

# Corporate Social Responsibility: Part I

Principles, Stakeholders & Sustainability

David Crowther; Güler Aras



David Crowther & Güler Aras

# **Corporate Social Responsibility: Part I**

Principles, Stakeholders & Sustainability



Corporate Social Responsibility: Part I – Principles, Stakeholders & Sustainability

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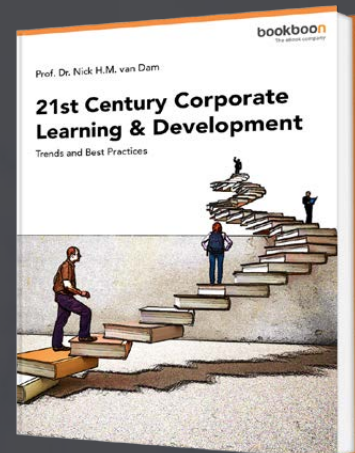
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# 1 Defining Corporate Social Responsibility

CSR "analyses economic, legal, moral, social and physical aspects of environment".

Barnard (1938)

*...being the managers of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they ... consider attention to small matters as not for their master's honour and very easily give themselves a dispensation from having it.*

## 1.1 Introduction

Corporate Social Responsibility (or CSR as we will call it throughout this book) is a concept which has become dominant in business reporting. Every corporation has a policy concerning CSR and produces a report annually detailing its activity. And of course each of us claims to be able to recognise corporate activity which is socially responsible and activity which is not socially responsible. There are two interesting points about this: firstly we do not necessarily agree with each other about what is socially responsible; and although we claim to recognise what it is or is not when we are asked to define it then we find this impossibly difficult. Thus the number of different definitions is huge and in this chapter we will look at some of these.

## 1.2 Definitions of CSR

The broadest definition of corporate social responsibility is concerned with what is – or should be – the relationship between global corporations, governments of countries and individual citizens. 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 each represents a dimension of the issue. A parallel debate is taking place in the arena of ethics – should corporations be controlled through increased regulation or has the ethical base of citizenship been lost and needs replacing before socially responsible behaviour will ensue? However this debate is represented it seems that it is concerned with some sort of social contract between corporations and society.



This social contract implies some form of altruistic behaviour – the converse of selfishness – whereas self-interest connotes selfishness. Self-interest is central to the Utilitarian perspective championed by such people as Bentham, Locke and J.S. Mill. The latter, for example, is generally considered to have advocated as morally right the pursuit of the greatest happiness for the greatest number – although the Utilitarian philosophy is actually much more based on selfishness than this – something to which we will return later. 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. 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 – which we will also return to later – because of implications for other members of society both now and in the future.

There is however no agreed definition of CSR so this raises the question as to what exactly can be considered to be corporate social responsibility. According to the EU Commission [(2002) 347 final: 5],

“...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.”

### 1.2.1 Corporations are part of society

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 should be to report upon the impact of an organisation in this respect. Such a suggestion 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.

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. Thus Hetherington (1973:37) states

“There is no reason to think that shareholders are willing to tolerate an amount of corporate non-profit activity which appreciably reduces either dividends or the market performance of the stock.”

Conversely, writing at a similar time, Dahl (1972:18) states

“...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.”

Similarly Carroll (1979), one of the early CSR theorists states that:

“business encompasses the economic, legal, ethical and discretionary expectations that society has of organization at a given point in time.”

More recently this was echoed by Balabanis, Phillips and Lyall (1998), who declared that:

“in the modern commercial area, companies and their managers are subjected to well publicised pressure to play an increasingly active role in [the welfare of] society.”

### 1.2.2 Profit is all that matters

Some writers have taken the view that a corporation should not be concerned with social responsibility and you are certain to come across the statement from Milton Friedman, made in 1970:

“there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.”

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Equally some people are more cynical in their view of corporate activity. So Drucker (1984) had the opinion that:

“business turns a social problem into economic opportunity and economic benefit, into productive capacity, into human competence, into well-paid jobs, and into wealth.”

### 1.2.3 CSR is conditional

While Robertson and Nicholson (1996) thought that:

“a certain amount of rhetoric may be inevitable in the area of social responsibility. Managers may even believe that making statements about social responsibility insulates the firm from the necessity of taking socially responsible action.”

Moir (2001) is more ambivalent:

“whether or not business should undertake CSR, and the forms that responsibility should take, depends upon the economic perspective of the firm that is adopted.”

So we can see that CSR is a contested topic and it is by no means certain that everybody thinks that it is important or relevant to modern business.

## 1.3 The effects of organisational activity

It is apparent of course 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. This effect of the organisation can take many forms, such as:

- The utilisation of natural resources as a part of its production processes
- 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
- And more recently the greatest concern has been with climate change and the way in which the emission of greenhouse gases are exacerbating this.

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.

“We are now, more than ever, aware of the potentially negative impact of business on the environment, whatever the nature or size of the business. There can only be positive results from developing sustainability – from benefiting your own bottom line to benefiting tomorrow’s industry to benefiting the environment in which we all live.”

– Tony Blair, UK Prime Minister, May 2000

## 1.4 The principles of CSR

Because of the uncertainty surrounding the nature of CSR activity it is difficult to define CSR and to be certain about any such activity. It is therefore imperative to be able to identify such activity and we take the view that there are three basic principles which together comprise all CSR activity. These are:

- Sustainability;
- Accountability;
- Transparency.

Sustainability will be considered in detail in chapter 4 while accountability and transparency will be considered in chapter 5. So here we will just outline the concepts.

