

# Corporate Social Responsibility

David Crowther; Güler Aras

David Crowther & Güler Aras

# Corporate Social Responsibility



Corporate Social Responsibility

1<sup>st</sup> edition

© 2014 David Crowther & Güler Aras & [bookboon.com](http://bookboon.com)

ISBN 978-87-7681-415-1

# Contents

<b>1</b>	<b>Defining Corporate Social Responsibility</b>	<b>11</b>
1.1	Introduction	11
1.2	Definitions of CSR	11
1.3	The effects of organisational activity	14
1.4	The principles of CSR	14
1.5	Conclusion	17
1.6	References	17
1.7	Further reading	18
1.8	Self-test Questions	18
<b>2</b>	<b>The principles of CSR</b>	<b>19</b>
2.1	Introduction	19
2.2	The prominence of CSR	19
2.3	Changing emphasis in companies	20
2.4	Environmental issues and their effects and implications	22
2.5	Externalising costs	22
2.6	The Social Contract	25

www.sylvania.com

**We do not reinvent  
the wheel we reinvent  
light.**

Fascinating lighting offers an infinite spectrum of possibilities: Innovative technologies and new markets provide both opportunities and challenges. An environment in which your expertise is in high demand. Enjoy the supportive working atmosphere within our global group and benefit from international career paths. Implement sustainable ideas in close cooperation with other specialists and contribute to influencing our future. Come and join us in reinventing light every day.

Light is OSRAM

**OSRAM  
SYLVANIA**

2.7	Conclusions	26
2.8	References	26
2.9	Further reading	26
2.10	Self-test Questions	26
<b>3</b>	<b>Stakeholders &amp; the social contract</b>	<b>27</b>
3.1	Introduction	27
3.2	What is a stakeholder?	28
3.3	Multiple stakeholding	29
3.4	The classification of stakeholders	29
3.5	Stakeholder Theory	30
3.6	Regulation and its implications	34
3.7	Risk Reducing	35
3.8	Conclusions	37
3.9	References	37
3.10	Further Reading	38
3.11	Self-test Questions	39



**CHALLENGING PERSPECTIVES**

## Internship opportunities

EADS unites a leading aircraft manufacturer, the world's largest helicopter supplier, a global leader in space programmes and a worldwide leader in global security solutions and systems to form Europe's largest defence and aerospace group. More than 140,000 people work at Airbus, Astrium, Cassidian and Eurocopter, in 90 locations globally, to deliver some of the industry's most exciting projects.

An **EADS internship** offers the chance to use your theoretical knowledge and apply it first-hand to real situations and assignments during your studies. Given a high level of responsibility, plenty of learning and development opportunities, and all the support you need, you will tackle interesting challenges on state-of-the-art products.

**We welcome more than 5,000 interns every year across disciplines ranging from engineering, IT, procurement and finance, to strategy, customer support, marketing and sales. Positions are available in France, Germany, Spain and the UK.**

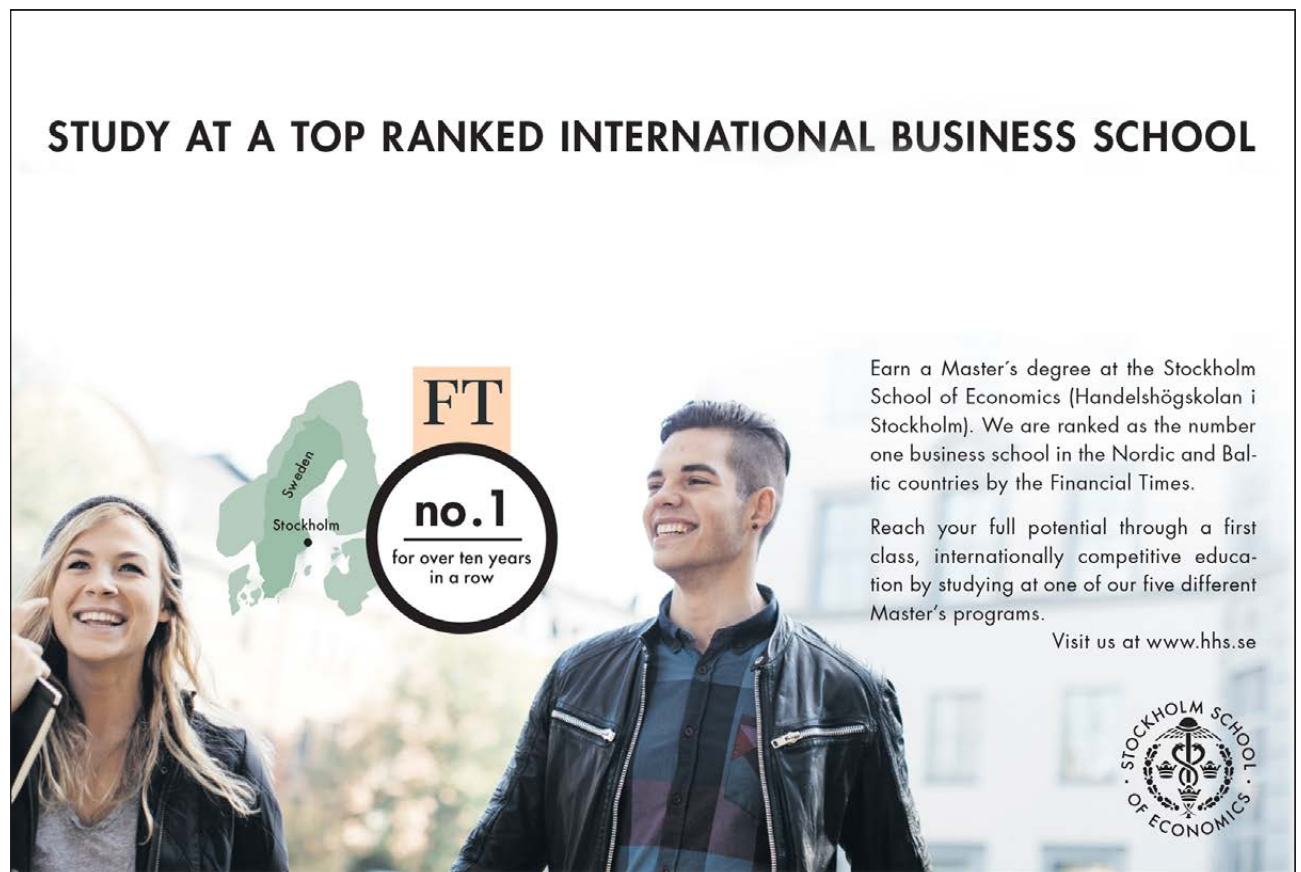
To find out more and apply, visit [www.jobs.eads.com](http://www.jobs.eads.com). You can also find out more on our **EADS Careers Facebook page**.

**AIRBUS** **ASTRIUM** **CASSIDIAN** **EUROCOPTER**

**EADS**

<b>4.</b>	<b>Issues concerning Sustainability</b>	<b>40</b>
4.1	Introduction	40
4.2	Defining sustainability	40
4.3	The Brundtland Report	41
4.4	Critiquing Brundtland	42
4.5	Sustainability and the Cost of Capital	44
4.6	Redefining sustainability	46
4.7	Distributable sustainability	48
4.8	Summarising Sustainability	49
4.9	Conclusions	50
4.10	References	50
4.11	Further reading	52
4.12	Self-test Questions	52
<b>5</b>	<b>Ethics, CSR and Corporate Behavior</b>	<b>53</b>
5.1	Introduction	54
5.2	What is Ethics? The Why ?	54
5.3	Ethical philosophies	55
5.4	The Gaia Hypothesis	58
5.5	Corporate Behaviour	59

**STUDY AT A TOP RANKED INTERNATIONAL BUSINESS SCHOOL**



Earn a Master's degree at the Stockholm School of Economics (Handelshögskolan i Stockholm). We are ranked as the number one business school in the Nordic and Baltic countries by the Financial Times.

Reach your full potential through a first class, internationally competitive education by studying at one of our five different Master's programs.

Visit us at [www.hhs.se](http://www.hhs.se)

**FT**  
**no.1**  
for over ten years in a row

STOCKHOLM SCHOOL OF ECONOMICS

5.6	CSR, Ethics and Corporate Behavior	61
5.7	Corporate Reputation	62
5.8	Conclusion	62
5.9	References	63
5.10	Further Reading	64
5.11	Self-test Questions	64
<b>6</b>	<b>Performance Evaluation and Performance Reporting</b>	<b>65</b>
6.1	Introduction	65
6.2	What is performance?	65
6.3	Social accounting	67
6.4	Aspects of performance	68
6.5	The balanced scorecard	70
6.6	The environmental audit	71
6.7	The Measurement of Performance	73
6.8	The Evaluation of Performance	74
6.9	Multi-dimensional performance management	75



Discover the truth at [www.deloitte.ca/careers](http://www.deloitte.ca/careers)

**Deloitte.**

© Deloitte & Touche LLP and affiliated entities.



Click on the ad to read more

6.10	Conclusions	76
6.11	References	77
6.12	Further reading	77
6.13	Self-test questions	77
<b>7</b>	<b>Globalisation and CSR</b>	<b>78</b>
7.1	Introduction	78
7.2	Globalisation	78
7.3	How Globalisation Affects CSR	83
7.4	Globalisation, Corporate Failures and CSR	84
7.5	Is Globalisation an opportunity or threat for CSR?	86
7.6	Conclusion	88
7.7	References	88
7.8	Further Reading	88
7.9	Self-test Questions	89



**INDEPENDENT MINDS  
LIKE YOU**

We believe in equality, sustainability and a modern approach to learning. How about you? Apply for a Master's Programme in Gothenburg, Sweden.

PS. University of Gothenburg is on the LPDP list!

[www.gu.se/education](http://www.gu.se/education)



UNIVERSITY OF  
GOTHENBURG



<b>8</b>	<b>CSR in not for profit organisations</b>	<b>90</b>
8.1	Introduction	90
8.2	Distinguishing features of sector	90
8.3	Types of NFP organisation	91
8.4	Motivation for NFP's	91
8.5	Implications for managers	93
8.6	Available resources	93
8.7	Structure of a charity	94
8.8	Accounting issues	95
8.9	CSR issues in NFPs	96
8.10	Conclusions	97
8.11	References	97
8.12	Further reading	97
8.13	Self-test questions	97
<b>9</b>	<b>CSR and Strategy</b>	<b>98</b>
9.1	Introduction	98
9.2	The Role of a Business Manager	98
9.3	The objectives of a business	100
9.4	The Tasks of a Manager	102
9.5	The importance of performance measurement	106
9.6	Managers and business ethics	107
9.7	Corporate Governance	108
9.8	Corporate Governance Principles	110
9.9	Conclusions	112
9.10	References	112
9.11	Further reading	113
9.12	Self-test Questions	113
<b>10</b>	<b>Corporate Social Responsibility and Leadership</b>	<b>114</b>
10.1	Introduction	114
10.2	The concept of leadership	114
10.3	Styles of Leadership	117
10.4	Organisational culture and styles of leadership	117
10.5	Motivation	119
10.6	Definitions of power	121

10.7	Sources of power	122
10.8	Systems of control	124
10.9	Strategic planning	124
10.10	Corporate planning	127
10.11	Planned and emergent strategy	128
10.12	Feedback	129
10.13	Agency Theory	132
10.14	The Limitations of Agency Theory	138
10.15	Conclusions	138
10.16	References	138
10.17	Further reading	140
10.18	Self-test Questions	140
<b>11</b>	<b>Endnotes</b>	<b>141</b>

# 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”.

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.

### 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.

Sweden Sverige

**PREPARE FOR A LEADING ROLE.**

*MSc programmes in strategy and management in international organisations, and industrial engineering and management*

← [liu.se/master](https://liu.se/master)

**li.u** LINKÖPING UNIVERSITY

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.

## 1.6 References

Carroll A.B. (1979); A three-dimensional conceptual model of corporate performance; *Academy of Management Review* 4 (4), 497–505.

Dahl R.A. (1972); A prelude to corporate reform; *Business & Society Review*, Spring 1972, 17–23.

Friedman M. (1970); The social responsibility of business is to increase its profits; *New York Times* 13 September.

Hetherington J.A.C. (1973); *Corporate Social Responsibility Audit: A Management Tool for Survival*; London; The Foundation for Business Responsibilities.

## 1.7 Further reading

Mintzberg H. (1983); The case for corporate social responsibility; *Journal of Business Strategy* 4(2), S. 3–15.

Friedman M. (1970); The social responsibility of business is to increase its profits; *New York Times* 13 September.

Davis K. (1973); The Case for and against Business Assumption of Social Responsibilities; *Academy of Management Journal*, 16, 312–322.

## 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?

SIMPLY CLEVER

ŠKODA



We will turn your CV into  
an opportunity of a lifetime



Do you like cars? Would you like to be a part of a successful brand?  
We will appreciate and reward both your enthusiasm and talent.  
Send us your CV. You will be surprised where it can take you.

Send us your CV on  
[www.employerforlife.com](http://www.employerforlife.com)



Click on the ad to read more

## 2 The principles of CSR



### 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.

### 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.



**Lnu.se**

Choose a university where life is possible.

**Bachelor programmes in**  
*Business and Economics | Design and Humanities |  
 Computer Science/IT | Natural Science*

**Master programmes in**  
*Business and Economics | Computer Science/IT |  
 Design and Humanities | Natural Science |  
 Social and Behavioral Science | Technology  
 and Engineering*

**Summer Academy courses**

**Linnæus University**  
 Sweden

Ellen, Marketig,  
 Master programme  
 120 CREDITS

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.

### 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 temporarily externalised, as they may not be recognised as a problem at the present time. For example, the widespread use of asbestos in the 1930s to 1960s was considered to be beneficial at the time and was only later found to be problematic.

This temporal externalisation of costs, through causing the clean up problems and costs 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.



**YOU?**

**#studyinsweden**

Striking a match, reconnecting with your family through Skype or over a phone network from Ericsson, refurbishing your apartment at IKEA or driving safely in your Volvo - none of this would be possible if not for Sweden. Swedish universities offer over 900 international master's programmes taught entirely in English.

Don't just pick a place - pick a future.  
>[studyinsweden.se](http://studyinsweden.se)

 Sweden Sverige	 SI. Swedish Institute of Information	 STUDY SWEDEN
---	---	---

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

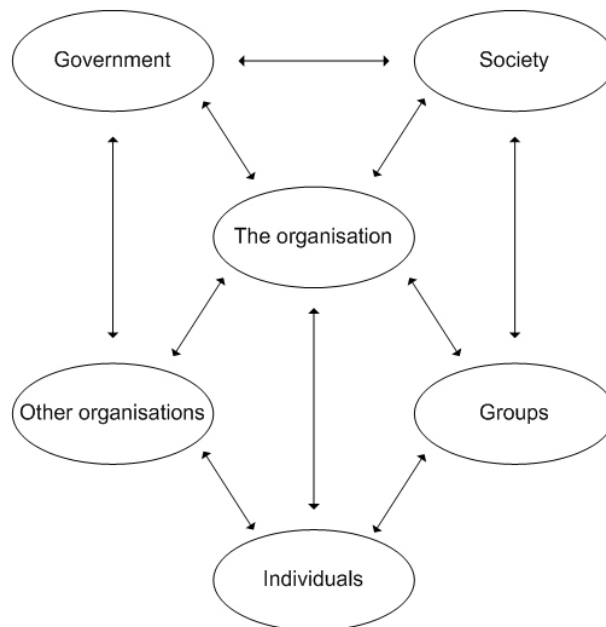
It is impossible that such governments as have hitherto existed in the world, could have commenced by any other means than a total violation of every principle sacred and moral.

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.

## 2.8 References

Crowther D. (2004); Limited liability or limited responsibility; in D Crowther & L Rayman-Bacchus (eds), *Perspectives on Corporate Social Responsibility*; Aldershot; Ashgate; pp. 42–58.

Ortiz-Martinez E. & Crowther D. (2006); ¿Son compatibles la responsabilidad económica y la responsabilidad social corporativa?; *Harvard Deusto Finanzas y Contabilidad*, No 71 pp. 2–12.

Paine T. (1792); *The Rights of Man* (many editions).

Rousseau J-J. (1762); *The Social Contract, Or Principles of Political Right* (many editions).

## 2.9 Further reading

Crowther D. & Ortiz Martinez E. (2004); Corporate Social Responsibility: history and principles; *Social Responsibility World*, 102–107; Penag; Ansted University Press.

Carroll A.B. (1979); A three-dimensional conceptual model of corporate performance; *Academy of Management Review* 4 (4), 497–505.

## 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.



**e-learning for kids**

- The number 1 MOOC for Primary Education
- Free Digital Learning for Children 5-12
- 15 Million Children Reached

**About e-Learning for Kids** Established in 2004, e-Learning for Kids is a global nonprofit foundation dedicated to fun and free learning on the Internet for children ages 5 - 12 with courses in math, science, language arts, computers, health and environmental skills. Since 2005, more than 15 million children in over 190 countries have benefitted from eLessons provided by EFK! An all-volunteer staff consists of education and e-learning experts and business professionals from around the world committed to making difference. eLearning for Kids is actively seeking funding, volunteers, sponsors and courseware developers; get involved! For more information, please visit [www.e-learningforkids.org](http://www.e-learningforkids.org).

### 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.


### 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:



**LIFE SCIENCE IN UMEÅ, SWEDEN  
– YOUR CHOICE!**

- 32 000 students • world class research • top class teachers
- modern campus • ranked nr 1 in Sweden by international students
- study in English

- Bachelor’s programme in Life Science
- Master’s programme in Chemistry
- Master’s programme in Molecular Biology

**APPLY NOW!**

  
**UMEÅ UNIVERSITY**  
FACULTY OF SCIENCE & TECHNOLOGY

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.

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.

I joined MITAS because  
I wanted **real responsibility**

The Graduate Programme  
for Engineers and Geoscientists  
[www.discovermitas.com](http://www.discovermitas.com)





**Month 16**  
I was a construction  
supervisor in  
the North Sea  
advising and  
helping foremen  
solve problems

Real work  
International opportunities  
Three work placements





### 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.

### 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.

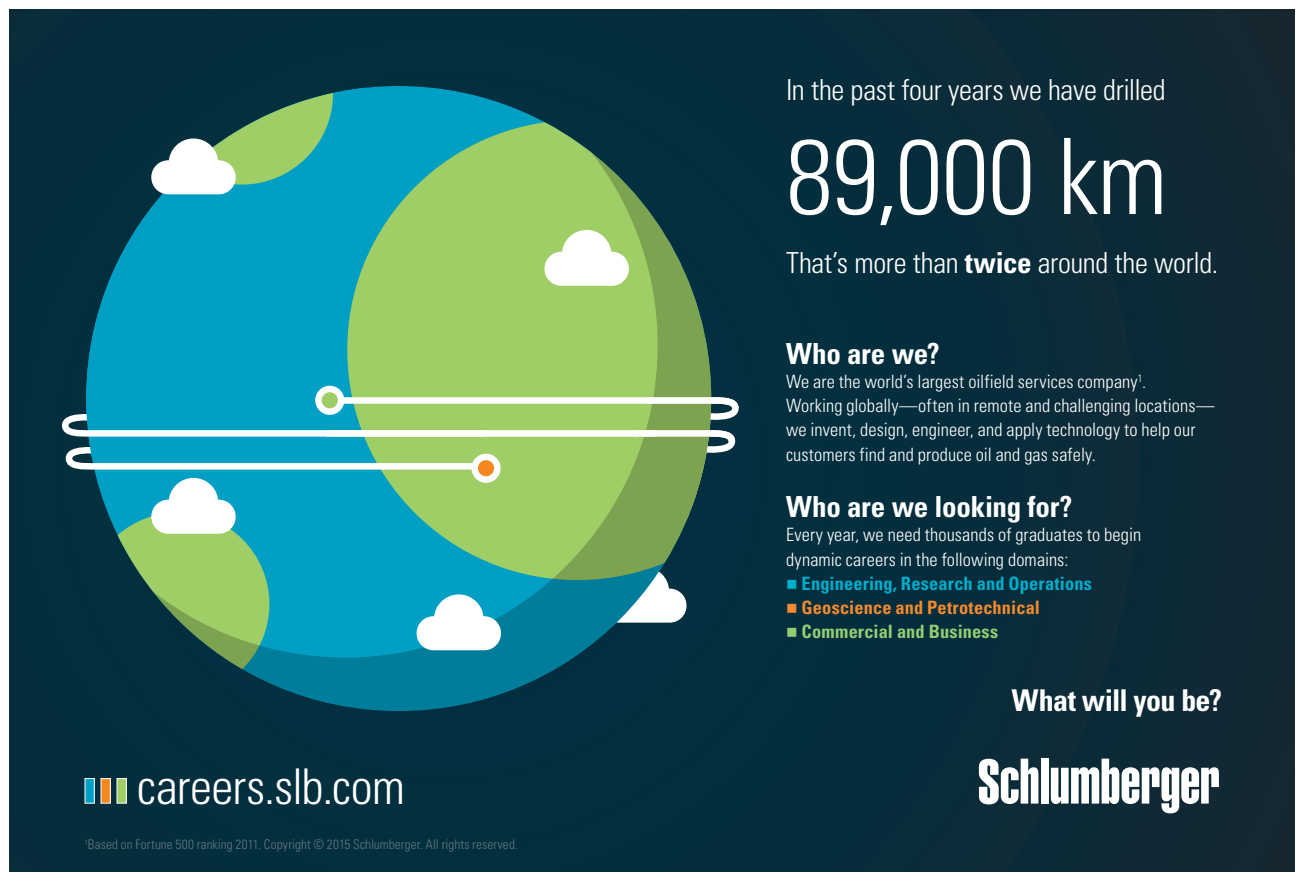
### 3.9 References

Aras G. & Crowther D. (2008); Corporate sustainability reporting: a study in disingenuity?; *Journal of Business Ethics*.

