a critical external discourse. In other words, to be of use to businesses it is not appropriate to consider environmental accounting as a means to provide a basis for the criticism of organisational activity and behaviour. Such accounting only becomes relevant and practical when its benefits are established and built into organisational accounting. It is the purpose of this book, not to show that such accounting provides a vehicle for criticism but rather to demonstrate its practical utility.

The terms social accounting and environmental accounting can therefore be seen to have a variety of meanings and uses which for some people are revolutionary in their implications but for others are merely concerned with the ways in which business performance can be improved. In summary the terms have two major dimensions to their use:

1. They can refer solely to those costs and benefits which directly impact upon the bottom line profitability of the company. These can be termed private costs and benefits.

2. They can refer to the costs and benefits which affect individuals, society and the environment for which a company is not accountable. These can be termed societal costs and benefits.

In this chapter we are concerned primarily with the private costs and benefits, partly because this is where organisations starting to implement social or environmental accounting typically begin and partly because any justification for the implementation of such accounting must have a demonstrable benefit to that organisation. Much of what we consider will, however, be applicable to societal costs and benefits, and where there are obvious benefits to the organisation these will also be considered. The starting point for any consideration of the implications for the decision-making processes of an organisation is the identification of the relevant costs and benefits. These can be identified through an environmental audit.

The Environmental Audit

Before the development of any appropriate measures can be considered it is first necessary for the organisation to develop an understanding of the effects of its activities upon the external environment. The starting point for the development of such an understanding therefore is the undertaking of an environmental audit. An environmental audit, therefore, is merely an investigation and recording of the activities of the organisation in order to develop this understanding. Such an audit will address, inter alia, the following issues:

- the extent of compliance with regulations and possible future regulations;
- the extent and effectiveness of pollution control procedures;
- the extent of energy usage and possibilities for increasing energy efficiency;
- the extent of waste produced in the production processes and the possibilities for reducing such waste or finding uses for the waste necessarily produced;
- the extent of usage of sustainable resources and possibilities for the development of renewable resources;
- the extent of usage of recycled materials and possibilities for increasing recycling;
- life cycle analysis of products and processes;
- the possibilities of increasing capital investment to affect these issues;
- the existence of or potential for environmental management procedures to be implemented.

The undertaking of such an audit will require a detailed understanding of the processes of an organisation. The audit will, therefore, need to be detailed, and cannot be undertaken just by the accountants of the organisation. It will also involve other specialists and managers within the organisation who will need to pool their knowledge and expertise to arrive at a full understanding. Indeed, one of the features of environmental accounting is that its operation depends to a significant extent upon the cooperation of the various technical and managerial specialists within the organisation. Thus, environmental accounting cannot be undertaken by the accountants alone, and one of its benefits is that it involves all these specialists in the pooling of knowledge and understanding.

The objectives of an environmental audit are:

- first, to arrive at a complete understanding of the effects of organisational activity; and
- second, to be able to assign costs to such activity.

The audit should also enable the managers of the organisation to consider alternative ways of undertaking the various activities which comprise the operational processes of the organisation. It should also enable them to consider and evaluate the cost implications, as well as the benefits, of undertaking such processes differently. Such an audit will probably necessitate the collection of information which has not previously been collected by the organisation, although it may well be in existence somewhere within the organisation's data files. A complete environmental audit is a detailed and time-consuming operation but there is no need for such an exercise to be completed as one operation. Indeed, the review of processes and costs should be a continuous part of any organisation's activity. In this way it can lead to the implementation of better processes or control procedures without any regard to environmental implications. Thus the way to approach this audit is to extend the normal routines of the organisation to include a consideration, and quantification, of environmental effects on an ongoing basis.

Once this audit has been completed then it is possible to consider the development of appropriate measures and reporting mechanisms to provide the necessary information for both internal and external reporting. The measures which are used need to be based upon the principles of environmental accounting, as outlined below. It is important to recognise, however, that such an environmental audit, while the essential starting point for the development of such accounting and reporting, should not be viewed as an discrete isolated event in the developmental process. Environmental auditing needs to be carried out on a recurrent basis, much as is financial or systems auditing, in order to both review progress through a comparative analysis and to establish where further improvement can be made in the light of progress to date and changing operational procedures.

The Framework of Sustainability Accounting

Social and environmental accounting is normally considered to be concerned with the compilation of the effects of the activities of organisations from a different perspective, and the reporting of those effects to a wider range of stakeholders. These effects will tend to be different from those covered by mainstream accounting and will cover a wider range of effects and people affected. If such accounting is to be useful to organisations, however, there is a need for this social and environmental accounting to be incorporated into the normal accounting and reporting mechanisms of the organisation. Thus, there is a need for a framework under which this can operate and which incorporates such accounting into the normal mechanisms of the organisation. While it is possible to operate a separate accounting system to deal with the concerns of social and environmental accounting, this is costly in terms of resources. Moreover, it does not help an organisation to understand how the addressing of the concerns of this form of accounting yield practical benefits to the performance of the organisation.

Any such framework therefore needs to integrate the concerns of social and environmental accounting into the main accounting systems of the organisation. This is necessary in order to maximise the benefits from this accounting as far as the organisation is concerned. These benefits and twofold:

- to ensure that the benefits are yielded to the organisation and can be reflected in the bottom line of the organisation;

- to ensure that the decisions made within the organisation are made with full acquaintance with the facts and their implications.

Separate systems may results in sub-optimal decisions being made because all the facts are not integrated and reported upon.

An integrated accounting system, however, depends upon the development of an appropriate framework. The development of such a framework, in turn, may necessitate the presentation of information in a way which is different from how information is normally reported. It will certainly require the integration of accounting and non-accounting information. Such a framework needs to be built upon a recognition of the principles of environmental accounting and so it is to these that we now need to turn our attention.

Accountability

Accountability is concerned with an organisation recognising that its actions affect the external environment. It therefore implies the assuming of responsibility for the effects of those actions. This concept therefore implies a quantification of the effects of actions taken, both internal to the organisation and externally. More specifically the concept implies a reporting of those quantifications to all parties affected by those actions. This implies a reporting to external stakeholders of the effects of actions taken by the organisation and how they are affecting those stakeholders. This concept therefore implies a recognition that the organisation is part of a wider societal network and has responsibilities to all of that network rather than just to the owners of the organisation. Alongside this acceptance of responsibility, therefore, must be a recognition that those external stakeholders have the power to affect the way in which those actions of the organisation are taken and a role in deciding whether or not such actions can be justified, and if so at what cost to the organisation and to other stakeholders.

Accountability therefore necessitates the development of appropriate measures of environmental performance and the reporting of the actions of the firm. This necessitates the incurring of costs on the part of the organisation in developing, recording and reporting such performance. Naturally in order to be of value to the organisation the benefits derived must exceed the costs. Benefits must be determined by the usefulness of the measures selected to the decision-making process and by the way in which they facilitate resource allocation, both within the organisation and between it and other stakeholders. Such reporting needs to be based upon the following characteristics:

- understandability to all parties concerned;
- relevance to the users of the information provided;
- reliability in terms of accuracy of measurement, representation of impact and freedom from bias;

- comparability, which implies consistency, both over time and between different organisations.

Inevitably, however, such reporting will involve qualitative facts and judgements as well as quantifications. This qualitativeness will inhibit comparability over time and will tend to mean that such impacts are assessed differently by different users of the information, reflecting their individual values and priorities. A lack of precise understanding of effects, coupled with the necessarily judgmental nature of relative impacts, means that few standard measures exist. This in itself restricts the inter-organisation comparison of such information.

Such accountability will inevitable involve the disclosure of information about the organisation which is not traditionally disclosed and may involve the provision of information, over and above what is normally provided, concerning such things as the prevention or reduction of pollution, the extent of community service undertaken, the effects of actions upon employees of the products or services of the company. More specifically, it will involve accounting in more than merely financial terms and reporting for different purposes. Such disclosure by companies has increased over time and has been shown to lead to benefits not just to the stakeholders who are reported to but also to the organisation itself. This is because of the greater amount of information which is captured by the organisation and reported upon. This in itself leads to better informed decisions on the part of the organisation.

Transparency

Transparency, as a principle, means that the reporting of the external impact of the actions of the organisation can be ascertained from that organisation's reporting and pertinent facts are not disguised within that reporting. Thus, all the effects of the actions of the organisation, including external impacts, should be apparent to all from using the information provided by the organisation's reporting mechanisms. Transparency is of particular importance to external users of such information as these users lack the background details and knowledge available to internal users of such information. Transparency, therefore, can be seen to follow from the other two principles. Equally it can be seen to be a part of the process of recognition of responsibility on the part of the organisation for the external effects of its actions and part of the process of transferring power to external stakeholders.

Principles of Sustainability Reporting

These principles will reflect not just in the decision-making processes of the organisation and in its accounting systems but also in its reporting systems. This leads to a consideration of the principles which need to apply to these reporting systems. These can be summarised as:

- **Relevance** – to meet this criterion the target audience must be considered when providing information to ensure that the appropriate information is being reported upon.

- **Comprehensibility** – this means that the target group must be able to interpret the information correctly and the information supplied must, therefore, be adapted to the needs of the audience.

- **Verifiability** – it must be possible to check the exactness and precision of the data.

- **Completeness** – both positive and negative information must be included.

- **Comparability** – to be comparable the figures reported must be given in a consistent manner and reports must be made at regular intervals.

The Implementation of Sustainability Accounting

Sustainability accounting, or its variations of social or environmental accounting, can be used by any organisation to gain some benefits in its operations and performance, although the form it takes will depend upon the needs of the company. In any firm, however, the successful implementation of such accounting will depend upon the following:

- The support of the top management of the firm. This is because environmental accounting is likely to involve a new way of looking at the performance of the firm and the decision made regarding its operation. Commitment from the top management is likely to be necessary to ensure a culture for successful implementation.

- The establishment of an appropriately cross functional team. Environmental accounting is not just an issue for accountants. It requires information which is not merely financial but arises from a wide range of specialisms within a company and the bringing together of a wide range of knowledge about the operational activities of the firm. This information needs to be acquired and shared so that an appropriate environmental accounting system can be implemented which will ensure the maximisation of benefits to the company.

It needs to be recognised, however, that there are increased costs of instituting a regime of sustainability accounting and that these additional costs need to be offset against the possible benefits to be accrued. These increased costs are concerned with the development of appropriate measures of environmental performance and the necessary alterations to the management information and accounting information systems to incorporate these measures into the reporting system. This is particularly problematical for the organisation in terms of justification because the increased costs are readily quantifiable but the benefits are much more difficult to quantify.

This leads to one of the main problems with the accounting for externalities through social and environmental accounting. This problem is concerned with the quantification of the effects of the activities of the organisation upon its external environment. This problem revolves around four main areas:

1. determining the effects upon the external environment of the activities of the organisation;

2. developing appropriate measures for those effects;

3. quantifying those effects in order to provide a comparative yardstick for the evaluation of alternative courses of action, particularly in terms of an accounting based quantification;

4. determining the form and extent of disclosure of those quantification so as to maximise the benefits of that disclosure while minimising the costs of the disclosure and minimising the possibility of knowledge of the firm's operational activities being given to competitors.

These are problems which have been addressed by proponents of this form of accounting. It is fair to say, however, that these problems have primarily been recognised to exist rather than being satisfactorily solved. Those that argue in favour of an increased extent of disclosure in this area tend to consider the advantages of the disclosure from the point of view of external stakeholders rather than from the point of view of the organisation itself. Indeed one of the features of the environmental accounting discourse is the polarisation of views between those concerned with the firm, and its owners and managers, and those concerned with the environmental and thereby certain external stakeholders. Nevertheless it is increasingly apparent that these environmental issues are recognised by organisations as being of importance and the extent of environmental reporting by organisations is increasing and seems likely to increase further in the future.

Financial Reporting and Management Accounting

There is a significant part of the discourse of accounting which argues that a focus upon financial accounting for external reporting purposes can lead to an inadequacy of data for internal decision-making purposes. This applies to environmentally-related reporting as well as to financially-related reporting. It is argued that this is for the following reasons:

- The financial perspective considers that the main aim of performance measurement is the collection of data for the provision of information to external stakeholders. This can compromise the collection and use of data for internal decision-making purposes.

- Data disclosed through annual reporting can be misleading or inappropriate when applied to internally for environmental management purposes.

- A focus upon financial reporting rather than management accounting can lead to a lack of the integration of financial and environmental data into the general decision-making process of the organisation.

Environmental management and performance measurement needs to be linked to the broader issue of business management and performance measurement for the following reasons:

- The environment is an important strategic issue for many companies which needs to be considered as part of a balanced scorecard of business performance measures;

- Environmentally-related performance measures can lead to insights into other areas of performance measurement and hence have practical applications in other areas of the business;

- The effects of environmental performance spread throughout the organisation and thereby provide experience with dealing with some of the generic problems of the measurement of performance, such as:
  - the inevitable balancing between simple measures of performance which can be easily collected and understood but which do not capture a complete picture of performance and more complex measures which capture this complete picture but are difficult to collect and understand;
  - the extent to which performance measurement should be concerned with solely quantitative data and the extent to which qualitative data is important in the performance measurement process;
  - the extent to which the purpose of performance measurement is concerned with control as opposed to motivation or the creation of continuous improvement.

While there is some validity to the criticisms which have bee expressed there is nevertheless a strong body of evidence which demonstrates that the linking of financial reporting to the needs of business management leads to better performance on the part of an organisation. Moreover, the incorporation of environmental accounting information increases this performance.

Sustainability Reporting

There have been many claims (see, for example, Crowther 2000a) that the quantification of environmental costs and the inclusion of such costs into business strategies can significantly reduce operating costs by firms;[5] indeed this was one of the main themes of the 1996 Global Environmental Management Initiative Conference. Evidence is gradually accumulating that this is indeed true but the evidence is mixed and, for example, Pava and Krausz (1996) demonstrate empirically that companies which they define as 'socially responsible' perform in financial terms at least as well as companies which

5 Indeed this is one of the claims made by the Association of Chartered Certified Accountants (ACCA), one of the worldwide leading professional accounting associations.

are not socially responsible. It is accepted, however, that different definitions of socially responsible organisations exist and that different definitions lead to different evaluations of performance between those deemed responsible and others. Similarly in other countries efforts are being made to provide a framework for certification of accountants who wish to be considered as environmental practitioners and auditors. For example, the Canadian Institute of Chartered Accountants is heavily involved in the creation of such a national framework. Azzone, Manzini and Noci (1996) however suggest that despite the lack of any regulatory framework in this area a degree of standardisation, at least as far as reporting is concerned, is beginning to emerge at an international level.

Growth in the techniques offered for measuring social impact, and reporting thereon, has continued throughout the last 25 years, during which the concept of this form of accounting has existed. However, the ability to discuss the fact that firms, through their actions, affect their external environment and that this should be accounted for has often exceeded within the discourse any practical suggestions for measuring such impact. At the same time as the technical implementation of social accounting and reporting has been developing, the philosophical basis for such accounting – predicated in the transparency and accountability principles – has also been developed. Thus some people consider the extent to which accountants should be involved in this accounting and argue that such accounting can be justified by means of the social contract as benefiting society at large. Others have argued that sustainability is the cornerstone of social and environmental accounting and that auditing should be given prominence.

An examination of the external reporting of organisations gives an indication of the extent of socially responsible activity. Such an examination does indeed demonstrate an increasing recognition of the need to include information about this and an increasing number of annual reports of companies include some information in this respect. This trend is gathering momentum as more organisations perceive the importance of providing such information to external stakeholders. It has been suggested, however, that the inclusion of such information does not demonstrate an increasing concern with the environment but rather some benefits – for example, tax breaks – to the company itself. One trend which is also apparent in many parts of the world, however, is the tendency of companies to produce separate social and environmental reports.[6]

6 Originally these were called environmental reports. Now they are normally known either as CSR reports or as sustainability reports.

In this context such reports are generally termed corporate social responsibility (CSR) reports or sustainability reports, depending upon the development of the corporation concerned. This trend is gathering momentum as more organisations realise that stakeholders are both demanding more information and are also demanding accountability for actions undertaken. Equally the more enlightened of these corporations are realising that socially responsible activity makes business sense and actually assists improved economic performance.

The Advent of Rating Systems

All corporate reporting, whether financial or other, is subject to audit.[7] Audits are performed to ascertain the validity and reliability of the information produced, and also to provide an assessment of a corporation's control systems. The goal of an audit is to express an opinion on the corporation under evaluation. An audit seeks to provide only reasonable assurance that the statements are free from material error – known as true and fair. Hence, statistical sampling is often adopted in audits. Traditionally audits were mainly associated with gaining information about financial systems and the financial records of a company or a business but more recently auditing has begun to include other information about the system, such as information about environmental performance. Audit risk is a term that is commonly applied in relation to the audit of the financial statements of an entity. The primary objective of such an audit is to provide an opinion as to whether or not the financial statements present fairly the financial position and results of the entity. Audit risk is the risk of the auditor providing an inappropriate opinion on the financial statements. In other words, it is the risk of the auditor stating the financial statements present fairly the financial position of the entity, when in fact they do not.

Audit has therefore been extended into the field of sustainability but one further innovation in this field is concerned with rating systems and rating agencies. Rating systems are arguably a consequence of the current interest in league tables and the concomitant desire to evaluate through setoff factors, each of which has points awarded to it. The total points for all factors enables a rating to be made and compared with others for which a different set of points have been awarded in a similar manner. Such systems are popular and have a function to enable a quick comparison between organisations to be made. Moreover, they are based upon an identification of important factors

7 The auditing of financial reporting is, of course, compulsory whereas the auditing of other forms of reporting tends to be completely voluntary, although becoming more the norm.

concerned with sustainability. We have argued throughout this book, however, that sustainability is a complex issue with different factors being important in different circumstances and for different organisations. Reducing this to a simple score, therefore, can be considered to be trite and little more than pandering to populism.

Perhaps a more significant development at present is that the current (2008) financial crisis has shown that there are major problems with rating agencies, which have exacerbated the situation by giving AAA ratings which cannot be justified to some of the financial instruments which are floating around the markets and which consist primarily of worthless rubbish. And of course the strength of such a rating agency is based entirely upon the reliability of its ratings – so there is a major problem for such agencies as the financial crisis continues to unfold.

Conclusions

External verification is important as a part of the process of reassuring and safeguarding stakeholders. It is also helpful in benchmarking by enabling some sort of comparative evaluation to be made. As we have seen there are many aspects which need to be considered in assessing sustainable activity, much is focused upon the relationship between the corporation and its stakeholders – an extension from the traditional view of the firm. This is similar to our assertion in the last chapter that sustainability necessitates a revised view of the firm and of its factors of production. In the next chapter we will continue by considering other ways in which a sustainable approach requires a different view of a firm and its processes.

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International Standards and Regulations

Introduction

The question of standards for sustainability activity is one which has been in existence for a long time and gradually some standards for reporting are starting to emerge. In many ways the development of sustainability reporting standards parallels the development of accounting standards – with a focus upon the harmonisation of common standards now being the main issue to consider, this is in distinct contrast to 10 years ago when the emergence of common standards – for either accounting or sustainability – looked no better than a remote possibility. In this chapter, therefore, we consider the development of standards, both for accounting and for sustainability, offer a prognosis for future standards and make our own suggestions.

Globalisation and Accounting

There is unquestioning acceptance within the discourse of accounting that there is a need for accounting standards and that these should be harmonised on a global basis.[1] From this acceptance two sets of standards have evolved: US GAAP as devised by the Financial Accounting Standards Board (FASB) of the USA, and obligatory for all companies reporting into the New York Stock Exchange; and International Financial Reporting Standards (IFRS) and codified by the International Accounting Standards Board (IASB), and now obligatory for all companies reporting into the Stock Exchanges of the EU. Each set of standards is vying for global dominance as the universal accounting

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1 This acceptance of the need is of course the rationale for Generally Accepted Accounting Principles (GAAP) on both a national and international basis.

standards. It is generally accepted within the accounting community[2] that there is only room for one set of standards and the debate continues regarding which approach to standard setting is superior and concerning the prognosis as to which approach will eventually win and become the accepted global set of standards.[3]

Although this debate is interesting and engaging, and has occupied accountants for a couple of decades, it is the argument of this chapter that this debate has resulted in the situation that the real issue is being missed – obfuscated by the competition between the alternative approaches to standard setting. We argue that both the FASB and IASB are vehicles of colonial exploitation, aiming to set standards which will benefit the standard setting (developed) countries at the expense of the less developed countries which must merely comply. Such an approach to standard setting cannot be sustainable (Aras and Crowther 2007a) so we argue that an observation of the debate concerning corporate social responsibility (CSR) and its regulation provides important data concerning the benefits of developing global standards. Indeed our argument[4] is that standards of behaviour evolve through natural selection just as effectively (if not more so) as through imposed standards. Therefore we consider that standards of sustainability reporting should just be allowed to evolve; of course, as we will see, there are vested interests to prevent this.

It is important to note that standards are designed to facilitate the interpretation of company accounts and to understand their financial situation. They are not perfect in achieving this and Enron, for example, complied (or appeared to) with the standards set by US GAAP. They were however one of the exponents of the current trend for off balance sheet financing which in effect avoids the need for complying with reporting standards and therefore makes an assessment of risk and financial viability more difficult and less certain. The extent of this activity and the amount of risk and doubtful financing hidden in this manner has recently become apparent as the current (2008) financial crisis has forced banks and other financial institutions to reveal their more dubious and risky activity and has caused the failure of some of these institutions and the government bail out of many more. Standards are designed to make such activity visible and thereby assist potential investors.

2 This includes both practitioners and academics who concur of this issue, even if very little else.
3 Currently the IFRS seem to be becoming dominant raising the expectation that they will eventually triumph – a distinct changes from a decade ago when all the betting would have been upon US GAAP becoming dominant.
4 See, for example, Crowther (2006) to follow this debate.

The tools of accountancy are its accounting and financial models. The accountancy profession has its work cut out to continue developing GAAP[5] models for external reporting that can be applied universally across the world and this work is in hand. Models for the production of internal financial information are much less well developed and standardised. Less progress is being made here partly because of strong resistance by corporate managers, often on the grounds that more transparency would erode their competitive advantage. Better internal financial management models must be devised. They must be coherent with external financial information models if they are to achieve the level of transparency needed to monitor and control the changing intentions of corporate mangers. There may be a case for more standardisation and possible regulation of these models.

As far as external financial information models are concerned then progress is being made to improve accounting worldwide and update it to increase its relevance in the 'global village' in which we now all live. New international accounting standards have been introduced from 1 January 2005 (Deloitte 2004). The aim is to harmonise accounting practices across the world which is crucial to providing a regulatory environment to monitor and control international activities, especially those of multinational companies, who can exploit gaps in different accounting regimes to their own advantages. There is a wide variety of practices worldwide making harmonisation a challenge requiring compromises at national level to move towards worldwide standardisation. If successful, external accounting reports across the world will become more universal, comprehensible and transparent. Accounting as a profession will be more uniform across the world with the possibility of more ready transferability of accounting skills. To achieve international harmonisation the focus must be, at least initially, on eroding differences rather than expanding the overall scope of regulation and conforming to the international standard may also reduce flexibility at national level. For these reasons it may be that innovative solutions for the improvement of internal financial management information will emerge from sources other than the international standard setting process (Eastburn 2000).

The Identification of Costs

Fundamental to the management of an organisation is the need to separate the core cost of generating income on an ongoing basis from all other costs. Both the

5 Generally Accepted Accounting Practice.

trading account and the cost of sales used in GAAP models purport to make this distinction but in fact do not do so. Separating core and discretionary costs would provide better financial management information to managers than if the GAAP model is used on its own. There is a possibility of using value-based models to overcome the weaknesses of GAAP models for the provision of relevant and useful financial management information. The main recommendation of value-based management is to separate operating and investing activities (Copeland et al. 2000), which more or less correlate to core and discretionary costs. The purpose is to classify expenditure transactions according to the characteristics of the return on that expenditure.[6] Operating transactions have a quick return whilst investing transactions have a longer term return cycle. This theme is continued with the further classification to value streams[7] (Baggaley and Maskell 2003), also recognised on the basis of different characteristics of return on expenditure. As yet, few organisations currently apply value-based models for day-to-day management, but those that do, also continue to use GAAP models. It is important that individual organisations develop alternative solutions to improving their financial management information because it is a vital potential source of competitive advantage.