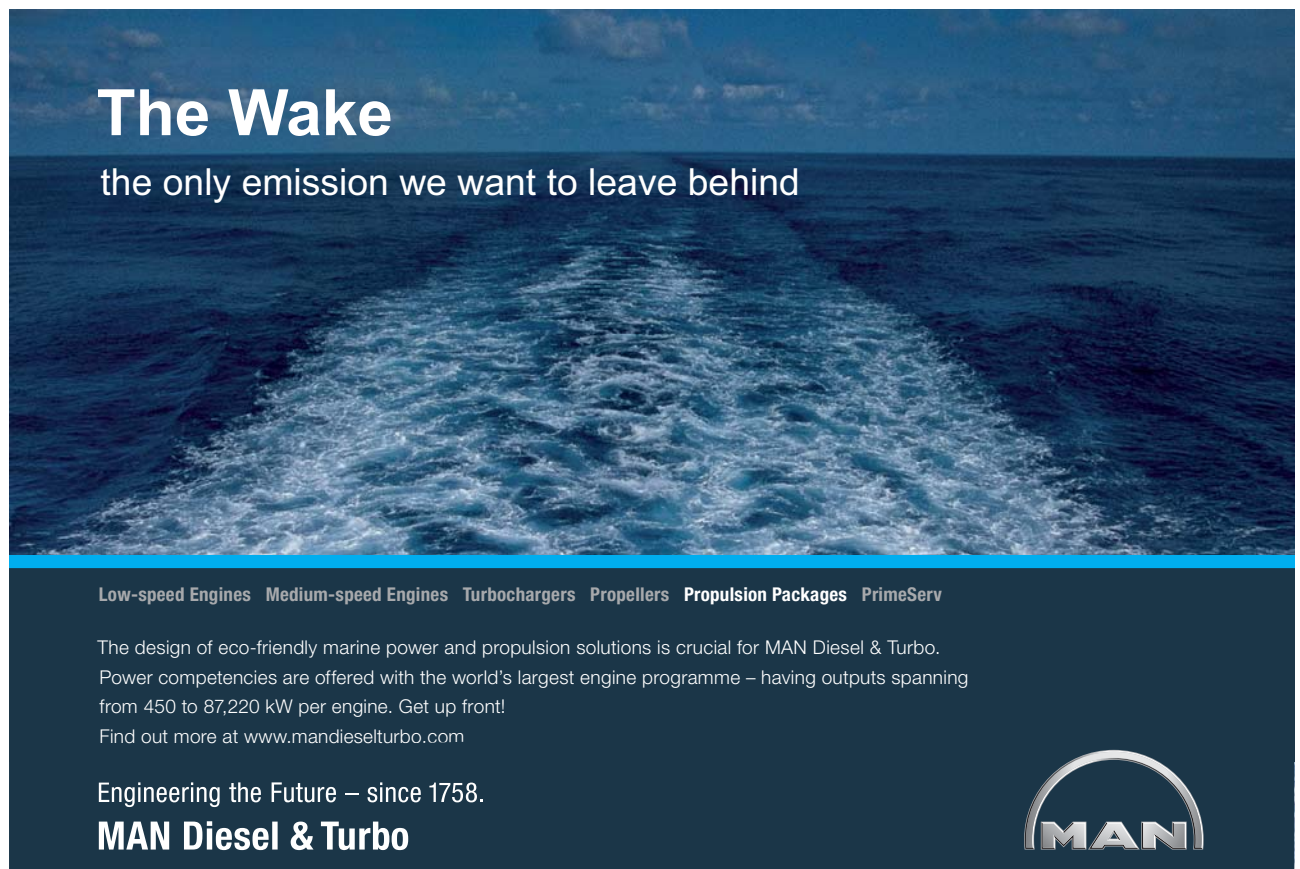
### 1.4.1 Sustainability

This is concerned with the effect which action taken in the present has upon the options available in the future. 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<sup>1</sup>.

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.

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. 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.




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### 1.4.2 Accountability

This 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 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 there 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 costs on the part of the organisation in developing, recording and reporting such performance and to be of value the benefits 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 qualitiveness 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. Although this limitation is problematic for the development of environmental accounting it is in fact useful to the managers of organisations as this limitation of comparability alleviates the need to demonstrate good performance as anything other than a semiotic.

### 1.4.3 Transparency

Transparency, as a principle, means that 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 and equally 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 transferring power to external stakeholders.

### 1.5 Conclusion

There is a sound business case for social responsibility

– Department of Trade & Industry (DTI)

As we can see, CSR is a broad subject which leads to a variety of opinions and can be considered in a number of different ways. In the rest of the book we will look at these aspects in more detail and at the actual implementation of CSR in a business.

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## 1.8 Self-test Questions

1. What are the principles of CSR?
2. Should CSR be a voluntary activity?
3. What is the relationship between CSR and profit?
4. What is the approach of the European Community to CSR?



## 2 The principles of CSR

### The principles of CSR

Accountability

Transparency

Sustainability

### 2.1 Introduction

In the last chapter we outlined the three main principles upon which CSR is based. As we explained, this gives a basis for the measurement and evaluation of performance while also giving flexibility for an organisation to consider its own socially and environmentally significant factors and plan accordingly without being compared favourably or unfavourably with organisations with different priorities. In this chapter therefore we are going to look at these principles in more detail.

### 2.2 The prominence of CSR

It is quite noticeable how much more prominent corporate social responsibility (CSR) has become – not just in the academic world and in the business world but also in everyday life. We can highlight a lot of factors which have led to this interest – such things as:

- Poor business behaviour towards customers
- Treating employees unfairly
- Ignoring the environment and the consequences of organisational action.

Since then other things have also featured prominently in popular consciousness. One of these which has become more pronounced is the issue of climate change and this has affected concern about CSR through a concern with the emission of greenhouse gases and particularly carbon dioxide. Nowadays it is quite common for people to know and discuss the size of their carbon footprint whereas even three years ago people in general did not even know what a carbon footprint was.

Another thing which has become prominent is a concern with the supply chain of a business; in other words with what is happening in other companies which that company does business with – their suppliers and the suppliers of their suppliers. In particular people are concerned with the exploitation of people in developing countries, especially the question of child labour but also such things as sweat shops.

So no longer is it acceptable for a company to say that the conditions under which their suppliers operate is outside of their control and so they are not responsible. Customers have said that this is not acceptable and have called companies to account. And there have recently been a number of high profile retail companies which have held their hands up to say *mea culpa*<sup>2</sup> and taken very public steps to change this.

Interestingly the popularity of companies increases after they have admitted problems and taken steps to correct these problems. In doing this they are thereby showing both that honesty is the best practice and also that customers are reasonable. The evidence suggests that individual customers are understanding and that they do not expect perfection but do expect honesty and transparency. Moreover they also expect companies to make efforts to change their behaviour and to try to solve their CSR problems.

### 2.3 Changing emphasis in companies

Companies themselves have also changed. No longer are they concerned with greenwashing – the pretence of socially responsible behaviour through artful reporting. Now companies are taking CSR much more seriously not just because they understand that it is a key to business success and can give them a strategic advantage, but also because people in those organisations care about social responsibility.

So it would be reasonable to claim that the growing importance of CSR is being driven by individuals who care – but those individual are not just customers, they are also employees, managers, owners and investors of a company. So companies are partly reacting to external pressures and partly leading the development of responsible behaviour and reporting. So accountability – one of the central principles of CSR – is much more recognised and is being responded to by increasing transparency – another of the principles of CSR.

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### 2.3.1 Sustainability

The third principle of CSR is that of sustainability and this is a term which has suddenly become so common as to be ubiquitous for business and for society. Every organisation mentions sustainability and most claim to have developed sustainable practices. A lot of this is just rhetoric from people who, we would claim, do not want to face the difficult issues involved in addressing sustainability. There is a danger therefore that sustainability has taken over from CSR itself as a target for greenwashing. Nevertheless although the relationship between organisations and society has been subject to much debate, often of a critical nature, evidence continues to mount that the best companies make a positive impact upon their environment.

Furthermore the evidence continues to mount that such socially responsible behaviour is good for business, not just in ethical terms but also in financial terms – in other words that corporate social responsibility is good for business as well as all its stakeholders. Thus ethical behaviour and a concern for people and for the environment have been shown to have a positive correlation with corporate performance. Indeed evidence continues to mount concerning the benefit to business from socially responsible behaviour and, in the main, this benefit is no longer questioned by business managers. The nature of corporate social responsibility is therefore a topical one for business and academics.

### 2.3.2 Recognising CSR

Most people initially think that they know what CSR is and how to behave responsibly – and everyone claims to be able to recognise socially responsible or irresponsible behaviour without necessarily being able to define it. So there is general agreement that CSR is about a company's concern for such things as community involvement, socially responsible products and processes, concern for the environment and socially responsible employee relations (Ortiz-Martinez & Crowther 2006).

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). According to the European Commission CSR 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 practice sustainability; how to report this activity to those interested; how to decide if one activity more socially responsible than another. The situation is complex and conflicting. In this book therefore the contributors are concerned with different aspects of CSR, both with theorising and with implementing CSR in practice.

## 2.4 Environmental issues and their effects and implications

When an organisation undertakes an activity which impacts upon the external environment then this affects that environment in ways which are not reflected in the traditional accounting of that organisation. The environment can be affected either positively, through for example a landscaping project, or negatively, through for example the creation of heaps of waste 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 accounting of the firm<sup>3</sup>, 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 quantification of the effect of such externalisation, particularly from an accounting viewpoint, is problematical and not easy to measure<sup>4</sup>, 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 organisation 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.