Argenti, J. (1993) *Your organization: What is it for?*, McGraw-Hill, London.

Atkinson, A.A., Waterhouse, J.H., and Wells, R.B., (1997) 'A stakeholder approach to strategic performance management', *Sloan Management Review*, Spring.

Clarkson, M.E., (1995) 'A Stakeholder Framework for analysing and evaluating Corporate Social Performance', *Academy of Management Review*, Vol. 20, No. 1, pp. 92–117.



In the past four years we have drilled

# 89,000 km

That's more than **twice** around the world.

**Who are we?**  
We are the world's largest oilfield services company'. Working globally—often in remote and challenging locations—we invent, design, engineer, and apply technology to help our customers find and produce oil and gas safely.

**Who are we looking for?**  
Every year, we need thousands of graduates to begin dynamic careers in the following domains:

- Engineering, Research and Operations
- Geoscience and Petrotechnical
- Commercial and Business

**What will you be?**

[careers.slb.com](http://careers.slb.com)

**Schlumberger**

Based on Fortune 500 ranking 2011. Copyright © 2015 Schlumberger. All rights reserved.

Cooper S., Crowther D., Davies M & Davis E.W. (2001); *Shareholder or Stakeholder Value? The development of indicators for the control and measurement of performance*; London; CIMA.

Dahl R.A. (1972); A prelude to corporate reform; *Business & Society Review* Spring 1972 pp. 17–23.

Heskett, J.L., Jones, T.O., Loverman, G.W., Sasser, Jr W.E. and Schlesinger, L.A., (1994). “Putting the Service-Profit Chain to Work”, *Harvard Business Review*, March-April, pp. 164–174.

Hetherington J.A.C. (1973); *Corporate Social Responsibility Audit: A Management Tool for Survival*; London; The Foundation for Business Responsibilities.

Jones, T.M. and Wicks, A.C. (1999); Convergent stakeholder theory; *The Academy of Management Review*, April, 24 (2), pp. 206–221.

Kaplan R.S. & Norton D.P. (1992); The balanced scorecard – measures that drive performance; *Harvard Business Review*, Jan/Feb, 71–79.

Kaplan R.S. & Norton D.P. (1993); Putting the balanced scorecard to work; *Harvard Business Review*, Sept/Oct, 134–147.

Kaplan, R.S. and Norton, D.P., (1996a) ‘Using The Balanced Scorecard As a Strategic Management System’, *Harvard Business Review*, January / February 1996, pp. 75–85.

Kaplan, R.S. and Norton, D. P., (1996b) *The Balanced Scorecard: Translating Strategy into Action*, Harvard Business School Press, Harvard.

Mitchell, R.K., Agle, B.R. and Wood, D.J. (1997) ‘Toward a theory of stakeholder identification and salience: Defining the principle of who really counts’, *The Academy of Management Review*, October, pp. 853–886.

Sternberg, E. (1997) ‘The Defects of Stakeholder Theory’, *Corporate Governance: An International Review*, Vol. 5, No. 1, pp. 3–10.

Waddock, S.A. and Graves, S.B. (1997) ‘Quality of management and quality of stakeholder relations’, *Business and Society*, Vol. 36, Issue 3, pp. 250–279.

### 3.10 Further Reading

Bhattacharya C.B. & 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.

Donaldson T. & Preston L.E. (1995); The stakeholder theory of the corporation: concepts, evidence, and implications; *Academy of Management Review*, 20(1): 65–91.

Kell G. (2003); The Global Compact: Origins, Operations, Progress, Challenge; *Journal of Corporate Citizenship*, 11, 35–49.

Jensen M.C. & Meckling M.H. (1976); Theory of the firm: managerial behaviour, agency costs and ownership structure; *Journal of Financial Economics*, 3 (4), 305–360.

### 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?



"I studied English for 16 years but...  
...I finally learned to speak it in just six lessons"  
Jane, Chinese architect

ENGLISH OUT THERE

Click to hear me talking before and after my unique course download

## 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.

WHILE YOU WERE SLEEPING...

[www.fuqua.duke.edu/whileyouweresleeping](http://www.fuqua.duke.edu/whileyouweresleeping)

DUKE  
THE FUQUA  
SCHOOL  
OF BUSINESS



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.*

Excellent Economics and Business programmes at:



university of  
 groningen




**“The perfect start  
 of a successful,  
 international career.”**

**CLICK HERE**  
 to discover why both socially  
 and academically the University  
 of Groningen is one of the best  
 places for a student to be

[www.rug.nl/feb/education](http://www.rug.nl/feb/education)

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

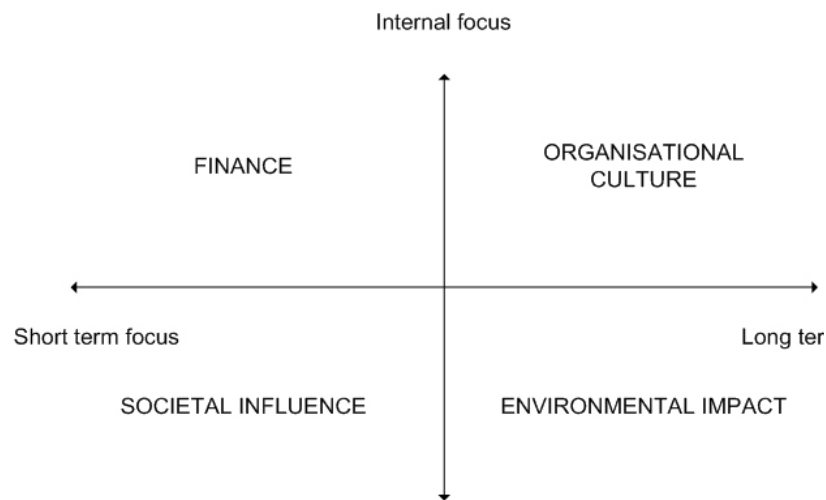
It is therefore time to re-examine the legacy of Brundtland and to redefine what is meant by sustainable activity.

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.

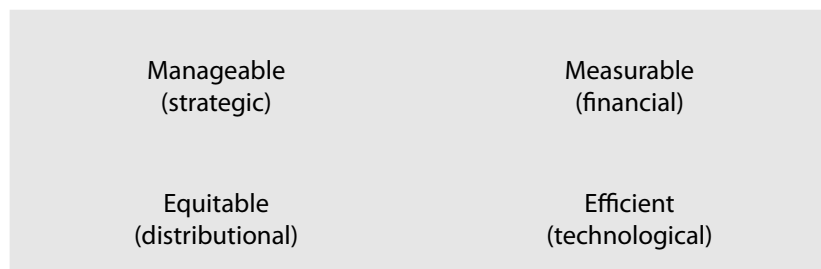


.....Alcatel-Lucent 

[www.alcatel-lucent.com/careers](http://www.alcatel-lucent.com/careers)

What if you could build your future and create the future?

One generation's transformation is the next's status quo. In the near future, people may soon think it's strange that devices ever had to be "plugged in." To obtain that status, there needs to be "The Shift".

**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 (ie 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.

## 4.10 References

Amba-Rao, S.C. (1993); Multinational Corporate Social Responsibility, Ethics, Interactions and Third World Governments: An Agenda for the 1990s; *Journal of Business Ethics*, 12, 553–572.

Aras G. & Crowther D. (2007b); Sustainable corporate social responsibility and the value chain; In D. Crowther & M.M. Zain (eds), *New Perspectives on Corporate Social Responsibility*, 109–128.

Aras G. & Crowther D. (2007a); Is the global economy sustainable?; in S Barber (ed), *The Geopolitics of the City*; London; Forum Press, 165–194.

Aras G. & Crowther D. (2007c); What level of trust is needed for sustainability? *Social Responsibility Journal* 3 (3), 60–68.

Aras G. & Crowther D. (2008a); Governance and sustainability: An investigation into the relationship between corporate governance and corporate sustainability; *Management Decision*, 46 (3), 433–448.

Aras G. & Crowther D. (2008b); The social obligation of corporations; *Journal of Knowledge Globalisation* 1 (1), 43–59.

Aras G. & Crowther D. (2009); *The Durable Corporation: Strategies for sustainable development*; Aldershot; Gower.

Daly H.E. (1996); *Beyond Growth*; Boston, MA; Beacon Press.

Hart S.L. & Milstein M.B. (2003); Creating sustainable value; *Academy of Management Executive*, 17 (2), 56–67.

Jacobs, M. (1991); *The green economy – environment, sustainable development and the politics of the future*; Pluto Press: London.

Marsden C. (2000); The new corporate citizenship of big business: part of the solution to sustainability; *Business & Society Review*, 105 (1), 9–25.

Spangenberg J.H. (2004); Reconciling sustainability and growth: criteria, indicators, policy; *Sustainable Development*, 12, 76–84.

WCED (World Commission on Environment and Development), *Our Common Future* (The Brundtland Report), Oxford University Press, Oxford, 1987.

Welford, R. (1997); *Hijacking environmentalism – corporate responses to sustainable development*; London: Earthscan.



**Join the best at  
the Maastricht University  
School of Business and  
Economics!**

#### Top master's programmes

- 33<sup>rd</sup> place Financial Times worldwide ranking: MSc International Business
- 1<sup>st</sup> place: MSc International Business
- 1<sup>st</sup> place: MSc Financial Economics
- 2<sup>nd</sup> place: MSc Management of Learning
- 2<sup>nd</sup> place: MSc Economics
- 2<sup>nd</sup> place: MSc Econometrics and Operations Research
- 2<sup>nd</sup> place: MSc Global Supply Chain Management and Change

Sources: Keuzegids Master ranking 2013; Elsevier 'Beste Studies' ranking 2012; Financial Times Global Masters in Management ranking 2012

**Maastricht  
University is  
the best specialist  
university in the  
Netherlands  
(Elsevier)**

**Visit us and find out why we are the best!  
Master's Open Day: 22 February 2014**

[www.mastersopenday.nl](http://www.mastersopenday.nl)



Zwetsloot G.I.J.M. (2003), From management systems to corporate social responsibility; *Journal of Business Ethics*, 44 (2/3), 201–207.

#### 4.11 Further reading

Aras G. & Crowther D. (2009 forthcoming); Sustainability; in *The Gower Handbook of Corporate Governance and Social Responsibility*.

Aras G. & Crowther D. (2009 forthcoming); *Durable Corporation: strategies for sustainable development*; Aldershot; Gower.

Hart S.L. (1997); Beyond greening: strategies for a sustainable world; *Harvard Business Review* (January-February) 67–76.

WCED (World Commission on Environment and Development), *Our Common Future* (The Brundtland Report), Oxford University Press, Oxford, 1987.

#### 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.

Adams (1992: 106–7)



**Empowering People. Improving Business.**

BI Norwegian Business School is one of Europe's largest business schools welcoming more than 20,000 students. Our programmes provide a stimulating and multi-cultural learning environment with an international outlook ultimately providing students with professional skills to meet the increasing needs of businesses.

BI offers four different two-year, full-time Master of Science (MSc) programmes that are taught entirely in English and have been designed to provide professional skills to meet the increasing need of businesses. The MSc programmes provide a stimulating and multi-cultural learning environment to give you the best platform to launch into your career.

- MSc in Business
- MSc in Financial Economics
- MSc in Strategic Marketing Management
- MSc in Leadership and Organisational Psychology

**BI NORWEGIAN BUSINESS SCHOOL**

EFMD **EQUIS** ACCREDITED

[www.bi.edu/master](http://www.bi.edu/master)

## 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, ones 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.

## Need help with your dissertation?

Get in-depth feedback & advice from experts in your topic area. Find out what you can do to improve the quality of your dissertation!

Get Help Now



Go to [www.helpmyassignment.co.uk](http://www.helpmyassignment.co.uk) for more info



Helpmyassignment



### 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.

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.

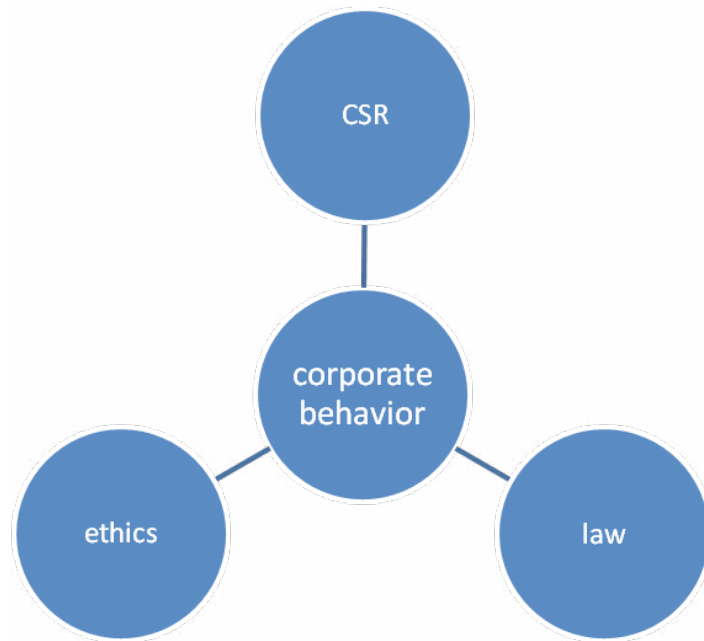


Figure 5.1: The components of Corporate behaviour

# Brain power

By 2020, wind could provide one-tenth of our planet's electricity needs. Already today, SKF's innovative know-how is crucial to running a large proportion of the world's wind turbines.

Up to 25 % of the generating costs relate to maintenance. These can be reduced dramatically thanks to our systems for on-line condition monitoring and automatic lubrication. We help make it more economical to create cleaner, cheaper energy out of thin air.

By sharing our experience, expertise, and creativity, industries can boost performance beyond expectations. Therefore we need the best employees who can meet this challenge!

The Power of Knowledge Engineering

Plug into The Power of Knowledge Engineering.  
Visit us at [www.skf.com/knowledge](http://www.skf.com/knowledge)



## 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.

## 5.8 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.

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.

## 5.9 References

Aras, G. (2006), “The Ethical Issues in the Finance and Financial Markets”, in *Globalization and Social Responsibility*, Eds. David Crowther & Kıymet Caliyurt, Cambridge Scholars Press.

Aras G. & Crowther D. (2008); The social obligation of corporations; *Journal of Knowledge Globalisation* 1 (1), 43–59.



“I studied English for 16 years but...  
...I finally learned to speak it in just six lessons”  
Jane, Chinese architect

ENGLISH OUT THERE

Click to hear me talking before and after my unique course download

Carroll, A.B. (1979). A three-dimensional conceptual model of corporate social performance; *Academy of Management Review*, 4, 497–505.

Fisher, J. (2004) Social Responsibility and Ethics: Clarifying the Concepts, *Journal of Business Ethics* 52: 391–400.

Friedman, M. (1962), *Capitalism and Freedom*, Chicago: University of Chicago Press.

Joyner, B.E., D. Payne (2002), Evolution and Implementation: A Study of Values, Business Ethics and Corporate Social Responsibility, *Journal of Business Ethics* 41: 297–311, 2002.

Lovelock J. (1979); *Gaia*; Oxford; Oxford University Press.

Whetten, D.A., Rands, G., & Godfrey, P. (2002). What are the responsibilities of business to society? In A. Pettigrew, H. Thomas, & R. Whittington (Eds.), *Handbook of strategy and management* (pp. 373–408). London: Sage.

## 5.10 Further Reading

Bhattacharya C.B. & 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.

Clarkson M.B.E. (1995); A stakeholder framework for analysing and evaluating corporate social performance; *Academy of Management Review*, 20 (1), 92–117.

Joyner B.E. & Payne D. (2002): Evolution and Implementation: A study of Values, Business Ethics and Corporate Social Responsibility; *Journal of Business Ethics*, 41, 297–311.

Kell G. (2003); The Global Compact: Origins, Operations, Progress, *Challenge*; *Journal of Corporate Citizenship*, 11, 35–49.

## 5.11 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?

# 6 Performance Evaluation and Performance Reporting

*'If the confidence of the public in the integrity of accountants' reports is shaken, their value is gone. To preserve the integrity of his reports, the accountant must insist upon absolute independence of judgment and action. The necessity of preserving this position of independence indicates certain standards of conduct.'*

Arthur Andersen 1932

In a survey organised by Faversham House Group four out of every five executives interviewed said that new laws were the most important factor in persuading their companies to spend on the right technology and management to save energy and reduce emissions. More than half viewed prosecution as the ultimate weapon for forcing responsibility to the top of the agenda at board meetings.

## 6.1 Introduction

For all organisation the question of the management of the organisation depends upon the ability to measure performance and then evaluate and report upon that performance. When we are considering CSR this is equally true, although it becomes more difficult to measure and evaluate that performance. In this chapter therefore we will consider some of the issues involved.

## 6.2 What is performance?

It should be clear that the determination of good performance is dependent upon the perspective from which that performance is being considered and that what one stakeholder grouping might consider to be good performance may very well be considered by another grouping to be poor performance (Child 1984). The evaluation of performance therefore for a business depends not just upon the identification of adequate means of measuring that performance but also upon the determination of what good performance actually consists of.

Just as the determination of standards of performance depends upon the perspective from which it is being evaluated, so too does the measurement of that performance, which needs suitably relevant measures to evaluate performance, not absolutely as this has no meaning, but within the context in which it is being evaluated. From an external perspective therefore a very different evaluation of performance might arise, but moreover a very different measurement of performance, implying a very different use of accounting in that measurement process, might arise.

The measurement of stakeholder performance is perhaps even more problematic than the measurement of financial performance. Objective measures of stakeholder performance are not reported in the annual reports of companies and therefore we have chosen to consider the subjective measures included within the “Britain’s Most Admired Companies” surveys annually published in Management Today. These measures provide a reputation rating, as gathered from ‘rivals’ perceptions, in nine categories and these measures are also added to also provide a total score. The nine categories are:

- Quality of management;
- Quality of goods and services;
- Capacity to innovate;
- Quality of marketing;
- Ability to retain top talent;
- Community and environmental responsibility;
- Financial soundness;
- Value as long-term investment;
- Use of corporate assets.



What do you want to do?

No matter what you want out of your future career, an employer with a broad range of operations in a load of countries will always be the ticket. Working within the Volvo Group means more than 100,000 friends and colleagues in more than 185 countries all over the world. We offer graduates great career opportunities – check out the Career section at our web site [www.volvogroup.com](http://www.volvogroup.com). We look forward to getting to know you!