There is no compulsion on organisations to use GAAP models as the basis of their internal financial management information. When an organisation does use GAAP as the basis of its financial management information it will be able to monitor the impact of management on external reporting. Internal and external financial information can be reconciled readily and this alignment will ensure a high level of transparency (Adler and Borys 1996; Ahrens and Chapman 2004). The lack of regulation over the use of models for internal use gives managers a degree of discretion which they can exploit to 'fudge' the links between the internal and the external information. In this way, their activities are not transparent. Auditors and stakeholders are unable to unlock the information for their purposes and the accountability trail is broken. Managers often justify such actions on the grounds of competitive advantage. One solution might be to develop GAAP models to fully support financial management information requirements as well as external reporting and regulate their use. This would ensure greater transparency but may have consequences on the competitive position of the organisation and this issue would need to be addressed in some way.

6 Return on expenditure is not the traditional ratio description for this; rather it can be considered to be return on investment (ROI). Instead, return on expenditure is used loosely to describe the streams of future cash flows that relate to the expenditure.

7 Also known as lines of business.

Just as slow has been the harmonisation of the rules that determine economic activity throughout the world which originally varied from country to country. Where there has been a high degree of worldwide standardisation there have been opportunities to develop worldwide channels of communication and trade. The information profession, for example, has benefited from a high level of standardisation of technical rules which has allowed the www to develop. The benefits of a worldwide level playing field are not universally accepted as the erosion of national specialities can be eroded along with conformation with global standards. The accountancy profession, lagging behind, has failed to achieve a high degree of harmonisation across the world and managers of organisations have exploited the loopholes thus created with as much attention as any other lucrative source of business. Whether or not harmonisation is ultimately good or bad, the process of harmonisation has increased complexity in the short term. There is still a long way to go, but partial harmonisation is worse than either of both extremes, and accelerating the pace of harmonisation to a situation where complexity starts to reduce will be a major factor in accountancy becoming a more useful tool once again for monitoring and influencing organisational behaviour.

The Evolution of Accounting Standards

Financial reporting is the principal means of communication between investors and firms and the accounting standards that guide financial reporting set the terms of a critical trust relationship between the firm and their stakeholders (Glauter and Underdown 1994). Such reporting has changed over time (Crowther 2000) as part of an evolutionary process. Gilmore and Willmott (1992) have argued that this reporting has developed to reflect a focus upon investment decision-making and the need to attract investment into the company in this period of expansion. The emphasis remained firmly upon the needs of the company however and only the emphasis had changed from informing existing investors to attracting new investors. Thus Jordan (1970: 139) was able to claim that:

> *'The purpose of accounting is to communicate economic messages on the results of business decisions and events, insofar as they can be expressed in terms of quantifiable financial data, in such a way as to achieve maximum understanding by the user and correspondence of the message with economic reality.'*

One set of standards is controlled by the International Accounting Standards Board (IASB), which develops and implements IFRS. It is composed of eight members each representing different jurisdictional areas: Australia, Canada, France, Japan, Germany, New Zealand, United Kingdom and the US (Alfredson 2003). Naturally countries representing different jurisdictions each have their own preferred interests in setting and implementing any standards, based on local conventions. If they can lobby successfully to ensure that their preferred interests are included in IFRS, then they can influence the financial reporting of other nations. Thus, setting standards is an exercise in the exertion of power and the hierarchical control operating through the IASB in the setting of accounting standards exhibits a situation which can be used to control other, less powerful nations.[8]

One of the main benefits from the adoption of IFRS is claimed to be the associated reduction in information costs (Daske 2006). The setting of standards at the IASB is of course a negotiated process and has less to do with meeting pre-determined outcomes through implementation of IFRS (Collett, Godfrey and Hrasky 2001) than it has to do with ensuring dominance. The diversity in reporting regimes is a result of an evolutionary process that reflects the uniqueness of cultural, legal and economic jurisdictions (Hegarty 1997). These legitimate differences (arguably arising from differences in concentrations of ownership of firms) lead to different degrees of reliance on general purpose financial reports, variations in optimal debt-equity ratios and different legal systems impacting upon accounting systems. Furthermore, financial reporting in some jurisdictions is led by the needs of taxation while in other jurisdictions it is based on a local conceptual framework (Collett et al. 2001). These differences have led the IASB constructing standards through a complex set of compromises between the various jurisdictions involved with the inevitable effect that the resulting standards may not serve the needs and circumstances of all – or even any – jurisdictions. It is therefore apposite to challenge one of the arguments for global standards, namely the notion of reduction in cost of information as the adoption of IFRS – and consequent reduction in associated costs – will only benefit those countries whose cultural, legal and economic systems are similar to those nations involved in setting IFRS; other countries, and the companies domiciled therein, will incur increased costs of compliance. This means that if those other countries and their firms are indirectly forced to adopt the cultural, legal and economic systems prevailing in nations setting IFRS they will not derive the maximum benefits from its adoption.

8 We use IFRS and the operations of the IASB to make our critique. All our arguments apply equally to US GAAP except that with these standards there is a single exploitative neo-colonial country involved and less care is taken to disguise the naked greed involved.

It is therefore apparent that those countries involved in setting IFRS should benefit through the reduction of cost of capital due to the inflow of capital into their capital market. The expanded capacity of the capital markets of these nations to raise capital also allows them to export their capital to other nations at a lower cost and on an unparalleled scale. Conventional wisdom suggests that an integration of national financial markets facilitates financial flows from rich countries to poor countries, thereby accelerating development in those poor countries. According to this view the globalisation of financial markets helps to reduce the inequality of nations. There is, however, a widely held belief that poor countries are unable to compete in an integrated financial market against rich countries, which can offer financial security to lenders in an imperfect world (Matsuyama 2004). The expected benefit from the development of financial market integration and financial asset movements is creating the prospect of a more efficient worldwide allocation of savings and investment than was possible in the past. However, the impact of this globalisation on financial markets in developing and transitional economies can be very severe and destructive. Imperfectly competitive financial markets[9] can react perversely to adverse economic shocks, which can be spread to other countries with a contagious effect. One of the main causes of financial shock and crisis (see Aras and Crowther 2007d) is these capital flows, especially portfolio investments, for developing countries which have unregulated markets and unsound financial systems. These countries are wide open for international financial shocks; therefore we can say that financial globalisation carries with it large risks.

This position is also promulgated by Caldwell (2000) who argues that this capital can then abort and distort the development of countries (especially, developing countries), which are dependent on this capital, in a manner that best suits the requirements of the IFRS setting IASB nations. The form and arrangement of capital transfer can vary from one country to another, but the outcome is the subjugation of the interests of the economically weaker developing countries to the benefit of the powerful developed countries. This capital determines the type of industries and activities that will survive in economic and political terms and will be complementary to the interests of the standard setting nations. It will also reinforce and perpetuate low labour wages in developing nations so that the IFRS setting IASB nations can invest capital to reap the maximum profits. The low wages actually discourage imperialist

9 It is frequently ignored that a completely unregulated free market only operates effectively in a situation of perfect competition – in other words never. It is simply a construct in theoretical economics. Nevertheless, the ideal of perfect competition is used to extol the virtues of the free market system – a myth successfully perpetuated by the Chicago School and subsequently unquestioned.

capitalists from replacing people with machinery that will reduce their profit, at least in the short term – thereby negating the claimed benefit of economic development from this scenario. The elimination of such distorted development requires foreign aid, which is of course provided by the same imperialists, with attached conditions to further their own political and economic agenda.

Thus another claimed objective of IFRS is to increase the capital market efficiency (Koedijk and van Dijk 2004) by setting globally accepted, high quality, comparable and transparent accounting standards (Tarca 2004). It has been argued (Mackenzie 2003) that IFRS will increase the accuracy of pricing capital but we state that a capital market must be completely efficient in order to accurately price capital. Equally, IFRS has moved away from reporting relevant information to determine fair value of a firm by restricting itself to reporting intangibles that can be measured in relation to an active market. Therefore, with the reduction of value relevant information recognised in financial reports, it is apparent that IFRS has determined how the various accounting elements should be measured and reported, and has thereby determined how profit figures will be derived and reported by firms. The profit figure determined through the application of IFRS appears to be designed to attract investor capital according to the agenda set by the few countries setting standards and prescribed to the rest of the countries. This can be interpreted as an attempt by the standard setting countries to attract more capital into their capital markets at a lower cost of capital. The surplus capital can then be exported back to other countries by firms in developed countries and utilised to produce goods and services at a beneficial cost. Thus Isaak (1991) is able to state that the product cycle almost always begins in high income market economies through their entrepreneurial culture for product innovation, as such economies provide a supportive environment – albeit in the distorted manner described here – for technological innovation, which is facilitated by flexible risk insurance, enabling the commercial application of such technological change. When the product has reached standardisation of mass production, it becomes cheaper to produce in a low wage developing economy with the technologies recycled by developed countries to maximise their capital accumulation. Inevitably when capital transcends geographical boundaries the success of capital accumulation depends on the extent of the support by means of socio-economic resources provided by other countries (Harvey 1990). Our argument is that the promotion of IFRS is an attempt to foster an environment conducive to the appropriation of the socio-economic resources of less powerful countries by the IFRS standard setting countries to their own advantage – legitimated exploitation in a post-colonial era!

This argument is also promulgated by Dwyer and Roberts (2004) who state that the fluidity of capital is designed to enable capital owners in the standard setting developed countries to control production in distant developing countries. Similarly it is argued (Isaak 1991; Murray 1981) that capital when freed from spatial constraints leads to imperfect competition through a chaos of imperfect markets, and thereby motivates firms and countries to maximise their global market share through cooperative pricing, transfer pricing and economies of scale – again to the advantage of the standard setting countries. Thus Clegg and Dunkerley (1980) state that capital is more than a mere collection of transferable resources while Holloway (1994) suggests that capital is an institutional system through which technology and organisational structures are increasingly developed and deployed to differentiate and legitimate processes for capital maximisation by the capital providing countries. Furthermore Holloway (1994) states that by restricting the mobility of labour capital in non-standard setting countries while promoting the mobility of capital between the IFRS standard setting nations reinforces the use of a low-wage system in developing countries, again resulting in increases in the profits of the standard setting countries. This territorial definition enforces a different global relationship of labour to that of global capital. It can therefore be seen that an undisclosed effect of adopting IFRS is to benefit the free movement of capital whilst restricting the free movement of workers, which inevitably leads to the capital providers in developed countries being able to extract surplus profits while restricting the movement of labour.

Competing Standards

The exploitative regime of accounting standards – FASB and IASB – has of course led to intense competition between the two dominant standards, as each tries to maximise the benefits to the standard setters. According to Zeff (2002), some Europeans firms have expressed their preference for US GAAP on the basis that they are well organised and constitute a powerful lobby. Zeff argues that the rigorous enforcement in the US is likely to be controversial and would generate stronger negative reactions than in any of the other seven countries collaborating with the IASB. This confrontational climate is heightened by the high incidence of litigation and traditional intense lobbying of legislators at state and federal level on the FASB. These legislators virtually assure the results for FASB. This is the primary reason why the Association for Integrity in Accounting[10] has argued that the FASB should be dissolved.

10 www.citizenworks.org/actions/aia.php.

According to Ham (2002) the IASB standards are moving closer to the FASB standards rather than the other way round. Although the FASB has come under recent criticism with the collapse of Enron, Ham argues that the Enron collapse is not significant enough to challenge the superiority of the FASB standards, since the US has continued to be the most successful capital market and the most resilient economy. Recently the USA has sought to expand its power base in the IASB by presenting a significant American presence. It is also widely accepted (Dye and Sunder 2001) that the acquiescence of the USA is required for truly global standards. Equally some economically powerful countries offer voluntary support to perpetuate FASB standards. Thus, for example, Canada explicitly ratified the US GAAP standards and the Canadian accounting standards board (AcSB) has an explicit purpose to harmonise with the US GAAP by eliminating significant unjustifiable differences with the FASB standards and to converge with the highest quality US and international accounting standards (Mackenzie 2003). Canada has publicly declared its commitment to contributing to, and developing, a reliable system of international accounting standards while recognising its critical dependence on access to capital markets in the USA. Street and Shaunessy (1997) point out that adopting the US standards brings Canada closer into alignment with Americans and will strengthen business relationships with their biggest trading partner.

The US public accounting profession, as represented by the 'big four' public accounting firms is also a dominant institutional factor in supplying accounting expertise to multinational firms across different countries. More than one half of the 215 nations recognised by the United Nations maintain offices of the 'big four' public accounting firms despite them all having their headquarters in the US (Cooper, Greenwood, Hinnings and Brown 1998; Hegarty 1997). Their expertise shapes the culture and economics of countries without occupying their territory – colonisation without colonialism. This expertise provided by the 'big four' firms also facilitates the expansion of the US Empire (Dwyer and Roberts 2004). This increases the scope for firms not just to expand geographically but to increase their range of services to further expand their capital (Hegarty 1997).

Introducing Corporate Social Responsibility

This indictment of accounting standards can be contrasted with the development of standards regarding corporate social responsibility (CSR).

The European Union, through its Commission, has concentrated on the enaction of CSR as an expression of European cohesion. Thus the *Green Paper – Promoting a European Framework for Corporate Social Responsibility* (EC, 2001) and the *Corporate Social Responsibility: A Business Contribution to Sustainable Development* (EC, 2002) defined the pressure from the European institutions so that corporations were reminded of their responsibilities to their various stakeholders, both internal and external. The first document (EC, 2001: 8) described CSR as:

> *'… a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.'*

The essential point is that compliance is voluntary rather than mandatory and this voluntary approach to CSR expresses the reality of enterprises in beginning to take responsibility for their true social impact and recognises the existence of a larger pressure exercised by various stakeholder groupings in addition to the traditional ones of shareholders and investors. Moreover it reflects the different traditions of business and differing stages of development throughout the Community.

Although this definition places an emphasis on such activity being voluntary the implication is that the EC will not be involved in any form of regulation and that the expectation is that companies will engage in socially responsible activity in excess of any regulatory requirements. Although phrased to place an expectation upon companies, this statement is in reality a clear abdication of any responsibility on the part of the EC.[11] Such abdication is in accordance with the action (or lack thereof) of other governments and is predicated in an assumption that the market will enable such socially responsible activity.[12] As far as the definition itself is concerned then this is

11 Conversely, as Ortiz-Martinez (2004) points out in a country such as Spain then some kind of information about socially responsible corporate behaviour is required to be shown on the corporate website. In this respect there is not a universal consensus among government organs, at least as far as the EU is concerned.

12 Of course, it is possible to argue that such things as International Financial Reporting Standards (IFRS) and such bodies as the International Accounting Standards Board (IASB) are effectively government endorsed regulations as they are supported by governments around the world and compliance is required by national and global corporations. Although this is a valid claim it must also be recognised that their enforcement has been policed by organisations such as Arthur Andersen and that corporations such as Enron would have been deemed to be in compliance, one of the problems causing a lack of faith in both financial markets and corporate behaviour.

not of course a new definition and has resonance with earlier idea such as those of Dahl (1972) who stated:

> *'… every large corporation should be thought of as a social enterprise; that is an entity whose existence and decisions can be justified insofar as they serve public or social purposes.'*

According to the European Commission, therefore, it is about undertaking voluntary activity which demonstrates a concern for stakeholders. But it is here that a firm runs into problems – how to balance up the conflicting needs and expectations of various stakeholder groups while still being concerned with shareholders; how to practise sustainability; how to report this activity to those interested; how to decide if one activity is more socially responsible that another. The situation is complex and conflicting. So here the intention is to consider both what is meant by CSR and what we know about the relationship between CSR and financial performance.

Nevertheless steps have been taken by interested parties to change this voluntary approach and to develop some kind of standards for reporting, but they have not been adopted by governments to become enshrined into standards. Thus in 1999, the Institute of Social and Ethical Accountability (the Institute of Social and Ethical Accountability is probably better known as AccountAbility) published the AA1000 Assurance Standard with the aim of fostering greater transparency in corporate reporting. AccountAbility, an international, not-for-profit, professional institute has launched the world's first ever assurance standard for social and sustainability reporting. The AA1000 Framework[13] is designed to improve accountability and performance by learning through stakeholder engagement. It was developed to address the need for organisations to integrate their stakeholder engagement processes into daily activities. It has been used worldwide by leading businesses, non-profit organisations and public bodies. The Framework is designed to help users to establish a systematic stakeholder engagement process that generates the indicators, targets and reporting systems needed to ensure its effectiveness in overall organisational performance. The principle underpinning AA1000 is inclusivity. The building blocks of the process framework are planning, accounting, and auditing and reporting. It does not prescribe what should be reported on but rather the 'how'.

13 http://www.accountability.org.uk.

According to AccountAbility, the AA1000 Assurance Standard is the first initiative offering a non-proprietary, open-source Assurance standard covering the full range of an organisation's disclosure and associated performance (that is, sustainability reporting and performance). It draws from and builds on mainstream financial, environmental and quality-related assurance, and integrates key learning with the emerging practice of sustainability management and accountability, as well as associated reporting and assurance practices.

At a similar time, the Global Reporting Initiative (GRI) produced its Sustainability Reporting Guidelines which have been developed through multi-stakeholder dialogue. The Guidelines are claimed to be closely aligned to AA1000, but focus on a specific part of the social and environmental accounting and reporting process, namely reporting. The GRI aims to cover a full range of economic issues, although these are currently at different stages of development. The GRI is an initiative that develops and disseminates voluntary Sustainability Reporting Guidelines. These Guidelines are for voluntary use by organisations for reporting on the economic, environmental and social dimensions of their activities, products and services. Although originally started by an NGO, GRI has become accepted as a leading model for how social, environmental and economic reporting should take place. It aims to provide a framework that allows comparability between different companies' reports whilst being sufficiently flexible to reflect the different impacts of different business sectors.

The GRI aims to develop and disseminate globally applicable Sustainability Reporting Guidelines. These Guidelines are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products, and services. The GRI incorporates the active participation of representatives from business, accountancy, investment, environmental, human rights, research and labour organisations from around the world. Started in 1997, GRI became independent in 2002, and is an official collaborating centre of the United Nations Environment Programme (UNEP) and works in cooperation with UN Secretary-General Kofi Annan's Global Compact. The Guidelines are under continual development and in January 2006 the draft version of its new Sustainability Reporting Guidelines, named the G3, was produced and made open for feedback. The GRI pursues its mission through the development and continuous improvement of a reporting framework that can be used by any organisation to report on its economic, environmental and social performance. The GRI has become the popular framework for reporting, on a voluntary basis, for several hundred organisations, mostly for-profit corporations. It claims to be the result of a permanent interaction with many people that supposedly represents a wide variety of stakeholders relative to the impact of the activity of business around the world.

GRI and AA1000 provide a set of tools to help organisations manage, measure and communicate their overall sustainability performance: social, environmental and economic. Together, they draw on a wide range of stakeholders and interests to increase the legitimacy of decision-making and improve performance. Individually, each initiative supports the application of the other – at least this is the claim of both organisations concerned; AA1000 provides a rigorous process of stakeholder engagement in support of sustainable development, while GRI provides globally applicable guidelines for reporting on sustainable development that stresses stakeholder engagement in both its development and content.

The Regulation of Standards

The tenor of the debate about CSR and its reporting can be considered to be an argument between two competing positions: the free market economic model and the concomitant greater corporate autonomy versus greater societal intervention and government control of corporate action. The latter would imply the regulation of reporting through the governmental adoption of standards while the former would imply the continuance of the current voluntary approach. There is clear evidence that the free market proponents are winning the argument. They point to the global spread of capitalism, arguing that this reflects a recognition that social wellbeing is dependent on economic growth, although the current financial crisis has weakened this argument and strengthened the argument for regulation.

Resolving these arguments would seem to be impossible because they assume divergent philosophical positions in the ethics v regulation debate as well as in more fundamental understandings of human nature. There is, of course, no definitive answer to this conflict and we restrict ourselves in this paper to examining the impact upon the development of standards. Growth in the techniques offered for measuring social impact, and reporting thereon, has continued throughout the last 25 years, during which the concept of this form of accounting has existed. However the ability to discuss the fact that firms, through their actions, affect their external environment and that this should be accounted for has often exceeded within the discourse any practical suggestions for measuring such impact. At the same time as the technical implementation of social accounting and reporting has been developing, the philosophical basis for such accounting – predicated in the transparency and accountability principles – has also been developed. Thus some people consider the extent to which accountants should be involved in this accounting and argue that such accounting can be justified by means of the social contract as benefiting society at large. Others have argued that sustainability is the cornerstone of social and environmental accounting and that auditing should be given prominence.

This realisation obviates any need for regulation and calls into question the standards suggested by such bodies as AccountAbility. The more progressive corporations have made considerable progress in what they often describe as their journey towards being fully socially responsible. In doing so they have developed an understanding of the priorities for their own business – recognising that CSR has many facets and needs to be interpreted differently for each organisation – and made significant steps towards both appropriate activity and appropriate reporting of such activity. The steps towards CSR can be likened to increasing maturity as all organisations progress towards that maturity by passing through the same stages (see Crowther 2006), although at different paces. The most mature are indeed recognising that nature of globalisation by recognising that the organisational boundary is permeable (see Crowther and Duty 2002) and that they are accountable also for the behaviour of other organisations in their value chain.

There can, therefore, be seen to be a stark contrast between the development of standards for financial reporting and the development of standards for CSR reporting. For financial reporting, two sets of standards are competing for global dominance. A masquerade of the reduced cost of information leading to reduced cost of capital diverts attention from the essentially exploitative nature of the way in which the standards operation. Conversely for CSR the amount of information being reported has gradually increased and become more meaningful without the need for any imposed standards, despite attempts from interested parties to colonise the standard setting arena. At the same time the evidence concerning standard setting suggests that effective standards are derived by consensual agreement rather than by being imposed. Thus CSR reporting standards are evolving to take into account a whole range of stakeholders and their actions – to address the requirements of interested parties, while financial reporting standards simply address the needs of the powerful who can lobby for their own interest most effectively. And, of course, CSR reporting is effectively the same as sustainability reporting.

Developing Standards of Sustainability

We have discussed throughout this book[14] the features of sustainability in terms of the factors involved. The later chapters will focus more upon the operationalisation of these features in practice; in this chapter we wish to focus upon its operationalisation, in terms of the development of standards. Our argument has been that sustainability must involve greater efficiency in the use of resources and greater equity in the distribution of the effects of corporate activity. For standards to be developed then, of course, the effects must be measurable and the combination must of course be manageable. This can be depicted as the model of sustainability shown as Figure 8.1:

Manageable (strategic)	Measurable (financial)
Equitable (distributional)	Efficient (technological)

Figure 8.1 The facets of sustainability

It is readily apparent that the features of this model are a prerequisite for all standards. These are, of course, that standards must be:

- manageable;
- measurable;
- equitable;
- efficient.

14 See also numerous articles but in particular Aras and Crowther (2007b, 2007c, 2008c, 2009b).

And that these are the things which we have raised as questionable concerning both accounting and CSR standards.

We have also argued that this acts as a form of balanced scorecard to provide a form of evaluation for the operation of sustainability within an organisation. It concentrates upon the four key aspects, namely:

- strategy;
- finance;
- distribution;
- technological development.

Moreover it recognises that it is the balance between these factors which is the most significant aspect of sustainability. From this a plan of action is possible for an organisation which will recognise priorities and provide a basis for performance evaluation.

Conclusions

Standards for reporting are obviously important as they enable comparison and benchmarking, as well as the tracking of change over time. Indeed Robson (1992) extends this and states that one of the qualities of such reporting is that it enables action at a distance,[15] which he describes as inscription. In doing so, this emphasises the role of reporting standards in enabling the transferring of best practice. We have highlighted the debates which are taking place in reporting standards before focusing upon our own model as a balanced scorecard of sustainability. We will expand upon this in later chapters.