## 2.5 Externalising costs

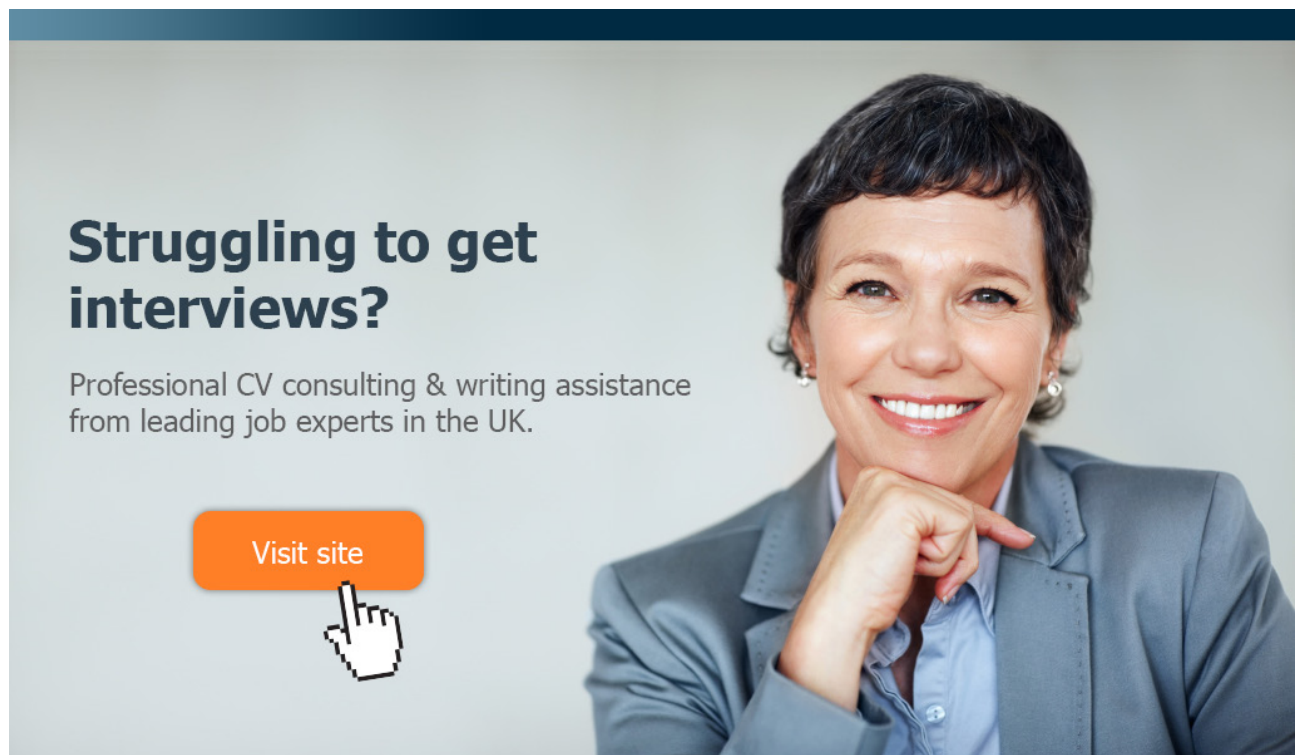
As far as the externalisation of costs is concerned it is important to recognise that these can be externalised both spatially and temporally.

### 2.5.1 Spatial externalisation

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 through such things as polluted – and therefore dead – rivers or through increased traffic imposes costs upon the local community through reduced quality of life;
- Causing pollution 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.



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### 2.5.2 Temporal externalisation

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 problem 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 in the 1930's to 1960's 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 to be deferred to a later time period, was therefore incurred unintentionally. Equally such costs may at the present time be in 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.

For example, if we consider the nuclear power generation industry it is now generally accepted that if the full costs of generating power by this means, which would include the costs of disposing of nuclear waste and the costs of decommissioning nuclear generators at the end of their working life, had been taken into account then the idea of power generation by this means would never have been put into operation.

Nevertheless nuclear power is again being considered in a lot of countries as the only realistic solution to global warming. Nuclear power stations emit minimal amounts of greenhouse gases and so are attractive for that reason. Of course their future costs are again being ignored and so temporarily externalised.

We can see therefore that if we take externalities into account that the decisions made and actions taken by firms may be very different. We can equally see that the recognition of the effect upon these externalities of actions taken by an organisation can have significant impact upon the activities of the organisation and that the way in which an organisation chooses to internalise or externalise its costs can have a significant impact upon its operational performance.

## 2.6 The Social Contract

It is impossible that such governments as have hitherto existed in the world, could have commenced by any other means than a total violation of every principle sacred and moral

The Rights of Man (Paine 1792)

In 1762 Jean-Jacques Rousseau produced his book on the Social Contract which was designed to explain – and therefore legitimate – the relationship between an individual and society and its government. In it he argued that individuals voluntarily gave up certain rights in order for the government of the state to be able to manage for the greater good of all citizens. This is of course a sharp contrast to the angry rhetoric of Tom Paine, shown above. Nevertheless the idea of the Social Contract has been generally accepted.

More recently the Social Contract has gained a new prominence as it has been used to explain the relationship between a company and society. In this view the company (or other organisation) has obligations towards other parts of society in return for its place in society.

This can be depicted thus:

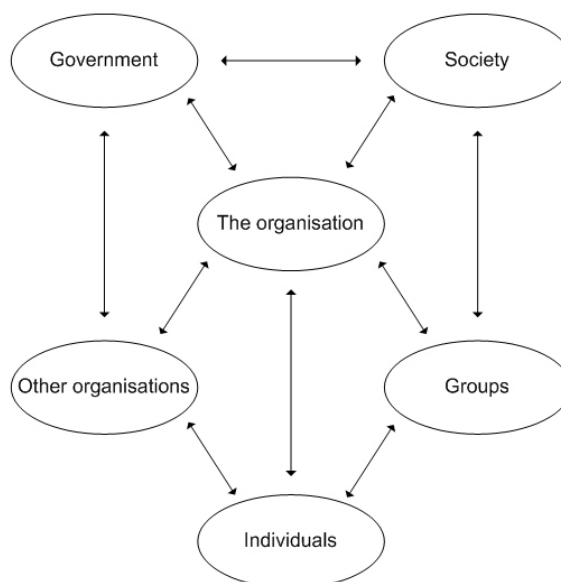


Fig 2.1 The Social Contract

This in turn led to the development of Stakeholder Theory, which we will consider in the next chapter.

## 2.7 Conclusions

As we have seen, CSR has gained in prominence in recent years. It has also changed in nature as different issues have become more prominent. We have considered these changes and looked in particular at environmental issues and the way in which the effects and associated costs can be externalised away from the company itself. This is of particular significance when we consider stakeholders in the next chapter.

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## 2.10 Self-test Questions

1. What has led to the current interest in CSR?
2. What is greenwashing?
3. What is cost externalisation? Why does it happen?
4. What is the Social Contract? Why has it become prominent in CSR?

# 3 Stakeholders & the social contract

"There is no reason to think that shareholders are willing to tolerate an amount of corporate non-profit activity which appreciably reduces either dividends or the market performance of the stock."

Hetherington 1973

"...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".

Dahl 1972

## 3.1 Introduction

Although we considered the social contract in the last chapter we now need to consider it in relationship to stakeholders and to Stakeholder theory. This theory is one of the major influences on CSR.