**VOLVO**  
AB Volvo (publ)  
[www.volvogroup.com](http://www.volvogroup.com)

VOLVO TRUCKS | RENAULT TRUCKS | MACK TRUCKS | VOLVO BUSES | VOLVO CONSTRUCTION EQUIPMENT | VOLVO PENTA | VOLVO AERO | VOLVO IT  
VOLVO FINANCIAL SERVICES | VOLVO 3P | VOLVO POWERTRAIN | VOLVO PARTS | VOLVO TECHNOLOGY | VOLVO LOGISTICS | BUSINESS AREA ASIA



### 6.3 Social accounting

Social accounting first came to prominence during the 1970s when the performance of businesses in a wider arena than the stock market, and its value to shareholders, tended to become of increasing concern. This concern was first expressed through a concern with social accounting. This can be considered to be an approach to reporting a firm's activities which stresses the need for identification of socially relevant behaviour, the determination of those to whom the company is accountable for its social performance and the development of appropriate measures and reporting techniques.

Thus social accounting considers a wide range of aspects of corporate performance and encompasses a recognition that different aspects of performance are of interest to different stakeholder groupings. These aspects can include:

- The concerns of investors
- A focus upon community relations
- A concern with ecology

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

- Consumer surplus
- Economic rent
- Environmental impact
- Non-monetary values.

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

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

<b>X Analysis of Social Performance</b>		
	Statement of Social Income:	£
	Value generated by the productive process	xxx
+	unappropriable benefits	xxx
–	external costs imposed on the community	<u>xxx</u>
	Net social profit/loss	<u>xxx</u>

**Fig 6.1:** Model for social performance

While Solomons proposes this model, which seems to provide a reasonable method of reporting upon the effects of the activities of an organisation on its external environment, he fails to provide any suggestions as to the actual measurement of external costs and benefits. Such measurement is much more problematic and this is one of the main problems of any form of social accounting – the fact that the measurement of effects external to the organisation is extremely difficult.

Indeed it can be argued that this difficulty in measurement is one reason why organisations have concentrated upon the measurement through accounting for their internal activities, which are much more susceptible to measurement.

#### 6.4 Aspects of performance

One factor of importance to all organisations, which comes from its control system, is the factor of performance measurement and evaluation. To evaluate performance it is necessary to measure performance and Churchman (1967) states that measurement needs the following components:

- Language to express results;
- Specification of objects to which the results will apply;
- Standardisation for transferability between organisations or over time;
- Accuracy and control to permit evaluation.

Kimberley, Norling and Weiss (1983) also make this point and argue that traditional measures do not necessarily even measure some aspects of performance and can certainly lead to inadequate and misleading evaluations of performance. They state that:

Traditional perspectives on performance tend to ignore the fact that organisations also perform in other, less observable arenas. Their performance in these arenas may in some cases be more powerful shapers of future possibilities than how they measure up on traditional criteria. And, paradoxically competence in the less observable arenas may be interpreted as incompetence by those whose judgements are based solely on traditional criteria. Particularly in the case of organisations serving the interests of more than one group where power is not highly skewed and orientations diverge, the ability to develop and maintain a variety of relationships in the context of diverse and perhaps contradictory pressure is critical yet not necessarily visible to the external observer. (p. 251)

**gaiTeye**<sup>®</sup>  
*Challenge the way we run*

**EXPERIENCE THE POWER OF  
FULL ENGAGEMENT...**

.....

**RUN FASTER.  
RUN LONGER..  
RUN EASIER...**

**READ MORE & PRE-ORDER TODAY  
WWW.GAITEYE.COM**

## 6.5 The balanced scorecard

A different perspective upon performance evaluation has been proposed by Kaplan and Norton (1992) with the development of their balanced scorecard approach. They argue that traditional measurement systems in organisation are based upon the finance function and so have a control bias but that the balanced scorecard puts strategy and vision at the centre. They identify four components of the balanced scorecard, each of equal importance, and each having associated goals and measures. The four components are:

- Financial perspective – how does the firm look to shareholders;
- Customer perspective – how do customers perceive the firm;
- Internal business perspective – what must the firm excel at;
- Innovation and learning perspective – can the firm continue to improve and create value.

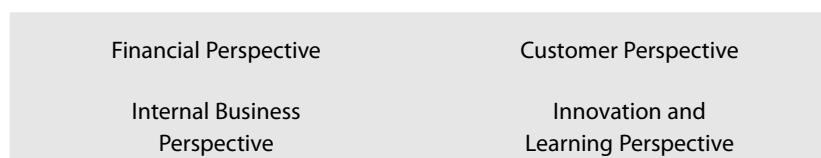
They state (1993) that measurement is an integral part of strategy, stating:

Today's managers recognise the impact that measures have on performance. But they rarely think of measurement as an essential part of their strategy. For example, executives may introduce new strategies and innovative operating processes intended to achieve breakthrough performance, then continue to use the same short-term financial indicators they have used for decades, measures like return on investment, sales growth, and operating income. (p. 135)

and

Effective measurement, however, must be an integral part of the management process. (p. 136)

They maintain that the balanced scorecard is a way of evaluating performance which recognises all the factors affecting performance and it is certainly true that an external perspective, in the shape of customers, is included in this framework. The framework they propose looks as in Figure 6.2.



**Figure 6.2:** The Balanced Scorecard

The scorecard enables companies to balance their short-run and long-run goals. It also highlights where results have been achieved by trade off of other objectives.

The scorecard uses four perspectives from which to view the firm. These are:

- Financial                                      How the company is perceived by the shareholders.
- Customers                                    How the company is perceived by its customers.
- Internal                                        What must the company excel at e.g. core competencies.
- Innovation & Learning                    How can future value be created.

Each business that adopts the approach develops its own purpose built scorecard that reflects its “mission, strategy, technology and culture”. The strength of the system is that it measures the success in achieving the strategies cascaded down by top management. There is often a divergence between mission statements, strategies and performance measures. The scorecard offers a mechanism to avoid this divergence.

The scorecard could, for example, take a mission statement that has a customer focus and convert generally stated goals into specific objectives and then develop associated performance measures. In this example the measurement system may seek an interface with the customer’s management information system. If the customer has a system for capturing data that assesses its suppliers the firm could attempt to capture this information to enable it to judge its performance through the customer’s eyes.

The balanced scorecard system, it is claimed, actually balances the competing needs of an organisation. In its original form (1992) the balanced scorecard was credited with the ability to “allow managers to look at the business from four important perspectives”. The techniques is claimed to focus upon the needs of the stakeholders of a business. Thus shareholders and customers are two specific stakeholders that are mentioned within the balanced scorecard. The focus upon innovation and learning however and upon continuous improvement would also indicate the need for employee development and supplier relations should be incorporated within the internal-business-process perspective (as it was referred to in 1996).

In fact each business is expected to design and adopt its own scorecard to meet its own needs. Kaplan and Norton (1996) explicitly state that they “don’t think that all stakeholders are entitled to a position on a business unit’s scorecard. The scorecard outcomes and performance drivers should measure those factors that create competitive advantage and breakthroughs for an organization.” The overarching objective of the balanced scorecard is to achieve both short-term and long-term financial success and is actually competing with other more explicitly shareholder value based approaches as a method to enable businesses to achieve this.

## 6.6 The environmental audit

Before the development of any appropriate measures can be considered it is first necessary for the organisation to develop an understanding of the effects of its activities upon the external environment. The starting point for the development of such an understanding therefore is the undertaking of an environmental audit. An environmental audit is merely an investigation and recording of the activities of the organisation in order to develop this understanding (Kinnersley 1994).

Indeed ISO14000 is concerned with such audits in the context of the development of environmental management systems. Such an audit will address, inter alia, the following issues:

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

Such an audit will require a detailed understanding of the processes of an organisation and so will be detailed and cannot be undertaken just by the accountants of the organisation. It will also involve other specialists and managers within the organisation who will need to pool their knowledge and expertise to arrive at a full understanding. Indeed one of the features of environmental accounting is that its operation depends to a significant extent upon the cooperation of the various technical and managerial specialists within the organisation such accounting cannot be undertaken by the accountants alone.

The objective of such an audit is firstly to arrive at an understanding of the effects of organisational activity and then to be able to assign costs to such activity. It should also enable the managers of the organisation to consider alternative ways of undertaking the various activities which comprise the operational processes of the organisation and to consider and evaluate the cost implications, as well as the benefits, of undertaking such processes differently.

Such an audit will probably necessitate the collection of information which has not previously been collected by the organisation, although it may well be in existence somewhere within the organisation's data files. A complete environmental audit is a detailed and time consuming operation but there is no need for such an exercise to be completed as one operation. Indeed the review of processes and costs should be a continuous part of any organisation's activity which can lead to the implementation of better processes or control procedures without any regard to environmental implications.

Thus the way to approach this is to extend the normal routines of the organisation to include a consideration, and quantification, of environmental effects on an ongoing basis.

Once this audit has been completed then it is possible to consider the development of appropriate measures and reporting mechanisms to provide the necessary information for both internal and external consumption. These measures need to be based upon the principles of environmental accounting, as outlined below. It is important to recognise however that such an environmental audit, while the essential starting point for the development of such accounting and reporting, should not be viewed as an discrete isolated event in the developmental process.

Environmental auditing needs to be carried out on a recurrent basis, much as is financial or systems auditing, in order to both review progress through a comparative analysis and to establish where further improvement can be made in the light of progress to date and changing operational procedures.

## 6.7 The Measurement of Performance

The measurement of performance is central to any consideration of performance evaluation and this resolves into two areas for consideration, namely why measure and what to measure. Measurement theory states that measurement is essentially a comparative process, and comparison provides the purpose for measurement. Measurement enables the comparison of the constituents of performance in the following areas:

- Temporally by enabling the comparison of one time period with another;
- Geographically by enabling the comparison of one business, sector or nation with another;
- Strategically by enabling alternative courses of action and their projected consequences to be compared.

Performance itself is not absolute but rather comparative and it is essential in evaluating performance to be able to assess comparatively in the nature of 'better than expected', 'worse than the competition' etc. It is not possible to assess performance in other than these terms and so a quantitative approach to performance evaluation is essential even if some aspects of performance are qualitative in nature. It is necessary therefore that measurement is a constituent of performance evaluation and so it becomes necessary to determine what should be measured in order to evaluate performance.

It is essential therefore to select appropriate measures for the purpose of the evaluation. It is argued however that appropriate measures cannot be selected until the purpose of evaluation has been determined. It is therefore again demonstrated that the foundation of performance measurement is the identification of the reasons for the evaluation of performance, and this must now be considered. It is clear from the evaluation of the literature, and a consideration of actual practice, that the evaluation of performance takes place for several reasons.

- For control
- For strategy formulation
- For accountability

## 6.8 The Evaluation of Performance

A variety of measures exist to measure and evaluate performance, and while these have been criticised in their efficiency by some writers, it is nevertheless true that such measures have a role in this function. The efficiency of measures of performance can only be determined however by considering their use in the measurement of performance when the purpose of that measurement has been determined. It seems reasonable to argue that different purposes need different measures and that perhaps some, but by no means all, measures are universal in addressing all needs.

Measurements derive their meaning however from the use to which they are applied and mismeasurement by using measures incorrectly causes conflict and misunderstanding. Once a framework has been developed which identifies and addresses needs and purposes of evaluation it is then possible to consider the efficiency and effectiveness of existing measures and identify deficiencies in the measurement system. It is then possible to develop and implement new measures which are appropriate to the purposes identified.

It can readily be seen that the differing needs of different parties in the evaluation process cause tensions within the organisation as it seeks to meet its internal control, strategy formulation and accountability functions and produce a reporting structure to meet these needs. While the basic information required to satisfy these needs is the same information, or at least derives from the same source data, the way in which it is analysed and used is different, which can lead to conflict within the organisation.



This e-book  
*is made with*  
**SetaPDF**

**SETASIGN**

PDF components for **PHP** developers

[www.setasign.com](http://www.setasign.com)



Such conflict is exacerbated when a measure is adapted for one need but only at the expense of a deterioration in its appropriateness for another purpose. Part of the semiotic of corporate reporting however is that managers have the ability to manage information provision in such a way that all stakeholders can be satisfied both with the information received and with the performance of the organisation.

One factor of importance in performance evaluation is the concept of the sustainability of performance. It is therefore important for all stakeholders to be able to ascertain, or at least project, not just current performance but its implications for the future. Performance evaluation must therefore necessarily have a future orientation for all evaluations. The appropriate measures developed through this proposed framework are likely to facilitate a better projection of the sustainability of performance levels and the future impact of current performance.

This is because the addressing of the needs of all stakeholders is likely to reveal factors which will impact upon future performance and which might not be considered if a more traditional approach was taken towards performance evaluation. An example might be the degree to which raw materials from renewable resources have become significant to many industries recently but were not considered at all until recently by any stakeholders of an organisation other than community and environmental pressure groups.

## 6.9 Multi-dimensional performance management

Probably the best known of the multi-dimensional performance measurement frameworks is the balanced scorecard, which we have considered. Another example is the service profit chain which 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.

Thus it is argued 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.

## 6.10 Conclusions

Social and environmental accounting has a significant part to play in the management of an organisation and the adoption of the techniques will have the following effects:

- Improved decision making within the organisation
- Better cost allocation, leading to improved decision making
- Better use of, and allocation of, resources within the organisation
- Improved operational performance
- Improved operational procedures, based upon greater understanding of the impact of activities
- Improved profitability, through either cost reduction or increased activity
- Greater support of investors and other stakeholders, through increased transparency and disclosure leading to greater confidence

These effects are based upon the adoption of the principles of social and environmental accounting but these principles need to be translated into action, in terms of the accounting and reporting systems of the organisation. It is to this that we now turn.



www.sylvania.com

We do not reinvent the wheel we reinvent light.

Fascinating lighting offers an infinite spectrum of possibilities: Innovative technologies and new markets provide both opportunities and challenges. An environment in which your expertise is in high demand. Enjoy the supportive working atmosphere within our global group and benefit from international career paths. Implement sustainable ideas in close cooperation with other specialists and contribute to influencing our future. Come and join us in reinventing light every day.

Light is OSRAM

OSRAM SYLVANIA 



Click on the ad to read more

## 6.11 References

Child J. (1984); *Organisation: A Guide to Problems and Practice*; London; Harper & Row.

Churchman C.W. (1967); Why measure; in C W Churchman & P Ratoosh (eds); *Measurement: Definition and Theories*; London; Wiley; pp. 83–94.

Kaplan R.S. & Norton D.P. (1992); The balanced scorecard – measures that drive performance; *Harvard Business Review*, Jan/Feb, 71–79.

Kaplan R.S. & Norton D.P. (1993); Putting the balanced scorecard to work; *Harvard Business Review*, Sept/Oct, 134–147.

Kaplan, R.S. and Norton, D.P., (1996) ‘Using The Balanced Scorecard As a Strategic Management System’, *Harvard Business Review*, January/February 1996, pp. 75–85.

Kimberley J., Norling R. & Weiss J.A. (1983); Pondering the performance puzzle: effectiveness in interorganisational settings; in Hall R.H. & Quinn R.E. (eds); *Organisational Theory and Public Practice*; Beverly Hills; Sage; pp. 249–264.

Kinnersley D. (1994); *Coming Clean: the politics of water and the environment*; London; Penguin.

Solomons D. (1974); Corporate social performance: a new dimension in accounting reports?; in H. Edey & B.S. Yamey (eds), *Debits, Credits, Finance and Profits*; London; Sweet & Maxwell; pp. 131–141.

## 6.12 Further reading

Gray R., Dey C., Owen D., Evans R., & Zadek S. (1997); Struggling with the praxis of social accounting: stakeholders, accountability, audits and procedures; *Accounting, Auditing and Accountability Journal*, 10(3): 325–364.

Perrini F. (2006); The Practitioner’s Perspective on Non-Financial Reporting: Strategies for Corporate Social Responsibility; *California Management Review*, 48(2), 73–103.

Waddock S.A. & Graves S.B. (1997); The Corporate Social Performance-Financial Performance Link; *Strategic Management Journal*, 18 (4), 303–19.

## 6.13 Self-test questions

1. What categories are included for Britain;s most admired companies?
2. What factors are included in he balanced scorecard?
3. Why is the measurement of performance important?
4. What is ISO14000 and what factors does it cover?

# 7 Globalisation and CSR

Truly accepted values must infuse the organisation at many levels, affecting the perspective and attitudes of personnel, the relative importance of staff activities, the distribution of authority, relations with outside groups, and many other matters. Thus if a large corporation asserts the wish to change its role in the community from a narrow emphasis on profit-making to a large social responsibility (even though the ultimate goal remains some combination of survival and profit-making ability), it must explore the implications of such a change for decision making in a wide variety of organisational activities.

Selznick (1957: 136)

## 7.1 Introduction

Globalisation is a leading concept which has become the main factor in business life during the last few decades. This phenomenon affects the economy, business life, society and environment in different ways, and almost all corporations have been affected by these changes. We can see these changes mostly related with increasing competition and the rapid changing of technology and information transfer. This issue makes corporations more profit oriented than a long term and sustainable company. However, corporations are a vital part of society which needs to be organised properly. Therefore we need some social norms, rules and principles in society and business life for socially responsible behavior.

## 7.2 Globalisation

Globalisation can be defined as the free movement of goods, services and capital. This definition does not cover all the aspects of globalisation or global changing. Globalisation also should be a process which integrates world economies, culture, technology and governance. This is because globalisation also involves the transfer of information, skilled employee mobility, the exchange of technology, financial funds flow and geographic arbitrage between developed countries and developing countries. Moreover globalisation has religious, environmental and social dimensions. In order to encompass this broad impact area globalisation covers all dimensions of the world economy, environment and society. Moreover it is apparent all over the world and the world is changing dramatically. Every government has a responsibility to protect all of their economy and domestic market from this rapid changing.

The question is how a company will adapt to this changing. First of all companies have to know different effects of globalisation. Globalisation has some opportunities and threats. A company might have learn how to protect itself from some negative effects and how to get opportunities from this situation.

Globalisation affects the economy, business life, society and environment in different ways:

- Increasing competition,
- Technological development,
- Knowledge/Information transfer,
- Portfolio investment (fund transfer between developed countries and emerging markets),
- Regulation/deregulation, International standards,
- Market integration,
- Intellectual capital mobility,
- Financial crisis-contagion effect-global crisis.

### 7.2.1 Competition

Globalisation leads to increased competition. (Increased competition is a consequence of globalisation) This competition can be related to product and service cost and price, target market, technological adaptation, quick response and quick production by companies etc. When a company produces with less cost and sells cheaper, it will be able to increase its market share.



**CHALLENGING PERSPECTIVES**

## Internship opportunities

EADS unites a leading aircraft manufacturer, the world's largest helicopter supplier, a global leader in space programmes and a worldwide leader in global security solutions and systems to form Europe's largest defence and aerospace group. More than 140,000 people work at Airbus, Astrium, Cassidian and Eurocopter, in 90 locations globally, to deliver some of the industry's most exciting projects.

An **EADS internship** offers the chance to use your theoretical knowledge and apply it first-hand to real situations and assignments during your studies. Given a high level of responsibility, plenty of learning and development opportunities, and all the support you need, you will tackle interesting challenges on state-of-the-art products.

**We welcome more than 5,000 interns every year across disciplines ranging from engineering, IT, procurement and finance, to strategy, customer support, marketing and sales. Positions are available in France, Germany, Spain and the UK.**

To find out more and apply, visit [www.jobs.eads.com](http://www.jobs.eads.com). You can also find out more on our **EADS Careers Facebook page**.

**AIRBUS** **ASTRIUM** **CASSIDIAN** **EUROCOPTER**

**EADS**



Customers have too much choice in the market and they want to acquire goods and services quickly and in a more efficient way. And also they are expecting high quality and a cheap price which they are willing to pay. All these expectations need a response from the company, otherwise sales of company will decrease and they will lose profit and market share. A company must be always ready for price, product and service and customer preferences because all of these are global market requirements.

### 7.2.2 Exchange of Technology

One of the most striking manifestations of globalization is the use of new technologies by entrepreneurial and internationally oriented firms to exploit new business opportunities. Internet and e-commerce procedures hold particular potential for SMEs seeking to broaden their involvement into new international markets (Wright & Etemad, 2001). Technology is also one of the main tools of competition and the quality of goods and services. On the other hand it necessitates quite a lot of cost for the company. The company has to use the latest technology for increasing their sales and product quality. Globalisation has increased the speed of technology transfer and technological improvement. Customer expectations are directing markets. Mostly companies in capital intensive markets are at risk and that is why they need quick/rapid adapting concerning the customer/market expectations. These companies have to have efficient technology management and efficient R&D management.