At this point though we offer our prognosis that the concern with the audit society and the verification of everything before it has validity will mean that standards of measurememnt and reporting will evolve – driven by the organisations with greatest interest in that evolution – and will become so

15 He explains that such inscription enables the translation of elements within their context and that viewed this way accounting has the following qualities: mobility by enabling the actor and his setting to be divorced; stability by the use of conventions which eliminate contextual dependencies thereby making information recognisable to all users; and combinability by enabling the accumulating and aggregating of data.

prevalent that corporations will be obliged (even without their being mandatory) to use these standards. Thus the GAAP approach will transfer into this arena also, with its concomitant advantages and problems. Our suggestion, however, would be to prevent this and to allow norms to simply evolve – good practice develops and gets taken up by concerned organisations before becoming generally adopted, whereas developing standards just results in obfuscation (see Aras and Crowther 2008a, 2008f).

9

Globalisation, Competition and Financial Crisis

Introduction

There is no doubt that we are in an era of globalisation and that we are feeling the effects, both positive and negative, of that environment. This environment has many implications for corporate activity and has, of course, much significance for our consideration of sustainability. The financial crisis has heightened the urgency of addressing these global issues. In this chapter therefore we will explore these various implications and the changed context of corporate activity. Indeed we will look at the whole philosophical underpinnings of the capitalist system. First, however, it is necessary to investigate the phenomenon of globalisation itself and precisely what is meant by such a ubiquitous term.

Globalisation

The phenomenon known as globalisation is a multidimensional process (Aras and Crowther 2007a) involving economic, political, social and cultural change. However, the most important discussion about globalisation is related to the economic effect it has upon countries. Globalisation in the economic and financial markets is a recognised international fact in the twenty-first century for all countries. The globalisation process has dynamic, critical and inevitable consequences for institutions, business and the environment, especially for developing countries. Because of this, globalisation is the main issue for some well-known international institutions and some associations such as the International Monetary Fund (IMF), World Bank, United Nations (UN), World Trade Organization (WTO), Bank for International Settlement (BIS), etc. – as well as for the anti-capitalist protest movement. For example, one of the international organisations – the IMF – has identified six key principles that should strengthen the framework for the global economy (IMF 2002a). These are:

1. The issue of international interdependence must be given greater priority within national policy.

2. International cooperation should not replace national self-responsibility.

3. Globalisation urgently requires solidarity.

4. The ecological threat to the planet knows no national boundaries.

5. We need recognised rules of the game or a level playing field, for participation in globalisation.

6. We should regard the diversity of experiences and cultures as part of the wealth of our planet.

As can be seen, these principles cover national politics, ecological and environmental issues, wealth distributions and international corporate behaviour, sharing experiences and roles of main players of this process. One of the main questions is whether globalisation is inevitable and will have the same effect or not for all countries and markets. Another question concerns whether or not globalisation causes less independence for countries by ensuring either mutual dependency[1] or by causing countries to become beholden to financial markets and the multinational companies influencing these markets. According to all literature, research and experiences, it looks that not only is it an inevitable fact but also that it is having a strong effect for all countries. Therefore, in another publication the IMF has also identified the following four key principles for strengthening the process of globalisation (IMF 2002b):

1. All countries need to have trust that their voices will be heard.

2. There must be trust that each country will live up to its own responsibility.

1 The financial crisis has effectively demonstrated this interdependence by the way in which first problems with bank lending and liquidity and then problems with economies have spread around the world, effecting both developed and developing countries without regard for their culpability.

3. International decision-making should be seen to respect national and local responsibility, religious, culture and traditions.

4. A global economy needs global ethics, reflecting respect for human rights.

These key principles indicated that globalisation has needed some basic rules such as solidarity, respect, and responsibility for each nation's value, and global ethics, for all actors in this process. Another issue is cooperation, solidarity, sharing experiences and decisions which also will affect the dependency of nations.

On the other hand, some writers mention that, as international institutions, the IMF and the World Bank – which are describing financial architecture – have been working hard to improve the life[2] of millions or billions of people in the world over the last 50 years or so (Moshirian 2003). And the call for a new international financial architecture by the IMF as well as the World Bank is a step in the right direction. However, this call is not going to change the fortunes of many developing countries and give them the ability to improve the underlying causes of their financial inability to deal with their economic and social or environmental problems (Moshirian 2002).

Financial Markets and Globalisation

The liberalisation of trade in financial assets is often called financial globalisation. In neoclassical models, financial globalisation generates major economic benefits: in particular, the theory holds that it enables investors worldwide to share risks better,[3] it allows capital to flow where its productivity is highest, and it provides countries an opportunity to reap the benefits of their respective comparative advantages (Stulz 2005). Globalisation is clearly an important influence on financial markets. Globalisation of financial markets affects assets and debts securities, bank loans and deposits, titles to land and physical capital. Trade in these assets and debts is much easier to globalise than trade

2 Others are more cynical and would argue that the restructuring programmes imposed by the IMF have been making life harder for billions of people and better for a very small number. Essentially this is the argument of Klein (2007) who blames the Chicago School of economists epitomised by Milton Friedman. We concur with Klein's analysis but are more inclined to blame Ronald Reagan, Margaret Thatcher and their successors – Bush, Blair, etc. We would also remind that this is all in accordance with the tenets of Utilitarianism.

3 Some would say that it has enabled the powerful to pass silly risk onto others.

in commodities and labour.[4] Indeed, their globalisation has progressed most rapidly because nothing is involved in financial transactions beyond exchanging pieces of paper or making entries in electronic ledgers. The communications revolution makes these transactions easy, fast and cheap. No physical frontiers have to be crossed by financial assets. The only barriers to financial transactions are national regulations (Tobin 2000). However, it can be seen that regulation is not enough to regulate and control for international transactions and capital flows in developing countries and transitional economies – or to effectively regulate global financial companies.

Conventional wisdom[5] suggests that an integration of national financial markets facilitates financial flows from rich countries to poor countries, thereby accelerating development in those poor countries. According to this view the globalisation of financial markets helps to reduce the inequality of nations. There is, however, a widely held belief that poor countries are unable to compete in an integrated financial market against rich countries, which can offer financial security to lenders in an imperfect world (Matsuyama 2004). The expected benefit from the development of financial market integration and financial asset movements is creating the prospect of a more efficient worldwide allocation of savings and investment than was possible in the past. However, the impact of this globalisation on financial markets in developing and transitional economies can be very severe and destructive. Imperfectly competitive financial markets[6] can react perversely to adverse economic shocks, which can be spread to other countries with a contagious effect. One of the main causes of financial shock and crisis is capital flows, especially portfolio investments, for developing countries which have unregulated markets and unsound financial systems. These countries are wide open for international financial shocks; therefore we can say that financial globalisation carries with it large risks.

Financial stability and market discipline are the main factors required to combat the inevitable, and most of the time, uncontrolled effects of globalisation. Therefore, until market discipline becomes more effective in ensuring sound

4 An alternative explanation, of course, is that it is much more profitable to globalise trade in financial matters while it is more profitable to deter global trade in commodities and labour because of the resultant possibilities for profit through arbitrage.

5 Also known, of course, as the Myth of the Free Market as espoused by the Chicago School; we have referred to this many times.

6 It is frequently ignored that a completely unregulated free market only operates effectively in a situation of perfect competition – in other words never. It is simply a construct in elementary theoretical economics.

financial systems, closer regulatory oversight will be the key to increasing the benefits and limiting the risks of globalisation. To achieve this goal, policy makers in developed and developing countries, as well as supervisory and regulatory bodies (such as the Basle Committee of Banking Supervisors – see Aras 2007a, 2007b) and international financial institutions (such as the IMF and the World Bank) are taking steps to enhance financial system soundness in the new environment (Knight 1998).

It is clear that globalisation is a growing influence on financial markets and for all the reasons mentioned, globalisation is necessitating global standards and regulations for international trading and for corporations. If the world is going to be (almost) only one federation we will have need of international rules and standards such as international bank regulations, international accounting standards and trade regulations. And also achieving true financial globalisation would require a global financial institution that can play a central coordinating and regulatory role (Arestis et al. 2005).

Globalisation, Market Misbehaviour and Financial Crises

Contagions and crises are the downside of financial globalisation, as we are currently witnessing. The economic and financial crises of the 1990s give an indication that financial globalisation is not always beneficial to all, and that it can potentially lead to serious disorder and high cost in terms of bank failures, corporate bankruptcies, stock market turbulence, depletion of foreign exchange reserves, currency depreciation and increased fiscal burden, while the 2008 crisis has demonstrated this even more severely. A unique characteristic of globalised financial markets is the sudden reversal of capital flows when market perception regarding the creditworthiness of the borrowing entity changes. The probability of a randomly selected country experiencing a crisis has doubled since 1973. To avoid recurrences of such scenarios, policy makers must strive to make their financial systems deep, broad and resilient. They must address financial weaknesses that make financial structures vulnerable to external shocks. This needs to be achieved both at national and global levels (Das 2006).

There are, of course, benefits to go alongside the problems. Thus the integration of financial markets also improved access to the pool of global savings for many developing countries. Many countries have been able to borrow more and hence grow faster than otherwise possible, while generating higher yields for international investors and giving them the opportunity to reduce risk though portfolio diversification. Thus the process of financial market integration and associated increase in international financial mobility has been viewed as a welcome development by many (Park 2002). For this reason, globalisation has increased the speed of market reactions in the financial markets of developing countries. These countries, which tend not to have sufficient market rules and regulations, are clearly open for the external effects which come from capital flows and portfolio investment. In terms of the increasing volume of international trade and portfolio investment, globalisation causes markets to misbehave in these emerging countries. For example, one of the main causes of the Asian crisis lies in the rapidly increasing globalisation and the unregulated market conditions. In 1997 the annual average net private capital flows in developing countries was $285 billion. If you compare net capital flows in earlier and later years then, for example, in 1982 was $57 billion while in 2003 it was $167 billion – a rapid increase followed by a sharp decrease in capital flows in these developing countries after the crisis.

As we have seen, globalisation caused a series of financial crises in the last century. This experience has indicated that developing countries need to have a set of preconditions in place to benefit from financial globalisation and to avoid an increased probability of a currency or banking crisis. The free market – an article of faith for the New Right (and also the New Left) – causes many possibilities which must be recognised. It is, however, an inevitable consequence of the philosophical foundations upon which the capitalist system is predicated. We need to understand this basis, necessitating the following diversion, and its relationship to corporate social responsibility (CSR) and hence the implications for sustainability.

The Philosophical Foundations of Capitalism

There are thus many reasons for the current interest in CSR; it is a topic which is considered to be of particular importance at the present time. Definitions of CSR are many and diverse but one which has been created by the European Commission is:

> *'CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.'*

One which we prefer though was produced by Dahl in 1972. He stated that:

> *'… every large corporation should be thought of as a social enterprise; that is an entity whose existence and decisions can be justified insofar as they serve public or social purposes.'*

Corporate social responsibility has been one of the most debated management issues, with both academics and practitioners trying to give proper meaning to the concept and justifying why corporations should adopt ethical and socially responsible behaviour, yet there is lack of consensus on what the concept means, what it entails, why it should be embraced, how it should be operationalised, what its roles are in achieving organisational effectiveness or performance and lots and lots of issues bordering on the concept. At the same time, the development of a theoretical underpinning for CSR has been given increased priority, with a critique of Utilitarianism and its antecedent, Classical Liberalism, featuring prominently.

Classical Liberal philosophy[7] is considered by many to be philosophy which underpins the capitalist economic system. Its adoption, as Utilitarianism, provides the legitimation for the free market philosophy of the Anglo-Saxon world. This is based upon one of the main principles of Utilitarianism as expounded by John Stuart Mill (1863) that maximising individual benefits would lead to the maximisation of organisational benefits and also societal benefits because outcomes are all that matters to the philosophy in order to determine net benefit which could be derived summatively. This, of course, leads to the situation whereby a large benefit accruing to one person would outweigh small disutilities accruing to a large number of people because the summative effect is positive and therefore deemed to be desirable – remembering of course that the philosophy is only concerned with outcomes: ends rather than means. Effectively this of course provides a legitimation of exploitation by the powerful of the relatively disadvantaged. By extension, this allows corporations to exploit their stakeholders without too much concern for effects, especially as traditional accounting conveniently failed to account for much of this exploitation (Crowther 2004b). Classical Liberal economic theory extended the individualistic view of society to include organisations as entities in their own right with the freedom to pursue their own ends.

7 See Barnett and Crowther (1998) for a more detailed consideration and critique of Classical Liberalism.

The seeds were, therefore, set for the acceptance of selfish behaviour and the abuses of corporate power which we have seen culminating in such things as the Enron debacle and the US sub-prime lending fiasco. But this was not sufficient to satisfy the wants of corporate magnates – the playing field was still too level! So, limited liability was also necessary. The concept of limited liability was first introduced in order to enable large-scale investment to take place. With the separation of investment in a business from the management of that business there was considered to be a need for the protection of the investors, who were often individuals with a relatively small amount of capital, from the possible fraudulent actions of the managers of the business. Similarly Agency Theory was developed to attempt explain and to align the interests of those managers with the investors through the development of suitable mechanisms. This paved the way for the attraction of many more investors, thereby enabling the growth in size of business enterprises, with those investors secure in the knowledge that they were protected from any loss greater than the sum they had invested in the enterprise. Thus for relatively small levels of risk they were able to expect potentially great rewards and thereby escape from some of the consequences of the actions of the enterprise. Further actions have been taken since to alleviate corporations (and hence shareholders) from the risk associated with their investments. Buckminster Fuller (1981) describes lucidly the actions of successive US governments[8] during the twentieth century which had the effects of transferring all risk to society in general through taxation, reduced regulation and through acting to bail out failed enterprises.[9]

Thus by the start of the twentieth century it had been accepted that firms had a corporate identity which was distinct from that of their owners and that such firms embodied a presumption of immortality (Hein 1978). In legal terms a company, therefore, is a person with the power to contract like any other individual[10] although the reality is that this power is vested in the managers of the company. The effect of this is that managers can enter into transactions for which they have no liability for non-fulfilment. Effectively by the introduction of this concept of limited liability, risk was transferred away from the legal owners of a business and onto those with whom that business transacted. Equally the ability of managers to engage in those transactions on behalf of the business, without any necessary evidence of ownership – merely delegated responsibility – meant that most risk was thereby transferred away from the

8 These changes have, of course, been paralleled in the actions of all other governments of the Western world.

9 In 2008 it has even been extended to the buying from banks of unsecured, ridiculously high risk defaulted debt, conveniently named as toxic investments to disguise their true nature.

10 *Wenlock (Baroness) v. River Dee Co* 1887.

business. The potential rewards from owning a business became divorced from any commensurate risk – effectively separating the risk – reward relationship upon which finance theory is based.

Still these changes have not been sufficient and so recent concern has been with the free market as a mediating mechanism. The argument, of course, is that unregulated transacting will benefit everyone but this is only true in a situation of perfect competition;[11] with the sort of power inequalities which exist in the present this philosophy only justifies exploitation by the powerful of the corporate world. This then creates an environment in which CSR is needed.

The Effects of Technological Development

Perhaps of more importance at this point is to return to Marshall McLuhan (1968) and the way in which technology is bringing about the global village – and we are, of course, referring now to the internet. The increasing availability of access to the internet has been widely discussed and its effects suggested, upon both corporations and upon individual members of society (Rushkoff 1997). For corporations, much has been promulgated concerning the opportunities presented through the ability to reach a global audience and to engage in electronic retailing; much less has been said about the effects of the change in accountability provided by this medium. Much of what has been said is based upon an expectation that the internet and the world wide web will have a beneficial impact upon the way in which society operates. Thus Sobchack (1996) argues that this technology will be more liberating, participatory and interactive than previous cultural forms while Axford (1995) argues that it will lead to increasing globalisation of politics, culture and social systems. Much of this discourse is concerned at a societal level with the effects of internet technology upon society and, only by implication, upon individuals within society. It is, however, only at the level of the individual that these changes can take place. Indeed access to the internet, and the ability to communicate via this technology to other individuals, without regard to time and place, can be considered to be a revolutionary redistribution of power (Russell 1975) – a redistribution in favour of us all as individuals. Moreover the disciplinary practices of society (Foucault 1977) breakdown when the internet is used because of the lack of spatial contiguity between

11 One of the first assumptions of economics is that of perfect competition – a readily acknowledged to be unrealistic set of assumptions which are quickly relaxed in theory. This, of course, never gets a mention by the free marketeers – or even their critics!

communicants and because of the effective anonymity of the communication which prevents the normalising surveillance mechanisms of society (Clegg 1989) to intercede in that communication. Thus the internet provides a space for resistance to foment (Robins 1995).

Of particular interest, however, is the way in which access to the technology to use the internet can redefine the corporate landscape and change the power relationship between large corporations and individuals. In this respect the changes in these power relationships can be profound and even revolutionary. The technology provides a potential challenge to legitimacy and can give individuals the ability to confront large corporations and to have their voice heard with equal volume within the discourse facilitated by cyberspace. In this respect the power imbalance is being equalised and we are moving from a global marketplace to a truly global village.

Globalisation and Sustainability

Sustainable development is often misinterpreted as focusing solely on environmental issues. In reality, it is a much broader concept as sustainable development policies encompass four general policy areas: *economic, environmental, cultural and social*. In support of this, several United Nations texts, most recently the 2005 World Summit Outcome Document, refer to the *'interdependent and mutually reinforcing pillars' of sustainable development* as *economic development, social development, and environmental protection*.

Sustainable development is a notoriously ambiguous concept, as wide arrays of views have fallen under its umbrella. The concept has included notions of weak sustainability, strong sustainability and deep ecology. Different conceptions also reveal a strong tension between ecocentrism and anthropocentrism. Thus, the concept remains weakly defined and contains a large amount of debate as to its precise definition. In the short term, environmental degradation leads to declining standards of living, the extinctions of large numbers of species, health problems in the human population, conflicts, sometimes violent, between groups fighting for a dwindling resource, water scarcity and many other major problems.

It is essential to recognise the realities of the global environment (see Aras and Crowther 2007a, 2007b, 2008d, 2009a) insofar as the company is firmly embedded into a global environment which necessarily takes into account the past and the future as well as the present. This effectively makes a stakeholder out of everything and everybody both in the present and in the future. Sustainability, therefore, requires a distribution of effects – positive and negative – in a way which eliminates conflict between all of these and pays attention to the future as well as the present. Thus, a short-term approach is no longer acceptable for sustainability and Figure 9.1 represents such an approach to sustainability and sustainable development, which we will develop further in subsequent chapters.

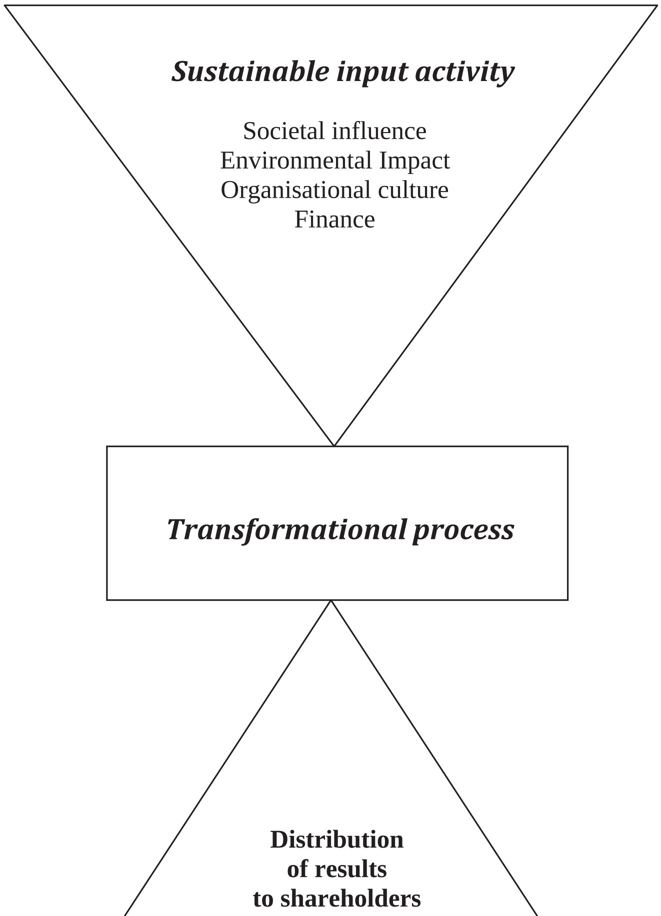

Figure 9.1 Model of sustainable distribution

Implications for Corporate Activity

The globalisation of the business environment means that no longer is the firm seeking to communicate internally – to members or potential members – but rather the focus is upon the external environment (Crowther 2000b). Indeed, reporting has now become predominantly forward looking and, perhaps more significantly, the forward orientation is not upon the economic prospects of the firm but upon the prospects for the shareholder community in terms of rewards – both dividends and share price increases. Additionally, the corporate communication now acknowledges the rest of the stakeholder community and seeks to demonstrate corporate citizenship by commenting upon relationships with, and benefits accruing to, employees, society, customers and the local community. Indeed, the communication has tended to become not a communication medium but rather a mechanism for self promotion. Thus the actual results of the firm's past performance no longer matter but rather the image of the firm is what matters (Crowther 2002c). Part of this has been brought about, of course, by technological change and one thing which is clear about the internet is that it provides a facility to give a voice to people who would otherwise find difficulty in obtaining that voice (see Grieco 1996) and as far as the technology is concerned that voice is equal to all other voices. In other words, all stakeholders feature more prominently in the concerns of the firm, and certainly a concern with employees and customers is apparent in all corporations, being merely a reflection of the power of those stakeholder groupings rather than any expression of social responsibility. Similarly, in some organisations a concern for the environment is less a representation of social responsibility and more a concern for avoiding legislation or possibly a reflection of customer concern. Such factors also apply to some expressions of concern for local communities and society at large. In practice this concern has become formalised, often through the development of a balanced scorecard and such things as customer or employee satisfaction surveys. Most organisations have progressed through this stage also, with such activity being embedded into normal ongoing business practice.

One of the biggest issues of the moment – certainly in Europe – is the question of firms accepting responsibility for what happens further along their supply chain. This is something that has been brought about largely because of customer pressure (Aras and Crowther 2008b) and has come about because of the revelations made about such things as child labour, slavery and other human rights abuses. So it is no longer acceptable for a firm to say that what happens in a supplying firm – or even the supplier of a supplier – is not their responsibility. Popular opinion says that the firm is responsible for ensuring socially responsible behaviour among their suppliers as well as in their own company. Thus there have been examples of some very large companies – such as Gap or Nike – acknowledging responsibility and taking appropriate action to ensure change. This is an issue which is growing in importance and is being addressed by the more mature (in CSR terms) companies.

Transparency, as a principle, necessitates that information is freely available and directly accessible to those who will be affected by such decisions and their enforcement. Transparency is of particular importance to external users of such information as these users lack the background details and knowledge available to internal users of such information. Equally, therefore, the decisions which are taken and their enforcement are done in a manner that follows rules and regulations. Transparency, therefore, can be seen to be a part of the process of recognition of responsibility on the part of the organisation for the external effects of its actions and equally part of the process of redistributing power more equitably to all stakeholders.

Accountability is concerned with an organisation recognising that its actions affect the external environment, and therefore assuming responsibility for the effects of its actions. This concept, therefore, implies a recognition that the organisation is part of a wider societal network and has responsibilities to all of that network rather than just to the owners of the organisation. Alongside this acceptance of responsibility therefore must be a recognition that those external stakeholders have the power to affect the way in which those actions of the organisation are taken and a role in deciding whether or not such actions can be justified, and if so at what cost to the organisation and to other stakeholders. It is inevitable, therefore, that there is a need for some form of mediation of the different interests in society in order to be able to reach a broad consensus in society on what is in the best interest of the whole community and how this can be achieved. As a general statement we can state that all organisations and institutions are accountable to those who will be affected by decisions or actions, and that this must be recognised within the governance mechanisms. This accountability must extend to all organisations – both governmental institutions as well those as the private sector and also to civil society organisations – which must all recognise that they are accountable to the public and to their various stakeholders. One significant purpose of this is to ensure that any corruption is eliminated, or at the very least minimised.