## 3.2 What is a stakeholder?

There are several definitions. The most common ones are:

- Those groups without whose support the organization would cease to exist
- Any group or individual who can affect or is affected by the achievement of the organization's objectives

We can see from these definitions that a lot of people can be a stakeholder to an organisation. The most common groups who we consider to be stakeholders include:

- Managers
- Employees
- Customers
- Investors
- Shareholders
- Suppliers

Then there are some more generic groups who are often included:

- Government
- Society at large
- The local community

Many people consider that only people can be stakeholders to an organisation. Some people extend this and say that the environment can be affected by organisational activity. 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
- 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
- pollution caused by increased volumes of traffic and increased journey times because of those increased volumes of traffic

Thus many people also consider that there is an additional stakeholder to an organisation, namely:

- The environment

As we will see in the next chapter the actions of an organisation have a big effect upon future possibilities. It is for this reason that we also add one extra stakeholder:

- The future

It should be noted however that others do not generally include the future as a stakeholder.

### 3.3 Multiple stakeholding

It is normal to consider all of these stakeholder groups separately. It should be noted however that each person will belong to several stakeholder groups at the same time. For example a single person might be a customer of an organisation and also an employee and a member of the local community and of society at large. He or she may also be a shareholder and a member of a local environmental association and therefore concerned about the environment. Most probably that person will also be concerned about the future also, on their own behalf or on behalf of their children.

We can therefore see that it is often not helpful to consider each stakeholder group in isolation and to separate their objectives. Reality is more complex.

### 3.4 The classification of stakeholders

There are two main ways to classify stakeholders:

#### Internal v external

Internal stakeholders are those included within the organisation such as employees or managers whereas external stakeholders are such groups as suppliers or customers who are not generally considered to be a part of the organisation. Although this classification is fine it becomes increasingly difficult in a modern organisation to distinguish the two types when employees might be subcontractors and suppliers might be another organisation within the same group.

#### Voluntary v involuntary

Voluntary stakeholders can choose whether or not to be a stakeholder to an organisation whereas involuntary stakeholders cannot. For example an employee can choose to leave the employment of the organisation and therefore is a voluntary stakeholder. The local society or the environment are not able to make this choice and must therefore be considered to be involuntary stakeholders.

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### 3.5 Stakeholder Theory

The argument for Stakeholder Theory is based upon the assertion that maximising wealth for shareholders fails to maximise wealth for society and all its members and that only a concern with managing all stakeholder interests achieves this

Stakeholder theory states that all stakeholders must be considered in the decision making process of the organisation. The theory states that there are 3 reasons why this should happen:

- It is the morally and ethically correct way to behave
- Doing so actually also benefits the shareholders
- It reflects what actually happens in an organisation

As far as this third point is concerned then this is supported by research from Cooper et al (2001) into large firms. This research shows that the majority of firms are concerned with a range of stakeholders in their decision making process:

Stakeholder	Concerned with %	Very concerned with %
Customers	89	59
Employees	89	51
Shareholders	100	78
Suppliers	70	3
The environment	62	5
Society	73	3

**Fig 3.1** Stakeholder inclusion in decision making

According to this theory, stakeholder management, or corporate social responsibility, is not an end in itself but is simply seen as a means for improving economic performance. This assumption is often implicit although it is clearly stated by Atkinson, Waterhouse and Wells (1997) and is actually inconsistent with the ethical reasons for adopting stakeholder theory. Instead of stakeholder management improving economic, or financial, performance therefore it is argued that a broader aim of corporate social performance should be used (Jones and Wicks, 1999).

Furthermore, Jones and Wicks note that certain ethicists need no instrumental justification as moral behaviour “is, and must be, its own reward”. Waddock and Graves (1997) consider whether stakeholder management enhances corporate social performance, as opposed to financial performance, and they find a positive relationship.

### 3.5.1 Details of Stakeholder Theory

A fundamental aspect of stakeholder theory, in any of its aspects, is that it attempts to identify numerous different factions within a society to whom an organisation may have some responsibility. It has been criticised for failing to identify these factions (Argenti, 1993) although some attempts have been made. Indeed Sternberg (1997) suggests that the second of Freeman's definitions of stakeholder (see above), which is now the more commonly used, has increased the number of stakeholders to be considered by management adopting a stakeholder approach to; in fact this definition includes virtually everything whether alive or not.

However attempts have been made by stakeholder theorists to provide frameworks by which the relevant stakeholders of an organisation can be identified Clarkson (1995) suggests that a stakeholder is relevant if they have invested something in the organisation and are therefore subject to some risk from that organisation's activities. He separated these into two groups: the voluntary stakeholders, who choose to deal with an organisation, and the involuntary stakeholders, who do not choose to enter into – nor can they withdraw from – a relationship with the organisation. Mitchell, Agle and Wood (1997) develop a framework for identifying and ranking stakeholders in terms of their power, legitimacy and urgency. If a stakeholder is powerful, legitimate and urgent then its needs will require immediate attention and given primacy.

Irrespective of which model is used, it is not controversial to suggest that there are some generic stakeholder groups that will be relevant to all organisations. Clarkson (1995) suggests that the voluntary stakeholders include shareholders, investors, employees, managers, customers and suppliers and they will require some value added otherwise they can withdraw their stake and choose not to invest in that organisation again. It is argued that involuntary stakeholders such as individuals, communities, ecological environments, or future generations do not choose to deal with the organisation and therefore may need some form of protection may be through government legislation or regulation. Other more specific interest groups may be relevant for certain industries due to the nature of the industry or the specific activities of the organisation.

For example utility industries have been regulated by a regulator since privatisation and thus the regulator is a stakeholder of these organisations. Similarly certain industries are more environmentally, politically or socially sensitive than others and therefore attract more attention from these stakeholder groups, again the water or nuclear industries provide examples here.

### 3.5.2 Informational needs

Stakeholder management has significant informational needs. It is extremely difficult to manage for a variety of stakeholders if there is no measurement of how the organisation has performed for those stakeholders. Thus for each stakeholder identified it is necessary to have a performance measure by which the stakeholder performance can be considered. Due to the nature of the stakeholders and their relationship with the organisation this will not necessarily be easy not it will necessarily be possible in monetary terms.

Therefore non-financial measures will be of great importance but this information is often considered more subjective than financial information. Therefore measures of customer satisfaction are sometimes based on surveys and sometimes on statistical performance measures such as numbers of complaints or returns, or market share or customer retention. Recently there have been a number of multi-dimensional performance measurement frameworks that can be argued to have some level of stakeholder orientation.

Probably the best known of the multi-dimensional performance measurement frameworks is the “balanced scorecard” (Kaplan and Norton 1992, 1993, 1996a, 1996b). Another example is the service profit chain (Heskett et al. 1994) that specifically considers three stakeholders; namely employees, customers and shareholders. Again this model specifically considers the first two stakeholders as means to achieving superior financial results.



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Thus they argue that satisfied and motivated employees are essential if service quality is to be of a high standard and hence customers are to be satisfied. Further it is then argued that satisfied customers provide the base for superior financial results. Both of these models acknowledge the needs of stakeholder groups and thus deem it necessary to measure performance for these groups but still target financial performance as the ultimate goal.

A stakeholder managed organisation therefore attempts to consider the diverse and conflicting interests of its stakeholders and balance these interests equitably. The motivations for organisations to use stakeholder management maybe in order to improve financial performance or social or ethical performance howsoever these may be measured. In order to be able to adequately manage stakeholder interests it is necessary to measure the organisation's performance to these stakeholders and this can prove complicated and time-consuming.

Recently the Centre for Business Performance, Cranfield University, has set up a "Catalogue of measures" related to their Performance Prism that contains measures of each of the "dimensions of performance" – stakeholder satisfaction; strategies; processes; capabilities; and stakeholder contributions. The stakeholders identified were customer, employee, investor, regulator & community, and suppliers and in total the catalogue includes over 200 relevant measures.

This shows the vast number of stakeholder measures that could be used to any organisation although it is not expected that all of these will be relevant for an individual organisation. This again highlights the potential complexity of measuring performance for stakeholders as these numerous measures will provide conflicting evidence on performance that somehow must be reconciled. In comparison VBM techniques that propose the use of a single metric to measure performance as well as set objectives and reward executives appear far simpler.