### 7.2.3 Knowledge/Information transfer

Information is a most expensive and valuable production factor in the current environment (presently/currently/at the current time) Information can be easily transferred and exchanged from one country to another. If a company have a chance to use knowledge and information then it means that it can adapt to this global changing. This issue is similar with the technology transfer issue in global markets. The rapid changing of the market requires also quick transfer of knowledge and efficient using of that knowledge and information.

### 7.2.4 Portfolio investment (Financial fund flows)

Globalisation encourages increased international portfolio investment. Additionally, financial markets have become increasingly open to international capital flows. For this reason, portfolio investment is one of the major problems of developing economies. It is almost the only way to increase liquidity of the markets and economies for emerging countries through attracting foreign funds. Significantly, this short term investment can dramatically impact on the financial markets. When the emerging economies have some problem in their country or investors make enough profit from their investment then these investors might leave the market. This would mean that market liquidity decreased and financial markets indicators plummet immediately.

### 7.2.5 Regulation/deregulation and international standards

Globalisation needs more regulation of the markets and economy. There are many new and complicated financial instruments and methods in the market and such instruments easily transfer and trade in other countries because of the globalisation effect. Every new system, instrument or tool requires new rules and regulations to determine its impact area. These regulations are also necessary to protect countries against global risks and crises. When the crisis comes out of one country then it influences other countries with trade channels and fund transfers, which we call the contagion effect. On the other hand, during globalisation the shares of big companies are trading in the international stock markets and these companies have shareholders and stakeholders in many different countries. International rules and regulations also offers protection to small investors against the big scandals and other problems in companies.

International standards also regulate markets and economies by means of international principles and rules such as International accounting standards, international auditing standards. It aims to make corporate reporting standardised and comparable.

So that is why the globalised world has more rules and more regulations and international standards than before.

### 7.2.6 Market integration

In fact globalisation leads to the conversion of many markets and economies into one market and economy. The aim of international standards and regulations is also to deregulate all these markets. The economy needs financial structures capable of handling the higher risk in the new economy. For this reason financial markets must be broad, deep, and liquid and at present only the U.S. financial markets are large enough to provide this financial structure in the world market. Global stock market projection and Pan-European stock market projection are part of this changing. There are many similar examples in the current situation for market integration which are also the result of increasing competition in the economy. Integration examples are prominent in company mergers and acquisitions as well.


### 7.2.7 Qualitative Intellectual capital mobility


Another effect of globalisation is human capital mobility through knowledge and information transfers. One of the reasons is that international/multinational companies have subsidiaries, partners and agencies in different countries. They need skilled and experienced international employees and rotation from country to country to provide appropriate international business practice. This changing also requires more skilled, well educated and movable employees who can adapt quickly to different market conditions.

### 7.2.8 Financial crisis-contagion effect-global crisis

Financial crises are mostly determined through globalisation and as a result of the globalisation impact. In fact, this is quite a true explanation. The financial world has witnessed a number of crises cases. Generally financial crises come out from international funds/capital flows (portfolio investments), lack of proper regulations and standards, complex financial instruments, rapid development of financial markets, asymmetric information and information transfers. One country crisis can turn into a global crisis with systemic risk effect. Systemic risk refers to a spreading financial crisis from one country to another country. In some cases, crises spread even between countries which do not appear to have any common economic fundamentals/problems. Previous global crises have also showed that one of the reasons for the crisis is unregulated markets.

## STUDY AT A TOP RANKED INTERNATIONAL BUSINESS SCHOOL




  
**no. 1**  
 for over ten years  
 in a row

Earn a Master's degree at the Stockholm School of Economics (Handelshögskolan i Stockholm). We are ranked as the number one business school in the Nordic and Baltic countries by the Financial Times.

Reach your full potential through a first class, internationally competitive education by studying at one of our five different Master's programs.

Visit us at [www.hhs.se](http://www.hhs.se)



### 7.3 How Globalisation Affects CSR

The question might be how globalisation affects CSR. But the answer to this question is not only related to the last quarter of the 20th century but also related to previous centuries. John Maynard Keynes calculated that the standard of living had increased 100 percent over four thousand years. Adam Smith had an important (seminal) idea about the wealth of communities and in 1776 he described conditions which would lead to increasing income and prosperity. Similarly there is much evidence from economic history to demonstrate the benefit of moral behaviour; for example, Robert Owen in New Lanark, and Jedediah Strutt in Derbyshire – both in the UK – showed the economic benefits of caring for stakeholders. More recently Friedman has paid attention to the moral impact of the economic growth and development of society.

It is clear that there is nothing new about economic growth, development and globalisation. Economic growth generally brings out some consequences for the community. This is becoming a world phenomenon. One of the most important reasons is that we are not taking into account the moral, ethical and social aspects of this process. Some theorists indicated the effect of this rapid changing more than a hundred year ago. Economic growth and economic development might not be without social and moral consequences and implications.

Another question is who is responsible of this ongoing process and for ensuring the wellbeing of people and safeguarding their prosperity. Is this the responsibility of governments, the business world (businessman), consumers, shareholders, or of all people? Government is part of the system and the regulator of markets and lawmakers. Managers, businessmen and the business world take action concerning the market structure, consumer behaviour or commercial conditions. Moreover, they are responsible to the shareholders for making more profit to keep their interest long term in the company. Therefore they are taking risk for their benefit/profit. This risk is not opposed to the social or moral/ethical principles which they have to apply in the company. There are many reasons for ethical and socially responsible behaviour of the company. However, there are many cases of misbehaviour and some illegal operations of some companies. Increasing competition makes business more difficult than before in the globalised world.

The good news and our expectations are that competition will not have any longer bad influence on company behaviour. According to international norms (practice) and expectations, companies have to take into account social, ethical and environmental issues more than during the last two decades. One of the reasons is more competition not always more profit; another reason is consumer expectation is not only related to the cost of products but also related to quality, proper production process and environmental sensitivity.

Moreover shareholders are more interested in long term benefit and profit from the company. The key word of this concept is long termism which represents also a sustainable company. Shareholders want to get long term benefit with a sustainable company instead of only short term profit. This is not only related to the company profit but also related to the social and environmental performance of the company. Thus, managers have to make strategic plans for the company concerning all stakeholder expectations which are sustainable and provide long term benefit for the companies with their investments. However, Sustainability can be seen as including the requirement that whatever justice is about – fair distribution of goods, fair procedures, respect for rights – is capable of being sustained into the future indefinitely. Thus sustainability requires that the values of justice are capable of being continued into the future: if current practices for instance were just from the present point of view but would prevent the same practices from occurring in the future, that would be rejected from the point of view of sustainability (Dower, 2004).... So investor or shareholder expectations and all other stakeholders approaches are supporting a socially responsible and ethical company more than other companies. Globalisation has had a very sharp effect on company behaviour and still we can see many problems particularly in developing countries. This is one of the realities of the globalisation process. However we are hoping to see some different approaches and improvements to this process with some of them naturally related to some international principles, rules and norms. But most of them are related to the end of this flawed system and the problems of capitalisation.

The challenge of CSR in a globalizing world is to engage in a process of political deliberation which aims at setting and resetting the standards of global business behaviour. While stakeholder management deals with the idea of internalizing the demands, values and interests of those actors that affect or are affected by corporate decision-making, we argue that political CSR can be understood as a movement of the corporation into environmental and social challenges such as human rights, global warming, or deforestation (Scherer & Palazzo, 2008).

#### 7.4 Globalisation, Corporate Failures and CSR

Enron, WorldCom, Qwest, Parmalat, SunKil, ImClone, and various other corporate failures bring out some governance and CSR issues and have increased attention to the role of business ethics. Managers and CEO's of these companies must be considered responsible for all of these failures and these are cases of "corporate irresponsibility". Many people have the opinion that if corporations were to behave responsibly, most probably corporate scandals would stop.

CSR protects firms against some long term loss. When corporations have social responsibilities, they calculate their risk and the cost of failure. Firstly, a company has to have responsibility to share holders and also all stakeholders which means that it has responsibility to all society. Corporate failures have an important impact on all society also. In particular, big scandals such as Enron have sharply affected the market and the economy. Various stakeholders (e.g. employee, customer, consumer, suppliers etc.) as well as shareholders and regulators of the firm have a responsibility to ensure good performance. Therefore, CSR is not only related to firms but also related to all society. So changing the role of corporate responsibility shifts/moves the focus from the real problem that society needs to address.

One of the reasons for this result is increasing competition between the company and the market. Managers tend to become much more ambitious than before in their behaviour and status in the globalised world. Thus we have to focus on corporate and managerial behaviour. The question is how to behave as a socially responsible manager and how to solve this vital problem in business life and in society. In the business world there are always some rules, principles and norms as well as regulations and some legal requirements.



Discover the truth at [www.deloitte.ca/careers](http://www.deloitte.ca/careers)

**Deloitte.**

© Deloitte & Touche LLP and affiliated entities.



Click on the ad to read more

However, to be socially responsible one must be more than simply law abiding who has to be capable of acting and being held accountable for decisions and actions. The problem is the implication for all of these directions for company and managerial behaviour. On the other hand, one perspective is that a corporation is a “legal person” and has the rights and duties that go with that status – including social responsibility. In the case of Enron, managers were aware of all regulations, even though they have known all irresponsible and unethical problems in the company management, they did not change their approach and behaviour.

The conclusion is that it is not always possible to control behaviour and corporate activity with regulations, rules and norms. So another question arises in this situation, that if people do not know their responsibility and socially responsible things to do and if they do not behave socially responsibly then, who will control this problem in business life and in the market. The concern is that the social responsibility implication of the company cannot be controlled through legal means. This is the only social contract between managers and society and stakeholders of the company and for responsible and accountable behaviour.

Firms will consciously need to focus on creating value not only in financial terms, but also in ecological and social terms. The challenge facing the business sector is how to set about meeting these expectations. Firms will need to change not only in themselves, but also in the way they interact with their environment (Cramer,2002).

## 7.5 Is Globalisation an opportunity or threat for CSR?

We have no certain answer for this question which is depends on from where are you are looking. It is clear that the globalisation has different effects on the social responsibility of the company and the behaviour of managers. Some of these are supporting companies/managers for motivating towards socially responsible behaviour, while others of them are destroying fair business and all principles, norms and regulations which are the result of increasing competition. Globalization has been created bigger companies in terms of turnover, market capitalization, and amount of assets. This causes imperfect competition with other small and medium size companies which is a major threat for them. But it might also provide to companies great opportunities for reaching people and customers, and for collaboration with other companies from all over the world. In fact we have to accept that globalisation is an inevitable phenomenon for which we have no alternative yet. Well regulated and controlled markets are not a big problem and threat, but lack of regulation and norms is the main problem in a developing country which globalisation has a big influence in these economies.

Moreover CSR implementation is the one of the most important issues for globalised economies and markets. CSR requires some rules for the determination of the relationship between the corporation and society, which is still a complicated process. The implication is that CSR is not merely a simple process but also needs a long term strategic approach by companies which need to learn socially responsible behaviour and their decision makers must enforce these principles in the company.

When the company takes a long term perspective it will have benefits concerning profit and stakeholder interests in the company. Some studies show that there is a clear relationship between CSR and corporate financial performance which is an important academic research topic. Research results focus on the existence of slack resources resulting from better financial performance made when companies invest in areas that are related to social actions. Some other results also support the good management approach which states that good management practice resulting from engagement in social actions enhances the relationship with stakeholders, leading to better financial performance. This topic still needs more research for finding better solutions for corporate behaviour.

The duty of corporations is serving their shareholder through providing proper products and services. The purchasing decision of the customer is not only related with price and quality but also based on a consideration of the social behaviour of the company. Socially responsible investment and behaviour gives some opportunities to the company which are more visible than others and show more concern for stakeholders also.

In particular, the development of information technology is helpful for the company for trading in any place in the world to any customer. Customers want the corporation to behave properly to its suppliers, and their suppliers to treat their labourers fairly even in far distant countries. When the company behaves unethically then people will know this problem all over the world and its effect on company sales and stakeholder interests for the company.

So from this aspect globalisation has a multidimensional effect relating to socially responsible behaviour. Good and bad behaviour are easily visible around the world and all company stakeholders will be aware of it. A company can use this opportunity both ways, which is that good behaviour affects the company positively but unethical behaviour will undoubtedly have negative effects for them. Companies already know that proper behaviour is the only way they can survive and enhance their commercial interests and thereby increase their profits. So the demands of society will be reflected in corporate behaviour. As a summary, a firm has an investment in reputation, including its reputation for being socially responsible. An increase in perceived social responsibility may improve the image of the firm's management and permit it to exchange costly explicit claims for less costly implicit charges. In contrast, a decline in the level of stakeholders' view of a firm's social responsibility may reduce its reputation and result in an increase in costly explicit claims (Mcguire & Sundgren & Schneeweis, 1988). We can also confidently say about CSR's impact at the present time is that it benefits some people and some companies in some situations. Consequently thought is being given to the implications of CSR for the developing world (Blowfield M, J.G. Frynas, 2005).

## 7.6 Conclusion

As we can see, globalisation has an enormous effect on society and business life which can be manifest in a number of different ways. So business life needs more regulation and proper and socially responsible behavior than before. In this chapter we have shown the relationship between CSR and globalisation. We pointed out that the relationship between business failure/ scandals increased after the globalization, and social responsible behavior.

## 7.7 References

Blowfield M., J.G. Frynas (2005), "Setting new agendas: critical perspectives on Corporate Social Responsibility in the developing world", *International Affairs* 8, 99 499–513.

Cramer J. (2002), "From Financial to Sustainable Profit", *Corporate Social Responsibility and Environmental Management*, 9, pp. 99–106 Published online in Wiley.

Dower N. (2004) "Global Economy, Justice and Sustainability" *Ethical Theory and Moral Practice* 7: pp. 399–415.

Mcguire, J.B, A. Sundgren, T. Schneeweis (1988), "Corporate social responsibility and firm financial performance", *Academy of Management*, Vol. 31, No, 4, 854–872.

Scherer, A.G., G. Palazzo (2008), "Globalization and corporate social Responsibility" *The Oxford Handbook of Corporate Social Responsibility* Eds.: A. Crane, A. McWilliams, D. Matten, J. Moon, D. Siegel Oxford University Press 2008 (forthcoming).

Selznick N. (1957); *Leadership in Administration: A Sociological Interpretation*; Evanston, Ill; Row, Peterson.

Wrighta, R.W, H. Etemad (2001), SMEs and the Global Economy, *Journal of International Management*, 7, pp. 151–154.

## 7.8 Further Reading

Prahalad C.K. & Hammond A. (2002); Serving the world's poor, profitably; *Harvard Business Review*, 80(9), 48–57.

Doh J.P., Rodriguez P., Uhlenbruck K., Collins J. & Eden L. (2003); Coping with corruption in foreign markets; *Academy of Management International Review*, 17 (2), 114–127.

## 7.9 Self-test Questions

1. What is the main indicator of Globalisation?
2. How globalisation effect CSR?
3. Is globalisation threat for CSR?
4. Is the reason of the big corporate scandal irresponsible management?



**INDEPENDENT MINDS  
LIKE YOU**

We believe in equality, sustainability and a modern approach to learning. How about you? Apply for a Master's Programme in Gothenburg, Sweden.

PS. University of Gothenburg is on the LPDP list!

 UNIVERSITY OF  
GOTHENBURG

[www.gu.se/education](http://www.gu.se/education)

# 8 CSR in not for profit organisations

A **not for profit organisation** is one whose objective is to support or engage in activities of public or private interest without any commercial or monetary profit. In many countries some will be charities but there will also be many which are not.

A **non-governmental organisation (NGO)** is a legally constituted organisation operates without any participation or representation of any government. In the cases in which NGOs are funded totally or partially by governments, the NGO maintains its non-governmental status insofar as it excludes government representatives from membership in the organisation.

## 8.1 Introduction

It is important to consider the nature of the sector. The not for profit (NFP) sector is one which is growing in importance all over the world. Moreover it is much bigger than people generally realise. In Europe for example it is estimated that the sector comprises around 40% of GDP. In this chapter we will explore the distinctive nature of the sector and consider the implications for CSR.

In the world as a whole there is an unknown number of such organisations. In India alone, for example, it is estimated that between 1million and 2 million such organisations exist. Some are very large – such as governmental institutions and the largest charity (eg WWF) but many are very small.

There is a growing movement within the “non”-profit and “non”-government sector to define itself in a more constructive, accurate way. Instead of being defined by “non” words, organisations are suggesting new terminology to describe the sector. The term “civil society organization” (CSO) has been used by a growing number of organisations, such as the Center for the Study of Global Governance. The term “citizen sector organisation” (CSO) has also been advocated to describe the sector — as one of citizens, for citizens. This labels and positions the sector as its own entity, without relying on language used for the government or business sectors. However some have argued that this is not particularly helpful given that most NGOs are in fact funded by governments and business.

## 8.2 Distinguishing features of sector

The first thing we must remember about this sector is that there is no profit motive and decisions must be taken according to different criteria. Instead the emphasis is upon the provision of a service, which is the essential reason for the existence of such an organisation. Additionally there is normally a disconnection between the acquisition of resources and their use – in other words the money to provide the services normally does not come from the recipient of those services. Moreover the need for those services frequently outstrips the ability of the organisation to satisfy those needs and it is forever operating under a situation of resource constrain.

This means that there are different motivations operating in the NFP. It also means that the stakeholders are different – something which we will return to as it is important for our consideration of CSR in such organisations.

### 8.3 Types of NFP organisation

We can classify NFPs into various types, each with different purposes:

#### 8.3.1 Public bodies

These are related to government in some way and include such things as a local authority and a health authority. These all have the function of providing services to members of society and receive their funding and powers directly from the national government.

#### 8.3.2 Quasi public body

These are also often known as Quangos (quasi autonomous non-governmental organisations) and serve a public or civic purpose without having any direct relationship with the government. Many civic societies are like this and other examples include such things as housing associations. These too often get some funding directly from the government.

#### 8.3.3 Educational institution

As the name suggests these serve an educational function and include such organisations as schools, further education colleges and universities. These may be publicly owned organisations or privately owned and the norm differs between countries.

#### 8.3.4 Charity

We will consider these in detail later but here we need to recognise that a charity exists to fulfil a particular function which involves providing a service.

### 8.4 Motivation for NFP's

The motivation for the existence of NFP's is important to consider as it tends to be different to profit seeking organisations and this has implications for CSR. Firstly a NFP organisation is motivated by some kind of societal concern. Normally this involves the provision of a service to some part of that society and this service provision is normally unrelated to payment for that service.

One motivation for an NFP therefore is the acquisition of resources in order to undertake the provision of those services. Thus there is a concern with the optimising of the utilisation and allocation of what is inevitable scarce and restricted resources. Similarly there is a concern with transaction cost minimisation. These issues are similar to those of profit seeking organisations but the way in which they are decided and the way in which effectiveness is measured tends to be quite different.

Because there is no profit motive then this way of providing motivation to managers and rewarding them for their performance does not exist and alternatives must be sought. Another factors which must be borne in mind is the matter of who decides what is good performance. For a profit seeking organisation the customer will ultimately decide by choosing to buy or not buy. In a NFO there is no customer and the service beneficiaries do not pay (or at least not full cost) for the service received.

Thus the determining of measures of performance is important for these organisations. So too is the setting of standards and the reporting of performance. This is normally done through the development of performance indicators. Often a variety of measures are used including:

- Budgetary control/cash flow
- Performance indicators
- Non-financial measures
- Qualitative factors

For the evaluation of performance then there is less relevance of accounting measures and a correspondingly greater importance of non-financial measures. This inevitable involves problems of quantification and a necessity for deciding between alternatives. One technique which is particular to this environment is that of cost benefit analysis.

Sweden  
Sverige

**PREPARE FOR A  
LEADING ROLE.**

*MSc programmes in strategy and  
management in international  
organisations, and industrial  
engineering and management*

← [liu.se/master](https://liu.se/master)

**li.u** LINKÖPING  
UNIVERSITY

## 8.5 Implications for managers

It will be apparent that there are a number of issues facing managers of these organisations. The first is concerned with the acquisition and utilisation of resources. There is considerable uncertainty regarding the acquisition of resources and this makes planning particularly difficult. The planning horizon therefore tends to be short even though the projects which some NFPs are involved in are inevitably long term in duration.

Other issues which concern managers include the setting of objectives and the measuring of performance. Finance, budgeting & control of course are particularly important in this environment. Another factor is concerned with the influence of stakeholders. Without customers and without shareholders and investors there are a range of other stakeholders who are important and have a great deal of influence. These will include such stakeholders as donors, recipients and society at large.