An examination of the external reporting of organisations gives an indication of the extent of socially responsible activity. Such an examination does indeed demonstrate an increasing recognition of the need to include information about this and an increasing number of annual reports of companies include some information in this respect. This trend is gathering momentum as more organisations perceive the importance of providing such information to external stakeholders. It has been suggested, however, that the inclusion of such information does not demonstrate an increasing concern with the environment but rather some benefits – for example tax breaks – to the company itself. One trend which is also apparent in many parts of the world, however, is the tendency of companies to produce separate social and environmental reports.[12] In this context, such reports are generally termed CSR reports or sustainability reports, depending upon the development of the corporation concerned. This trend is gathering momentum as more organisations realise that stakeholders are both demanding more information and are also demanding accountability for actions undertaken. Equally, the more enlightened of these corporations are realising that socially responsible activity makes business sense and actually assists improved economic performance.

This realisation obviates any need for regulation and calls into question the standards suggested by such bodies as accountability. The more progressive corporations have made considerable progress in what they often describe as their journey towards being fully socially responsible. In doing so they have developed an understanding of the priorities for their own business – recognising that CSR has many facets and needs to be interpreted differently for each organisation – and made significant steps towards both appropriate activity and appropriate reporting of such activity. The steps towards CSR can be likened to increasing maturity as all organisations progress towards that maturity by passing through the same stages (see below), although at different paces. The most mature are indeed recognising that nature of globalisation by recognising that the organisational boundary is permeable (see Crowther and Duty 2002) and that they are accountable also for the behaviour of other organisations in their value chain.

All businesses[13] recognise the business benefits of CSR activity in their reporting. Equally all business recognise that sustainability is important and it

12 Originally these were called environmental reports. Now they are normally known either as CSR reports or as sustainability reports.

13 We base our assertion regarding *all businesses* upon our study of the FTSE100 businesses, and so recognise that our claim may not have universal truth.

features prominently in their reporting. Indeed it is noticeable that extractive industries – which by their very nature cannot be sustainable in the long term – make sustainability a very prominent issue. Any analysis of these statements regarding sustainability however quickly reveals the uncertainty regarding what is meant by this sustainability. Clearly the vast majority do not mean sustainability as defined in this book, or as defined by the Brundtland Report. Often is appears to mean little more than that the corporation will continue to exist in the future. Our argument is not just that this focus upon such a vague notion of sustainability is misleading and obfuscates the need for a rigorous debate about the meaning of sustainability. Our argument is that this treatment of sustainability is actually disingenuous and disguises the very real advantages that corporations obtain by creating such a semiotic of sustainability.

It is recognised in the financial world that the cost of capital which any company incurs is related to the perceived risk (Aras and Crowther 2008a) associated with investing in that company – in other words there is a direct correlation between the risk involved in an investment and the rewards which are expected to accrue from a successful investment. Therefore it is generally recognised that the larger, more established companies are a more certain investment and therefore have a lower cost of capital. This is all established fact as far as finance theory is concerned and is recognised in the operating of the financial markets around the world. Naturally a company which is sustainable will be less risky than one which is not. Consequently most large companies in their reporting mention sustainability and frequently it features prominently. Indeed it is noticeable that extractive industries – which by their very nature cannot be sustainable in the long term – make sustainability a very prominent issue. The prime example of this can be seen with oil companies – BP being a very good example – which make much of sustainability and are busy redesignating themselves from oil companies to energy companies with a feature being made of renewable energy, even though this is a very small part[14] of their actual operations.

Just as a company which is sustainable is less risky than one which is not then one which can claim sustainable development is even less risky and many companies mention this concept and imply that it relates to their operations. Such a company has a rosy future of continued growth, with an expectation of continued growth in profitability. An investigation of the FTSE100 for example shows that 70 per cent make a feature of sustainability while 15 per cent make a feature of sustainable development. So the cost of capital becomes lower as

14 It needs a very careful reading of the annual report to discover this.

the certainty of returns becomes higher. We have shown in this chapter that the concept of sustainability is complex and problematic and that the idea of sustainable development is even more problematic. It is our argument that companies are not really addressing these issues but are merely creating an image of sustainability.[15] The language of the statements made by corporations tends, therefore, to be used as a device for corrupting thought (Orwell 1970) by being used as an instrument to prevent thought about the various alternative realities of organisational reality. Significantly, it creates an image of safety for investors and thereby reduces the cost of capital for such corporations. Such language must be considered semiotically (Barthes 1973) as a way of creating the impression of actual sustainability. Using such analysis then the signification is about inclusion within the selected audience for the corporate reports on the assumption that those included understand the signification in a common way with the authors. This is based upon an assumed understanding of the code of signification used in describing corporate activity in this way. As Sapir (1949: 554) states:

> *'… we respond to gestures with an extreme alertness and, one might almost say, in accordance with an elaborate and secret code that is written nowhere, known by none and understood by all.'*

Globalisation, Homogenisation and Convergence

Thus we can see that a number of factors are involved in the phenomenon of globalisation but that one outcome is that the world is getting smaller and that media such as the internet are bringing people closer together; indeed ICT (Information and Communication Technology) will eventually change the way organisations operate and society itself will also change. As the world shrinks different cultures are coming into contact with each other. This is having an effect on different areas of life and business is no exception. As Solomon and Solomon (2004: 153) state, 'international harmonisation is now common in all areas of business'.

When cultures meet it is the dominant culture that prevails; thus for example Solomon and Solomon (2004) highlight concerns that the Anglo–American model of corporate governance is becoming more prevalent internationally than others. It could be argued on a number of levels that this is not the best way forward as countries have their own individuality. As Cornelius (2005) states, if all countries were the same it would erase the competitive advantage

15 See Crowther (2002d) for a full discussion of image creating in corporate reporting.

that some countries have over others. At the same time there are organisations such as the OECD which are promoting a need for a basic global standard of corporate governance.

One of the main issues, therefore, which has been of concern to business managers, accountants and auditors, investment manages and government officials – again all over the world – is that of corporate governance. Often a company's main target is to became global – while at the same time remaining sustainable – as a means to get competitive power. But the most important question is concerned with what will be a firm's route to becoming global and what will be necessary in order to get global competitive power. There is more then one answer to this question and there are a variety of routes for a company to achieve this.

Probably since the mid-1980s, corporate governance has attracted a great deal of attention. Early impetus was provided by Anglo-American codes of good corporate governance.[16] Stimulated by institutional investors, other countries in the developed as well as in the emerging markets established an adapted version of these codes for their own companies. Supranational authorities like the OECD and the World Bank did not remain passive and developed their own set of standard principles and recommendations. This type of self-regulation was chosen above a set of legal standards (Van den Barghe 2001). After big corporate scandals, corporate governance has become central to most companies. It is understandable that investors' protection has become a much more important issue for all financial markets after the tremendous firm failures and scandals. Investors are demanding that companies implement rigorous corporate governance principles in order to achieve better returns on their investment and to reduce agency costs. Most of the times investors are ready to pay more for companies to have good governance standards. Similarly, a company's corporate governance report is one of the main tools for investor decisions. Because of these reasons, companies cannot ignore the pressure for good governance from shareholders, potential investors and other market actors.

On the other hand, banking credit risk measurement regulations are requiring new rules for a company's credit evaluations. New international bank capital adequacy assessment methods (Basel II) necessitate that credit evaluation rules are elaborately concerned with operational risk which covers corporate

16 An example is the Cadbury Report, which has mutated into the Combined Code which is now mandatory for all firms quoted on the London Stock Exchange.

governance principles. In this respect corporate governance will be one of the most important indicators for measuring risk. Another issue is related to firm credibility and riskiness. If the firm needs a high rating score then it will have to be pay attention for corporate governance rules also. Credit rating agencies analyse corporate governance practices along with other corporate indicators. Even though corporate governance principles have always been important for getting good rating scores for large and publicly-held companies, they are also becoming much more important for investors, potential investors, creditors and governments. Because of all of these factors, corporate governance receives high priority on the agenda of policy makers, financial institutions, investors, companies and academics. This is one of the main indicators that the link between corporate governance and actual performance is still open for discussion. In the literature, a number of studies have investigated the relation between corporate governance mechanisms and performance (for example, Agrawal and Knoeber 1996; Loderer and Martin 1997; Dalton and others 1998; Cho 1998; Bhagart 1999; Choles 2001; Gompers, Ishii and Metrick 2001; Patterson 2002; Heracleous 2001; Demsetz and Villalonga 2002; Bhagat and Jefferis 2002; Becht et al. 2002; Millstein and MacAvoy 2003; Bøhren and Ødegaard 2004). Most of the studies have shown mixed result without a clear-cut relationship. Based on these results, we can say that corporate governance matters to a company's performance, market value and credibility, and therefore that company has to apply corporate governance principles. But the most important point is that corporate governance is the only means for companies to achieve corporate goals and strategies. Therefore companies have to improve their strategy and effective route to implementation of governance principles. So, companies have to investigate what their corporate governance policy and practice needs to be.

Is Success Sustainable?

The definition of success for an organisation is often multiple and involves much more than profit maximisation. Indeed profit maximisation in a long-term perspective can involve very different behaviour to that of a short-term perspective. Often the approach taken is that of satisficing – the balancing of the long term with the short term and the balancing of the expectations of all stakeholders. These, in combination with a desire for growth – now often called sustainable development – and for survival form the objectives of an organisation and a mix of these in the form of a balanced scorecard will be the objectives of an organisation and its definition of success will be dependence upon meeting these objectives.

Of course for any firm which is successful according to its definition of success, then the matter of maintaining that success becomes important. Here we argue that only by recognising – and addressing – the four aspects of sustainability outlined earlier, is it possible for a firm to maintain its success. In other words, the sustainability of success is dependent upon recognising and addressing the components of sustainability. Here obviously the creation of the semiotic without action will not be sufficient and there are many firms which have adopted the rhetoric and created this semiotic without taking action. For these firms any success achieved can only be ephemeral.

Conclusions

There are equally many other factors involved in the globalisation phenomenon, which we need to mention only briefly. For example, one factor which is topic at the moment is the effect of the entry of China into the world economy and the consequent distortion of markets due to the size of the country and its economy but also due to the deliberate policy of undervaluing its currency. Such distortions give rise to the phenomenon of geographical arbitrage; normally this is speedily corrected although profitable to a few people. But China is so big that such corrections are not possible though market mechanisms. Another phenomenon which is prevalent in such a global environment[17] is that of transfer pricing[18] whereby economies are manipulated by powerful multinational corporations.

These kinds of manipulations are an effect of globalisation – some would say an inevitable consequence. Part of our argument in this book is to state that such behaviour is not sustainable, either for a corporation or for a nation. Having explored all of the issues concerning sustainable business activity we will now continue by exploring the features of sustainable corporate activity.

17 See Chapter 10 where this is explored in more detail.

18 Transfer pricing is the process which determines the price at which goods are transferred from one division to another within the company. Transfer pricing is an internal bookkeeping exercise which does not affect the overall profit of the company but merely the respective performance of the divisions involved in the transfer. This can in its turn impact upon the overall company profitability when it is a multinational and one of the main aspects of transfer pricing is to encourage behaviour within the divisions which ensures that overall company profitability is maximised. The setting of transfer prices, therefore, is crucial in this respect. It is also a cause of much argument as value is transferred (rather than goods) from a high tax area to a low tax area or from an undeveloped country to a developed country.

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10

Corporate Social Obligations for Sustainability

Introduction

As we have seen, the social responsibility of organisations – commonly known as corporate social responsibility (CSR) or corporate responsibility – has become an important issue in contemporary international debates. In recent years, it has become more widespread and recognised as being more central to the activity of corporations all over the world. Central to CSR is a concern for sustainability (see Aras and Crowther 2007a) for all aspects of sustainability as we have considered in this book, as this is crucial for long-term success and even survival – even in the financial terms by which firms normally judge their success. Indeed many corporate reports which used to be designated as environmental reports and subsequently as CSR reports, have now been repackaged as sustainability reports. CSR, however, is more problematic as it is often perceived that there is a dichotomy between CSR activity and financial performance with one being deleterious to the other and corporations having an imperative to pursue shareholder value. Moreover, there is no agreed upon definition of exactly what constitutes CSR (Ortiz Martinez and Crowther 2005) and, therefore, no agreed upon basis for measuring that activity and relating it to the various dimensions of corporate performance. Consequently, much of the previous research regarding CSR deals with this issue and the problems in development of standards for definition and reporting for such indeterminate activity (see Crowther 2006).

Although this problem is widely recognised, it is equally widely accepted that the impact of corporate activity upon society and its citizens – as well as all stakeholders including the environment – is considerable and has an impact not just upon the present but also upon the future. Moreover, these stakeholders are increasingly exercising their power not just in their own interests but also in the interests of long-term sustainability. So it is necessary to develop some methods of analysing and measuring sustainable CSR activity (see Aras and Crowther 2007b) in such a way that it is universally understood, and can be evaluated by interested parties. It will, therefore, become of assistance to societal decision-making.

It is recognised that each organisation has an impact upon society far in excess of its planned activity. This behaviour represents the new age of globalisation. Because resources are scarce while desires are very great, then corporations need to play an important role in fostering social responsibility but, of course, this not a new concept[1] which needs to be promoted. Social responsibility involves a host of complex, contradictory and competing needs from within and without the corporation which influence its ability to respond to social needs (Mintzberg 1983). It is our argument (see Aras and Crowther 2008b) that this responsibility is not optional but is actually obligatory and therefore we prefer the term ***corporate social obligation*** to represent the societal expectation of corporations.

From Social Responsibility to Social Obligation

Recently the selfish indulgence of the 1990s has again been replaced by a concern for socially responsible behaviour and CSR is again back on the agenda of corporations, governments and individual citizens throughout the world. Previously this concern has been known by such terms as environmental responsibility, stakeholder involvement or some similar term. It is only in its current manifestation that it has become generally known as corporate social responsibility or CSR. Thus the term 'corporate social responsibility' is in vogue at the moment but as a concept it is vague and means different things to different people.[2] There is of course no agreed definition of CSR, and this raises the question as to what exactly can be considered to be corporate social responsibility. Most people would agree with the EU (2002) definition that CSR activity is essentially voluntary, although accepting this view means that the details change over time as more corporate activity becomes incorporated into regulations. Although not pertinent to our analysis, this must inevitably cause a re-examination of this definition.

1 We have detailed earlier some of its antecedents.

2 See Crowther and Rayman Bacchus (2004c) or Crowther and Caliyurt (2004), and the contributions in each, for a wide variety of definitions and concerns.

As we have discussed earlier, the broadest definition of CSR is concerned with what is – or should be – the relationship between the global corporation, governments of countries and individual citizens.[3] More locally the definition is concerned with the relationship between a corporation and the local society in which it resides or operates. Another definition is concerned with the relationship between a corporation and its stakeholders. For us, all of these definitions are pertinent and represent dimensions of the issue. At the same time, of course, a similar debate is taking place in the arena of ethics concerning whether corporations should be subject to increased regulation or whether the ethical base of citizenship has been lost and needs replacing before socially responsible behaviour will ensue – the perennial debate.[4] However this debate is represented it seems that it is concerned with some sort of social contract between corporations and society.

The central tenet of social responsibility, however, is the social contract between all the stakeholders to society, which is an essential requirement of civil society. This is alternatively described as citizenship but for either term it is important to remember that the social responsibility needs to extend beyond present members of society. Social responsibility also requires a responsibility towards the future and towards future members of society. Subsumed within this is, of course, a responsibility towards the environment because of implications for other members of society both now and in the future. Recently the concept of the social contract[5] has been reintroduced to explain the relationship which should exist between a corporation and society, and all other stakeholders.

One feature of the corporate landscape is that the greater the power that multinational corporations and some groups of potential interest in the firm have, the more is spoken about CSR. Agency Theory, as we have seen earlier, establishes the relationship between the principal, the shareholder, the agent and the manager, bearing in mind that the goals of the shareholders must be got through the management of the agents. And the shareholders' objective is, of course, to increase the enterprise value through the generation of profit. Multinational corporations have sometimes even more power than governments in order to influence, and stakeholders have gained more power through the

3 The current financial and economic crisis has again raised the profile of the debate over this and focused attention upon the global nature of the relationships.

4 The ethics v regulation debate has been a feature of CSR since its inception. Of course, neither satisfactorily answers all the issues, which is why the debate continues.

5 The idea of the social contract was first introduced by Rousseau who argued that individuals would voluntarily give up some of their freedom to enable society as a whole to function more satisfactorily. The current debate revolves around corporations giving up some of their freedom for the greater good of society, and whether this will be voluntary or require regulation. In many ways this is a reversal of what happened 50 years ago.

media and public opinion in order to require some kind of specific behaviour from companies. Within this new environment the primary objective of the company has become wider. Although, generally speaking, the first goal is to get financial performance in the company, after that the next step will be to comply with other socially responsible policies. That is because to pay attention to social objectives, or to show an orientation to multiple stakeholders group, could be considered a luxury, because it must have meant that the other basic company goal had been completed. This argument is the basis of the first hypothesis about the relationship between CSR, linked to pay attention to stakeholders, and business success: 'Better performance results in greater attention to multiple stakeholders' (Greenley and Foxall 1997: 64). While the other hypothesis about this relationship will run in the opposite direction: 'that orientation to multiple stakeholder groups influences performance' (Greenley and Foxall 199: 264).

Intuitively it seems as if there is a clear relationship between CSR and business success, but although the measurement of business success may be easy, through different economic and financial tools, such as ratios; the measurement of the degree of compliance of a company with social policies is really difficult. We can have in mind some kind of indicators such as funds destined for charitable objectives, but a company can spend immeasurable quantities of money on charitable causes and have problems in the relationship with labour unions because of bad working conditions or low wages, for example. There are, of course, long-established companies whose objectives include philanthropic aims.[6] But finally, if they want to survive in the competitive market they have to bear in mind the traditional objective of profit generation – one of our key factors for sustainability. It may be understood that the initial values are charitable ones, and then the market and capitalist regime forces a change to this in order to survive in this modern environment. Although at the same time the double-sided relationship operates, because socially concerned people bear in mind this basic aim and the image of the organisation is improved, which has got direct relationships with the economic performance. This may, of course, be only one speaking about the market inefficiencies and the trend to acquire human values and ethics that must be forgotten when we are surrounded by this society and the market.

CSR and Business Behaviour

As we have stated, in recent years the term CSR has gained prominence, both in business and in the press to such an extent that it seems to have become ubiquitous.

6 The Quaker companies in the UK form a good example.

There are probably many reasons for the attention given to this phenomenon not least of which is the corporate excesses witnessed in recent years. For many people the various examples of this kind of behaviour – ranging from BCCI to Enron to Union Carbide to the collapse of Arthur Andersen, Barings, Lehman Bros and the Madoff hedge fund – will have left an indelible impression among people that all is not well with the corporate world and that there are problems that need to be addressed (Crowther and Rayman-Bacchus 2004).

One of the implications of this current concern, however, is that this is a new phenomenon – one which has not been of concern previously. Issues of socially responsible behaviour are not, of course, new and examples can be found from throughout the world and at least from the earliest days of the Industrial Revolution and the concomitant founding of large business entities (Crowther 2002) and the divorce between ownership and management – or the divorcing of risk from rewards (Crowther 2004). Thus, for example in the UK (where the Industrial Revolution started), Robert Owen (1816, 1991) demonstrated dissatisfaction with the assumption that only the internal effects of actions need be considered and the external environment was a free resource to be exploited at will. Furthermore, he put his beliefs into practice through the inclusion within his sphere of industrial operations the provision of housing for his workers at New Lanark, Scotland. Thus there is evidence from throughout the history of modernity that the self-centred approach towards organisational activity was not universally acceptable and was unable to satisfactorily provide a basis for human activity.

Since that time there has been a concern for the socially responsible behaviour of organisations which has gained prominence at certain times while being considered of minor importance at others. Thus, during the 1970s, for example, there was a resurgence of interest in socially responsible behaviour. This concern was encapsulated by Ackerman (1975) who argued that big business was recognising the need to adapt to a new social climate of community accountability but that the orientation of business to financial results was inhibiting social responsiveness. Similarly McDonald and Puxty (1979) argued that companies are no longer the instruments of shareholders alone but exist within society and so, therefore, have responsibilities to that society, and that there is, therefore, a shift towards the greater accountability of companies to all stakeholders. Recognition of the rights of all stakeholders and the duty of a business to be accountable in this wider context, therefore, has been a recurrent phenomenon. The economic view of accountability only to owners has only recently been subject to debate to any considerable extent.[7]

7 See Crowther (2000b) for a full discussion of these changes.

Indeed the desirability of considering the social performance of a business has not always, however, been accepted and has been the subject of extensive debate.[8]

More recently, as we have seen, the language used in business has mutated again and the concept of CSR is being replaced by the language of sustainability. To some extent this must be treated as semiological (see Crowther 2002c; Aras and Crowther 2008a) as a different image is designed to be created without any change in actual practice – sustainability has been a concern for a while and CSR still remains a concern. It can equally be seen as a response to fashion as the discourse of sustainability is popular (and fashionable) at present. No doubt in time this too will change and these report become redesignated as whatever the latest term is! Of course what really matters is the extent to which companies grapple with the issues involved rather than how they are described – and this is the purpose of this book.

A Typology of CSR

No matter whether the discourse is of CSR or of sustainability there exists a high degree of scepticism about the reality of corporate activity. Accusations of greenwashing – presenting a false picture – abound. We argue that this is a legacy of past behaviour when such an accusation could reasonably be made about many organisations, and that there has been a change of corporate attitude more recently. Our argument is that CSR is a developmental process and changes as organisations mature in their behaviour and attitude towards both their stakeholders and their ideas concerning social responsibility. Of course we also acknowledge that there is a growing body of evidence to show that socially responsible behaviour becomes reflected positively in the financial performance of a company, thereby providing a financial imperative for changing behaviour. Moreover we argue that there are stages of growth as far as CSR is concerned which become reflected in corporate behaviour. These can be seen as increasing levels of maturity.

In order to consider the implications for CSR then the typology developed by Crowther (2006) provides a useful vehicle. As he argues, it would be relatively easy to develop a typology of CSR activity based upon the treatment of the various stakeholders to an organisation but as Cooper et al. (2001) show, all corporations are concerned with their important stakeholders and

8 Even in the present it is common for reference to be made to Milton Friedman's epithet that the only social responsibility of business is to make a profit without breaking the law.

make efforts to satisfy their expectations. Thus a concern with employees and customers is apparent in all corporations, being merely a reflection of the power of those stakeholder groupings rather than any expression of social responsibility. Similarly in some organisations a concern for the environment is less a representation of social responsibility and more a concern for avoiding legislation or possibly a reflection of customer concern. Such factors also apply to some expressions of concern for local communities and society at large. It is, therefore, inappropriate to base any typology of CSR activity upon the treatment of stakeholders as this is often based upon power relationships rather than a concern for social responsibility and it is not realistic to distinguish the motivations.

A different typology was therefore proposed – one which is based upon the three principles of social responsibility outlined earlier. Moreover it shows the way in which CSR develops in organisations as they become more experienced and more convinced of the benefits of a commitment to this form of corporate activity. The development of this typology is based upon research and interviews with CSR directors and concerned managers in a considerable number of large corporations, many of which are committed to increasing social responsibility. It demonstrates stages of increasing maturity.

Stage of development	***Dominant feature***	***Typical activity***	***Examples***
1	Window dressing	Redesigning corporate reporting	Changed wording and sections to reflect CSR language (see Crowther, 2004a)
2	Cost containment	Re-engineering business processes	Energy efficiency programmes
3	Stakeholder engagement	Balanced scorecard development	Customer / employee satisfaction surveys (see Cooper et al, 2001)
4	Measurement and reporting	Sophisticated tailored measures	CSR reports
5	Sustainability	Defining sustainability: re-engineering processes	Sustainability reporting
6	Transparency	Concern for the supply chain: requiring CSR from suppliers	Human rights enforcement: eg child labour
7	Accountability	Reconfiguration of the value chain	Relocating high value added activity in developing countries

From Crowther (2006)

Figure 10.1 Stages of maturity of CSR activity

This can be explained as stages of growth reflecting increased maturity. The stages can be elaborated as follows:

STAGE 1 WINDOW DRESSING

The initial engagement with CSR was to change corporate reporting to indicate a concern for CSR without any actual change in corporate behaviour. This is the stage which led to accusations of greenwashing. It is also the stage which most observers of corporate activity continue to see even though in reality probably every organisation has progressed to a stage of greater maturity.