### 3.6 Regulation and its implications

As we will see later in the book, the disclosure of the actions of the firm in terms of their impact upon the external environment is essentially voluntary in nature – but this does not necessarily mean that the actions themselves are always voluntary. Nor does it mean that all such disclosure is necessarily voluntary.

The regulatory regime which operates in any particular country 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 that country – both the national government and local government.



For example those regulations probably 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<sup>5</sup>. 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.

### 3.6.1 Environmental Impact Reporting

As the extent of regulation of such activities can be expected to increase in the future therefore 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 environmental accounting and reporting among 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. 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 later. 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.

When the UK government, for example, initiated its process of the privatisation of nationally owned utilities it was felt necessary to compensate for the inadequacy of the market mechanism for mediating between the conflicting needs of the stakeholders to these industries. Thus the concept of regulation was devised, with appropriate bodies formed, to compensate for the imperfections of competition in the quasi-markets which came into being.

One of the functions of the regulators created in this manner was to control the prices charged by these privatised utilities in order to ensure that the benefits and efficiencies gains vaunted as a benefit of privatisation were shared between shareholders and other stakeholders, principally the customers. Thus the regulators were to act as the very visible, “invisible” hand of the market. The main mechanism for this has been achieved by means of a periodic review of pricing policy. For other industries however the effects of regulation vary in extent but in general terms can be stated to be increasing over time and this increase can be expected to continue into the future.

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### 3.7 Risk Reducing

One thing which is of particular importance for all corporations, and is becoming more important is the matter of risk and the managing of that risk. A stakeholder approach to decision making and managing the organisation is likely to identify more risks and to manage them better<sup>6</sup>. Risk is also very related to sustainability (see the next chapter) and we will show that the lack of a full understanding of what is meant by sustainability, and particularly by sustainable development, means that the issue is confused in corporate planning and reporting (Aras & Crowther 2008).

This allows for the kind of confusion which is taking place. We do not necessarily claim that such obfuscation is deliberate but we do suggest that it indicates a certain amount of disingenuity, which it is convenient for corporations to exhibit. Moreover we suggest that 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 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.

Once all the data has been recognised, collected and quantified it then becomes possible to incorporate this data, in financial terms, into an evaluation which incorporates risk in a more consistent manner. It is important to recognise benefits as well as costs, and it is perhaps worth reiterating that many of these benefits are less subject to quantification and are of the less tangible and image related kind. Examples include:

- Enhanced company or product image – this in itself can lead to increased sales
- Health and safety benefits
- Ease of attracting investment and lowered cost of such investment
- Better community relationships – this can lead to easier and quicker approval of plans through the planning process
- Improved relationship with regulators, where relevant
- Improved morale among workers, leading to higher productivity, lower staff turnover and consequently lower recruitment and training costs
- General improved image and relationship with stakeholders

Many of these benefits are not just intangible but will take some time to realise. Hence the need to select an appropriate time horizon for the evaluation of the risk and associated effects. This time horizon will very likely be a longer one than under a traditional financially based evaluation. Obviously cash flows need to be considered over that period and an appropriate method of evaluation (eg a discounted cash flow technique) needs to be used in the evaluation.

None of this will change with the incorporation of environmental accounting information, except for assessment of risk and its associated impact upon the cost of capital, which can be expected to rise as the true extent of the environmental impact is fed into the calculation.

The steps involved in the incorporation of environmental accounting into the risk evaluation system can therefore be summarised as follow:

- Identify environmental implications in term of costs and benefits
- Quantify those costs and incorporate qualitative data regarding less tangible benefits
- Use appropriate financial indicators
- Set an appropriate time horizon which allows environmental effects to be fully realised

### 3.8 Conclusions

Stakeholder Theory is one approach to the managing of an organisation. It is particularly important for an understanding of CSR and its incorporation into organisational activity. There are various aspects to this which we have considered in this chapter. At the same time we have introduced a variety of other aspects which are related. Our purpose is to show that all of these concepts are inter-related in the management of an organisation and that CSR cannot be considered in isolation from the rest of organisational activity. We will see this more clearly throughout this book.

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### 3.11 Self-test Questions

1. What justification does Stakeholder Theory use for considering stakeholders?
2. How can we classify stakeholders?
3. Name a multi-dimensional performance measurement framework.
4. What are the steps involved in the incorporation of environmental accounting into the risk evaluation system of an organisation?

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# 4 Issues concerning Sustainability

People of the same trade seldom meet together, even for merriment or diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law which could either be executed, or would be consistent with liberty and justice.

Adam Smith

## 4.1 Introduction

Of the three principles of CSR the one which is most prominent at the present time is sustainability. Consequently we are devoting a complete chapter to dealing with this topic. It is one that has recently become very important for businesses and all large businesses – and many smaller ones – have a sustainability plan, or at least claim to have such a plan. We need therefore to start by establishing exactly what we mean by sustainability.

## 4.2 Defining sustainability

Sustainability is concerned with the effect which action taken in the present has upon the options available in the future. The starting point for every definition of sustainability comes from the Brundtland Report, which was published in 1987. This is actually a report named *Our Common Future* which was produced by the World Commission on Environment and Development. It is generally known however as the Brundtland Report after its chair.

Strictly speaking the Brundtland Report was concerned with sustainable development which they regarded as unquestioningly both possible and desirable. This definition of sustainability starts from the premise that if resources are utilised in the present then they are no longer available for use in the future. This has led to the standard definition of sustainable development which states that this is:

“Development which meets the needs of the present without compromising the ability of future generations to meet their own needs”

This principle has been incorporated in the Maastricht and Amsterdam Treaties on European Union, as well as in the Rio Declaration and Agenda 21, adopted by the United Nations Conference on Environment and Development (UNCED), meeting in Rio de Janeiro 3 to 14 June 1992. The European Community and its Member States subscribed to the Rio Declaration and Agenda 21 and committed themselves to the rapid implementation of the principal measures agreed at UNCED.

### 4.3 The Brundtland Report

This report is considered to be extremely important in addressing the issue of sustainability. The report described seven strategic imperatives for sustainable development:

- Reviving growth;
- Changing the quality of growth;
- Meeting essential needs for jobs, food, energy, water and sanitation;
- Ensuring a sustainable level of population;
- Conserving and enhancing the resource base;
- Reorienting technology and managing risk;
- Merging environment and economics in decision-making.

It also emphasized that the state of our technology and social organisation, particularly a lack of integrated social planning, limits the world's ability to meet human needs now and in the future.

This report makes institutional and legal recommendations for change in order to confront common global problems. More and more, there is a growing consensus that firms and governments in partnership should accepted moral responsibility for social welfare and for promoting individuals' interest in economic transactions (Amba-Rao, 1993).

Significantly however the Bruntland report made an assumption – which has been accepted ever since – that sustainable development was possible and the debate since has centred on how to achieve this. Thus ever since the Bruntland Report was produced by the World Commission on Environment and Development in 1987 there has been a continual debates concerning sustainable development. Similarly emphasis has been placed on such things as collaboration, partnerships and stakeholder involvement. It has however been generally accepted that development is desirable and that sustainable development is possible – with a concomitant focus on how to achieve this. Quite what is meant by such sustainable development has however been much less clear and a starting point for any evaluation must be to consider quite what is meant by these terms.



There is a considerable degree of 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 & Milstein 2003) and the terms sustainability and sustainable development are for many viewed as synonymous. For us we take the definition as being concerned with stasis (Aras & Crowther 2008a); 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. Moreover, sustainable development is often misinterpreted as focusing solely on environmental issues. In reality, it is a much broader concept as sustainable development policies encompass three general policy areas: economic, environmental 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*.