As far as the external environment is concerned there are a number of issues which are important and distinctive. The first is the question of market identification; this is essential for planning but is not necessarily obvious. Then, as we have implied already there is the fact that service delivery is not evaluated by its beneficiaries who do not pay for its receipt. There are a lot of different stakeholders who all have a view about performance and some influence on its evaluation – a complex situation.

NFPs are – in theory at least – not in competition with each other: this is true as far as helping beneficiaries is concerned but there is an element of competition in the acquisition of resources. For the provision of services there are generally several organisations involved in providing the same services and it might be thought that collaboration – rather than competition – might be an effective way of providing such services. Certainly high profile disasters always several large charities which often collaborate and pool resources.

One of the factors in this sector however is that the largest NFPs are most able to acquire additional resources. Thus there is competition for market share because this leads to easier resource acquisition. In theory also NFPs exist to fulfil a particular purpose. Once that purpose has been satisfied there is no purpose to their continued existence. For both of these factors however the egos of the people managing the NFPs becomes a factor as each strives to extend its life, extend its purpose and extend its size and market share.

## 8.6 Available resources

For many NFPs the main source of funding comes from the government. This is certainly true for public bodies and for quasi public bodies. In most countries it is also true for educational institutions. For the largest charities it is also true as governments tend to use these charities to distribute their aid programmes.

Other sources of funding include borrowing but this is only really an option for capital projects when some security can be provided. So for many NFPs the other main source of funding is from fund raising. This can take the form of seeking donations or legacies or trusts. For the larger organisations then raising funds through trading is also a viable possibility and in the UK, for example, the shopping centres have a considerable number of charities represented.

## 8.7 Structure of a charity

As charities are a significant number of the organisations in the NFP sector then we need to consider their structure in some detail. The first point to make is concerning the legal environment in which they operate. This can be described *intra vires* rather than *ultra vires*. The difference is as follows:

### *Ultra vires*

An *ultra vires* organisation has the power to do anything which it is not specifically prevented to do according to either the law or its founding legal articles of association. All commercial organisations are founded like this and can therefore extend and change their operations according to market needs and circumstances.

### *Intra vires*

An *intra vires* organisation can only undertake those activities which it is specifically empowered to undertake. It is therefore much more difficult for such an organisation to extend or change its activities. All charities are established as *intra vires* organisations. This can be defined as its charitable purpose.

A charity has many tax and regulation advantages but in return there are certain restrictions on what it can do. Thus a charity is not able to act as a pressure group – at least not overtly. Politics are excluded from its sphere of operation. It can engage in fund raising of course but it is prevented from trading as a means of raising funds. This might seem surprising given how many charities are visibly engaged in trading. This is done either through a third party or by means of a trading subsidiary which then gifts the proceeds to the charity.

Thus these restrictions are legal restrictions to ensure that the benefits of being a charity can only accrue to an organisation with a genuine charitable purpose but they are interpreted fairly liberally for organisations which are recognised to be charities. The ultimate sanction of course is the removal of charitable status from such an organisation.

The final point to make about charities is that they make extensive use of volunteers as well as of paid employees. This keeps their operating costs down of course but also adds another stakeholder group with an interest in and concern for how the charity operates, manages its performance and services its beneficiaries. Moreover the relationship between volunteers and paid employees is sometimes a source of conflict.

## 8.8 Accounting issues

We have dealt with a number of accounting issues already in our consideration of planning and budgeting; of the measurement and reporting of performance; and of the evaluation of results. Another important point to make though is concerning the time horizon adopted by these organisations. Many projects are long term in nature but sources of funds are often short term in nature. So there is a long term horizon for expenditure but a short term horizon for income, this is problematic and a source of difficulty in planning for many of these organisations.

Many of these NFP organisation engage in fund raising, as we have seen. This itself causes complications for the accounting iof such organisations and can affect its operational procedures. Money can be given to one of these organisations either for its general activities or for a specific purpose. For example the larger charities frequently have appeals for a specific disaster relief operation. When money is given for a specific purpose then it can only be used for that purpose. Thus these organisations tend to have a number of funds for specific purposes.

This can be problematic when the need for such money has been completed and there is a surplus – it is difficult to use this for another purpose. A further difficulty is caused by the fact that some funding is needed for general administration. People are willing to give for a specific cause but not for general administration. Thus the accounting for these organisations is geared towards making as much expenditure as possible direct expenditure rather than indirect.

SIMPLY CLEVER

ŠKODA



We will turn your CV into  
an opportunity of a lifetime



Do you like cars? Would you like to be a part of a successful brand?  
We will appreciate and reward both your enthusiasm and talent.  
Send us your CV. You will be surprised where it can take you.

Send us your CV on  
[www.employerforlife.com](http://www.employerforlife.com)



Click on the ad to read more

## 8.9 CSR issues in NFPs

All of these factors have implications as far as CSR is concerned. It is often thought that if an organisation exists for a public or charitable purpose then it must be a socially responsible organisation. Our consideration of issues throughout this book should have enabled you to understand that this is not necessarily the case. CSR is about how an organisation conducts its operations and deals with its stakeholders. For NFPs we can see that there is a different focus and we need to consider this in terms of CSR implications. We can consider this according to these criteria:

### 8.9.1 Stakeholders

There are different stakeholders for a not for profit organisation and the different stakeholder groups have different amounts of power to a profit seeking organisation. It is inevitable therefore that dealing with these stakeholders will be a much more important function for a NFP. Moreover the sources of conflict might be different and the actions taken in resolution of this might also be different. Inevitably also the decision making process is likely to be different.

### 8.9.2 Sustainability

In terms of doing more with fewer resources (see Aras & Crowther 2009) then this is always an objective for this kind of organisation. In terms of affecting the choices available to future generations then an NFP actually seeks to do this and to redistribute resources more equitably. In terms of seeking a continual existence then really an NFP should strive to make its purpose of existence no longer relevant and should not seek sustainability.

Thus sustainability is an equally important issue for these organisations but its implications are very different in terms of both motivation and decision making.

### 8.9.3 Accountability

Accountability is an even more important issue for this kind of organisation and who it is accountable to can be very different. Without either shareholders or customers then accountability is to donors, beneficiaries and a wide range of other stakeholders. Moreover it needs to address this accountability – which can be different for different stakeholders – in order to be able to continue with its operations.

### 8.9.4 Transparency

With this diverse set of stakeholders groupings who all have considerable interest in the organisation and its activity then there is obviously a great need for transparency and all such organisations will strive for this. This is particularly exacerbated by the need to keep funds for specified restricted purposes. On the other hand it is in the interest of the NFP to seek to use its accounting system and procedures to classify indirect costs as direct and thereby to minimise the apparent administrative costs incurred. This is contrary to the principle of disclosure but completely understandable!

### 8.9.5 Disclosure

Increasing disclosure is a feature of corporate reporting as they seek to satisfy stakeholders through increased accountability and transparency. Disclosure has of course always been a feature of NFP activity as such disclosure is necessary to seek additional funds as well as to satisfy the diverse but powerful and vociferous stakeholder groupings. In this respect there it might be considered that profit seeking organisations are becoming more like not for profit organisations.

## 8.10 Conclusions

The environment in which not for profit organisations operate is somewhat different but there are still CSR implications which are mostly concerned with sustainability and with accountability. Particular features of this environment are:

- Uncertain resource availability and its effect on long term planning
- Stakeholder power and involvement
- Conflicting priorities
- Legal environment
- Managing ambiguity

## 8.11 References

Aras G. & Crowther D. (2009); *The Durable Corporation: strategies for sustainable development*; Aldershot; Gower.

## 8.12 Further reading

Claver E., Llopis J., Gasco J.L., Molina H. & Cocna F.J. (1999); Public administration – from bureaucratic culture to citizen-oriented culture; *International Journal of Public Sector Management* 12 (5), 455–464.

Davis P. (2001); The Governance of Co-operatives Under Competitive Conditions: Issues, Processes and Culture; *Corporate Governance* 1 (4), 28–39.

## 8.13 Self-test questions

1. What is ultra vires?
2. What types of NFP exist?
3. What CSR issues exist for NFPs?
4. What measures of performance are typically used by these organisations?

# 9 CSR and Strategy

I discern two sorts of inequality in the human species: the first I call natural or physical...; the second we might call moral or political inequality because it derives from a sort of convention, and is established, or at least authorised, by the consent of men. This latter inequality consists of the different privileges which some enjoy to the prejudice of others...

Rousseau (1755) – A Discourse on Inequality

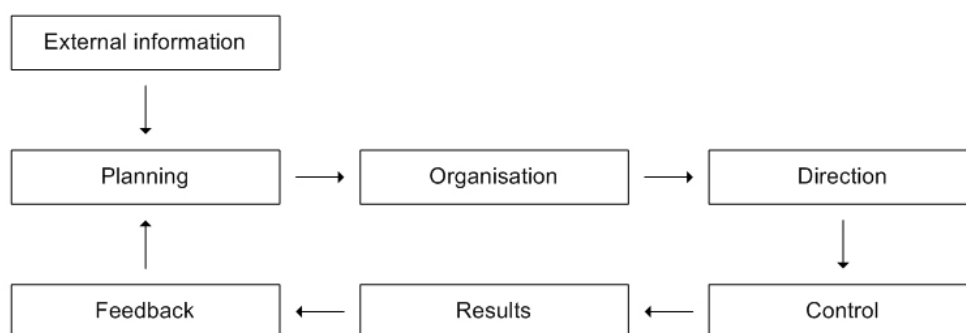
## 9.1 Introduction

The development and implementation of strategy is of course important for every organisation, and this has always been so. Increasingly however in the present CSR is being considered as a crucial part of that strategy with corresponding advantages to the organisation. In this chapter therefore we will consider aspects of this in the context of the objectives of the firm and its procedures for governance.

## 9.2 The Role of a Business Manager

A manager of any modern business has a difficult job to perform. A crucial part of his job is to meet the objectives of the organisation of which he is a part and in order to do so he must pay attention to a number of important issues. Although the exact nature of a manager's job may vary quite significantly from one organisation or department to another, so that the role of a marketing manager, a production manager or a manager of a supermarket may appear to be quite different, there is however considerable similarity in terms of the fundamental tasks to be performed.

These tasks can be categorised as follows:



**Fig 9.1:** The tasks of management

Every manager plans his/her work and the work of others as well as organising him/herself and others, directing others as to what to do, motivating them and exercising control over situations and other people. The results are fed back into the planning process in order to modify future plans for the business.

All managers are concerned with working with people: those they work with, those they supervise, those they report to, and those who are the customers for the product or service which is provided by that area of an organisation which the manager is responsible for. All managers are therefore naturally concerned with the output for their particular area of responsibility and so are also concerned with the inputs to their area of responsibility, whether these be raw materials, information or goods to be displayed and sold.

Using the information available, a manager must plan for the future of the business. In this context a manager must decide upon the courses of action which need to be taken in order to achieve the best results, and must consider what alternative courses of action are available, and what the consequences of any particular decision might be.

Thus the manager of a restaurant, for example, will need to decide what its opening hours need to be and how these might affect possible customers who might want to dine when the restaurant is closed. The manager however needs also to decide upon the ingredients of the menu and how much of each to order; in doing so he needs to consider what the effect of not ordering enough of a particular item might be in terms of dissatisfied customers and the possible effect this might have upon the future of the business but also what the effects of overordering and having waste might be upon the profitability of the business. The manager therefore needs to consider alternatives and their consequences and decide what course of action to take after this consideration of the facts.



**Lnu.se**

Choose a university where life is possible.

**Bachelor programmes in**  
*Business and Economics | Design and Humanities |  
 Computer Science/IT | Natural Science*

**Master programmes in**  
*Business and Economics | Computer Science/IT |  
 Design and Humanities | Natural Science |  
 Social and Behavioral Science | Technology  
 and Engineering*

**Summer Academy courses**

**Linnæus University**  
 Sweden

Ellen, Marketig,  
 Master programme  
 120 CREDITS

Decision making is a crucial part of the job of any manager, and decisions need to be made between conflicting alternatives. These decisions are often to a large extent conflicting in their possible outcomes and there is a degree of uncertainty surrounding the consequences. Selecting the best possible decision to make is therefore often a difficult and skilful process but it is important that the decisions made are the right ones. Because of this a manager needs tools to help him/her to evaluate the consequences of the alternative decisions which he might make. These tools will assist him/her in making better decisions.

### 9.3 The objectives of a business

A business manager must be concerned not just with the internal running of the business but must also be concerned with the external environment in which the business operates – that is with his/her customers and suppliers, with competitors, and with the market for the products or services supplied by the business.

Such concerns of a business manager comprise the strategic element of the manager's job and a manager must therefore be familiar with this aspect of management, and with the way in which accounting can help in this area. This chapter therefore is concerned with a consideration of the external environment of a business and with the strategic part of a manager's job. First however we need to consider the various objectives which an organisation might have.

The objectives of a manager need to be considered in terms of their helping to meet the objectives of the organisation in which he works. While most business organisations aim to make a profit this is not true of all, and the not-for-profit sector of the economy is one which is increasing in importance, and making a profit is not the only objective of most organisations. Nevertheless organisations do have objectives, and the following possible objectives of an organisation can be identified:

#### 9.3.1 Profit maximisation

For organisations which exist to make a profit it seems reasonable that they should seek to make as large a profit as possible. It is not however always clear what course of action will lead to the greatest profit, and it is by no means clear whether profit maximisation in the short term will be in the best interests of the business and will lead to the greatest profit in the longer term. Thus profit maximisation may not be in the best interests of a business and it certainly may conflict with other objectives which a business may have.

#### 9.3.2 Maximising cash flow

Cash flow is not the same as profit and an organisation needs cash to survive. In some circumstances this cash flow may be more important than profit because the lack of cash can threaten the survival of the organisation.

### 9.3.3 Maximising return on capital employed

This is a measure of performance of a business in terms of its operating efficiency and therefore provides a measure of how a business is performing over time. Comparative measures are useful in helping the owners and managers of a business to decide what course of action may be beneficial to the business.

### 9.3.4 Maximising service provision

This is the not-for-profit sector equivalent of maximising the return on capital employed and thus provides a similar means of evaluating decisions.

### 9.3.5 Maximising shareholder value

The value of a business depends partly upon the profits it generates and partly upon the value of the assets it possesses. These assets can comprise partly of tangible assets such as plant and machinery or land and buildings and partly of intangible assets such as brand names. Thus the value of Coca Cola as a business far outweighs the value of its fixed assets because of the value of its brand name which is recognised world-wide. Maximising the value of the business to shareholders therefore involves much more than maximising the profit generated.

### 9.3.6 Growth

Growth through expansion of the business, in terms of both assets and earnings, and the increase in market share which the business holds is one objective which appeals to both owners and managers. If this is an objective of the business then it will lead to different decisions to those of profit maximisation.

### 9.3.7 Long term stability

The survival of a business is of great concern to both owners and managers and this can lead to different behaviour and a reluctance to accept risk. All decisions involve an element of risk and seeking to reduce risk for the purpose of long term stability can lead to performance which is less than desirable.

### 9.3.8 Satisficing

It must be recognised that all objectives of an organisation are dependent upon the people who set them and business behaviour cannot be considered without taking this into account. Satisficing is a way of reducing risk and taking multiple objectives into account by making decisions which are acceptable from several viewpoints without necessarily being the best to meet any particular objective.

Any business is likely to seek to pursue a number of these objectives at any point in time. The precise combination of them is likely to vary from one organisation to another and from one time to another, depending upon the individual circumstances of the organisation at any point in time. The organisation will not however view all the objectives which it is pursuing at any particular time as equally important and will have more important ones to follow. These objectives will therefore tend to be viewed as a hierarchy, which may vary from time to time.

None of these conflict with socially responsible behaviour and there is growing evidence that social responsibility actually enhances the ability to achieve all of these objectives.

#### 9.4 The Tasks of a Manager

We have seen how the role of a manager of a business will vary greatly according to his area of responsibility. We have also seen how the manager needs to help the organisation meet its objectives and that these can vary significantly from one organisation to another. The roles of different managers are therefore very different and the tasks which they undertake to perform their roles are also very different. Nevertheless we can classify these different tasks into one of several types according to their nature. These tasks can be classified as follows:



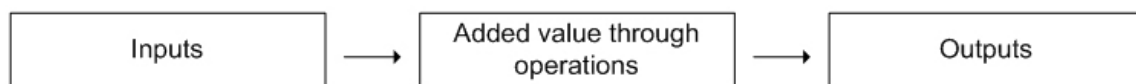
Striking a match, reconnecting with your family through Skype or over a phone network from Ericsson, refurbishing your apartment at IKEA or driving safely in your Volvo - none of this would be possible if not for Sweden. Swedish universities offer over 900 international master's programmes taught entirely in English.

Don't just pick a place - pick a future.  
>[studyinsweden.se](https://studyinsweden.se)

 Sweden Sverige	 SI Swedish Institute	 STUDY SWEDEN
---	---	---

### 9.4.1 Planning

A manager needs to plan for the future in order to decide how best to meet the objectives of the organisation. He needs to decide what can be achieved and what inputs are needed to help him meet his plan. Planning therefore needs to be not just qualitative but also quantitative in order to evaluate the plan and determine inputs and outputs to the plan. All business processes can be considered as taking a set of inputs and performing operations in order to add value and transform them into outputs. The function of any business can therefore be considered to be adding value through the transformations made during its processing. This can be illustrated as follows:



**Fig 9.2:** The transformational process

Planning needs to consider alternatives, not just in terms of alternative targets to set but also in terms of alternative methods of achieving these targets. Planning cannot be done in isolation but needs to take into account what effect the planning has upon the plans of other managers within the organisation. This is especially true when the inputs of this plan come from the outputs of the plan of another manager or when these outputs affect the planning of another manager.

Thus a sales manager cannot plan how much to sell without taking into account the plan of the production manager concerning how much will be produced, and the production manager cannot make his plans for production without taking into account the planning of the sales manager regarding how much can be sold. The planning tasks of the manager therefore are important but cannot be made in isolation.

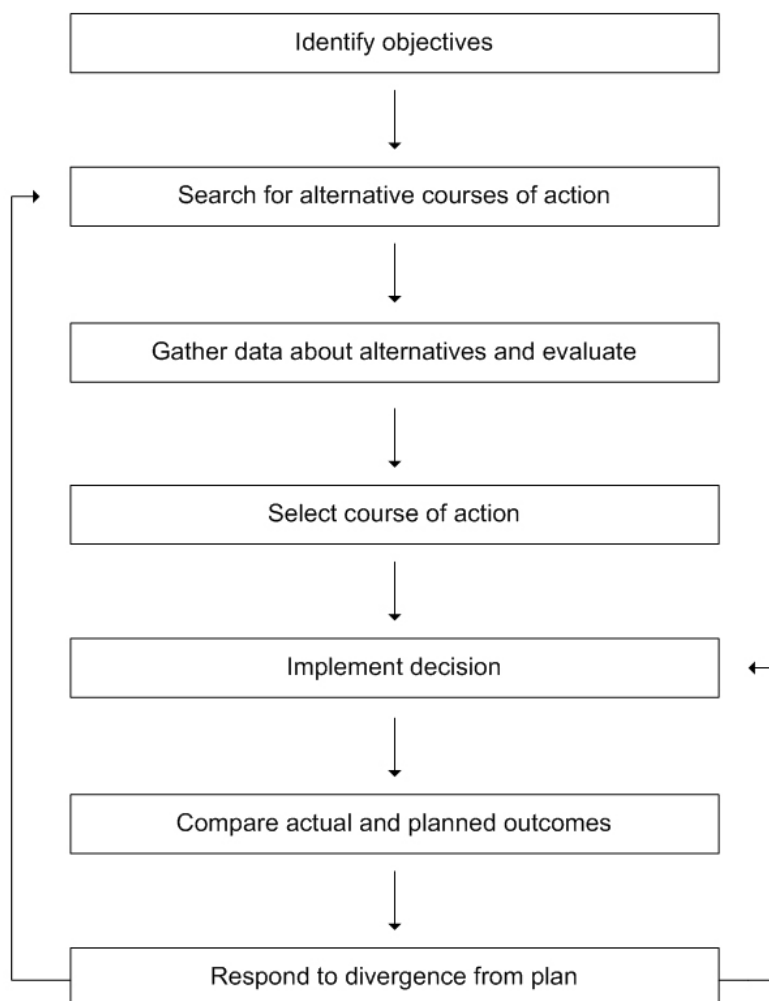
### 9.4.2 Control

Control is concerned with making sure that things happen in accordance with the plan. It therefore involves monitoring the plan, and progress being made in accordance with the plan. It also involves taking action when things are not going in accordance with the plan in order to attempt to change things so that the plan can be achieved. Control is therefore an ongoing activity for a manager and involves comparing actual performance with targets, providing feedback on actual performance and taking action to change performance when it diverges from the plan.