STAGE 2 COST CONTAINMENT

Corporations are always, of course, looking at their processes and seeking to operate more efficiently, thereby reducing costs. Organisations have realised that some of these can be represented as CSR activity – with things like energy efficiency or water efficiency being obvious examples. So there is a double imperative for this kind of activity – to improve financial performance and also improve the socially responsible image. Not surprisingly, therefore, corporations quickly moved from Stage 1 to this stage – where action has been taken even though it is not necessarily motivated by a sense of social responsibility.

Much of this kind of activity is easy to undertake and requires very little in the way of capital investment. Naturally this activity has been undertaken first. Activity requiring capital investment has a longer payback period and tends to be undertaken more cautiously, with the threat of regulation often being needed to encourage such activity. All organisations have progressed through this stage also, although it must be recognised that the possible actions under this stage will probably never be completed by most organisations. Such cost containment there remains ongoing even when the easy targets have been addressed.

STAGE 3 STAKEHOLDER ENGAGEMENT

As stated earlier, all corporations are concerned with their important stakeholders and make efforts to satisfy their expectations. Thus a concern with employees and customers is apparent in all corporations, being merely a reflection of the power of those stakeholder groupings rather than any expression of social responsibility. Similarly, in some organisations a concern for the environment is less a representation of social responsibility and more a concern for avoiding legislation or possibly a reflection of customer concern. Such factors also apply to some expressions of concern for local communities and society at large. For CSR though this concern has become formalised, often through the development of a balanced scorecard and such things as customer or employee satisfaction surveys. Most organisations have progressed through this stage also, with such activity being embedded into normal ongoing business practice.

STAGE 4 MEASUREMENT AND REPORTING

Some companies have been practising social and environmental reporting for 15 years but for many it is more recent. Now, most companies – certainly most large companies – provide this information in the form of a report. Over time these reports have become more extensive and more detailed with a broader range of measures of social and environmental performance being included. So, most organisations have reached this stage of maturity also. The problem with this stage though is that at the moment there are no standards of what to report and so organisations tend to report different things, thereby hindering comparability. Organisations such as AccountAbility, with its AA1000 standard, and the Global Compact have sought to redress this through the introduction of a standard but none have gained universal acceptance. Consequently it is probably true to state that this is the current stage of development for most organisations.

STAGE 5 SUSTAINABILITY

The discourse of sustainability has become as ubiquitous as the discourse of CSR, and Aras and Crowther (2007c) report that every firm in the FTSE100, for example, mentions sustainability with 70 per cent of them focusing upon this. Any analysis of these statements regarding sustainability, however, quickly reveals the uncertainty regarding what is meant by this sustainability. Clearly the vast majority do not mean sustainability as defined by Aras and Crowther (2007d) or as defined by the Brundtland Report. Often it appears to mean little more than that the corporation will continue to exist in the future. A full understanding of sustainability would imply radical changes to business practice and a significant amount of process re-engineering, and there is little evidence that this is happening. So we argue that most companies are only starting to reach this stage of maturity and to grapple with the issues involved.

STAGE 6 TRANSPARENCY

One of the biggest issues of the moment – certainly in Europe – is the question of firms accepting responsibility for what happens further along their supply chain. This is something that has been brought about largely because of customer pressure and has come about because of the revelations made about such things as child labour, slavery and other human rights abuses. So it is no longer acceptable for a firm to say that what happens in a supplying firm – or even the supplier of a supplier – is not their responsibility. Popular opinion says for companies and so we wait for them to become sufficiently mature to enter this stage. That the firm is responsible for ensuring socially responsible behaviour among its suppliers as well as in its own company. Thus there have been examples of some very large companies – such as Gap or Nike – acknowledging responsibility and taking appropriate action to ensure change.

This is an issue which is growing in importance and is being addressed by the more mature (in CSR terms) companies. Thus it is claimed that some companies are at this stage in their maturing, but still a minority of companies.

STAGE 7 ACCOUNTABILITY

The final stage represents our wishes rather than actuality – at least so far! It is based upon the fact the multinationals can decide where to locate their operations and that all high value added operations are located in developed countries. For many it would be relatively easy to transfer to less developed countries and if that happened then the company would be making a real contribution towards effecting change. And we argue that there is no real cost involved – just that corporations should seek to do this to benefit society rather than simply for cost minimisation.

Essentially the argument being made here is that CSR must be considered as a process of development for every organisation – a process which is still taking place. Furthermore, every organisation goes through the same stages in the same chronological order.[9] Thus, the leading exponents of CSR are only now beginning to address Stage 6 and possibly consider Stage 7. Less developed corporations are at lower stages of development. What is significant about this, however, is that our argument is that sustainability only starts to be recognised once a company has reached Stage 5 of its development. More significantly, Stages 6 and 7 are essential for true sustainability as it is only then that an organisation recognises – and acts upon the recognition – that it is an integral part of a value chain and that sustainability depends upon the actions of the complete value chain. In others words, an organisation cannot be

9 This can be likened to Erikson's stages of growth for human beings, of which (coincidentally) there are also seven.

sustainable without its suppliers and customers. At the moment it is doubtful if organisations recognise this and whether any organisation is (yet) truly sustainable.

Corporate Social Obligations

We have referred earlier to the social contract as a way of explaining the role of a corporation in society. As a part of society the corporation has, of course, obligations within that society and to all the stakeholders concerned. For Rousseau, of course, the social contract described the way in which individuals voluntarily surrendered to society some of their rights in order to gain the benefits from society as a whole. We have considered earlier how corporations have shown themselves reluctant to give up rights but have expected the benefits of society. This is, of course, based upon an understanding of the obligations which a corporation has. This in turn is predicated in the ethical position of corporations in society. In general terms this – and indeed the whole capitalist economic system – is based upon a Utilitarian philosophy. And Utilitarianism, of course, as we have seen, developed from Classical Liberalism.

Classical Liberal Theory

Classical Liberal theory started to be developed in the seventeenth century by such writers as John Locke as a means of explaining how society operated, and should operate, in an era in which the Divine Right of Kings to rule and to run society for their own benefit had been challenged and was generally considered to be inappropriate for the society which then existed. Classical Liberalism is founded upon the two principles of reason and rationality: reason in that everything had a logic which could be understood and agreed with by all; and rationality in that every decision made was made by a person in the light of what their evaluation had shown them to be for their greatest benefit. Classical Liberalism, therefore, is centred upon the individual, who is assumed to be rational and would make rational decisions, and is based upon the need to give freedom to every individual to pursue his/her own ends. It is, therefore, a philosophy of the pursuance of self-interest. Society, insofar as it existed and was considered to be needed, was therefore merely an aggregation of these individual self-interests. This aggregation was considered to be a sufficient explanation for the need for society. Indeed Locke argued that the whole purpose of society was to protect the rights of each individual and to safeguard these private rights.

There is, however, a problem with this allowing of every individual the complete freedom to follow his/her own ends and to maximise his/her own welfare. This problem is that in some circumstances this welfare can only be created at the expense of other individuals. It is through this conflict between the rights and freedoms of individuals that problems occur in society. It is for this reason, therefore, that de Tocqueville argued that there was a necessary function for government within society. He argued that the function of government, therefore, was the regulation of individual transactions so as to safeguard the rights of all individuals as far as possible.

Although this philosophy of individual freedom was developed as the philosophy of Liberalism, it can be seen that this philosophy has been adopted by the Conservative governments throughout the world, as led by the UK government in the 1980s. This philosophy has led increasingly to the reduction of state involvement in society and the giving of freedom to individuals to pursue their own ends, with regulation providing a mediating mechanism where deemed necessary. It will be apparent however that there is a further problem with Liberalism and this is that the mediation of rights between different individuals only works satisfactorily when the power of individuals is roughly equal. Plainly this situation never arises between all individuals and this is the cause of one of the problems with society. This problem will be returned to periodically throughout this book in the context of the role of accounting in maintaining this inequilibrium in power relationships.

While this philosophy of Liberalism was developed to explain the position of individuals in society and the need for government and regulation of that society, the philosophy applies equally to organisations. Indeed Liberalism considers that organisations arise within society as a mechanism whereby individuals can pursue their individual self-interests more effectively that they can alone. Thus firms exist because it is a more efficient means of individuals maximising their self-interests through collaboration than is possible through each individual acting alone. This argument provides the basis for the theory of the firm, which argues that through this combination between individuals the costs of individual transactions are thereby reduced.

The Development of Utilitarianism

The concept of Utilitarianism was developed as an extension of Liberalism in order to account for the need to regulate society in terms of each individual pursuing, independently, his or her own ends. It was developed by people such as Jeremy Bentham and John Stuart Mill who defined the optimal position for society as being the greatest good of the greatest number and argued that it was government's role to mediate between individuals to ensure this societal end. In Utilitarianism it is not actions which are deemed to be good or bad but merely outcomes. Thus any means of securing a desired outcome was deemed to be acceptable and if the same outcomes ensued then there was no difference, in value terms, between different means of securing those outcomes. Thus actions are value neutral and only outcomes matter. This is, of course, problematical when the actions of firms are concerned because firms only consider outcomes from the point of view of the firm itself. Indeed accounting as we know only captures the actions of a firm insofar as they affect the firm itself and ignores other consequences of the actions of a firm. Under Utilitarianism, however, if the outcomes for the firm were considered to be desirable then any means of achieving these outcomes was considered acceptable. In the nineteenth and early twentieth centuries this was the way in which firms were managed and accounting information was used purely to evaluate actions and potential actions from the point of view of the firm itself. It is only in more recent times that it has become accepted that all the outcomes from the actions of the firm are important and need to be taken into account.

The development of Utilitarianism led to the development of economic theory as means of explaining the actions of firms. Indeed the concept of perfect competition is predicated in the assumptions of Classical Liberal theory. From economic theory, of course, accounting developed as a tool for analysis to aid the rational decision-making assumed in economic theory.

The Organisational Failure Framework

While the Theory of the Firm explains why firms come into existence and the role of accounting in firms as a tool to aid rational decision-making, it does not sufficiently explain the workings of a firm. Thus the role of accounting within a firm cannot be considered without a consideration of the people involved in that firm as a firm, of course, consists of a collection of people who are involved. The people involved in the firm are affected by the accounting systems of that firm as well as affecting those accounting systems, and this has been outlined regularly, by many people. The main people involved in the control of a firm are of course its managers and Williamson (1970) argues that because in any large organisation the management of the firm is normally divorced from its ownership then this is a factor which hinders its control and decision-making. This leads to internal efficiencies within the firm and conflicts of interests which mean that organisations do not operate efficiently as a means of transaction cost minimisation and value creating maximisation. From this analysis Williamson developed what is known as the organisational failure framework.

Thus, Williamson (1975) develops this analysis and considers organisations to be complex due to their size, which leads to uncertainty, bounded rationality and information impactedness. He argues that the extent of these factors determines the likelihood of organisational failure from organisations becoming the principal means of resource allocation and decision-making. Thus, he argues that there are organisational limits to the size of a firm brought about by such factors as diseconomies of scale, communication distortion and bureaucratic insularity. Furthermore, he argues that the market as a mediating mechanism cannot itself overcome these inefficiencies brought about through the organisation of productive activity into firms. He states that multidivisionalism is a method of overcoming this but that there are still limits to size because of difficulties of communication, resource allocation and lack of entrepreneurial opportunities. He argues, therefore, that organic growth beyond a certain size leads to failure, thereby limiting the size of a firm. While this theory has a certain logic to it, practical examples of such activity are lacking and there do appear to be some very large firms in existence in the world. Perhaps, however, current trends towards downsizing and returning to core business aims is evidence of the validity of this theory, but some empirical testing seems to be needed which is beyond the scope of this chapter.

These factors together are described as the organisational failure framework. In its simplest form this framework can be summarised as follows:

- people are not perfect and managers are unlikely to ignore their own self-interest in pursuing the interests of the owners of the firm;

- organisations as resources allocation mechanisms are not perfect and inefficiencies arise as the size of firms increases;

- markets are not perfect and cannot by themselves compensate for the other inefficiencies inherent in the organising of productive activity into firms.

Upon this premise if founded Agency Theory as a way of defining and addressing the problems.

The Agency Problem

The general agency problem can be characterised as a situation in which a principal (or group of principals) seeks to establish incentives for an agent (or group of agents) who takes decisions that affect the principal to act in ways that contribute maximally to the principal's own objectives. In business this means the relationship between the owner of the business and other investors – as principal – and the managers of the business – as agents. The difficulties in establishing such an incentive structure arise from either divergence of the objectives of principals and agents or the asymmetric information between principals and agents (Vickers and Yarrow 1988), and very often from both of these factors.

As stated by Lambert (2001), Agency Theory evaluates the impact of the conflict of interest between principals and agents because of: (1) shirking by agent; (2) diversion of resources by the agent for private consumption; (3) differential time horizon of the agent and the principal; and (4) differential risk aversion of the agent and the principal. Jensen and Meckling (1976) developed Agency Theory in the context of the conflicts of interest between corporate managers and outside equity and debt holders. Agency Theory starts with the assumption that people act unreservedly in their own narrowly defined self-interest with, if necessary, guile and deceit. The firm is usually seen as a set of contracts between the various parties involved in the production process including the owners, managers, workforce and creditors, among others. Agency Theory switches the centre of attention from the firm to the set of contracts that define each firm. It is primarily concerned with the contracts and relationships between principals and the agents under asymmetric information.[10]

10 Information asymmetry has two separate, though related elements: moral hazard and adverse selection. Moral hazard arises where it is difficult or costly for owners to observe or infer the amount of effort exerted by managers. In such a situation, there is an inevitable temptation for managers to avoid working to the terms of the agreed employment contract, since owners are unable to assess the 'true picture'. Managers may also have the incentive as well as the means to conceal the 'true picture' by misrepresenting the actual outcomes reported to the owners.

Agency costs are defined as the costs associated with cooperative efforts by human beings. The agency costs within the organisation occur when an entity, the principal, hires another, the agent, to act for him or her. According to the financial theory, rational shareholders will recognise the incentives facing managers to shirk, to diversify their interests and to under-invest their time and effort and resources in the business. Therefore, the firm would suffer losses from these decisions, and these losses would represent the agency costs of outside equity financing. Agency costs are defined as the sum of the contracting, monitoring and bonding costs undertaken to reduce the costs associated with conflicts of interest plus the 'residual loss' that occurs because it is generally impossible to perfectly identify the agents' interests and align them with those of the principal. Markets are assumed to be potent forces to help control agency costs.[11]

Ethical behaviour that is either altruistic, which is concerned for the welfare of others or by the desire to feel good by helping others, or Utilitarian, which is concerned with the compliance with rules in the individual's self-interest, is essential for efficient functioning in the economy; this has many implications in Agency Theory (Noreen 1988). Unwritten agreements, trust and mutual understanding constitute the core of the relationships within the firm. Written contracts which are the foundation of the Agency Theory 'hit only

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Accounting provides one such means for misrepresentation through its ability to represent outcomes from any course of action in more than one way – a point which we will return to in subsequent chapters.

Whereas moral hazard relates to the 'post-decision' consequences of information asymmetry, adverse selection is concerned with the 'pre-decision' situation. Since all the information that is available to the manager at the time a decision is made is not also available to the owner, then the owner cannot be sure that the manager made the right decision in the circumstances. In addition, the manager has no incentive to reveal what he knows since this will then make it easier for the principal to properly assess his actions in the future. This is known as 'information impactedness'.

The existence of 'information asymmetry' means that for owners to obtain relevant information concerning the manager's effort, they must either rely on the communications received from the managers themselves, or must incur monitoring costs. An example of monitoring costs would include the annual audit of the firm's financial statements; indeed such auditing of financial statements was instituted as a means of safeguarding such investments in firms made by those who had no part in the operational activity of the firm. In the context of the agency relationship between top management and divisional management, such monitoring costs would include the cost of employing head office staff to monitor the performance of divisions. One approach to this problem is to get managers to commit to acting in the best interests of the owners, but in this situation the owners will incur a bonding cost to effect this relationship. Even in this situation, however, since managers may not share the same beliefs and preferences as the owner, there may still, however, be a 'residual loss'.

11 Agency costs are, of course, an aspect of transaction costs – the costs of firms engaging in collaborative ventures (through treaties) with others (for example, managers) – and the proponents of markets maintain that they optimise the efficiency of these treaties through the minimisation of transaction costs.

the high spots of agreements' (McKean 1975: 31). Therefore, if unconstrained opportunism pervades the economy, contracting, monitoring and bonding costs, and therefore, agency costs, increase. Conversely, 'altruism economises on the costs of policing and enforcing agreements' (Hirshleifer 1977: 28).

Transaction Cost Theory

As far as the activities of a firm are concerned, the management and control systems adopt an entirely internal perspective and fail to recognise that the effects of the actions of the firm have effects outside the organisation: these are considered to be irrelevant to the firm operating under the assumptions of Classical Liberalism. Moreover, accounting as practised by firms is based upon the product or service provided by the firm as the basic unit of cost. In working in this manner, accounting has been designed to capture the costs that are incurred in the provision of these products or services and to simply measure the costs that are accumulated in the production process. These cost accumulations form the basis of accounting information which is used for the multiple purposes for which management accounting is used within the firm. These uses of course will include:

- operational planning and control;
- decision-making;
- performance measurement and reporting;
- the evaluation and rewarding of managerial performance.

The implications from the use of accounting in this way by firms is that the key to successful management of the firm is the understanding of cost behaviour and so extensive techniques have been developed to understand the behaviour of costs in the operational processes of the firm. Equally, many techniques have been developed for the allocation of costs and their absorption into the product costs which are the outcome of the accounting process. There is an implicit assumption therefore, that cost minimisation is the key to operational success for a firm. This is, of course, untrue and the key to sustainable success by a firm is the optimisation of value creation – depending upon the four factors identified by Aras and Crowther (2007a) and detailed previously. This is achieved through an understanding of the transformational process of the firm.

Transaction cost theory adds to accounting theory through an understanding of the transformational process. The starting point for the theory is that all activities of the firm are transactions. This is true whether these activities are carried out within the firm or are carried out by an interaction between the firm and a part of its external environment. Thus there is no difference in principle between internal activities and external activities as far as the firm is concerned as they are all transactions. The only difference is that when these transactions take place externally to the firm then a price can be determined for the transactions through the operation of the market mechanism. When they occur entirely within the firm then no market mechanism exists to set a price for the transactions and hence we have to develop accounting techniques to compensate for this deficiency and to simulate the operation of the market mechanism. Such techniques would include, for example, the transfer pricing systems used by firms.

As well as a price for the exchange, all transactions have a cost associated with them. This is the cost of engaging in the transaction itself and examples include the cost of acquiring raw materials, which is included into the accounting cost of those raw materials, or the cost of creating a Pareto optimal principal – agent contract. In theory firms exist because the cost of engaging in these transactions is reduced when they are carried out within the firm rather than through the market as mediated through the price mechanism. In practice, all firms carry out some transactions entirely within the firm and some are carried out through the market mechanism. This is theoretically because the cost of each individual transaction is minimised either by internalising it within the firm or by externalising it to the market. For optimal value creation in the transformational process these transaction costs need to be minimised and therefore this theory turns the focus of organisational activity upon the transaction costs associated with the transformational process. Minimising the costs of all transactions will inevitably achieve the following:

- the maximising of the efficiency of operational activity through optimising the source of all transactions;
- the maximising of the profitability of the firm through the minimising of the costs of the products or services provided;
- the minimising of the costs of the transformations undertaken and hence the maximising of value created within the firm.

If a firm understands the transaction costs associated with its transformational process then it will be able to decide whether transactions are more efficiently accommodated within the firm or through the market. If transactions are reduced in cost through accommodating them within the firm then they should be carried out within the firm and this could imply a firm engaging in vertical integration as a means of reducing its transaction costs. Another way of reducing the cost of any particular type of transaction is by ensuring that economies of scale lead to a reduction in unit transaction costs and this could lead to horizontal integration. On the other hand, an understanding of these transaction costs may lead to a firm externalising transactions and engaging in them through the market. This would lead to a firm downsizing and divesting certain activities while engaging in the outsourcing of such transactions as the need arises. In such a way the performance of any individual firm would be optimised and this implies that there is an optimal size for any particular firm and an optimal set of activities in which it should engage.

An observation of the economy of any country will show that firms are engaging in the changing of the source of their transactions through integration and through divestment at all times. The assumption to be drawn from this is that the managers of these organisations understand their transaction costs and are reacting accordingly. The organisational failure framework, however, argues that this is not the case and that communication distortions and bureaucratic mechanisms prevent this from happening efficiently. One problem which firms face, however, which interferes with this process is the use of accounting information itself. Accounting as cost accumulation does not, however, measure these transaction costs and so does not provide a means of measurement which will facilitate transaction cost minimisation. This, therefore, reveals one problem with the use of accounting information to manage the value creation process of the firm and this is that accounting does not even measure this key determinant of operational performance. Transaction cost theory, therefore, provides a different perspective upon the operation of a firm and shows that accounting fails the managers of the firm in determining its transaction costs. It argues that accounting differently would help a firm optimise its performance.

The Problems of Transaction Cost Theory

This sounds intuitively logical and these arguments accord with those of strategic management which focus upon the value chain. There are, however, problems with the use of this theory in practice. These problems stem from the points made earlier and which stem from the organisational failure framework, namely that firms are not efficient allocators of resources and that markets themselves do not operate efficiently. It is to these points that we now turn.

ORGANISATIONS AS RESOURCE ALLOCATORS

Traditionally, organisations base their resource allocation decisions on the information available to them from their accounting systems. We have already identified, however, that accounting information does not provide the information necessary to base decisions concerning the allocation of resources upon the transaction costs associated with individual transactions in the transformational process. Thus, such decisions tend to be made based upon incomplete information and it is logical, therefore, to accept that the optimum allocation of resources within a firm will not be achieved through the use of traditional accounting information as a decision-making tool. Furthermore, when we consider the behaviour of managers in the context of Agency Theory then it becomes apparent that these managers do not necessarily have the incentive to allocate resources in a way which is optimum for the organisation itself. The behaviour of managers in organisations is further complicated by the way in which accounting information is used to motivate managers and reward them for performance as well as the way in which the accounting information is shaped in its use by the managers of the organisation themselves. In this respect it becomes impossible to separate accounting information from the decision-making process and both of these from the power relationships which exist in all organisations.

It is therefore apparent that both the behaviour of managers and the way in which accounting information is used in organisations are factors which prevent organisations operating efficiently as resource allocators. These arguments support the problems of organisations which have been identified in the organisational failure framework itself.

INEFFICIENCIES IN THE MARKET

Economic theory focuses upon the market as a means of exchange between different individuals or organisations, with the assumption that one party to the exchange offers goods or services while the other offers money in payment. These exchanges take place in the market. The market, therefore, is a shorthand expression for the process by which consumers of goods and services decide upon their needs and the suppliers of those goods and services decide upon what to provide. The mediating mechanism which reconciles the demand and supply for any particular good or service is that of price. There is an implicit assumption that each party to a transaction will behave rationally in seeking to maximise his/her utility and that in the long term the free operation of the price mechanism will be sufficient to determine a price at which supply and demand are brought into equilibrium. These assumptions, however, only apply in a situation of perfect competition and in reality such competition never exists. In reality, therefore, the market is affected by the respective power of various competitors in the market, the actions of the firm itself in the market, government regulation of the market, and the expectations of the various actors in the market concerning both the present and the future. Thus it can be argued that an equilibrium price never actually exists, or at least never exists for more than a brief period of time.

Thus, one of the basic assumptions of economic theory, as far as the operations of markets is concerned, that equilibrium is a natural state, can be seen not to apply and this is the basic problem with market efficiency and the price mechanism for transaction mediation. The actions of the firm in determining its operational processes and seeking to minimise its transaction costs depend, however, upon a stable equilibrium in the market in order to make the necessary planning for operational activities. It therefore follows that the market too is problematical as far as the allocation of resources for the minimisation of transaction costs is concerned.