#### 4.4 Critiquing Brundtland

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 glib assumptions that sustainable development is both desirable and possible and that corporation can demonstrate sustainability merely by continuing to exist into the future.



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The problem with Brundtland is that its concern with the effect which action taken in the present has upon the options available in the future has directly led to glib assumptions that sustainable development is both desirable and possible and that corporation can demonstrate sustainability merely by continuing to exist into the future (Aras & Crowther 2008b). It has also led to an acceptance of what must be described as the myths of sustainability:

- Sustainability is synonymous with sustainable development;
- A sustainable company will exist merely by recognising environmental and social issues and incorporating them into its strategic planning.

Both are based upon an unquestioning acceptance of market economics predicated in the need for growth and are based upon the false premise of Brundtland to which we will return later. An almost unquestioned assumption is that growth remains possible and therefore sustainability and sustainable development are synonymous. Indeed the economic perspective considers that growth is not just possible but also desirable and therefore 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.

Concomitantly all corporations are becoming concerned about their own sustainability and what the term really means. Such sustainability means more than environmental sustainability. As far as corporate sustainability is concerned then the confusion is exacerbated by the fact that the term sustainable has been used in the management literature over the last 30 years to merely imply continuity. Thus Zwetsloot (2003) is able to conflate corporate social responsibility with the techniques of continuous improvement and innovation to imply that sustainability is thereby ensured. Consequently the trajectory of all of these effects is increasingly being focused upon the same issue.

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 all that is necessary in order to ensure not just sustainability but to also enable sustainable development. And all corporations imply that they have recognised the problems, addressed the issues and thereby ensured sustainable development. Let us start with the Triple Bottom Line – 3 aspects of performance:

- Economic
- Social
- Environmental

It is our argument that these conceptions are not just incorrect but also positively misleading through an obfuscation of the key issues and have led to an inevitable outcome of fallacious complacency. It is therefore time to re-examine the legacy of Brundtland and to redefine what is meant by sustainable activity.

In order to do this we reject the accepted terms of sustainability and sustainable development, preferring instead the term durability to emphasise the change in focus. From this we argue for a rejection of the Triple Bottom Line as insufficiently refined for practical use, suggesting instead alternatives developed from our own work.

#### 4.5 Sustainability and 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<sup>7</sup> of their actual operations.

BP provide a good illustration of the confusion between sustainability and continued existence. In their 2006 report<sup>8</sup> is stated:

*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.*

It would be misleading to single out oil companies however. Other examples of companies with sustainability issues include:

#### **BAT<sup>9</sup>:**

*We are committed to the principles of sustainable development – development that meets the needs of the present, without compromising the ability of future generations to meet their own needs.*

*Sustainable development came to the fore in the 1980s, when the United Nations examined some of the world's largest problems, including poverty, overpopulation, famine, drought, deforestation and climate change. It gained important impetus when the 1992 Earth Summit in Rio de Janeiro approved the Agenda 21 framework, which emphasised improving and sustaining quality of life, especially for the world's poor, without destroying the environment.*

**Ryanair<sup>10</sup>:**

*Ryanair is Europe's original and largest low fares airline. Ryanair's steady growth is being achieved in the most environmentally friendly and sustainable way by investing in the latest aircraft and engine technologies (which have reduced fuel burn and CO2 emissions by 45% over the past 9 years) and the implementation of certain operational and commercial decisions that help to further minimise environmental impacts (by an additional 10% between 1998 and 2007). Ryanair is currently the industry leader in terms of environmental efficiency and it is constantly working towards further improving its performance.*



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All businesses<sup>11</sup> recognise the business benefits of CSR activity in their reporting. Equally all business recognise that sustainability is important and it features prominently in their reporting. For example an investigation of the FTSE100 companies (see Aras & Crowther 2007a) reveals the following:

Mention on corporate website	% of companies
Sustainability	100
Sustainable development	35
Expressly link sustainability to CSR policy	70

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 discussed in this paper, 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. 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.

#### 4.6 Redefining sustainability

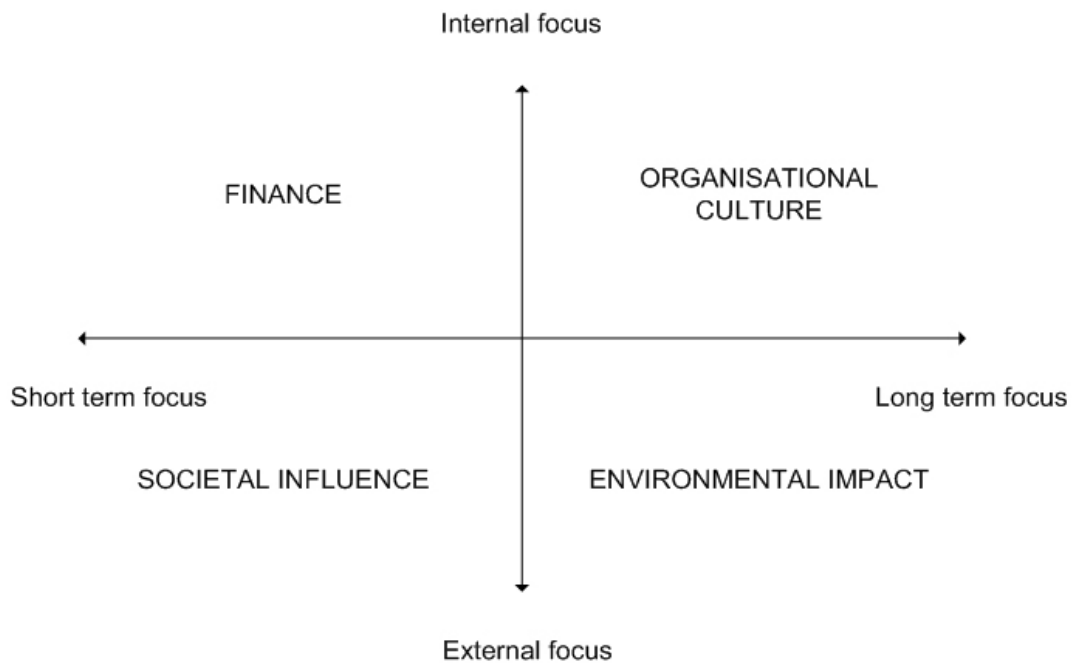
It is therefore time to re-examine the legacy of Brundtland and to redefine what is meant by sustainable activity.

These are the component of sustainability:

- *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 are all necessary in order to ensure not just sustainability but to also enable sustainable development. Moreover it is the balance between them which is crucial.

These four must be considered as the key dimensions of sustainability, all of which are equally important. This analysis is therefore considerably broader – and more complete – than that of others. Furthermore Aras & Crowther (2007b, 2007c) consider that these four aspects can be resolved into a two-dimensional matrix along the polarities of internal v external focus and short term v long term focus, which together represent a complete representation of organisational performance this can be represented as the model below:



**Fig 4.1** Model of Corporate Sustainability (Aras & Crowther 2007b)

These can be described differently:

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

#### 4.7 Distributable sustainability

At this point we deliberately use 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.

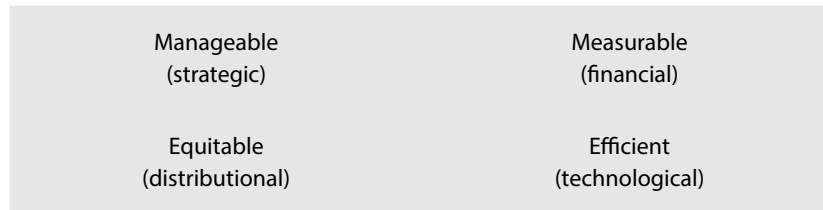


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**Fig 4.2** Distributable sustainability (Aras & Crowther 2009)

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 4 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.