Although the manager may be able to achieve this by physical observation and communication with people, it is likely that this will not be sufficient. He will probably need to rely to a large extent upon reports in order to exercise control. The reports which management accounting provide are therefore crucial in assisting a manager to exercise control.

### 9.4.3 Decision making

One of the key aspects of a manager's job is concerned with making decisions. There is always more than one course of action which a manager can take in any particular situation (even if one of the courses is to do nothing!) and so he needs to decide between the alternatives in order to make the decision which is most beneficial. In order to make a decision the manager needs to identify the possible alternative courses of action open to him, to gather data about those course of action and to evaluate the consequences of each particular alternative. The stages in the decision making process are shown in the diagram below, which illustrates that the decision making process is not complete when an alternative has been selected and implemented but that the outcomes of the decision need to be followed through into the control process.



**Fig 9.3:** The Decision Making Process

In order to make a decision a manager needs information. Management accounting is one tool which exists to help the manager by providing information about the consequences of the alternatives open to him.

#### 9.4.4 Performance evaluation

While the performance of organisations is evaluated by such measures as return on capital employed, the organisation in turn needs to evaluate the performance of its units and the managers running these units. The managers in turn need to evaluate the actual performance of their tasks against that which has been planned. In order to evaluate performance there needs to be acceptable measures of performance. Measurement needs to be relative to be meaningful – to compare performance with plans and with past performance. Performance measures also need to be quantitative in order to enable comparisons to be made and financial information provides important data for the measurement of performance. Unless performance can be evaluated managers have no basis upon which to exercise control, to make decisions and to plan for the future.

#### 9.4.5 Communication

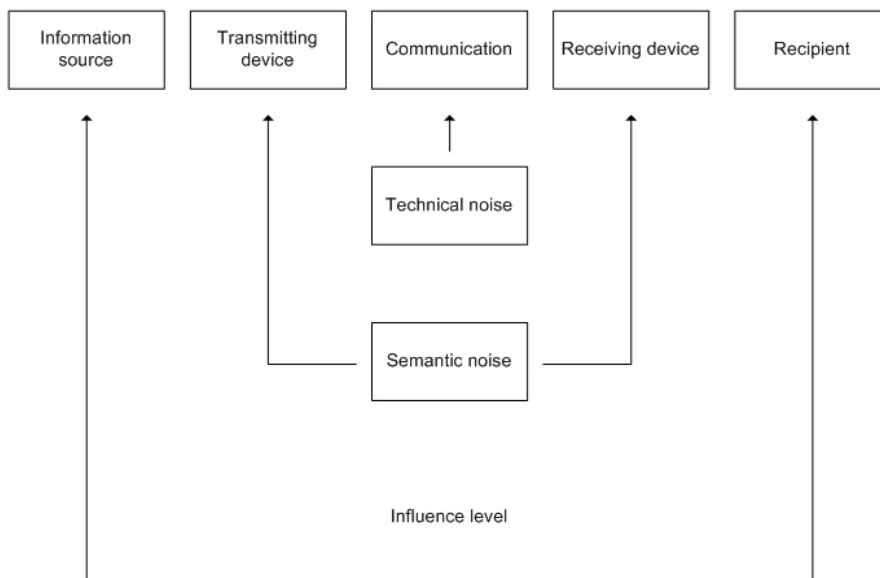
Information available to help managers in their tasks needs to be communicated to them, and managers in turn need to communicate their plans and decisions to others. Communication involves both the sender of information and its recipient, and for the information to be of value it needs to be understood by the recipient as intended by the sender. Any interference which prevents the message being received by the recipient is known as noise and the diagram below shows that two types of noise prevent a message being received as transmitted.



**e-learning for kids**

- The number 1 MOOC for Primary Education
- Free Digital Learning for Children 5-12
- 15 Million Children Reached

**About e-Learning for Kids** Established in 2004, e-Learning for Kids is a global nonprofit foundation dedicated to fun and free learning on the Internet for children ages 5 - 12 with courses in math, science, language arts, computers, health and environmental skills. Since 2005, more than 15 million children in over 190 countries have benefitted from eLessons provided by EFK! An all-volunteer staff consists of education and e-learning experts and business professionals from around the world committed to making difference. eLearning for Kids is actively seeking funding, volunteers, sponsors and courseware developers; get involved! For more information, please visit [www.e-learningforkids.org](http://www.e-learningforkids.org).



**Fig 9.4:** The Communication of Information

Technical noise is that such as occurs on a telephone or radio which is concerned with the technical means of communication. A more crucial type of noise however is semantic noise which occurs because a message is not transmitted in a clear and unambiguous manner and so is not correctly understood by the recipient. Quantitative information is less likely to be misunderstood than qualitative information and this is one of the importance features of accounting information. Management accounting therefore has an important part to play not just in enabling decisions to be made but also in the communication of this information.

### 9.5 The importance of performance measurement

In order for a business to be able to control its operations it is necessary that the managers of that business are able to measure the performance of the business and of individual parts of that business. A significant feature of business management therefore is the need to measure and evaluate performance, both of the business as a whole and of individual parts of that business. Of equal significance is the ability to evaluate the performance of individual managers. This is of importance to the business but particularly to the managers themselves, as their rewards are increasingly based, at least in part, upon an assessment of their performance.

Increasingly also managerial rewards are based upon a variety of aspects of performance and this includes their effect upon the CSR activity of the corporation. This is another reason why CSR is being increasingly linked into the strategic planning process.

## 9.6 Managers and business ethics

Business ethics is a subject of considerable importance to any organisation and we have considered some of the high profile business failures which have led to the current interest in CSR. Freedom in the markets is of course another source of potential abuse and unethical behaviour and late 2008 provides just such an example where the misbehaviour in the housing lending market – the so called sub-prime scandal – has led the serious economic problems in the USA which then spread elsewhere.

Accounting information has often been accused of providing an excuse for unethical behaviour. Indeed this accusation has been extended to accountants and business managers generally who have been accused of behaving unethically in their search for profits to the exclusion of all else. The unethical ways in which accounting information has been used have been described in detail by Smith (1992) who describes the way in which new accounting techniques have been created with the sole purpose of boosting reported profits. These techniques have become known as creative accounting and have been the subject of much media attention. Smith's book, "Accounting for Growth", makes interesting reading for any prospective business manager.

Other writers have however been concerned with highlighting the value of ethical behaviour and have claimed that this actually leads to better business performance. Thus McCoy (1985) considers that ethics need to be at the core of business behaviour and that effective business management is based upon ethical behaviour. He claims that this recognition, and acting accordingly, actually increases the performance of a business. The UK accounting bodies are also concerned with business ethics and all have a stance in this matter, and have incorporated a requirement for ethical behaviour into their codes of conduct. The subject of ethical behaviour amongst businesses has also had an effect upon auditing practice and upon the financial reporting of businesses.

Any manager operating in a business environment needs to be aware of the importance of ethical behaviour. Equally (s)he will experience conflicts, in attempting to behave ethically, between different alternative courses of action, and may find conflicts between the firm's objectives and his / her own personal motivation and objectives. No ready solution to these conflicts is available but a manager should be aware that research has shown that ethical behaviour leads to better performance in the longer term, and so should be encouraged to act accordingly.

## 9.7 Corporate Governance

Another important issue which has been exercising the minds of business managers, accountants and auditors, investment managers and government officials – all over the world – is that of corporate governance (Aras 2008). Often companies main target is to become global – while at the same time remaining sustainable – as a means to get competitive power. But the most important question is concerned with what will be a firms' route to becoming global and what will be necessary in order to get global competitive power. There is more than one answer to this question and there are a variety of routes for a company to achieve this.

Probably since the mid-1980s, corporate governance has attracted a great deal of attention (Aras & Crowther 2008). Early impetus was provided by Anglo-American codes of good corporate governance<sup>13</sup>. Stimulated by institutional investors, other countries in the developed as well as in the emerging markets established an adapted version of these codes for their own companies. Supra-national authorities like the OECD and the World Bank did not remain passive and developed their own set of standard principles and recommendations. This type of self-regulation was chosen above a set of legal standards (Van den Barghe, 2001).



**LIFE SCIENCE IN UMEÅ, SWEDEN  
– YOUR CHOICE!**

- 32 000 students • world class research • top class teachers
- modern campus • ranked nr 1 in Sweden by international students
- study in English

– Bachelor's programme in Life Science  
– Master's programme in Chemistry  
– Master's programme in Molecular Biology

**APPLY NOW!**

  
**UMEÅ UNIVERSITY**  
FACULTY OF SCIENCE & TECHNOLOGY

After the various big corporate scandals corporate governance has become central to most companies. It is understandable that investors' protection has become a much more important issue for all financial markets after the tremendous firm failures and scandals. Investors are demanding that companies implement rigorous corporate governance principles in order to achieve better returns on their investment and to reduce agency costs. Most of the times investors are ready to pay more for companies to have good governance standards. Similarly a company's corporate governance report is one of the main tools for investor' decisions. Because of these reason companies can not ignore the pressure for good governance from shareholders, potential investors and other markets actors.

On the other hand banking credit risk measurement regulations are requiring new rules for a company's credit evaluations. New international bank capital adequacy assessment methods (Basel II) necessitate that credit evaluation rules are elaborately concerned with operational risk which covers corporate governance principles. In this respect corporate governance will be one of the most important indicators for measuring risk. Another issue is related to firm credibility and riskiness. If the firm needs a high rating score then it will have to be pay attention for corporate governance rules also.

Credit rating agencies analyse corporate governance practices along with other corporate indicators. Even though corporate governance principles have always been important for getting good rating scores for large and publicly-held companies, they are also becoming much more important for investors, potential investors, creditors and governments. Because of all of these factors, corporate governance receives high priority on the agenda of policymakers, financial institutions, investors, companies and academics. This is one of the main indicators that the link between corporate governance and actual performance is still open for discussion. In the literature a number of studies have sought investigated the relation between corporate governance mechanisms and performance (eg Agrawal and Knoeber, 1996; Millstein and MacAvoy, 2003)

Most of the studies have showed mixed result without a clear cut relationship. Based on these results, we can say that corporate governance matters to a company's performance, market value and credibility, and therefore that company has to apply corporate governance principles. But most important point is that corporate governance is the only means for companies to achieve corporate goals and strategies. Therefore companies have to improve their strategy and effective route to implementation of governance principles. So companies have to investigate what their corporate governance policy and practice needs to be.

## 9.8 Corporate Governance Principles

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

- Transparency,
- Accountability,
- Responsibility,
- Fairness

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

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

The definition and measurement of good corporate governance is still subject to debate. However, good corporate governance will address all these main points:

- Creating sustainable value
- Ways of achieving the firm's goals
- Increasing shareholders' satisfaction
- Efficient and effective management
- Increasing credibility
- Ensuring efficient risk management
- Providing an early warning system against all risk
- Ensuring a responsive and accountable corporation
- Describing the role of a firm's units
- Developing control and internal auditing
- Keeping a balance between economic and social benefit
- Ensuring efficient use of resources
- Controlling performance

- Distributing responsibility fairly
- Producing all necessary information for stakeholders
- Keeping the board independent from management
- Facilitating sustainable performance

As can be seen, all of these issues have many ramifications and ensuring their compliance must be thought of as a long term procedure. However firms naturally expect some tangible benefit from good governance. So good governance offers some long term benefit for firms, such as:

- Increasing the firm's market value
- Increasing the firm's rating
- Increasing competitive power
- Attracting new investors, shareholders and more equity
- More or higher credibility
- Enhancing flexible borrowing condition/facilities from financial institutions
- Decreasing credit interest rate and cost of capital
- New investment opportunities
- Attracting better personnel/employees
- Reaching new markets

I joined MITAS because  
I wanted **real responsibility**

The Graduate Programme  
for Engineers and Geoscientists  
[www.discovermitas.com](http://www.discovermitas.com)



**Month 16**

I was a construction  
supervisor in  
the North Sea  
advising and  
helping foremen  
solve problems

Real work  
International opportunities  
Three work placements



 **MAERSK**



Click on the ad to read more

Although corporate governance is primarily considered to be concerned with how a firm conducts itself in relationship to its investors, increasingly it is being extended to a consideration of how it conducts itself in relation to all of its stakeholders. This is a part of the current concern for greater accountability. Thus governance is increasingly being considered to be related to CSR and the concerns of the two are merging (Aras & Crowther 2009).

## 9.9 Conclusions

CSR is now generally considered to be an integral part of strategy for any organisation and built into the strategic planning process. There are many perceived benefits to an organisation from this. Governance also is an integral part of this process.

## 9.10 References

Agrawal A. & Knoeber C.R. (1996); Firm Performance and Mechanisms to Control Agency Problems between Managers and Shareholders; *Journal of Financial and Quantitative Analysis*, 31 (3), 377–398.

Aras G. (2008); Corporate Governance and the Agency Problem in Financial Markets; in D. Crowther & N. Capaldi (eds), *Ashgate Research Companion to Corporate Social Responsibility*; Aldershot; Ashgate; pp. 87–96.

Aras G. & Crowther D. (2008); Exploring frameworks of corporate governance; in G. Aras & D. Crowther (eds), *Culture and Corporate Governance*; Leicester SRRNet; pp. 3–16.

Aras G. & Crowther D. (2009); Corporate Social Responsibility: a broader view of corporate governance; in G. Aras & D. Crowther (eds), *Gower Handbook of Corporate Governance and Corporate Social Responsibility*; Aldershot; Gower (forthcoming).

McCoy C.S. (1985); *Management of Values: The Ethical Difference in Corporate Policy and Performance*; Marshfield, Mass; Pitman.

Millstein. I.M. and MacAvoy. P.W. (2003); The Active Board of Directors and Performance of the Large Publicly Traded Corporation; *Columbia Law Review*, 8 (5), 1283–1322.

Smith T. (1992); *Accounting for Growth*; London; Century Business.

Van den Berghe, L. (2001), “Beyond Corporate Governance”, *European Business Forum*, Issue 5, Spring.

## 9.11 Further reading

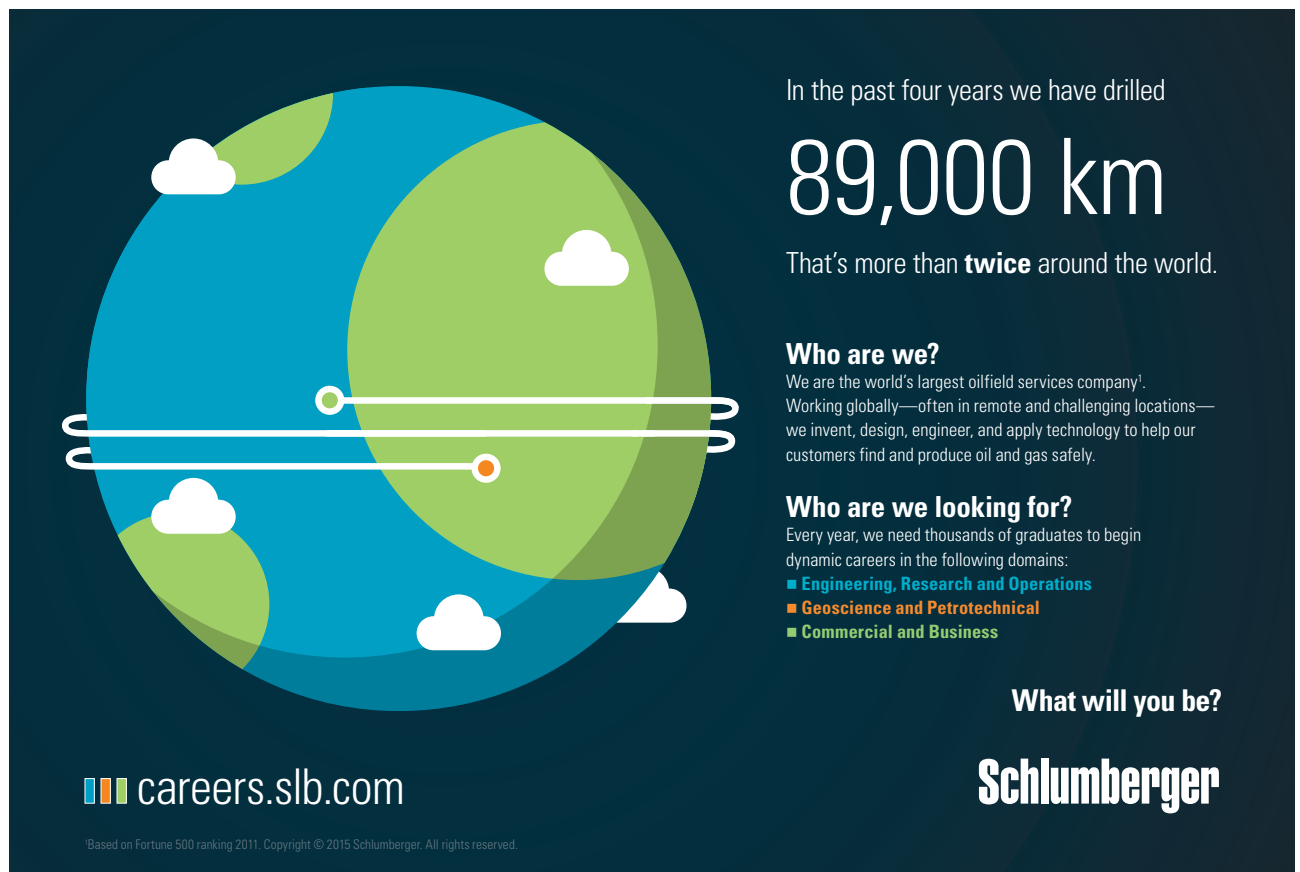
Burke L. & Longsdon J.M. (1996); How corporate social responsibility pays off; *Long Range Planning*, 29(4), 495–502.

Fombrun C. & Shanley M. (1990): What's in a name? Reputation building and corporate strategy; *Academy of Management Journal*, 33(2), 233–258.

Sethi S.P. (2002); Standards for corporate conduct in the international arena: challenges and opportunities for multinational corporations; *Business and Society Review*, 107(1), 20–40.

## 9.12 Self-test Questions

1. What are the principles of corporate governance?
2. What are the objectives of a business, and which is the most important?
3. What are the tasks of a manager?
4. How many steps are there in the decision making process, and what are they?



In the past four years we have drilled

# 89,000 km

That's more than **twice** around the world.

**Who are we?**  
We are the world's largest oilfield services company<sup>1</sup>. Working globally—often in remote and challenging locations—we invent, design, engineer, and apply technology to help our customers find and produce oil and gas safely.

**Who are we looking for?**  
Every year, we need thousands of graduates to begin dynamic careers in the following domains:

- Engineering, Research and Operations
- Geoscience and Petrotechnical
- Commercial and Business

**What will you be?**

**Schlumberger**

[careers.slb.com](http://careers.slb.com)

<sup>1</sup>Based on Fortune 500 ranking 2011. Copyright © 2015 Schlumberger. All rights reserved.

# 10 Corporate Social Responsibility and Leadership

There are few circumstances among those which make up the present condition of human knowledge, more unlike what might have been expected, or more significant of the backward state in which speculation on the most important subjects still lingers, than the little progress which has been made in the decision of the controversy respecting the criterion of right and wrong.

John Stuart Mill (1863) – Utilitarianism

## 10.1 Introduction

Practical experience demonstrates that if an organisation is to be socially responsible then it needs the commitment of the senior managers of that organisation. All organisations of course have leaders but this is not what we are concerned with – rather it is the leadership process which we are going to look at. Effect change management requires leadership to instigate and drive the process and an understanding of this leadership process will help you become a more effective change manager.

Central to a consideration of leadership is the concept of power, and this was highlighted in that last chapter. Moreover Rowlinson (1997) has argued that power is central to understanding organisations. We will therefore devote a substantial part of this chapter to a consideration of power in organisations.