Thus although it seems that transaction cost theory provides a means for focusing upon the transformation process within the firm as a basis for managerial decision-making and transaction cost minimising as a basis for profit maximisation, it can be seen that this would imply a restructuring of the way in which accounting information is collected and utilised within organisations. We can see, however, that there are practical problems with the application of the theory as far as ongoing decision-making within organisations is concerned. Unfortunately, therefore, we must conclude that the theory has little practical application for organisations other than to provide a means to focus upon different aspects of the organisational transformational and operational processes.[12] Nevertheless, the transformational process is important to our understanding of sustainability and we will need to reconsider and redefine this to develop our model of sustainability. This will be for the final chapter.

12 See in particular Chapters 6 and 12 where we discuss this in great detail.

Conclusions

In this chapter we have focused upon the role of corporations in society and some of the debates surrounding this. In part, some of the theory – such as utilitarian philosophy – explains why corporations have developed their current problematic behaviour. In this context it can be seen as rational behaviour within the current capitalist free market system. Other aspects have focused upon the obligations of corporations as members of society at large, remembering that this society has become global. All of this is an essential part of the sustainability debate and represent another strand which we will pick up in the final concluding chapter.

11

Implementing Sustainable Practice

Introduction

We have discussed a lot of issues in this book and our approach to sustainability would necessitate considerable change to business strategy and operations and even to business planning. The implications may even imply changes to business structure. These changes are significant and will not happen without some planning – essentially we are advocating a change from one paradigm to another. We are, therefore, devoting this penultimate chapter to a consideration of the practicalities of such change and the implications of such radical organisational change.

The Causes of Change

It is common to view change as a constant process in organisations – basically as an incremental process of small changes. In order to deal effectively with change, however, it is important to understand the underlying causes of change. It is these causes which tend to create the imperative for change and understanding them will help you to both recognise what changes are necessary and to develop strategies for managing the necessary change. These causes affect the external markets of organisations but can also affect the internal structures and process of an organisation. These underlying causes can be classified into three distinct types:

- economic causes;
- social causes;
- technological causes.

ECONOMIC CAUSES

The most talked about economic change which is taking place at the present is the trend towards globalisation as markets converge. Globalisation means that customers can now purchase their requirements from a firm which may be based anywhere in the world. Equally, businesses are competing against other businesses which might be located anywhere in the world. No longer do national boundaries have any effect upon the patterns of trade. Thus markets and the level of competition have changed dramatically in recent times and this change is still continuing. This has affected the size of markets and the level of competition but it has also had a significant effect upon established patterns of demand as customers gain access to new products and services and new ways of dong business. Globalisation has also had an effect upon the financing of both businesses and governments as the flows of finance around the world are subject to change.

There are other patterns of economic change which are important, however, and which take place at a more national level. The economic cycle of an individual country can create a powerful cause for change in a business. In times of recession, a business must change in order to survive. Conversely in times of growth a business must change in order to take advantage of the new conditions. This economic cycle tends to take place at a national or even regional level and can affect a business but not its competitors. This gives an added imperative to the understanding of the economic causes of change and the need to react to them.

SOCIAL CAUSES

Social, political and demographic changes affect everyone but they also affect organisations. During the 1960s and 1970s there was a boom in youth culture and the development of new products and markets to meet the needs of these young affluent people. During the 1980s we witnessed a change from a community to an individual centred society. During the 1990s and the early years of the twenty-first century we are witnessing an increasingly aged population with a consequent change in patterns of demand and purchasing. These changes have affected businesses and the types of products and services which are demanded. This has caused these businesses to change to meet the needs of society brought about by these socio-demographic changes. Over the last 50 years there have also been many political changes: first towards state ownership and the provision of social benefits to individuals, then towards privatisation and the need for individuals to make provision for their own health and pensions requirements; now there is a move towards a community based individualism. Throughout all this period there has been one other change which is in terms of fashion. Fashions change for a variety of reasons, some of which are socio-demographic but these changes affect many if not all businesses.

Businesses cannot affect these changes in the political environment to any great extent but they affect those businesses and the patterns of demand for their goods and services. Thus there has been a big increase in demand for financial products such as pensions and healthcare insurance and new types of products such as personal pensions and savings schemes. At the same time a reduction in demand for such things as public transport has been apparent – although this change is now being reversed. All of these changes are as a result of the changing political climate but they provide a cause for change within organisations to which they must respond.

TECHNOLOGICAL CAUSES

We have already mentioned technological change as being important for sustainable development. But technological change takes place constantly and this change has brought about new processes in businesses, new organisational structures, new products and services and new demands from customers. All of these have demanded change for businesses to such an extent that most businesses now are unrecognisable from what they were 25 years ago. Indeed many new businesses have come into existence while others no longer exist. There is a big demand now for computers and software, for example, which barely existed 25 years ago. This demand could not have been anticipated only a few decades ago. When the computer was invented by what is now IBM, for example, it was forecast that the total world demand for computers would be for less than 50 machines! Soon nearly everyone will have their own computer. At the same time, the demand for products such as mechanical calculating machines (which were in common use 30 years ago) has completely disappeared. On a smaller scale, few people now want a black and white television while almost everyone owns a colour television, and quite possibly several. Technological change is ongoing and it is difficult to image what will happen in the next 25 years. Nevertheless this technological development will require organisations to continue to change and adapt. A concern for sustainable development therefore merely extends the speed and extent of this change.

The underlying causes of change are not always easy to predict. They are however a root cause of the necessity for change in businesses. An awareness of them is therefore essential for any manager in a business and being aware of changes in society can help a manager be aware of possible necessity for change in the organisation in which she or he is employed.

The Dominant Paradigm[1]

The management of any organisation is generally predicated in the dominant paradigm of the organisation in terms of what it considers as strategically relevant. Such strategic paradigms tend to be applied uncritically to manage organisations and are as the basis of rigid ideologically polar views with little consideration of any alternative points of view (see, for example, Firat 1985; Shrivastava 1986; Venkatesh 1985); indeed opposing strategy paradigms are excluded from the discourse of management within the organisation. Rigid ideological thinking in relation to strategy may provide a cognitive explanation (Porac and Thomas 1990; Hodgkinson 1997) for structural inertia (Hannan and Freeman 1984) or lack of response to external environmental change. This rigid ideological thinking can be considered to be theological, based upon belief rather than current circumstances. When experiencing change, this rigid ideological thinking may not be appropriate for the new environmental conditions in which a company operates. In such circumstance this theology of strategy could have important consequences for companies and could lead to company failure (for example, Barr, Stimpert and Huff 1992).

The theology of strategy can also have important consequences for the development of knowledge within organisations, and this knowledge development is becoming synonymous with success in the current technological era (Carter, Mueller and Swan 2000; Sanchez 1995). Whereas the development of knowledge within organisations has important consequences at an organisational level, Grant (1996) states that knowledge creation is essentially an individual activity while the primary role of firms is in the application of knowledge. However, firms can influence the development of knowledge by buying in knowledgeable individuals (Simon 1991) and by providing the internal and external context for knowledge acquisition, sharing and application. This context is important to the development of knowledge because individuals learn within the context of their own organisation. Thus

1 A paradigm is a model for understanding the world and how it works. The dominant paradigm, therefore, is the one which is in general acceptance at any particular point in time.

the presence of a theology of strategy in an organisation can influence what and how individuals learn within this organisational context. The power exerted through a dominant theology of strategy can also influence what an individual working within the organisation conceptualises as knowledge.

There is some empirical evidence to support the influence of contextual factors in the development of strategic thinking; thus factors such as culture (Hitt, Dacin, Tyler and Park 1997) and past experience (Ireland, Hitt, Bettis, and De Porras 1987) have been shown to influence strategic decision-making. It can therefore be suggested that current ways of thinking about strategy within an organisation, and the organisational routines built up to support these ways of thinking, can have important knowledge implications. In developing a theology around any single strategy paradigm, an organisation will be forced to live with a restricted knowledge base, because of the limitations inherent in any particular paradigm. In this chapter, therefore, we will explore these limitations and also highlight some of the advantages of flexibility in the change process. To address the knowledge implications of a theological approach to strategy we must first discuss the theoretical background by considering the role of paradigms in the development of knowledge and incommensurability between paradigms.

A Critique of the Dominant Paradigm

The theology[2] associated with any particular paradigm requires the acceptance of that paradigm and the consequent rejection of alternative paradigms. These paradigms are, however, social constructs and one could equally well attribute a different set of interpretations to the same process or outcome. Indeed a focus upon different facets of the same phenomenon produces a separate paradigm with equal claim to the exclusivity of explanation. What is clear, however, is that the discourse is based upon the partiality of the sources of information and possible self-referentiality and unquestioning adoption of previous truth claims.

It is generally recognised that strategic management decisions within any organisation are based upon a rational approach; this rational approach is, however, determined by the dominant paradigm within that organisation. Rationalism, for example, has been a dominant strategy paradigm for many decades. This is not surprising considering that strategic management as

2 We use the word theology to signify the dogmatic attitude towards acceptance of the established and rejection of the new; there is no intention to attach to this any religious significance.

a discipline 'grew up' during periods of moderately predictable external environments and increasing complexity of organisations (Ansoff 1979). These are the conditions that rational strategy was developed to help deal with (Mintzberg 1973a). Social interactive factors, however, also support rationalism in strategy, and researchers have highlighted a creeping rationality (Fredrickson and Inquinto 1989) as organisations develop because of the institutional frameworks set up to borrow money for investments to implement strategic decisions. Decision-makers have to be at least partially accountable for the rationality of their decisions. Thus rationality can become self-referencing and unquestioning, even when the conditions that the rational planning paradigm was developed to deal with, are no longer present.

Probably one of the few constants in the business-related literature today is the issue of change, and how it is manifest and affecting business organisations generally. The affects this has on traditional approaches to performance is well documented (see, for example, Howell and Soucy 1988; Kidd 1994; Wisner and Fawcett 1991). Another observable phenomenon is how this subject spans the management disciplines; from personnel to finance, from operations to marketing, all cannot fail to be touched in some way by this issue of change. The clearest indication of this change phenomenon, and of the importance of time, can be found in the imperatives that many customers are placing upon business organisations. Whereas 20 years ago the emphasis might have been on cost, and 10 years ago on quality, today the emphasis has swung decidedly toward time-based issues. Stalk and Hout (1990) provide a temporal analysis of strategy through these concepts arriving at a contemporary supposition that time is now paramount as the competitive factor in business.

More significantly for the purposes of our analysis in this chapter, we can suggest that the most appropriate strategies and organisational form for the management of the organisation from an internal perspective and from a societal and environmental perspective are not incompatible. Moreover, it would also imply that these two modes of performance are not seeking to manage different aspects of performance and that the reporting upon such performance is not seeking to address two different parts of the audience to the organisation's reporting script. Nevertheless, in the semiotic of organisational behaviour, these two aspects of performance tend to be distinctly separated with the internal organisational dimensions assuming paramouncy on the assumption that the organisation exists as a discrete entity with a rigid demarcational boundary. It is our argument in this chapter that this does not present a picture of organisational existence and certainly does not provide a mechanism for understanding the behaviour of people within and without an organisation. To explore this we need to consider social networks surrounding organisational activity.

Expressing the Organisation through Social Networks

The importance of the informal social structures within organisations was probably first recognised in the Hawthorne Studies of the 1930s. For Blau and Scott (1962: 6) 'it is impossible to understand the nature of formal organisation without investigating the networks of informal relations'. However, the informal organisation is often regarded as a monolithic and benign structure, frequently ignoring its complex and often dysfunctional nature. Indeed, it is argued here that to improve our understanding of organisations, an appreciation is needed of the fragmentary, dysfunctional, conflicting, dynamic, pluralistic and boundary-spanning nature of informal networks.

Rogers (1987) distinguishes between two main research traditions of network research: relational and structural. Relational analysis evolved out of the Moreno-type network sociometry of the 1930s to 1950s. While scholarly interest in structural analysis was sparked by the development of block-modelling techniques by White and others at Harvard University in the mid-1970s (Boorman and White 1976; White et al. 1976). Relational network analysis essentially focuses on the pathways in networks and entails identifying the cliques of individuals among the members of a network. In contrast, structural network analysis focuses on patterns of similarity in relational configurations and entails identifying blocks of actors. Two actors are said to be structurally equivalent, and thus in the same block, if they have the same (or similar) pattern of relationships with other members of the system who occupy the same position (Boorman and White 1976; White et al. 1976; Burt 1980). Rogers (1987: 11) argues that in the relational research tradition 'structure emerges from communication among a set of individuals'. This view is supported by Monge and Eisenberg (1987) who argue that in the relational approach, structure grows out of persistent patterns of communication rather than structure prescribing how individuals should communicate. This relational view of social networks allows for greater emphasis to be placed on dynamism, pluralism and atomism, and hence is more appropriate for expressing the postmodern organisation.

Organisational charts and job descriptions generally reflect the formal structure or prescribed network in a given organisation. Such prescriptions are often guided by the missions and strategies of the organisation (Chandler 1962), even though their explicitness may vary greatly between one organisation and another. In contrast, informal or *emergent* networks refer to the often covert and unsanctioned informal relations that emerge over and above such prescribed patterns of interaction (Roethlisberger and Dickson 1939; Jacobson and Seashore 1951; Blau 1955; Mintzberg 1973b; Tichy 1981; Monge and Eisenberg 1987).

It is apparent that variations exist in the meaning attached to the terms 'informal' or 'social' organisation. Mouzelis (1967) distinguishes between four categories of meaning: (1) informal as deviation from the formal; (2) informal as irrelevant to organisational goals; (3) informal as unanticipated; and (4) informal as 'what really goes on in organisations'. However, Burns and Flam (1987: 232) argue that 'organisational theorists have in large part failed to make systematic distinctions between different types and origins of informal rules …'. From the range of descriptions and definitions of 'informal organisation' that exist in the literature, it is possible to envisage a spectrum from the formally prescribed organisation chart, through to the 'purely' social groupings within and transcending the organisation.

Dynamism and the Emergence of Social Networks within Organisations

Stacey (1996) argues that the need for informal organisation arises from two major failings of bureaucratic control: first, the subordination of individuality, and the alienating and de-motivating nature of bureaucracy; and second, the inability of the bureaucratic structure to handle environmental ambiguity and uncertainty. Indeed, Tichy (1981: 225) notes that 'social networks play important roles in business organisations', since 'unplanned structures ... emerge because organisations are so complex that plans can never anticipate all contingencies'; Burns and Flam (1987) term this the 'principle of bounded rationality'. The importance of social or informal networks to innovative organisations is highlighted by Kreiner and Schultz (1993).

Stacey (1996: 341) sees the informal organisation as the mechanism that people employ to 'deal with the highly complex, the ambiguous, the unpredictable, the inconsistent, the conflicting, the frustrating, and the alienating. They use it to satisfy social and motivational needs … and as the tool to promote innovation and change'. While Burns and Flam (1987) argue that organisations are 'embedded in larger social structures and are partially open to the introduction of unofficial or informal rule systems'; this they term 'the principle of insufficient exclusivity'.

A 'complex rule system' is one in which multiple (and often contradictory) rule systems are espoused by different groups. Burns and Flam (1987) term such social settings, polylithic. Organisations have long been perceived in such a way – for example by Weber (1968). These contradictory rule systems emerge, develop and are mobilised through a plethora of overlapping social groupings or networks. For instance, Burns and Flam (1987) argue that such social groupings in organisations may emerge around professional or occupational groupings. In the social network literature, the degree to which individuals are linked by multiple role relations, such as friend, social club member and work colleague, is termed *multiplexity*. It is contended that the greater the number of role relations (or strands) linking two actors, the stronger the linkage (Tichy et al. 1979; Boissevain 1974).

Laumann and Pappi (1976) argue that a social system may be differentiated in any number of ways, depending on the questions the researcher is interested in answering, but that certain bases of social differentiation are likely, in any empirical case, to be of special significance. They (1976: 6) also contend '… that there exists a multiplicity of social structures in any complex social system that arises out of the many possible types of social relationships linking positions [actors] to one another'.

Pluralism and Dissonance in Goals

Although a number of empirical studies have highlighted the efficacy of the informal organisation in supplementing and complementing the activities of the formal organisation, 'emergent [informal] networks can be dysfunctional as well as functional' (Tichy 1981: 225). This is not surprising, since as Burns and Flam (1987: 214) note, 'participants in the organisation bring into it external statuses, relationships, network and organisational ties, each with their own social rule system, which may or may not contradict the formal system'. Furthermore, while management may set the legal parameters for informal exchange behaviour 'what actually gets traded is determined by day-to-day interactions of engineers, marketers, and product developers' (Hamel et al. 1989: 136). Wolek and Griffith (1974: 411) see this reliance on the informal organisation as 'somewhat troublesome, for it is the *formal* channels which seem to be much more amenable to control and institutional support'. Wolek and Griffith (1974: 411) also note that informal networks are 'sometimes interpreted as a sign of both weakness and need for better formal systems'; certainly informal networks present a number of stresses in attempting to steer the organisation towards formally defined goals and objectives.

A central characteristic of social networks is their tendency to span organisational boundaries: team boundaries, functional boundaries and the organisational boundary itself. Consequently, a key managerial concerning social networks involves the flow of information across the organisational boundary. Informal boundary-spanning activity not only provides for the sourcing and acquisition of information and know-how, but can also result in information *leakage*. Mansfield postulates that the rapid diffusion of technology via informal channels is one reason why many firms have difficulty in appropriating benefits from their innovations. This view is supported by Carter (1989: 158) who argues that 'exchangers of information do incur costs. The cost to the trader … is not the loss of the information itself, but rather the *competitive back-lash*'. Thus, the information transfer behaviour of an employee cannot necessarily be assumed to be in accordance with the economic interests of his or her employer. This dissonance may arise where the *trading* or *sharing* of information by employees is guided by personal objectives, or even misguided, due to the insufficient availability of managerial information to enable well-informed decisions to be made. While Hamel et al. (1989) suggest measures to restrain informal boundary-spanning activity, Schrader argues that an organisation should employ mechanisms to induce desirable information transfer behaviour. This may include incentive schemes to motivate employees to act in the interests of the organisation and mechanisms to diffuse information internally.

The unpredictable nature of the linkages and interaction patterns within informal networks provides further consternation for managers in organisations. Carter (1989: 155) argues that 'because knowhow trading is informal and *off-the-books* such trading is difficult for the firm to evaluate and to manage'. In addition, Kreiner and Schultz (1993), in their study of the Danish bio-technology sector, found that 'the norms governing the interaction seem to reside in the network itself rather than in any of the participating organisations'. The transient and intangible nature of informal organisation is highlighted by Mueller (1986: 155), who sees informal networks as 'short-lived, self-camouflaging and adisciplinary. They are invisible, uncountable, unpollable, and may be active or inactive'.

Given the importance of informal boundary-spanning activity to the innovation process and the reliance on a relatively small number of specific individuals acting as *boundary-spanners*, the organisation is to some extent vulnerable. Indeed, Lawton-Smith et al. (1991) argue that 'the downside of the key role which personal relationships play in collaborative ventures is over-dependence on certain individuals'. However, in his study of the communication patterns of engineers, Allen (1977) found that gatekeepers were easily recognised by the organisation, with an overlap between guesses of the management and the study data of around 90 per cent. In addressing this concern, Allen (1977) argues against formalising the role of boundary-spanners, which he believes 'seems unnecessary and could even prove undesirable', favouring 'recognition be afforded on a private, informal basis'.

Pluralism and the Fragmentation of Power

Much of the innovation studies literature referred to in the previous section tends to see the informal organisation as misdirected but essentially benign, and thus in need of management and control (Knights and Murray 1994). The same can be said for the social quality of organisational life. The organisational studies literature stresses this more critical perspective; it locates 'politics' at the heart of informal organisation. Burns and Stalker (1994: 188) argue that 'no concern, it is safe to say, is without political or social conflict which generate, or contribute to, manifest inefficiencies of communication within the working organisation'. According to Stacey (1996), informal networks are political in nature.

Just as the informal organisation is in constant flux, so, too, is the nature and locus of conflict and 'challenge' within the organisation both in relation to the formal organisation and to other cliques and coalitions within the informal organisation. Indeed, for Burns and Flam (1987: 214) '… power relations among the actors or groups advocating different [rule] systems become critical, since these will in part decide which of several competing or contradictory social rule systems will prevail'.

Pettigrew (1973) argues that key to an understanding of the 'political landscape' of an organisation is an appreciation of access to, and control of, information, since these are essential sources of power. The informal organisation constitutes an important element of this landscape, since as Pfeffer (1981: 130) argues: 'clearly, the power that comes from information control … derives largely from one's position in both the formal and informal communication networks'. Research has highlighted a robust link between network centrality and the power accrued by individuals in organisations (Laumann and Pappi 1976; Brass 1984). Krackhardt (1990: 343) argues that an important adjunct to network centrality is the 'accuracy' of an actor's perception of the informal organisation, or what Freeman et al. (1988) term 'social intelligence': 'power accrues not only to those who occupy central network positions in organisations but also to those who have an accurate perception of the network in which they are embedded'. In fact, as Freeman et al. (1988) demonstrate, network centrality and social intelligence are closely inter-connected; they found that an actor's ability to accurately recall social structure was a function of whether they were a member of the core group or a peripheral or transitory member.

Changing the Existing Paradigm

As we have seen, organisations can be considered really to consist of networks of people and one of the principal focuses of this module is that change can only be effected by working with and through people. That change, however, can be enacted more effectively if it is actually planned. The stages of that planned change can be described as shown in Figure 11.1.

Normally, an organisation's view of itself and the world it inhabits is fixed into the dominant paradigm. In order to make the change intended, therefore,

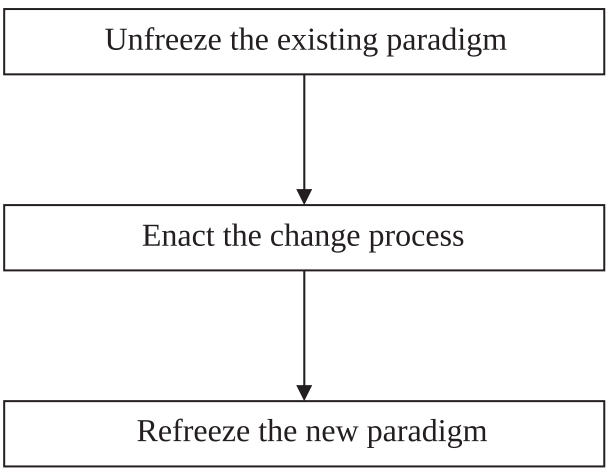

Figure 11.1 Enacting a paradigm change

it is necessary to make this paradigm less rigid and therefore susceptible to change. This we can term 'unfreezing' which makes the change process possible. Then we can make our intervention and effect the change we wish to make. The end result, however, is that of moving to a new paradigm but this new paradigm must be stable. In other words, it is necessary for this new paradigm to be embedded within the culture and procedures of the organisation and we can term this as 'refreezing'. The change process begins with the unfreezing of the existing paradigm and is not complete until the refreezing of the new paradigm is complete.

This unfreezing and refreezing of paradigms is a complex process which involves time and changes to the culture of the organisation but is essential to the success of any change intervention. It requires, among other things, an understanding of the different views of the organisation and the power relationships which exist as well as the politics of the organisation. In other words, various aspects are required to successfully effect change within an organisation.

Planning Change

Although the changing of paradigms is important to the successful outcome of a change intervention this is not all that is required. The enacting of the change itself is an important process which requires careful planning. There are many ways to approach this planning. We start with a model of the process as shown in Figure 11.2.

Identifying the objectives of the change are obviously important but a part of this is to decide upon the criteria by which the success (or otherwise) of the intervention will be judged. There is always more than one course of action to achieve the objectives which have been decided upon and part of the planning process is to consider these alternatives and select the most appropriate one. There are various criteria for considering appropriateness which will include:

- cultural and political practicality;
- level of expertise within the organisation for different approaches;
- cost;
- timescale involved.