#### 4.8 Summarising Sustainability

To summarise, sustainability requires a radical rethink and a move away 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 (i.e. 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



## 4.9 Conclusions

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 satisfying of all stakeholders, and not merely the provision of returns to owners and investors. These are the prerequisites for sustainable development.

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.



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#### 4.12 Self-test Questions

1. What does the Triple Bottom Line consist of?
2. What are the 4 factors of sustainability?
3. What are the factors of distributable sustainability?
4. What is Brundtland and why is it important?

# 5 Ethics, CSR and Corporate Behavior

In Britain during the last four decades, within a market economy driven by consumer preference and purchasing capacity, greater economic leisure has provided the opportunity to both analyse and reflect on the underlying nature and direction of a demand led economic system. There is an increasing requirement for information on the social and environmental impact of corporate policy and appraisal effects. The movements for healthy eating, ethical investment and, above all environmental concern have played a big part in awakening the consumer's social awareness.... The very process by which the majority in the West have become affluent is increasingly being questioned by some of its beneficiaries. Can we go on like this? Is it sustainable? Is the whole system flawed and ultimately self destructive? These questions are being asked not just by pressure groups but also by individuals, by business, by governments and global institutions.

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## 5.1 Introduction

Ethics is not new for people in business. The corporate world has always had some rules, standards and norms for doing business. However these are generally changing with some social and cultural basis which can be different country by country, even though we might expect universal rules. When the company applies these standards or norms as a part of their responsibility we can call them an ethical code of conduct of business. Moreover ethics is also inevitably part of business responsibility. Corporate behavior should be ethical and responsible; that is why corporate promises for their shareholders and stakeholders have to behave fair, ethical and equitable.

## 5.2 What is Ethics? The Why?

Ethics shows a corporation how to behave properly in their all business and operations. However, business ethics is characterized by conflicts of interests. Businesses attempt to maximize profits as a primary goal on one hand while they face issues of social responsibility and social service on the other. Ethics is the set of rules prescribing what is good or evil, or what is right or wrong for people. In other words, ethics is the values that form the basis of human relations, and the quality and essence of being morally good or evil, or right or wrong. Business Ethics means honesty, confidence, respect and fair acting in all circumstances. However, such values as honesty, respect and confidence are rather general concepts without definite boundaries. Ethics can also be defined as overall fundamental principles and practices for improving the level of wellbeing of humanity.

Ethics is the natural and structural process of acting in line with moral judgments, standards and rules. Being a concrete and subjective concept, “business ethics” can be discussed with differing approaches and in varying degrees of importance in different fields. Indeed, it is highly difficult to define ethics and identify its limits and criteria. Accordingly, there are difficulties in discussing this concept in literature as it is ubiquitous in business life, at the business level, and in human life. According to what, how, how much and for whom ethics is or should be are important questions. It is not always easy to find answers to these questions (Aras 2006).

A business which does not respect ethical criteria and fails to improve them will disrupt its integrity and unity, i.e., its capacity to achieve its goal, and lead to internal or external conflicts. Business ethics is the honest, respectful and fair conduct by a business and its representatives in all of its relations (Aras, 2006). A predicate question to the role of ethics in business is the question of why businesses engage in ethical practices. Some authors, notably Milton Friedman (1962), would strongly deny that a business has a fiduciary responsibility to any group but the firm’s stockholders.

To initiate corporate giving, for example, would be a fiduciary breach of management in Friedman’s opinion: an agent for a principal is neither legally nor morally permitted to give away or “waste” the principal’s capital (Joyner & Payne, 2002). Milton Friedman also argued that ‘there is only one social responsibility of business – use its resources and engage in activities designed to increase its profits so long as it...engages in open and free competition without deception and fraud’ (Friedman, 1962).

However, ethical behavior and ethical business has effects not only on stakeholders, and shareholders but also on the entire economy. We believe that when we act ethically in business decision-making process this will ensure more effective and productive utilization of economic resources.

### 5.3 Ethical philosophies

One component of the change to a concern with social responsibility and accountability has been the recognition (or reinstatement) of the importance of ethics in organisational activity and behaviour. In part this can be considered to be a recognition of the changing societal environment of the present time and in part a recognition of the problems brought about through corporate activity taken without any account of ethical implications. Among such activity can be seen the many examples of pollution (for example Union Carbide at Bhopal, India or the Exxon Valdez oil spill) and greed such as the Enron incident. These have caused a rethinking of the role of ethics in organisation theory.

Ethics is however a problematical area as there is no absolute agreement as to what constitutes ethical (or unethical) behaviour. For each of us there is a need to consider our own ethical position as a starting point because that will affect our own view of ethical behaviour. The opposition provided by deontological ethics and teleological ethics (regarding the link between actions and outcomes) (see below), and by ethical relativism and ethical objectivism (regarding the universality of a given set of ethical principles) represent key areas of debate and contention in the philosophy of ethics. This provides a starting point for our consideration of ethics.

#### 5.3.1 Deontological Ethics

According to deontologists certain actions are right or wrong in themselves and so there are absolute ethical standards which need to be upheld. The problems with this position are concerned with how we know which acts are wrong and how we distinguish between a wrong act and an omission. Philosophers such as Nagel argue that there is an underlying notion of right which constrains our actions, although this might be overridden in certain circumstances. Thus, there may be an absolute moral constraint against killing someone, which in time of war can be overridden.

#### 5.3.2 Teleological Ethics

Teleological theory distinguishes between 'the right' and 'the good', with 'the right' encompassing those actions which maximise 'the good'. Thus it is outcomes which determine what is right, rather than the inputs (i.e. our actions), in terms of ethical standards. This is the viewpoint which is promoted by Rawls in his 'A Theory of Justice'. Under this perspective, one's duty is to promote certain ends, and the principles of right and wrong organise and direct our efforts towards these ends.

### 5.3.3 Utilitarianism

Utilitarianism is based upon the premise that outcomes are all that matter in determining what is good and that the way in which a society achieves its ultimate good is through each person pursuing his/her own self interest. The philosophy states that the aggregation of all these self interests will automatically lead to the maximum good for society at large. Some Utilitarians have amended this theory to suggest that there is a role for government in mediating between these individual actions to allow for the fact that some needs can best be met communally.

### 5.3.4 Ethical Relativism

Relativism is the denial that there are certain universal truths. Thus, ethical relativism posits that there are no universally valid moral principles. Ethical relativism may be further subdivided into: 'conventionalism', which argues that a given set of ethics or moral principles are only valid within a given culture at a particular time; and 'subjectivism', that sees individual choice as the key determinant of the validity of moral principles.



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According to the 'conventional' ethical relativism it is the mores and standards of a society which define what is moral behaviour and ethical standards are set, not absolutely, but according to the dictates of a given society at a given time. Thus if we conform to the standards of our society then we are behaving ethically. We can see however that ethical standards change over time within one society and vary from one society to another; thus the attitudes and practices of the 19th century are different to our own as are the standards of other countries.

A further problem with this view of ethics is that of how we decide upon the societal ethics which we seek to conform to. Thus there are the standards of society at large, the standards of our chosen profession and the standards of the peer group to which we belong. For example, the standards of society at large tend to be enshrined within the laws of that society. But how many of us rigorously abide by the speed limits of this country?

Different grouping within society tend to have different moral standards of acceptable behaviour and we have a tendency to behave differently at different times and when we are with different groups of people. Equally when we travel to a foreign country we tend to take with us the ethical standards of our own country rather than changing to the different standards of the country which we are visiting. Thus it becomes very difficult to hold to a position of ethical relativism because of the difficulty of determining the grouping to which we are seeking to conform.