## 10.2 The concept of leadership

When we consider the attributes of a good leader it is very common to come up with a list of the qualities which a good leader should have such a list might look as follows:

- Integrity
- Judgement
- Energy
- Humour
- Fairness
- Initiative
- Foresight
- Dedication
- Objectivity
- Decisiveness
- Ambition

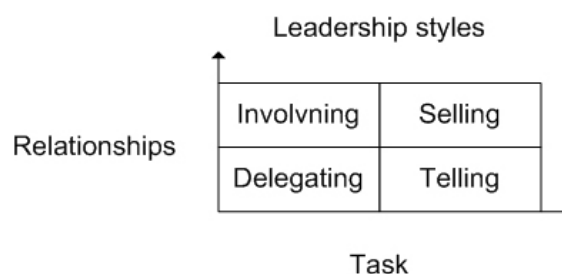
And of course we can also come up with a set of attributes which we consider that a good leader should not have. This might include the following:

- Stubbornness
- Vainness
- Self centredness
- Ruthlessness
- Unfairness
- Prejudice

The problem with defining a leader through the definition of desirable and undesirable attributes is that what we are seeking is the perfect person. In reality of course such a person does not exist – moreover this kind of definition would exclude both you and me from being considered as a leader – and hence as a manager within an organisation.

A manager in an organisation is, by definition, assigned a role of leadership and every manager would probably claim to be able to exercise leadership in some form. This view would not necessarily be agreed with by the subordinates of that manager. We therefore need to distinguish between the role of a leader and the exercise of leadership. This leadership involves more than the assigning of tasks to subordinates and being accountable for their performance. Such tasks are merely administrative. It is in the way that those administrative tasks are performed that we should look to discover the features of leadership. At that point we will be in a position to consider whether leadership can only be exercised by those with administrative responsibility or whether anyone can be an effective leader.

Leadership itself is more concerned with how a person influences another to carry out various tasks and so it is more concerned with communication and motivation. Leadership is therefore concerned not just with the task in hand but also with relationships between the leader and others involved in the tasks. Hersey & Blanchard used this notion of the relationship between these two to model leadership styles in the following way:



**Fig 10.1:** Leadership styles

According to them those most concerned with performance of the task in hand will seek to get it done by assign the carrying out of it to their subordinates – telling. With concern for their relationship with their subordinates they will seek to persuade them to undertake the task in hand – selling. Those who are more concerned with relationships than with the immediate performance of the task in hand will seek to involve their subordinates in the decision making and planning process – involving. Those who are not overly concerned with either the completion of the task or their relationship with their subordinates will leave it to them to determine when and how the task should be performed – delegating.

This might make it seem that delegation is a symptom of indifference but in actual fact delegation – leaving the decision as to when and how to carry out a task – is the highest form of trust because in this case the manager keeps responsibility for the performance of the task but cedes control of how it is performed to others. Heresy and Blanchard argue that as managers mature in their roles and become more familiar with both the tasks required and the people with whom they are working they change their leadership style, moving from the telling style through the selling and involving styles to the delegating style. For them trusting others in this way is the ultimate form of leadership.



"I studied English for 16 years but...  
...I finally learned to speak it in just six lessons"  
Jane, Chinese architect

ENGLISH OUT THERE

Click to hear me talking before and after my unique course download

### 10.3 Styles of Leadership

These ideas suggest that the qualities of leadership are not fixed but rather that they depend upon the people involved, and their respective personalities. This in turn suggests that it is fruitless to study leadership in terms of defining a set of qualities which make a good leader. Good leadership depends upon the interaction between the leader and the led, but it depends upon more than this. It also depends upon the situation. The leadership style for a brand new start up business would probably need to be very different from that to lead a company which is long established but going through a difficult period. This in turn might be very different to a style needed to reorganize a business after a takeover. The demands of leadership depend therefore upon the circumstances as well as the people involved.

We can classify leadership styles into three distinct types:

- Authoritarian
- Laissez – faire
- Democratic

We can relate these back to the styles identified by Hersey & Blanchard by comparing the authoritarian style to the telling style, the laissez – faire style to the delegating style and the democratic style to the selling and involving styles. What we cannot do however is to state that any style is necessarily better than any other. This depends upon both the people involved and the situation in which the organisation finds itself. Thus we can state that there are three variable involved in the determination of good leadership. These are:

- The personality of the leader
- The personality of the followers
- The situation at the time

### 10.4 Organisational culture and styles of leadership

There are of course other factors which we need to consider and we have considered on of those in the last chapter – namely the culture of the organisation. Different styles of leadership will work better in different cultures so let us spend a while considering the relationship between organisational culture and leadership style.

We need to think about this firstly in terms of the structure of the organisation and it is possible to classify organisations according to their structure in a number of different ways. Thus Etzioni classifies organisational cultures into 3 types:

- Coercive – where the structure is hierarchical and conformity depends upon the imposition of sanctions for failure to conform. The ultimate example of this kind of structure is the military.
- Utilitarian – where the structure is focused around the completion of the tasks which need to be undertaken. Thus an organisation structured into departments such as Accounting, Production and Marketing would normally be a utilitarian structure.
- Normative – where the culture of the organisation is focused upon a shared vision which all members of the organisation buy into. For this type of culture the structure is largely irrelevant as it is the vision which prevails. Many of the new dot com companies have this type of culture.

A different type of classification was provided by Handy, who classified organisations into 4 types:

- Hierarchical – where the organisation and the people within it are organised into lines of responsibility reaching upwards and downwards in the organisation.
- Functional – where the organisation is organised according to the functions to be performed. This is similar to the utilitarian structure identified by Etzioni.
- Matrix – where the organisation has a mix of hierarchy and functionality to meet the needs of particular tasks. Thus a person may have two sets of responsibilities – a functional one depending upon his/her area of specialism (e.g. accounting or IT) and a task one – eg the implementation of a new project which requires a multi-disciplinary team.
- Individual – where people work largely on their own and only joint together into an organisation for administrative convenience. Examples of this type of organisation would be the doctors in a health centre or barristers in a practice.

A third type of classification was provided by Miles & Snow. They classified organisations into the following types, based upon their approach to change and development:

- Defender
- Prospector
- Analyser
- Reactor

## 10.5 Motivation

We can see that leadership is to a large extent concerned with dealing with people in order to optimise the results achieved. Indeed all managerial action is concerned with dealing with people. This has been expressed by McGregor in the following terms:

“Every managerial decision has behavioural consequences. Successful management depends upon the ability to predict and control human behaviour”.

McGregor also classified people according to two types, which he labelled as Theory X and Theory Y. According to him Theory X described the fact that people dislike work and can only be persuaded to work by coercion. His Theory Y on the other hand described the fact that people are conscientious and self motivated. As far as organisations are concerned they are often managed on the assumption that Theory Y applies to managers and senior professionals, who are motivated and can be trusted to perform effectively, while Theory X applies to other workers who need to be controlled and coerced through sanctions. The ideas of good leadership which we have discussed however show this to be problematic. What we should be aiming for as part of good leadership is to motivate people. There are a variety of different theories of motivation however which all suggest different things about what motivates people.



WHILE YOU WERE SLEEPING...

[www.fuqua.duke.edu/whileyouweresleeping](http://www.fuqua.duke.edu/whileyouweresleeping)

**DUKE**  
THE FUQUA  
SCHOOL  
OF BUSINESS



### 10.5.1 Theories of motivation

The Expectancy Theory of motivation, developed by Vroom and Lawler, suggests that people are motivated by an internal calculation which they do. In this calculation a person works out how difficult a task is to do and how much the rewards for successful completion of the task are worth. The interaction determines the level of motivation. Thus a person may be motivated to attempt a difficult task if the rewards for success are highly desired but not otherwise. One implication of this theory however is that motivation is personal and that the same rewards for successful completion of the same task will motivate different people differently depending upon how hard they consider the task to be and how much they value the rewards on offer. This would suggest a problem with the kind of performance bonuses offered to people.

A different motivation theory was developed by Herzberg and is known as the Two Factor Theory. For Herzberg there are two types of factor (hence the name) which have different effects upon a person as far as motivation is concerned. These two factors, and their effects are:

- Hygiene factors – these do not motivate people if they are present but do demotivate people if they are absent. For Herzberg money, above a certain minimal level, is a hygiene factor and does not motivate people.
- Motivators – these motivate people if they are present but do not demotivate people if they are absent. Motivators are concerned with job enrichment, recognition and praise, and the social aspects of working life.

The Hawthorne studies provide a good example of the difference between hygiene factors and motivators. Initially Elton Mayo and his team thought that factors such as lighting and speed of work required were the motivating factors but further investigation and chance discovery showed that these did not motivate people but the fact that they were being researched (and someone was interested in them) provided the motivating force.

Another motivation theory is known as the Equity Theory of motivation. This theory argues that motivation is a comparative process and that people will compare what is expected from them and the rewards on offer for success with what they believe is expected from others and their rewards. Moreover this comparison is not necessarily a realistic one as people will tend to believe that others have to work less hard to achieve the same level of rewards or to gain greater rewards for the same level of effort.

It is important therefore to be careful about making assumptions about what will motivate people. The obvious factor is not necessarily the motivating factor, which might be something quite different. Of equal importance to remember though is that motivation is essentially personal. What motivate you will not necessarily motivate someone else good leaders who are successful in motivating others need to know the people they are trying to motivate in order to understand what it is which will provide the necessary motivation for people as individuals.

### 10.5.2 Motivation and behaviour

Research into motivation in the 1960s and 1970s showed variety of things which might be helpful to managers in developing their leadership abilities. Firstly Williamson (1964) demonstrated that people were motivated by a desire to achieve 2 sets of goals – those of the organisation & personal goals, suggesting that leadership should be concerned with the alignment of those two sets of goals. Ronen & Livingstone (1975) found that involvement in the making of decisions and the setting of targets led to higher motivation from those involved. This was supported by the findings of Rockness (1977) who found that people would tend to set higher targets for themselves than might otherwise be set and that difficult targets were more highly motivating for people.

There is one danger of this however in that if people set difficult targets then there will be a tendency for some to fail to meet those targets. This can have a problem for organisational planning purposes as not all plans will necessarily be achievable. Another problem, particularly in the present, is that many organisations are disapproving of failure and will punish people for failure, often by dismissal. This can have the effect of deterring people from striving to achieve high levels of performance and cause an effect which Schiff & Lewin (1970) observed, namely a tendency for people to create slack in their targets to allow some leeway in case of problems of achievement. Equally Peters & Waterman (1982) found that those companies which excelled were those which tolerated failure and thereby encouraged people to experiment and take risks in doing so.

## 10.6 Definitions of power

‘Power is the capacity to affect organisational outcomes.’ – Mintzberg

‘Power is that which enables A to modify the attitudes or behaviour of B.’ – Handy

The ubiquitous nature of power in organisational life is undeniable. This makes it essential that we have an understanding of the nature of power. Bachrach and Baratz (1974) state:

‘Of course power is exercised when A participates in the making of decisions that affect B. Power is also exercised when A devotes his energies to creating or reinforcing social and political values and institutional practices that limit the scope of the political process to public consideration of only those issues that are comparatively innocuous to A.’

Power, or rather the exercise of power, can be recognised by all of us as existing within these definitions. Also existing within these definitions is an implicit assumption that it is observable and therefore measurable. It has been argued that it is an inherent part of the political system of an organisation but Lukes (1974) argues that this kind of definition of power fails as an analytical device as it is incapable of highlighting the way in which power operates ‘beneath the surfaces’, the way in which it acts in favour of some groups against others.

In spite of this reservation about the theory of power it remains popular within the realm of organisational theory. Indeed its very weaknesses are also its strengths; it can indicate the outcomes of power plays. In this sense it can provide insights into the tactics of power, which is a point articulated at the level of an individual by French and Raven (1959). Viewing power as being observable when exercised by one party over another, their findings were that individuals may possess power which can be derived from one of the following power bases; reward, coercive, legitimate, referent and expert power. These power bases have proved to be remarkably durable within the discourse of organisational studies in the last forty years. Indeed more instrumental texts have used them in order to advise ‘how power may be gained’.

This dominant view of power regards it as being a possession i.e. a department has power or a department has lost power. Thus we can state that power is a commodity at both the level of the individual and at the collective. This is a sentiment that is shared by the strategic contingencies of power literature, which argues that the relative power of a department, in an organisation, can be calculated through an equation. The strategic contingencies perspective links in directly with the issue of organisational resources.

## 10.7 Sources of power

We all have some understanding of what power is, whether or not we agree with the definitions we have considered above. Consequently we all understand when power is being exercised. What is important to understand however is why people are able to exercise power over others in an organisation. For this we need to consider where power comes from – in other words the sources of power that exist.

Excellent Economics and Business programmes at:



university of  
 groningen




“The perfect start  
 of a successful,  
 international career.”

**CLICK HERE**  
 to discover why both socially  
 and academically the University  
 of Groningen is one of the best  
 places for a student to be

[www.rug.nl/feb/education](http://www.rug.nl/feb/education)

We can consider that power comes from variety of sources and the following are the most common sources of power:

- Legitimate power – a leader has legitimate power if people believe that this leader has the right to give orders which they have an obligation to obey. In most organisations this legitimate power derived from a person's status and position in the organisation, which carries with it delegated authority.
- Reward power – if a person is able to give or withhold rewards from another (e.g. the giving or not giving of a performance related bonus) then this gives the person with the authority to grant those rewards power over the other. In a hierarchical organisation this ability to grant rewards exists for all people in the hierarchy who are above yourself.
- Coercive power – this power exists if the subordinates believe that the leader has the ability to impose penalties which are undesirable. In an organisation these can be social (such as loss of friendship or support), administrative (such as in the way work is allocated) or financial (such as loss of overtime opportunities, performance bonus or promotion). In most respects the ability to bestow rewards and coercive power are opposite sides of the same coin.
- Referent power – this source of power exists depends upon the personality and charisma of the leader. It exists if people believe that the leader has characteristics which are desirable and which command respect.
- Expert power – this exists if a leader has superior knowledge or expertise which is relevant to the task in hand. Expert power exists regardless of a person's role in an organisation and does not depend upon having an assigned leadership role.
- Information power – this is similar to expert power but arises not because of particular skills but rather because of access to a particular knowledge base.
- Contingent power – this form of power exists, as its name suggests, because of the demands of a particular situation. It is very often visible in an emergency where someone will assume a leadership role because of the needs of the situation.

Obviously not all of these sources of power will be available to everyone and will not necessarily be available to anyone all of the time. Thus, for example, contingent power will only be available to anyone when the circumstances make it appropriate. Equally expert power or information power may be assumed by all of us but only in the particular situations, or with respect to the particular tasks, for which this power is appropriate.

Most people use all of these sources of power at some point or other and very often use more than one of them in any particular situation. We can see that many of them are interrelated. The other thing to note about these sources of power is that they are to a large extent dependant upon the beliefs of people. To a large extent it is a truism to say that each of us have power over others if those others think that we have.

## 10.8 Systems of control

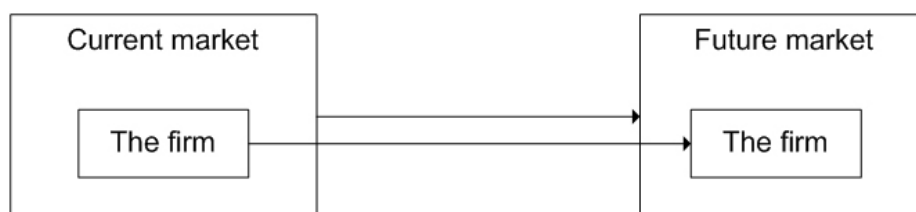
The exercise of power is part of the exercise of control within an organisation. Three different types of control systems have been identified as being used within an organisation (Ouchi 1979). These are:

- Behavioural control. This involves being able to observe people as they go about their work. Behavioural control works best when cause and effect relationships are well understood.
- Output controls. This form of control involves the collecting and analysing of information about the outcomes of work effort. The most common form of output control in use in an organisation stems from its accounting system. The budgetary system is used to measure performance within the organisation but it is measured entirely in terms of output without regard to the inputs. Indeed the advantage of this form of control is that it is only necessary to collect information about outputs but this can be a problem in itself in that there may not necessarily be a relationship between effort and results.
- Clan control. This is based upon the creation of a sense of solidarity and commitment towards the organisation and its objectives. It is thus strong in the normative type of organisation which we considered earlier. It is based upon a shared culture but in its extreme form can be viewed as repressive and as a form of social control.

## 10.9 Strategic planning

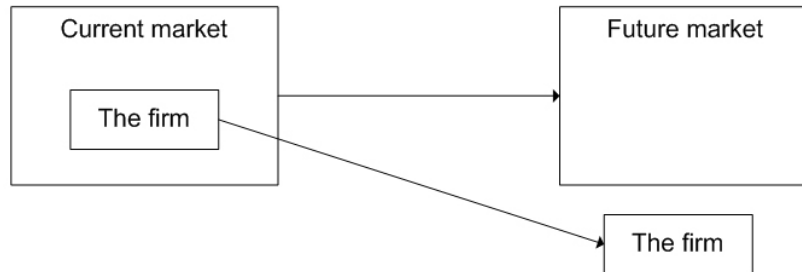
Strategic planning is concerned with the future of the business and with how the firm can best supply what the market desires. This requires an analysis of the market in which the business is operating in order to decide what the market (ie potential customers) wants and what price it is willing to pay for the satisfaction of its wants. This is then followed by an analysis of what the firm is able to produce and supply (and at what price). This then determines how the firm will organise its activities in order to provide these goods or services.

Strategic planning is not concerned with the present but rather with the future and is therefore especially concerned with changes to current patterns of demand, and with ensuring that the firm's capabilities change to meet the changes in market demand. Thus strategic planning is concerned with ensuring the future of the business by ensuring that the firm changes to reflect changed market conditions. This can be modelled thus:




**Fig 10.2:** Strategic planning and market development

Without strategic planning there is a danger that the market would change without the firm being aware of this change and reflecting it in its own changes pattern of operations. thus the firm would find itself outside the market, thus:



**Fig 10.3:** Market development without strategic planning and the firm would effectively go out of business.

Strategic planning therefore is concerned with the future direction of the business. This planning must of course ensure that the business has the capability of achieving whatever direction and objectives are determined in this planning stage. Thus the strategic plan must define a set of objectives for the business and the steps necessary to ensure the achieving of these objectives – in other words an implementation plan. Most managers of organisations, at the commencement of their strategy development process, start with a vision of where they see the organisation being in the future. This is known as a ‘strategic vision’ and is often promulgated throughout the organisation in the form of a Mission Statement, which sets in very broad terms the reason for the firm’s existence.

.....Alcatel-Lucent 

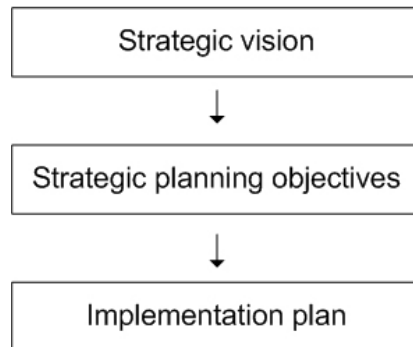
[www.alcatel-lucent.com/careers](http://www.alcatel-lucent.com/careers)

**What if you could build your future and create the future?**

One generation’s transformation is the next’s status quo. In the near future, people may soon think it’s strange that devices ever had to be “plugged in.” To obtain that status, there needs to be “The Shift”.