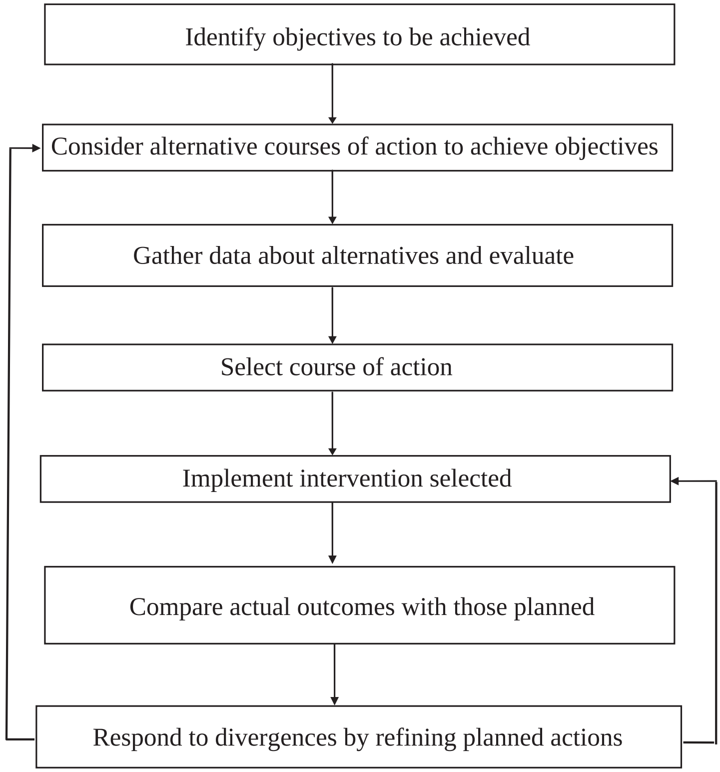

Figure 11.2 The change planning process

Selecting the most appropriate course of action will increase the chances of a successful intervention and this selection is one of the skills required of a change agent. Once decided upon the course of action can be implemented but the planning process does not end there. It is a frequent occurrence that any particular course of action does lead to exactly the outcomes which had been expected and so the monitoring of outcomes is an essential and continual part of the change process. It is necessary to do this in order to spot where deviations from expectations are occurring at the earliest possible time in order to take corrective action. The earlier this corrective action is taken the simpler it will be to enact the necessary corrections and the more likely therefore will be the achievement of a successful planned intervention.

The successful planning of a change intervention can therefore be considered in terms of the key aspects of:

- clear objectives;

- structured implementation;
- continual monitoring.

The Learning Organisation

The concept of the learning organisation stems from strategic theory where the reconfiguration of organisations led to the question of how organisations learn. The recognition of strategic development as an iterative process led to a need to understand the process of organisational learning. Although the concept of *the learning organisation* is a relatively new one, Garratt (1994) argues that all the major ideas underpinning the concept had been developed by the 1940s. He argues that the sole source of learning in an organisation is through people. Moreover this learning has both an intrinsic value (associated with personal development) and an extrinsic value (associated with organisational asset creation). Multiple feedback loops are required for the development of continuous learning. This can be depicted as a continual cycle of making decisions and monitoring their effects (see Figure 11.3).

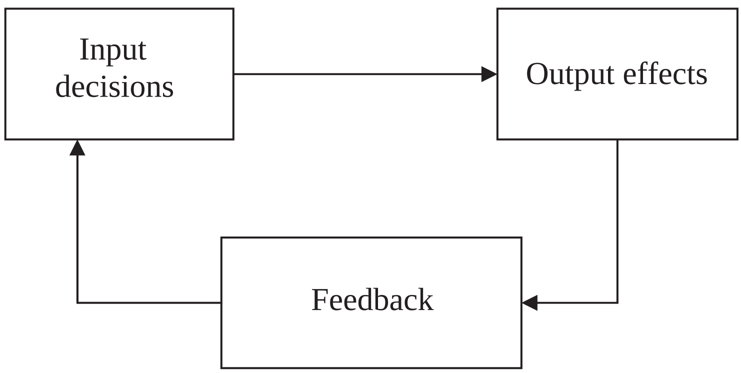

Figure 11.3 The feedback loop

A more sophisticated way of viewing learning, however, is based upon the work of Kolb (1984). The Kolb learning cycle was originally developed to represent the process of individual learning but has been adapted to describe organisational learning. There are four steps in the cycle (see Figure 11.4), with a continual iteration around the cycle.

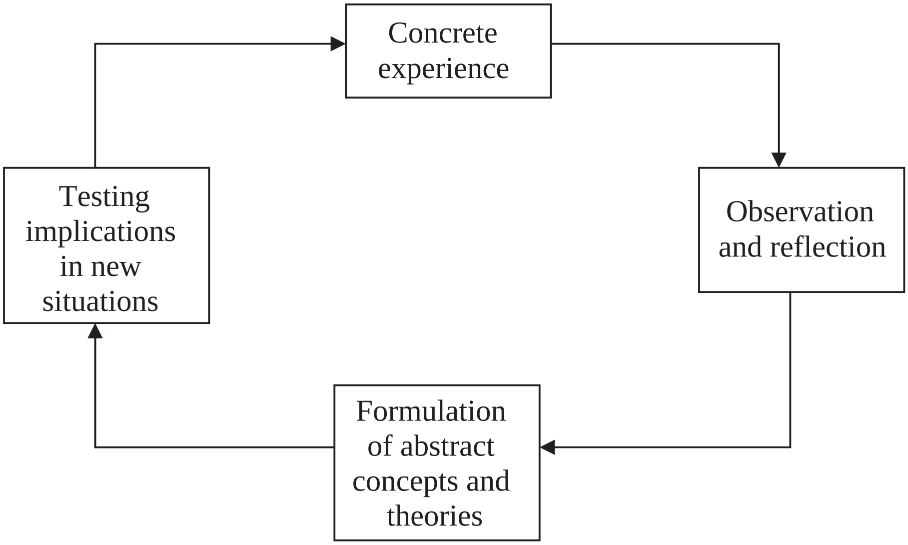

Figure 11.4 The Kolb learning cycle

For an organisation there is an additional factor which is important, and that is the dissemination of the learned information throughout the organisation. This raises the problem of communication and for an organisation an effective communication system is necessary, which can be either formal or informal and is normally a combination of both. In an organisation this communication depends upon shared language among the people of the organisation. Such shared language becomes a part of the culture of the organisation.

What is a Change Agent?

Any successful change management project needs a competent manager and this is the role of the change agent. This change agent must work with and through people and so must be able to communicate effectively with those people and must be comfortable in dealing with interpersonal relationships. Change can be an uncomfortable process for people and the change agent must be able to facilitate change by motivating people and steering the process of change towards a successful conclusion by involving those people.

A change project requires ownership. Although decisions are made within an organisation by individuals, or groups of individuals such as the management team, these decisions, once made, become the property of the organisation and enter the public domain. Ownership of the decisions made, therefore, needs to move from the person, or group, making the decision into organisational ownership. Indeed to be effectively implemented such decisions need to be owned by the people responsible for putting them into effect. Decisions, once made, need to be communicated throughout the organisation in order for ownership of these decisions to transfer from the decision-makers to the organisation as a whole. If this communication makes use of the rituals embedded within the organisational culture then the legitimacy of the decision is increased and its acceptance into organisational ownership is facilitated. This point is made by Yates and Orlikowski (1992) who argue that the means of communicating decisions within an organisation themselves become part of the social ritual of that organisation.

Similarly Swales and Rogers (1995) consider that the language used in business affairs is important as it provides a framing context for the communication of decisions in terms of the history and culture of that organisation. The language used by the dominant coalition therefore becomes part of institutional behaviour but also gives power to the coalition as they set the agenda of communication. Indeed Hanna and Wilson (1984: 21) argue that language is inextricably entwined in power relationships, stating:

> *'Communication is almost always an attempt to control change, either by causing it or preventing it.'*

It is relatively easy for the dominant coalition to become victims of groupthink (Janis 1972) and make decisions based upon their self reinforcing ideas and interpretations of the information within the decision domain, which are not rational when evaluated using alternative criteria. This possibility is particularly likely if the power of the decision-makers is strong and the mechanisms for excluding others from the decision are particularly effective. Williamson (1970) states that the divorce of ownership and management hinders decision-making and leads to inefficiencies in the decisional process but an alternative explanation is that the decisions made are grounded in the needs and desires of the management team rather than in the needs of the business as far as the owners are concerned.

It has been argued by Dermer (1988) that organisations consist of a sustained set of beliefs and behaviours and that the existence of organisational rules, beliefs and rituals limit the extent of the control which it is possible for managers to exert in the organisation. Similarly Abernethy and Stoelwinder

(1995) have found that formal administrative controls in organisations have needed to be replaced by less obtrusive forms of control due to the increasingly complex nature of the tasks which managers perform. Thus the control of the decision-making domain, as exercised by the dominant coalition of the management team, is constrained by the institutional nature of the organisation and the need to transfer ownership of decisions from the decision-makers to the organisation as a whole for the implementation of those decisions. In this context, Covalenski and Dirsmith (1986) state that organisational politics play a key role in the construction of reality as far as members of the organisation are concerned. Thus although the decision agenda is set by the decision-makers, this agenda is in reality constrained by the nature of organisational behaviour and rather than having a free choice as to decisions to be made the management team actually have a limited choice of decisions. These decisions are limited by: the available information and the way in which it is presented and interpreted, and accounting information is crucial in this respect; the organisational rules and rituals which determine the way decisions are put into effect; and the need to transfer decision ownership into the public domain within the organisation.

Of course technical skills in the subject matter of the change and in the process of change (for example, systems diagramming or project management) are also required of the change agent. If these are not already possessed, however, they can be readily acquired. According to Kanter (1989) the traits associated with a successful change agent are:

- the ability to work independently without the power and sanction of the management team;
- the ability to be an effective collaborator, able to enhance rather than destroy collaboration;
- the ability to develop high trust relationships, with high ethical standards;
- the possession of self-confidence coupled with humility;
- a respect for the process of change as well as the substance;
- the ability to work across business functions and units;
- a willingness to take rewards for results and gain satisfaction from success.

Approaches to Organisational Change

Change theories are characterised by their practical, hands on, 'how to go about it', approach. Characteristically they draw on experiences of organisations that have undergone change in the (recent) past; from these experiences 'rules' or 'norms' are extrapolated and represented as 'best practice', to be followed by other organisations. Readers of change texts are treated to a scenario whereby organisations – and people within them – must 'learn to love change' or lose out in the competitive global market place. This is generally followed by an account about how to go about 'doing change'; within such books there are generally guidelines given on how to overcome resistance to change, how to envision change, empower people and such like. Burrell (1997) has referred to these books as belonging to the Heathrow School of management, in the sense that they are 'airport lounge' texts: heavily normative and easily readable.

The origins of this approach to change lie with Lewin (1947) who developed an unfreezing, changing, refreezing model of change. Whilst Lewin did not view his model as being applicable, in a visible demonstration of the 'Death of the Author'[3] it has been interpreted since in this way (see Buchanan and Huczinski 1985). The model has been used on countless occasions to argue that to enact organisational change, the process must begin by unfreezing the existing organisation, to be followed by the implementation of the change programme, and finally the organisation must refreeze itself by embarking on a period of consolidation. Lewin's (1947) perspective on organisational change is that it is a linear, sequential process. Lewin's (1947) view of organisational change being a series of sequential states or steps is a dominant theme within the body of applicable change literature. For example, Hickman and Silva (1985) argue that 'By focusing on one step of implementation at a time, you can bring about … permanent change' (1985: 199), therefore, organisational change is viewed as rational process which consists of a number of different linear stages. These steps are often incorporated into 'checklists' for management to follow.

The downplaying of the limits of strategic choice serves to elevate the role of the 'leader' as an agent of organisational change. Moreover, it imbues the reader of such texts with the notion that through effective and inspirational leadership any problem is surmountable: managers are leaders whom should

3 The Death of the Author is a post-structural concept that suggests that the literary preoccupation of trying to decipher what it is an author is really trying to communicate has been superseded. The new sensibility places emphasis on what it is that the reader understands and interprets from the message.

be able to master the organisational situation. The importance of leadership is emphasised, for instance by Kotter (1986). Indeed Kanter (1983) earlier referred to managers as being change masters.

The cult of the leader is firmly embedded in the applicable change literature with the exploits of successful corporate leaders sometimes being glorified to the point of hyperbole. This it could be argued is part of the wider 'fetish' for leadership that has bedevilled organisational theorising (c.f. Hosking 1990). Many influential books on organisational change are written by former chief executives who were successful in changing their organisations. Clegg (1997) highlights the genesis of this genre to be in the writings of Chester Barnard over 60 years ago. The books are typically in a semi-autobiographical style delivering their nostrums on 'how to change organisations', or for Clegg and Palmer (1996), they can be considered to be 'karaoke texts' remarkable for their Frank Sinatran 'I did it my way quality'. Notable examples include Sir John Harvey-Jones who is perhaps the best UK example of this phenomenon with his analysis even being turned into a popular television series on managing change; which saw him apply his prescriptions to a wide variety of different organisations. In terms of understanding their warrant, or their credentials, their exploits in the corporate world provide them with a legitimacy to talk about 'how to manage change'.

Thus the literature also places great importance on reducing or overcoming resistance to change. This, too, is discussed in a rational and planned perspective. According to this literature, the reduction of resistance to change is achieved by a combination of visionary leadership (see above) combined with strategies to overcome resistance. Under the heading of 'Making it Happen' Plant (1987) puts forward a model which he terms Key Relationship Mapping which offers a framework to anticipate any potential resistance and more generally to plan the implementation of change. In most of the accounts of overcoming resistance to change, there is no indication that resistance may be a 'rational' response to managerial prerogative, with their being in existence competing views in the workplace. Many of these writers include questionnaires for managers, which purport to increase the manager's own self-awareness. For instance, Hickman and Silva (1985) argue that to be successful in implementing change a manager must be focused.

A characteristic of this literature is that it employs many practical examples from different organisations to illustrate and support the arguments; examples are used in a highly selective way to illustrate a particular point, without adequate reference to an organisation's experience over a longer period of time. For instance, Plant (1987) cites the Burton group 'as a company moving very rapidly and successfully in this direction'. (The direction being towards what Plant defines as participative, supportive management – which in his organisational lexicon refers to a company being adept at managing change.) The books can therefore reduce into being little more than a reproduction of corporate fables.

The applicable change school, so far as it constitutes a coherent body of thought, suffers from overly simplistic analyses and dubious blueprints for corporate success. A noticeable feature of the genre is the tendency for the content of any change process to reflect the managerialist wisdom of the day. However, the practice-based nature of such works combined with their 'call to action' style messages continue to be popular. This popularity at once gives some indication of the degree to which change is something confronted by managers and employees within organisations. Moreover Weick (1995) states that it is arguable that having a map or some guidance is better than none – even if the map is wrong. In summary, though we can argue that there is little to commend in the applicable change literature, with the oversimplifications and the importance afforded to the actions of individual managers. Furthermore, we can consider that much of the theorising by applicable change writers amounts to the constructions of fables, which are notable for their dubious analyses and blueprints for change; these ideas treat organisations as malleable entities which can be transformed through a 10-point plan. That said, it is too easy to be unreflexively dismissive of practice-based books, not corresponding to the expectations of academia. Merely criticising them or holding them up as 'straw men' is equally problematic. Moreover such critiques imply that managers read and take in all of the nostrums of the *change gurus*, this is a highly questionable presumption. Moreover mere criticism does not help anyone become a successful change agent. We are therefore for the remainder of this chapter going to consider some of the ways for becoming a more successful change agent by taking the message of this book – that change is all about working with and through people – and looking at ways of improving this aspect of the requisite skills of a change agent.

Conclusions

The tenor of this book has been to suggest that fairly dramatic change is needed if organisations are going to aspire towards sustainability, let alone sustainable development. In this chapter we have shown some of the factors necessary to successfully introduce such dramatic change. In reality, of course, the change required should be attempted over a period and therefore broken into smaller steps. Moreover it is essential that the approach to sustainability must be embedded into the strategic planning of the corporation, and implementation is an essential part of this planning. All of these aspects of implementation need to be considered as we move into the final chapter and develop the important strategies to enable sustainable development to take place.

12

Conclusion: Creating and Sharing Common Value

Introduction

For more than 20 years the starting point for any discussion of sustainable corporate activity has been the Brundtland Report. Its concern with the effect which action taken in the present has upon the options available in the future has directly led to simplistic assumptions that sustainable development is both desirable and possible, and that corporations can demonstrate sustainability merely by continuing to exist into the future. There have been various descendents of Brundtland, including the concept of the triple bottom line. This in turn has led to an assumption that addressing the three aspects of economic, social and environmental is the epitome of corporate social responsibility (CSR). It is our argument throughout this book that this notion is not just incorrect but also positively misleading through an obfuscation of the key issues surrounding such responsibility (see Aras and Crowther 2008a). In this book, therefore, we have re-examined the legacy of Brundtland and redefined what is meant by sustainable activity. In order to do this we have rejected the accepted term of sustainability, preferring instead the term durability to emphasise this change in focus. From this we have argued for a rejection of the triple bottom line and a redefinition of both CSR and sustainability.

As we have seen, there has been considerable change in the emphasis of corporate reporting of their CSR activity which has taken place in recent years. This change is not just in terms of the extent of such reporting, which has become more or less ubiquitous throughout the world, but also in terms of style and content. When researching into corporate activity and the reporting of that activity in the 1990s, it was necessary to acknowledge (Crowther 2002c) that no measures of social or environmental performance existed which had gained universal acceptability. Good social or environmental performance was subjectively based upon the perspective of the evaluator and the mores of the temporal horizon of reporting. Consequently, any reporting concerning such performance could not easily be made which would allow a comparative evaluation between corporations to be undertaken. Sustainability has always been one of the key principles of CSR but recently it has become the most ubiquitous one, with all corporations claiming to address it (Aras and Crowther 2008d) and many replacing their CSR reports with sustainability reports.

Our analysis so far in this book has shown us that sustainability is a complex issue with many ramifications, affecting all aspects of corporate activity and affecting its relationship with society, the environment and all stakeholders. Moreover, the conventional view of sustainability and the inevitability of sustainable development, stemming from the Bruntland definition, is unhelpful. In this final chapter, therefore, it becomes imperative to take a different view of sustainability – stemming from our definition and analysis in earlier chapters – and to consider implications for corporate activity before developing some strategies which will lead to sustainable development.

Sustainable Corporate Activity

A reconsideration of sustainability has shown that when resources are limited then the way to manage sustainable development is through the more efficient use of those resources (Aras and Crowther 2008c); this is, of course, completely in accordance with economic theory and finance theory which requires the efficient use of scarce resources as a way to development. Thus, all corporations are practising cost management and efficient operational management as a matter of course but also as a means of achieving sustainability. We have sought to show that there are two discourses concerning corporate sustainability which are operating in parallel with each other. One is predicated in the environmental sustainability discourse which is epitomised by such work as Jacobs (1991), Welford (1997), and Gray and Bebbington (2001). The second is predicated in the going concern principle of accounting as epitomised by the corporate reporting described earlier. Although seemingly incompatible, both are actually based on an acceptance of a conventional view of the transformational process (see Figure 12.1).[1]

1 It is important to note that we are using the term capital in its original sense of land and the resources contained thereon, rather than the modern usage of referring to financial assets. These are identified separately in our model. It is an important distinction for our analysis in this chapter. By extension we are using the term capital to refer to raw materials also.

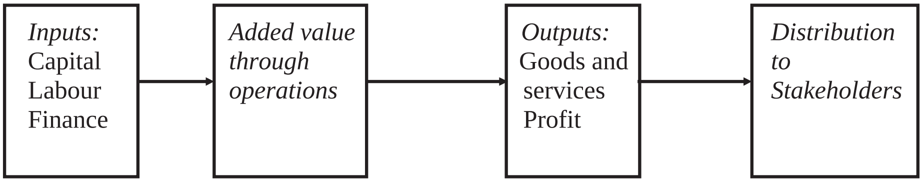

Figure 12.1 The extended transformational process

Our argument is that this does not actually lead to corporate sustainability without a consideration of the distributional impact of the corporate activity. Thus in our model none of the stakeholders are merely factors of production but are also affected by – and hence concerned with – the results of corporate activity, as described through the transformational process. This can be represented as shown in Figure 12.2.

This is essentially a balancing model of corporate activity. In other words we are stating, for example, that the conventional view of sustainability in terms of either use no more of a resource than can be regenerated or not limiting the choices of future generations – in other words stasis (Aras and Crowther 2007a) – is neither a realistic nor an ethical model of sustainability. It is unrealistic because all economic activity inevitably affects future choices through using some in the present – this has always been the case since we first emigrated from Africa 10,000 years ago and started to hunt animals. It is not an ethical model because an ethical view of sustainability, predicated in a Utilitarian philosophy, would allow actions, as long as full evaluation of the consequences are made and as long as all stakeholders understand and accept the implications. Then it would be ethical behaviour if the net effect of summation of effects was positive. Thus it could be acceptable to affect the environment and hence the possibilities for future generations if this condition was met. In this model (Figure 12.2) we are not arguing for or against sustainable development (as others do) but merely acknowledging that it may be possible and outlining the circumstances in which it is acceptable.

Conditions for Growth

An almost unquestioned assumption of the sustainability discourse is that growth remains possible (Elliott 2005) and therefore sustainability and sustainable development are synonymous. Indeed the economic perspective of post-Cartesian ontologies predominates and growth is considered to be not just possible but also

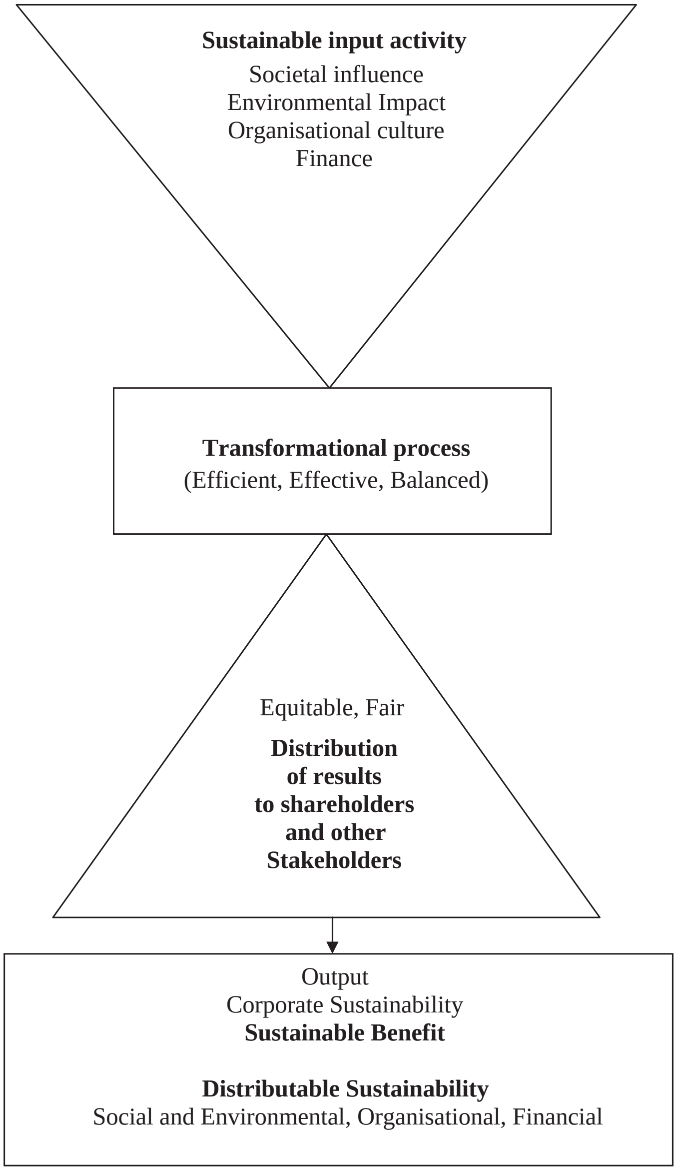

Figure 12.2 Sustainability model

desirable (see, for example, Spangenberg 2004). So it is possible, therefore, for Daly (1992) to argue that the economics of development is all that needs to be addressed and that this can be dealt with through the market by the clear separation of the three basic economic goals of efficient allocation, equitable distribution and sustainable scale. We argue that this analysis is incorrect and sustainability is more complex than any economic problem, and cannot therefore be resolved merely through the market. We can demonstrate this through an examinational of the transformational process, the simplest, conventional version of which we have considered previously but is repeated here and depicted as Figure 12.3:

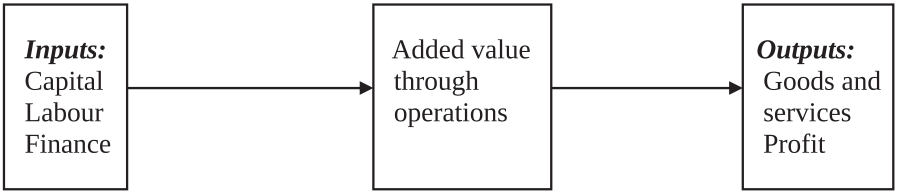

Figure 12.3 The conventional transformational process

This model assumes that inputs (of capital labour and finance) are used to make goods and services through the employment of the operational factors of production (for example, employees, suppliers, etc.) in order to make goods and services with a resultant profit. The implications of this conventional view of the transformational process are that the inputs can be freely acquired in the desired quantities and that the operational factors of production are commodified. This view of the process enables mediation through the market and is legitimated by the views of such writers as Spangenberg (2004), referred to earlier.