### 5.3.5 Ethical Objectivism

This philosophical position is in direct opposition to ethical relativism; it asserts that although moral principles may differ between cultures, some moral principles have universal validity whether or not they are universally recognised. There are two key variants of ethical objectivism: 'strong' and 'weak'. Strong ethical objectivism or 'absolutism' argues that there is one true moral system. Weak ethical objectivism holds that there is a 'core morality' of universally valid moral principles, but also accepts an indeterminate area where relativism is accepted.

### 5.3.6 Concluding remarks

We can see that each of these theories of ethics is problematical and that there is no overarching principle which determines either what is ethical or what is not. Nevertheless a concern with ethics has been introduced explicitly into organisation theory and strategy in recent years. This has led to an increased interest in Corporate Social Responsibility.



## 5.4 The Gaia Hypothesis

While theorists of organisations were developing the notion of greater accountability to stakeholders during the 1970s, other developments were also taking place in parallel. Thus in 1979 Lovelock produced his Gaia Hypothesis in which he proposed a different model of the planet Earth; in his model the whole of the ecosphere, and all living matter therein, was co-dependant upon its various facets and formed a complete system.

According to this hypothesis, this complete system, and all components of the system, were 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 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 behind the model of accounting adopted by society. The Gaia hypothesis however implied that interdependence, and a consequent recognition of the effect of ones actions upon others, was a facet of life. This consequently necessitates a different interpretation of accountability in terms of individual and organisational behaviour.

Given the constitution of economic activity into profit seeking firms, each acting in isolation and concerned solely with profit maximisation, justified according to classical liberalism, it is perhaps inevitable that organisation theory developed as organisation-centric, seeking merely to manage the activities of the firm insofar as they affected the firm. Any actions of the firm which had consequences external to the firm 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. As a consequence any concern by the firm with the effect of its actions upon externalities was irrelevant and not therefore a proper concern for its managers.

The Gaia hypothesis stated that organisms were interdependent<sup>12</sup> 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. Thus the actions of an organism upon its environment and upon externalities was a matter of consequence for every organism. 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 for the organisation of 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 concern to the organisation, and hence a proper subject for the management of organisational activity.

While it is not realistic to claim that the development of the Gaia Theory has had a significant impact upon organisational behaviour, it seems perhaps overly coincidental to suggest that a social concern among business managers developed at the same time that this theory was 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.

## 5.5 Corporate Behaviour

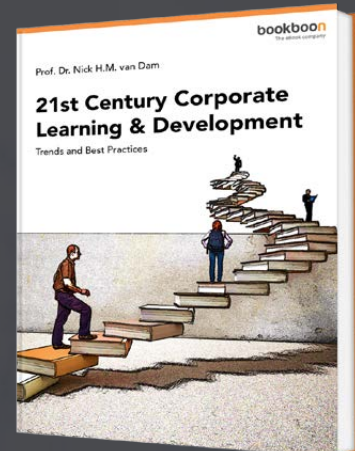
Corporate behavior is important for company success both financially and concerning the relationship between corporate and business interests (stakeholders). We cannot define corporate behaviour without a ethical and CSR base in order to refer to that behavioral aspect. Corporate behaviour involves legal rules, ethical codes of conduct and social responsibility principles (figure1). In other words corporate behavior is based on all of these components and involves law, ethics and CSR. It is important to recognize also that this behavior must be ethical but must also be seen to be ethical – perceptions are very important.

Corporate behavior has effects not only on stakeholders and shareholders but also on the entire economy. When a corporation acts ethically and socially responsibly in its business decisions and strategic planning then that corporation will be more sustainable. As we have seen socially responsible corporate behavior is increasingly seen as essential to the long term survival of companies.

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**Figure 5.1** The components of Corporate behaviour

## 5.6 CSR, Ethics and Corporate Behavior

Carroll (1979: 500) describes CSR in these terms: “the social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time”. After his definition, in 2002 Whetten et al. defined CSR as “societal expectations of corporate behavior; a behavior that is alleged by a stakeholder to be expected by society or morally required and is therefore justifiably demanded of a business” (p. 374). After the first definition, the CSR definition on the one hand expanded and covered more corporate behavior and stakeholder expectation. On the other hand some broad terms – especially society – have been narrowed to stakeholders.

Corporate behavior toward the stakeholders is becoming a much more important concept in every definition. Corporate behaviour is an important concept because it has to be ethical, legal, and responsible behaviour for organizations, stakeholders and society. This aspect of the corporate behavior has more benefit for society also and so that is why it is more related with ethics and CSR. We have of course referred to stakeholders in other chapters and this is an increasingly important aspect of CSR.

To be a socially responsible corporation, a company must be more than a legal and ethical person also. CSR is not always a legal necessity; increasingly it is an obligation. However a company has to be socially responsible even though it is not a legal obligation (Aras & Crowther 2008) – which is one of the most important characteristics of CSR. These provide the platform (see figure 2) upon which social responsibility is built.



**Figure 5.2** The Corporate Behavior Pyramid

## 5.7 Corporate Reputation

One concept which is of growing importance for business management 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. 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.

There are many benefits claimed for being perceived as having a good corporate reputation. One of the main 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. It brings increased customer loyalty to the products of the company. 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.

## 5.7 Conclusion

Ethical behavior and ethical business has effects not only for stakeholders, and shareholders but also on the entire economy. We believe that when acting ethically in the business decision-making process then this will ensure more effective and productive utilisation of economic resources. Corporate behavior affects responsible and proper economic and institutional improvement. It will be also an influence on all society and a common benefit.



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Additionally we can make the following points:

- Organizations affect the external environment – businesses and the wider global environment
- The Gaia hypothesis shows that the whole ecosphere forms a complete system, unlike classical liberal theory which postulates the independence of each entity
- From 1970 there have developed theories and regulations to include all stakeholders inside and outside the organisation
- Corporate reputation is an increasingly important factors for organisations
- Ethics has been reinstated as a standard for organisational activity
- Corporate Social Responsibility (CSR) as a subject indicates concern with social and environmental effects of organisational behaviour.

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## 5.9 Further Reading

Bhattacharya CB & Sen S (2004); Doing Better at Doing Good: when, why and how consumers respond to corporate social initiatives. *California Management Review*, 47(1): 9–24

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## 5.10 Self-test Questions

1. What are the responsibilities of business in their corporate decisions?
2. Why does a company have to be ethical?
3. What is the relationship between CSR and corporate behaviour?
4. Is CSR a legal necessity? Why?

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# Endnotes

1. 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.
2. "I am guilty."
3. 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.
4. This will be dealt with more fully in chapter 6.
5. In other words the extent of regulation in this area has increased in recent years and is continuing to increase.
6. See later chapters for further explanation of this claim.
7. It needs a very careful reading of the annual report to discover this.
8. [www.bp.com](http://www.bp.com)
9. From [http://www.bat.com/oneweb/sites/uk\\_3mnfen.nsf/vwPagesWebLive/53D459A7C9548DC480256BF4000331DD?opendocument&DTC=&SID=](http://www.bat.com/oneweb/sites/uk_3mnfen.nsf/vwPagesWebLive/53D459A7C9548DC480256BF4000331DD?opendocument&DTC=&SID=) accessed on 21 August 2007.
10. From <http://www.ryanair.com/site/EN/about.php?page=About&sec=environment> accessed on 21 August 2007.
11. We base our assertion regarding *all businesses* upon our study of the FTSE100 businesses, and so recognize that our claim may not have universal truth.
12. 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.