There are, however, two fundamental flaws with this form of analysis:

1. The input referred to as capital actually represents environmental resources and these are quite definitely finite in quantity. Thus the market cannot mediate adequately as the ensuing competitive bidding will raise the price but will not bring more of the resource into the market because there is no more in existence. Substitution can compensate for shortages only to a limited extent: it is difficult, for example, to see the extent to which more finance or labour can compensate for instance for the absence of oil.

2. The factors of production are not actually commodities: rather they are stakeholders of the organisation. It may aid analysis to commodify them but they require benefits from the organisational activity. In particular, when resources are recognised to be finite, market mediation in this way does not satisfactorily accommodate the requirements of all stakeholders to the organisation. Thus these stakeholder need to become a part of the output section of the transformational process.

The revised transformational process is therefore depicted as Figure 12.4:

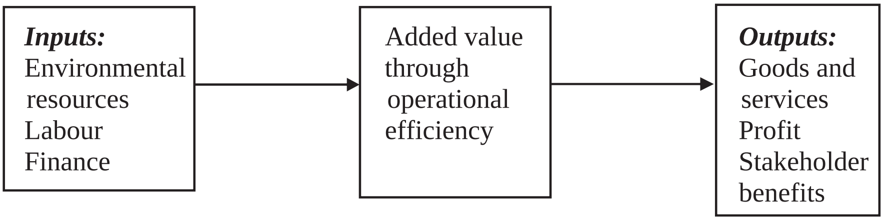

Figure 12.4 Equitable sustainability and the transformational process

Additionally, there are a wide variety of such stakeholders who justifiably have a concern with those activities, and are affected by those activities. Those other stakeholders have not just an interest in the activities of the firm but also a degree of influence over the shaping of those activities. This influence is so significant that it can be argued that the power and influence of these stakeholders is such that it amounts to quasi-ownership of the organisation. Our argument, therefore, is that sustainability can only exist if equity also exists.

Introducing Equitable Sustainability

Hence we introduce the term *equitable sustainability* to reflect this argument that sustainability cannot exist without equity in the distributional process. It is our argument that sustainability is presently not really either understood by theorists or addressed by corporations, despite the many claims that are being made. Indeed we regard much analysis – based on the notion of mediation through the market – as being both complacent and obfuscatory[2] concerning the issues which need to be addressed. As we have explained earlier, the Brundtland definition has actually done a disservice through focusing attention away from the important issues. Indeed we maintain that it is only by introducing the concept of equity into the analysis that we can start to address the question of sustainability.

Central to our argument, therefore, is that an understanding of sustainability must include not just what raw materials are used by the organisation or even how they are used. It must also take into consideration an evaluation of how the effects – both positive and negative – are distributed to the various stakeholders

2 See Aras and Crowther (2008a).

concerned. This requires some rethinking of organisational activity and a revision of processes and effects.

As far as inputs to the transformational process are concerned then it is apparent that environmental resources are finite and effectively fixed. Currently all the resources of the planet are in use (some would say overuse) and the resources for one corporation can only be increased by taking them from another through the process of competition in the market place. This highlights two alternative routes to development. The first is through the substitution of environmental resources with other inputs – of labour or finance. The second is through making better use of the available environmental resources – effectively doing more with less. Both require technological development in order to bring into effect and so sustainable development essentially requires technological development – also known as research and development – in order to be tenable. This is the first point of intersection whereby sustainability comes into conflict with organisational accounting. Technological development for sustainability requires the more efficient use of environmental resources whereas accounting efficiency requires the more effective use of financial resources. Sustainable development therefore requires greater use of human resources, particularly highly skilled people, in order to develop the necessary technology, and this of course will incur additional cost. Accounting efficiency requires the replacement of people – particularly skilled and, therefore, expensive people – with relatively low cost techniques such as programmed change initiatives – total quality management (TQM), business process re-engineering (BPR), etc. – and computer-based management systems. We therefore argue that the use of conventional accounting to a large extent is in direct opposition to the concept of sustainability. Sustainability requires the efficient utilisation of scarce resources – just as economic theory suggests – and simply redefines those scare resources. Efficient use requires some investment.

As far as substituting environmental resources with other resources is concerned then of course there is limited scope for this. Design can possible reduce the amount of raw materials required – effectively substituting people for environmental resources – and just in time techniques can substitute raw materials with financial resources but the scope of these is obviously limited. Thus, additional people or additional finance does not solve any problem and these are currently in a situation of oversupply. The scarce resource is clearly environmental resources and production planning needs to be managed around the effective use of this scarce resource.

Recycling

Recycling of used materials and products has been part of the agenda in developed countries for centuries. For example in the UK waste metal has always been recovered but now throughout Western Europe domestic waste is sorted into categories and around 40 per cent – varying between countries – is recycled. The EU target is to increase this significantly, although the 2008 economic crisis has focused attention upon other issues. Nevertheless recycling has been part of the environmental lobbying for many years, and has equally been a part of the natural environment. This is illustrated for example by trees as the leaves and branches shed are mulched and eventually reabsorbed to fuel further growth and development. In industry it is represented by the creation of products which can be recycled and by the emphasis placed upon the recovery of re-useable waste. This makes financial sense and provides an illustration of the way in which the conservation of environmental resources and financial resources have become aligned in corporate planning and operations.

A Traditional View of Organisational Accounting

Thus, although risk management, efficient management, regulation, international standards and corporate governance are necessary all for sustainability and for sustainble business (Aras and Crowther 2009c), there are actually two discrete discourses concerning corporate sustainability which are operating in parallel with each other – as we described earlier. Although seemingly incompatible, both are actually based on an acceptance of a conventional view of the transformational process (see Figure 12.3).

Traditional accounting theory and practice assumes that value is created in the business through the transformation process and that distribution is merely concerned with how much of the resultant profit is given to the investors in the business now and how much is retained in order to generate future profits and hence future returns to investors. This is, of course, overly simplistic for a number of reasons. Even in traditional accounting theory it is recognised that some of the retained profit is needed merely to replace worn out capital – and hence to ensure sustainability in its narrowest sense. Accounting, of course, only attempts to record actions taking place within this transformational process, and even in doing so regards all costs as things leading to profit for distribution.

This traditional view of accounting is that the only activities with which the organisation should be concerned are those which take place within the organisation;[3] consequently it is considered that these are the only activities for which a role for accounting exists. Here, therefore, is located the essential dialectic of accounting – that some results of actions taken are significant and need to be recorded while others are irrelevant and need to be ignored. This view of accounting places the organisation at the centre of its world and the only interfaces with the external world take place at the beginning and end of its value chain. It is apparent, however, that any actions which an organisation undertakes will have an effect not just upon itself but also upon the external environment within which that organisation resides – and specifically upon a wide range of stakeholders. In considering the effect of the organisation upon its external environment, it must be recognised that this environment includes both the business environment in which the firm is operating, the local societal environment in which the organisation is located and the wider global environment in addition to the natural environment.[4]

The discourse of accounting can, therefore, be seen to be concerned solely with the operational performance of the organisation. Contrasting views of the role of accounting in the production process might therefore be epitomised as either providing a system of measurement to enable a reasonable market mediation in the resource allocation problem or as providing a mechanism for the expropriation of surplus value from the labour component of the transformational process. Both strands of the discourse however tend to view that labour as a homogeneous entity – suitably commodified and described as infinitely divisible – and to consider the effect of organisational activity upon that entity. Labour is of course composed of individual people; moreover these individual people have a lifetime of availability for employment and different needs at different points during their life cycle. The depersonalisation of people through the use of the term labour, however, provides a mechanism for the treatment of labour as an entity without any recognition of these personal needs. Thus it is possible to restrict the discourse to that of the organisation and its components – labour, capital, etc. – and to theorise accordingly. The use of the term labour is a convenient euphemism which disguises the fact that labour consists of people, while the treatment of people as a variable cost effectively commodifies these people in the production process. In order to create value in the transformational process of an organisation then commodities need to

3 Essentially the only purpose of traditional accounting is to record the effects of actions upon the organisation itself.
4 Essentially these are the four factors in our sustainability model described in Chapter 2.

be used efficiently, and this efficient use of such commodities is measured through the accounting of the organisation. When this commodity consists of people then this implies using them in such a way that the maximum surplus value can be extracted from them. The way in which this can be achieved is through the employment of young fit people who can work hard and then be replaced by more young fit people. Alternatively, surplus labour can be used as a mechanism to bargain the price down – with the threat of moving to a lower labour cost region as a threatened consequence.[5]

In this way surplus value (in Marxian terms) can be transferred from the future of the person and extracted in the present – with the effects in terms of social and health costs being deferred into the future. As people have been constituted as a commodified variable cost then they become merely a factor of production which can be exchanged for another factor of production, as the costs determined through the use of accounting legitimate. Thus it is reasonable, through an accounting analysis, to replace people with machinery if more value (profit) can be extracted in doing so, and this has provided the imperative for the industrial revolution which has continued up until the present. Accounting is only concerned with the effect of the actions of an organisation upon itself and so the effect of mechanisation upon people need not be taken into account. Thus, if mechanisation results in people becoming unemployed (or possibly unemployable) then this is of no concern – except to the people themselves. This, of course, is also an inevitable outcome from a system which is predicated in Utilitarian theory as the present economic system undoubtedly is. Arguably this is the root cause of many of the problems of overproduction and overconsumption existing alongside the commodification and exploitation of people – but this is another story which will be told in another book…

The Transformational Process Revisited

In order to explain our alternative approach to developing sustainable practice we need to go back to the transformational process which describes corporate activity. This model assumes that inputs (of capital, labour and finance) are used

5 For example, Ford has negotiated with labour unions that the rate of pay in its new factory will be almost halved from the norm in that country in order to combat the threat of lower cost areas in the Far East. It is questionable, of course, if this is any kind of sustainable strategy for either Ford or for the trade unions. It seems to have been quickly forgotten that the growth in the car industry and the demand for motor vehicles was created by Henry Ford when he decided to pay his workers much higher wages so that they could afford to buy the products which they were manufacturing – thereby stimulating demand and enabling costs to be lowered!

to make goods and services through the employment of the operational factors of production (for example, employees, suppliers, etc.) in order to make goods and services with a resultant profit. The implications of this conventional view of the transformational process are that the inputs can be freely acquired in the desired quantities and that the operational factors of production are commodified.

This view is entirely in accordance with the conventional use of accounting, and is even encouraged through this use. We have therefore argued that the use of conventional accounting to a large extent is in direct opposition to the concept of sustainability. Our model of sustainable corporate activity seeks to resolve this into on model which recognises both the transformational process within a corporation but also the distribution of the benefits as being equally significant to sustainability.

There are a number of problems with this economic view of corporate activity, encapsulated in the way that accounting for corporate activity has evolved. These problems can be summarised:

- First, the economic view of corporate activity is that efficiency is all that matters. This leads to various scenarios being desirable: economies of scale suggests that growth per se is desirable; efficiency will be promoted through the deregulation of markets; and globalisation is of universal benefit.

- Second, efficiency is always equated to cost reduction – producing at a lower financial cost because finance is the scarce resource.

- Third, cost reduction is sustainable – so business migrates around the world in search of ever lower costs of production – cheap labour and cheap raw materials.

- Fourth, substitution is always possible – labour by technology, one source of energy by another, etc.

These assumptions are all incorrect.

The other main problem with the traditional economic view of corporate activity is the assumption that stakeholders are merely a part of the factors of production – to be used to provide the surplus which is distributed to the owners and investors of the corporation. So employees and suppliers are merely a part of the production process; the effects of corporate activity can be externalised to society at large with impunity; the environment is a free resource to be used for financial gain. And the future – also a key stakeholder – can be neglected. But it is still possible to talk about sustainable corporate activity!

Let us return to the transformational process and redefine the terms. When we say capital then what we really mean is natural resources. Labour means people, while finance is unchanged. Thus the transformational process becomes that shown in Figure 12.5.

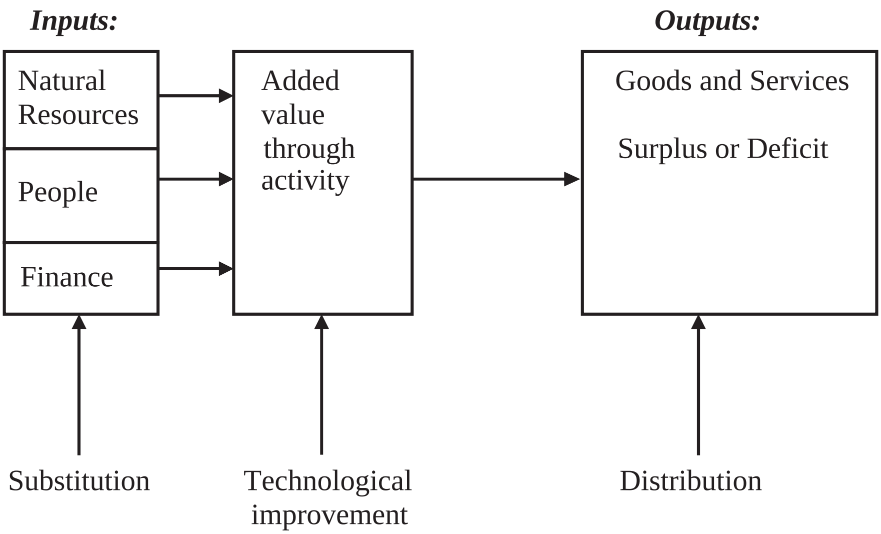

Figure 12.5 The sustainable transformational process

We accept that value is created through corporate activity but a crucial part of this is the distribution of the effects – positive and negative – to all stakeholders, including society, the environment and the future. One of the tricks performed through accounting is to make redistribution appear to be value created.[6] Consequently, our argument is that this does not actually lead to corporate sustainability without a consideration of the distributional impact of the corporate activity. Thus in our model none of the stakeholders are merely factors of production but are also affected by – and hence concerned with – the results of corporate activity, as described through the transformational process.

6 For example, costs transferred to society at large would reduce the costs shown in the corporation's accounts. This would increase the recorded profits and make it appear that value has been created, merely through a changed distribution of effects. It is one of the lesser acknowledged features of accounting that profit can be created without actually doing anything – a fact which was understood and used to great effect by the managers of Enron!

A reconsideration of sustainability shows that when resources are limited then the way to manage sustainable development is through the more efficient use of those resources. Thus, all corporations are practising cost management and efficient operational management as a matter of course but also as a means of achieving sustainability.

Conventionally, corporations grow by consuming more resources but redefining the problem shows us that natural resources are finite and are being fully committed at present – if not actually being over committed. So growth through the use of more natural resources is not possible. These are the scarce resources – not finance.

Consequently, efficiency must be redefined away from financial efficiency and applied to the use of natural resources. Growth requires us to do more with less. So innovation, technology and R&D become more important. So we must redefine the transformational process to provide a more realistic description of the input resources used – and the potential for substitution and to highlight that growth must come through technological improvement rather than through the use of more resources.

The full transformational process, therefore, is as shown in Figure 12.6.

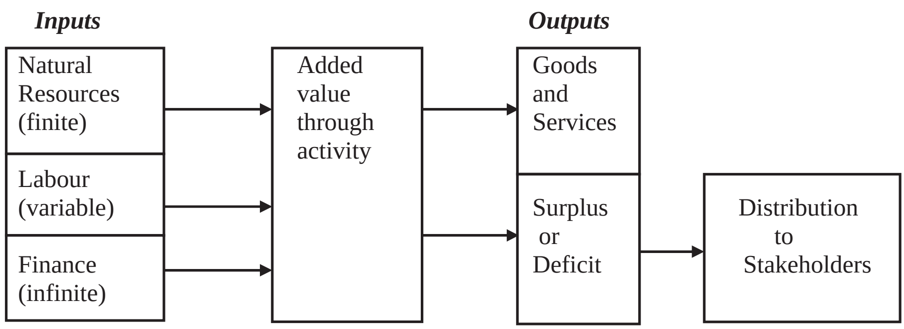

Figure 12.6 The complete transformational process

Moreover, in our model none of the stakeholders are merely factors of production but are also affected by – and hence concerned with – the results of corporate activity, as described through the transformational process.

We have deliberately used the term **distributable sustainability** in order to reflect one of the key components of this argument. This is that true sustainability depends not just upon how actions affect choices in the future but also upon how the effects of those actions – both positive and negative – are distributed among the stakeholders involved. A central tenet of our argument is that corporate activity, to be sustainable, must not simply utilise resources to give benefit to owners but must recognise all effects upon all stakeholders and distribute these in a manner which is acceptable to all of these – both in the present and in the future. This is in effect a radical reinterpretation of corporate activity.

It is necessary to consider the operationalisation of this view of sustainability. Our argument has been that sustainability must involve greater efficiency in the use of resources and greater equity in the distribution of the effects of corporate activity. To be operationalised then, of course, the effects must be measurable and the combination must of course be manageable.

This can be depicted as a model of sustainability (see Figure 12.7).

This acts as a form of balanced scorecard to provide a form of evaluation for the operation of sustainability within an organisation. It concentrates upon the four key aspects, namely:

- strategy;
- finance;
- distribution;
- technological development.

Manageable (strategic)	Measurable (financial)
Equitable (distributional)	Efficient (technological)

Figure 12.7 The facets of sustainability

Moreover, it recognises that it is the balance between these factors which is the most significant aspect of sustainability. From this a plan of action is possible for an organisation which will recognise priorities and provide a basis for performance evaluation.

Furthermore we argue that any approach to sustainability must contain the facets encapsulated in the mnemonic **2M2E**. In other words all successful planning must be:

- manageable;
- measurable;
- equitable;
- efficient.

Traditional approaches do not satisfactorily address these issues and are therefore unlikely to be successful for the development of strategies for sustainability.

To summarise, sustainability requires a radical rethink and a move aware from the cosy security of the Brundtland definition. We therefore reject the accepted terms of sustainability and sustainable development, preferring instead to use the term ***durability*** to emphasise the change in focus.

The essential features of durability can be described as follows:

- Efficiency is concerned with the best use of scarce resources. This requires a redefinition of inputs to the transformational process and a focus upon environmental resources as the scarce resource.
- Efficiency is concerned with optimising the use of the scarce resources (that is, environmental resources) rather than with cost reduction.
- Value is added through technology and innovation rather than through expropriation.
- Outputs are redefined to include distributional effects to all stakeholders.

Square Theory

We therefore also argue for a rejection of the concept of the triple bottom line as insufficiently refined for practical use. Instead we introduce Square Theory as an appropriate vehicle for corporate strategic planning and for durable development. This is modelled as shown in Figure 12.8.

	Operational	Strategic
Internal	Technology	Innovation
External	System	Governance

Figure 12.8 Square Theory

This theory addresses all the aspects of corporate activity which are necessary for durability – and recognises their essentially symbiotic nature. So we can consider the transformational process in terms of technological development. Equally, innovation is what leads to value added, and at the same time the two must be combined for sustainable growth to take place. This must be set in the context of the whole system which enables the regulation of activity and the distribution of effects. And we need also to consider its governance – and for us governance is about ensuring equity rather than merely managing processes. It recognises the need to take account of both the internal and the external – on an equal basis rather than through the privileging of corporate activity. It recognises the essential need to combine both the operational and the strategic levels of corporate activity, without either being more important.

The two key components of durability – or durable sustainability – therefore are efficiency and equity. But efficiency needs to be redefined to prioritise the efficient use of environmental resources rather than the efficient use of financial resources. And equity requires as a minimum the satisficing of all stakeholders, and not merely the provision of returns to owners and investors. These are the prerequisites for sustainable development.

Recycled Sustainability

Recycling is, of course, an integral part of the discourse of sustainability as far as environmental issues are concerned. The concept of recycling applies equally to corporate sustainability in terms of the recycling relationship with each stakeholder. By this we mean that a sustainable corporation needs to invest in all of its stakeholders in order to maintain and improve relationships between the company and its stakeholders but that the investment in stakeholder relations is returned to the company through being recycled. So a stakeholder who is well treated both receives benefit from the company and returns benefit to that company. For example, employees will work better when they receive better conditions; similarly suppliers will reciprocate the receipt of good conditions while customers will pay a premium for quality. This can be considered to be renewable performance.

Conclusions

The focus of CSR activity has shifted to a greater concentration upon sustainability but in this context our argument has been that Brundtland with its definition of sustainable development has misdirected concern to the wrong issues which need to be re-examined. Rather than trying not to affect future choices – and obvious impracticality – the debate must focus upon the efficient use of scarce resources. Hence we refer to Durability to signal the move away from the Brundtland misdirection. Moreover, we argue that any debate about sustainability must focus upon efficiency and equity – efficiency in the transformational process and equity in the distribution of effects. The focus of such concern cannot be upon the three aspects of the triple bottom line – another misdirection. Instead we have introduced Square Theory as an appropriate vehicle for corporate strategic planning and for durable development. İn doing so our aim is to move the discourse to the next level and enable some progress to be made in addressing the real issues regardinng sustainable CSR.

Strategies for Sustainable Development

The current discourse of sustainable development concentrates upon a concern for not limiting the choices available to future generations. This is plainly unrealistic as mankind has been unable to achieve this since he changed from hunter gatherer to farmer and cut down the forests around the world. In the present it is not just unrealistic but attracting attention away from the real issues. Resources are important of course but attention needs to be directed towards the real scarce resources which need to be used efficiently. And those scarce resources are not financial resources as conventional finance theory would have us believe – they are environmental. So the first strategy for sustainable development can be described:

1. Identify the true scarce resources and develop techniques to use then efficiently.

We have argued that the factors of production are not resources to be exploited but rather they are stakeholders with an interest in the distribution of effects of organisational activity. Sustainability can only be achieved if all stakeholders are reasonably satisfied with the way in which they are effected. Thus, all distributional effects – positive and negative – must be taken into account and all stakeholders must consider the distribution of these to be equitable.[7] This leads to the second strategy for sustainable development:

2. Measure and record all the effects of organisational activity and ensure an equitable distribution of these effects.

Most management and finance theory privileges one aspect above all others. In management theory this is often the development of strategy; for finance it is finance and its distribution to investors. Our argument is that it is balance between the factors – howsoever identified and described – which is crucial to long-term success. Hence we start the book with our definition of sustainability and conclude with Square Theory. Both contain four factors which need to be balanced along two dimensions, and no sense of hierarchy. This leads to our third strategy for sustainable development:

3. Development requires the continual balancing of all relevant factors and the privileging of none.

These three strategies together provide a basis for sustainable development for every corporation. And, inevitably, although we have numbered the strategies as 1, 2 and 3 they are not hierarchical. They are all equally important and so it is the balance between these also which is essential…

7 Equitable does not, of course, imply equal – merely a perceived fairness or reasonableness.

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