 [Click on the ad to read more](#)

Thus the strategic planning process can be modelled as follows:



**Fig 10.4:** The strategic planning process

The implementation plan will involve the following aspects of planning:

**Operations plan:** to ensure that the firm has the resources (i.e. manpower, capital investment, working capital) and capabilities to achieve the objectives of the plan. These capabilities include:

- technological capability
- capacity planning
- ability to produce required costings

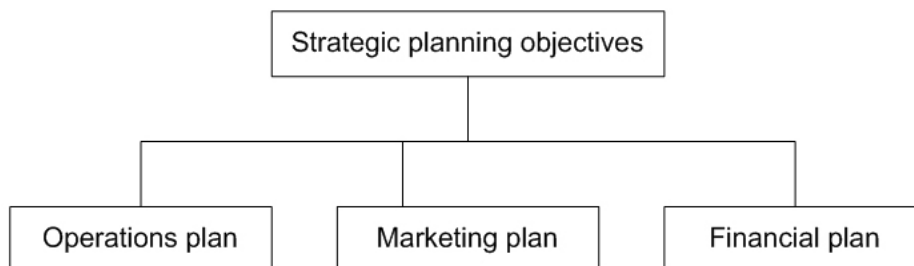
**Marketing plan:** to ensure that the firm is able to:

- produce the requires amount and maintain adequate stocks
- to price the product correctly

**Financial plan:** to ensure that the firm has the financial resources to:

- manage operations
- undertake any necessary capital investment

Thus the strategic plan will need to be as follows:

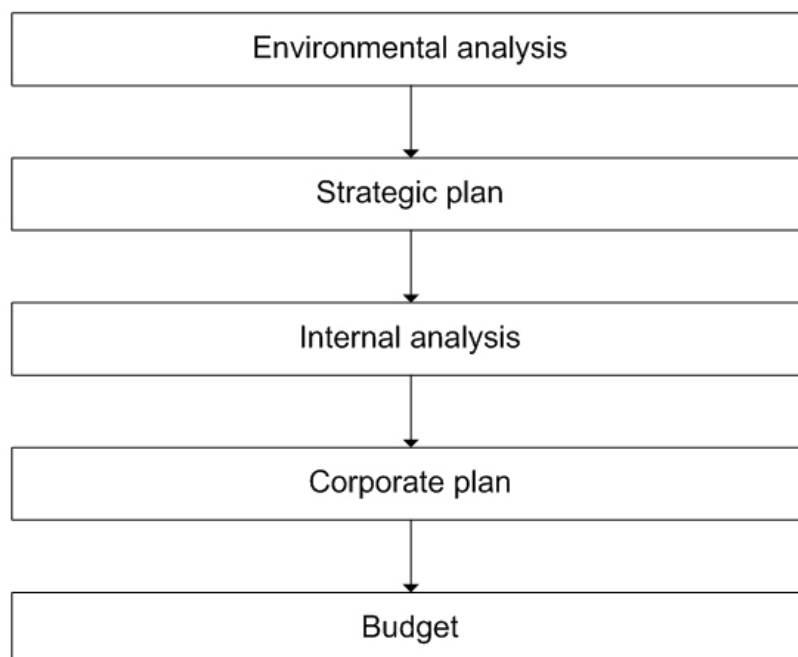


**Fig 10.5:** The components of the strategic plan

## 10.10 Corporate planning

The strategic plan sets out the objectives of the business for the future in outline terms and considers the options available to the business and the capabilities of the business to meet this plan. Once the future direction of the business has been determined by this planning there is a need to change this plan into a more definite plan which can be expressed in quantitative terms. This is the function of the corporate plan, which provides a detailed plan for the organisation, and its components parts, in order to enable the organisation of the future activities of the firm and to communicate this planning throughout the organisation. This in turn leads to the development of the short term plan, or budget, of the organisation.

Thus the planning stages of the organisation are as follows:



**Fig 10.6:** Stages in the corporate planning process

The environmental analysis will enable a firm to develop its strategic plan through an examination of the external environment in which the firm is operating. An examination of the internal environment will enable a firm to translate this plan into a corporate plan for implementation. part of this analysis will comprise a GAP Analysis which will inform the managers of the firm of the ability of the firm to meet the plan and any gaps in resources which need to be addressed. Thus this GAP Analysis will enable the managers of the business to determine what resources are needed in order to implement the plan and this will feed through into both the operating budget and the capital investment budget.

We can see that the business manager needs to be involved at all stages of this planning process and that the accounting techniques which we have discussed have an important part to play in helping at all levels and all stages of the planning process. Thus management accounting is of importance to a business and its managers, not just operationally but also strategically.

### 10.11 Planned and emergent strategy

Although an organisation develops its strategy through this planning process, it is often the case that the effects of this strategy do not materialise in the manner intended. While following this strategy the managers of the business will continue making decision on a day to day basis. These decision will inevitably affect the strategic direction of the organisation and may cause changes in the way the strategy is manifest in the operations of the organisation. This is known as emergent strategy, and can be modelled as follows:

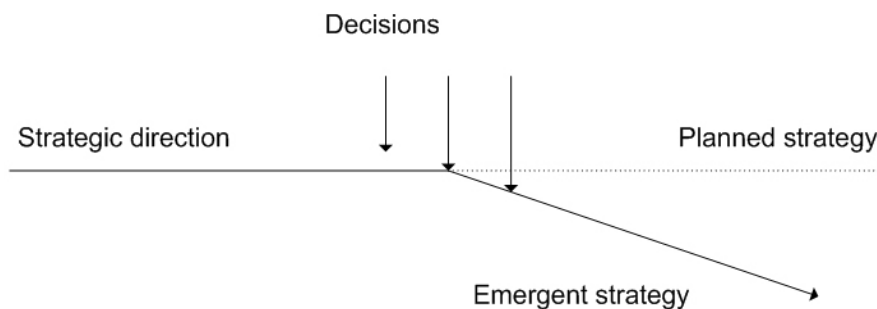


Fig 10.7: Planned and emergent strategies



Join the best at  
the Maastricht University  
School of Business and  
Economics!

#### Top master's programmes

- 33<sup>rd</sup> place Financial Times worldwide ranking: MSc International Business
- 1<sup>st</sup> place: MSc International Business
- 1<sup>st</sup> place: MSc Financial Economics
- 2<sup>nd</sup> place: MSc Management of Learning
- 2<sup>nd</sup> place: MSc Economics
- 2<sup>nd</sup> place: MSc Econometrics and Operations Research
- 2<sup>nd</sup> place: MSc Global Supply Chain Management and Change

Sources: Keuzegids Master ranking 2013; Elsevier 'Beste Studies' ranking 2012; Financial Times Global Masters in Management ranking 2012

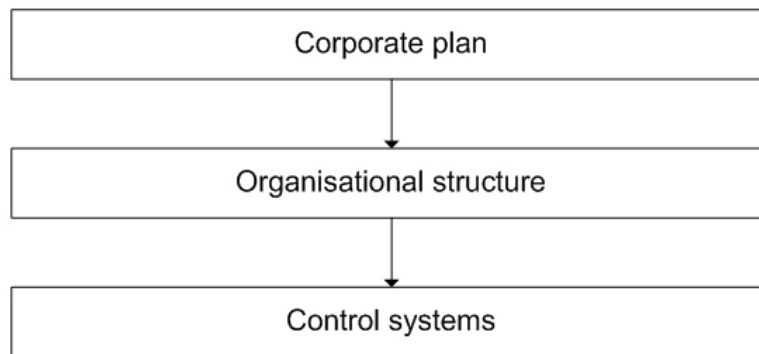
Maastricht University is the best specialist university in the Netherlands (Elsevier)

Visit us and find out why we are the best!  
Master's Open Day: 22 February 2014

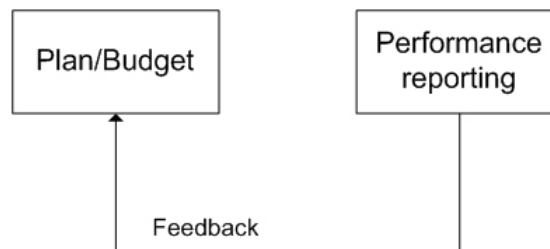
[www.mastersopenday.nl](http://www.mastersopenday.nl)

## 10.12 Feedback

An important part of strategic planning is to ensure that the organisation is structured in such a way that the plan can be achieved, and that the control systems of the organisation provide appropriate feedback to managers. This feedback is necessary in order to ensure that managers are able to measure performance against the plan and take corrective action as necessary. Thus the structure of an organisation needs to be determined by its planning while its control systems need to be determined by its structure, thus:



**Fig 10.8:** Planning and control systems and the control systems provide a feedback loop thus:



**Fig 10.9:** The feedback loop

Organisational design is therefore dependent upon the planning of the business and accounting information is used to provide managers with feedback via the control systems in order to measure performance.

Feedback is necessary so that individual managers can be informed of how the business is performing in relation to the planned level of performance and in order to indicate what corrective action needs to be taken in order to correct deviations from the plan. Thus individual managers need feedback on the performance of that part of the business for which they are responsible. Accounting information from the accounting control system, in the form of reports on current performance, is an important part of that feedback. This feedback needs to be frequent and regular but also needs to be timely so that the feedback is received as soon after the action as possible. This is important in order to ensure that the feedback can be related to the actual decisions made and to ensure that any corrective action can be speedily taken. Detailed feedback given long after the event is of little value in the operations of a business.

Emery and Thorsrud (1963) identify 6 criteria which a job needs to have in order to maintain the interest of an employee. Such a job must:

- be reasonably demanding in terms other than sheer endurance, yet provide a certain amount of variety
- allow the person to learn as (s)he works
- give the person an area of decision making or responsibility which can be considered to be his/her own
- increase the person's respect for the task (s)he is undertaking
- have a meaningful relationship with outside life
- hold out some sort of desirable future, and not just in terms of promotion, because not everyone can be promoted.

The management of a business therefore needs to take into account the needs of the people working in that business, and this must be reflected in the control system of that business. Specifically this needs to be reflected in the setting of targets, the recognition of achievements and the reward structure for the level of performance achieved.

#### 10.12.1 Setting of targets

The targets set for managers need to be achievable but research has shown that targets which are difficult to achieve and which stretch managers have a higher motivational effect than those which are relatively easy to achieve. On the other hand targets which are too difficult to achieve are felt to be unreasonable and therefore lead to a loss of motivation. Targets are set in the budgeting process, which we will consider later, but it is important to recognise here that research has also shown that people tend to set harder targets for themselves than those which are set for them by others. This suggests the need for managerial involvement in the budgeting process.

#### 10.12.2 Recognising achievements

Recognition of achievements has a powerful motivational effect not only for the person recognised but also for others who are aware of the recognition given. It is for this reason that firms have tended to introduce achievement recognition systems such as the award of merit certificates, distinctions, 'manager of the month' schemes, and prizes for the best performance.

### 10.12.3 Rewarding performance

The reward structure for managers needs to be related to their performance in such a way that a manager can relate his/her rewards directly to performance. This performance however needs to be measured in such a way that individual managerial performance can be directly translated into company performance. Rewards systems normally operate in the form of bonuses and the payment of a bonus can be related either to the individual manager meeting or exceeding his/her target level of performance or to the performance of the company as a whole. The first method aims to maximise individual performance while the second method aims to maximise company performance and stresses the fact that each individual is contributing towards company performance. There is merit in both methods of reward and it is for this reason that managerial rewards and payment tend to be linked to both with a bonus payable partly for individual performance and partly for company performance.

The operational control systems of a business need to recognise the problems associated with setting standards of performance which are realistic and allow for the revision of standards on a regular basis. The systems also need to recognise that business circumstances can change, and that the economic and competitive climate can also change, thereby making these standards inappropriate. The control systems therefore need to be flexible and to encourage maximum performance rather than merely the achievement of the standards set. This is particularly important in a modern business environment where the emphasis is upon quality and level of service rather than merely the control of the costs identified within the accounting system.



**Empowering People. Improving Business.**

BI Norwegian Business School is one of Europe's largest business schools welcoming more than 20,000 students. Our programmes provide a stimulating and multi-cultural learning environment with an international outlook ultimately providing students with professional skills to meet the increasing needs of businesses.

BI offers four different two-year, full-time Master of Science (MSc) programmes that are taught entirely in English and have been designed to provide professional skills to meet the increasing need of businesses. The MSc programmes provide a stimulating and multi-cultural learning environment to give you the best platform to launch into your career.

- MSc in Business
- MSc in Financial Economics
- MSc in Strategic Marketing Management
- MSc in Leadership and Organisational Psychology

**BI NORWEGIAN BUSINESS SCHOOL**

EFMD  
**EQUIS**  
ACCREDITED

[www.bi.edu/master](http://www.bi.edu/master)

### 10.13 Agency Theory

It is important to recognise that the firm is assumed to exist for the benefit of its owners who are assumed to be solely interested in the maximisation of their wealth. Managers, on the other hand, are the decision-makers in an organisation and they are implicitly assumed to automatically act in the best interests of owners, either because they are also the owners, or because they share the same interests. In other words, managers are assumed to make the same decisions that owners would make, irrespective of the effect on their personal interests.

Managers are, therefore, assumed to assess objectively alternative actions, and always select the option favoured by the owners of the firm. The management accountant, therefore, is then concerned with providing the 'right' information combined with the 'right' decision-model which will help the manager make the 'right' decision. An obvious criticism of this approach, however, is that it fails to recognise that managers may not share the same interests as owners, and that this is likely to impact upon real-world decision-making. Agency theory attempts to address this problem, by providing a more realistic representation of decision-making.

Agency theory therefore recognises that people are unlikely to ignore their own self interest in making decisions; in other words people do not behave altruistically. It is a relatively new approach to analysing decision-making which provides a framework within which the political and behavioural aspects of decision-making can be considered as part of the decision making process. The theory is therefore positive rather than normative as it seeks to understand and explain what happens in practice rather than seeking to prescribe what ought to happen. It recognises that the manager is an agent of the owners of the firm, whose actions the management accounting system seeks to influence.

An agency relationship exists whenever one party, the principal (P), hires another party, the agent (A), to perform some task. This relationship applies to many superior/subordinate relationships in business and elsewhere, and in a management accounting context, agency relationships can be seen to exist between shareholders and directors, between directors and managers (including divisional managers), and between managers and other employees. In this chapter, we will concentrate on the relationship between the owners of the firm and its managers – in other words the owner-manager principal-agent relationship.

Under Agency Theory both P and A are assumed to be rational economic persons: in other words they know what they are doing and they act consistently and rationally. They are both assumed to be motivated by self-interest alone, although the theory recognises that they possess different preferences, beliefs and information. Both wish to maximise their own 'utility' (the value or benefit they place on any economic good they receive). P and A may also have different attitudes to risk, an issue to which we return later. Agency theory is concerned with the design of effective contracts between the P and A, which specify the combination of incentives, risk-sharing and information system which maximise the utility of P subject to the constraints imposed by ensuring that A's self-interest will also be served through his/her actions. Thus Agency Theory provides a means of establishing a contract between the principal and the agent which will lead to optimal performance by the agent on behalf of the principal. This can be depicted thus:



**Fig 10.10:** Optimal Contracts: balancing risk, incentives and choice of information system

Focusing on the shareholder-manager agency relationship, the key elements of agency theory will now be examined.

The owners of the firm provide capital to the firm, and are assumed to be interested solely in the returns to be derived from their use of capital in the firm – in other words the expected monetary value of their investment. Managers, on the other hand, not only derive utility from their wealth, provided through their employment in the firm, but also from their leisure time, when they are not employed by the firm. Thus managers derive utility from all their activities, whether or not these activities are associated with the firm by which they are employed. It is important to appreciate this distinction between 'utility' and 'monetary wealth' in this context, as utility applies to well being in general rather than simply to wealth.

While it is certainly true that managers derive utility from additional wealth, it must be recognised that this is unlikely to be in the form of a linear relationship whereby each increment to wealth results in the same addition to utility. Managers will derive greater incremental utility from additions to wealth from lower levels of wealth, but as wealth increases the extra amount of utility gained from each unit addition to wealth will diminish. In other words, the utility which managers derive from wealth is subject to decreasing marginal returns.

For example, a manager who is paid £100,000 per annum derives greater utility from the first £10,000 of pay than that which takes his pay from £90,000 to £100,000. At higher levels of pay, non-financial factors associated with employment such as status, job-related pressure and so on take on greater significance.

The manager's utility function in relation to income received from employment can thus be shown as follows:

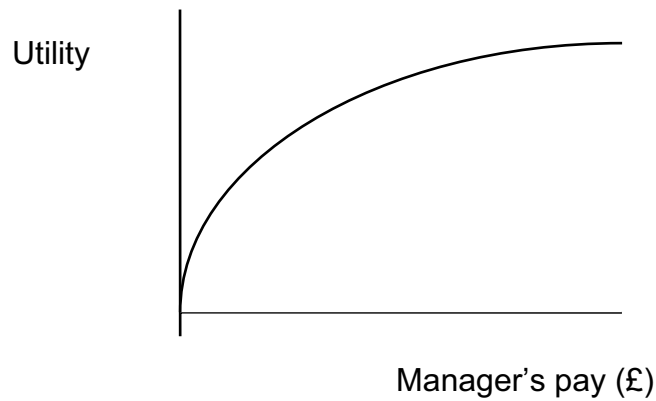


Fig 10.11: The manager's utility function

## Need help with your dissertation?

Get in-depth feedback & advice from experts in your topic area. Find out what you can do to improve the quality of your dissertation!

Get Help Now



Go to [www.helpmyassignment.co.uk](http://www.helpmyassignment.co.uk) for more info



Helpmyassignment



Click on the ad to read more

In addition however, managers are assumed to value their own leisure time, which means that they attach disutility to effort. The extra utility which is derived from higher levels of compensation is offset, therefore, by the negative utility which is derived from any extra effort required of the manager to achieve that higher level of compensation. The term 'leisure' in this context is defined as the opposite of any effort that increases the expected value of the firm to its owners. It includes the manager's consumption of so-called 'perquisites' (commonly known as perks), which are benefits relating to the job such as company cars, lavish offices, and so on. The consumption of such perquisites diverts the owners' capital away from what the owners would regard as desirable productive investments into the manager's own consumption.

Therefore, to summarise, the owners supply capital to the firm and hire managers to act on their behalf. Managers allocate their time at work between productive effort and leisure ('shirking'), and also allocate the firm's resources between productive investments and the consumption of perquisites.

An intuitive solution to the above situation would be for owners to simply monitor the actions of managers to reduce shirking and the over-consumption of perquisites. This, however, can be extremely difficult in practice. There are several reasons why this monitoring is difficult in practice. Firstly, the tasks undertaken by managers are generally considered to be relatively complex and consequently not well understood by the owners who are not involved in the detailed running of the business. Secondly, the decisions made by managers are taken in an uncertain environment, which makes it difficult for owners to judge the appropriateness of managerial actions in any particular set of circumstances. Finally, and perhaps most importantly, information is not evenly distributed between managers and owners. This problem is known as 'information asymmetry' and has two separate, though related elements: moral hazard and adverse selection.

#### 10.13.1 Moral hazard

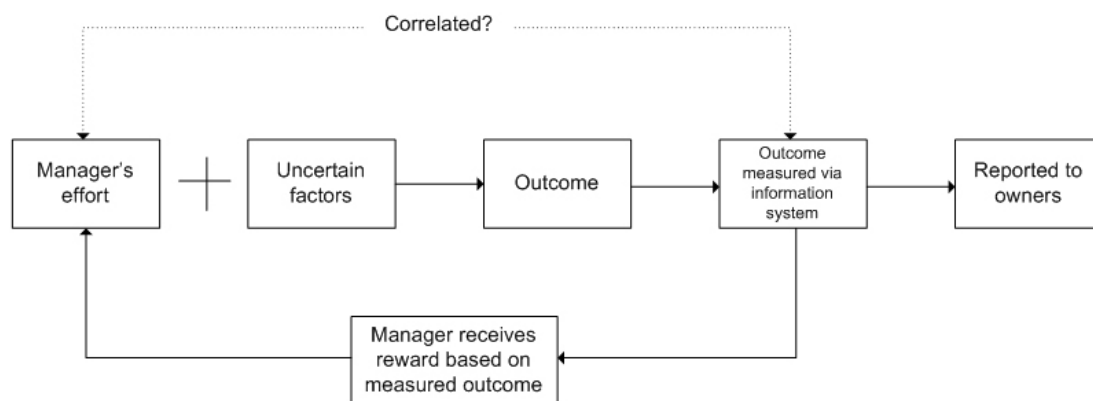
Moral hazard arises where it is difficult or costly for owners to observe or infer the amount of effort exerted by managers. In such a situation, there is an inevitable temptation for managers to avoid working to the terms of the agreed employment contract, since owners are unable to assess the 'true picture'. Managers may also have the incentive as well as the means to conceal the 'true picture' by misrepresenting the actual outcomes reported to the owners. Accounting provides one such means for misrepresentation through its ability to represent outcomes from any course of action in more than one way – a point which we will return to in subsequent chapters.

### 10.13.2 Adverse selection

Whereas moral hazard relates to the 'post-decision' consequences of information asymmetry, adverse selection is concerned with the 'pre-decision' situation. Since all the information that is available to the manager at the time a decision is made is not also available to the owner, then the owner cannot be sure that the manager made the right decision in the circumstances. In addition, the manager has no incentive to reveal what he knows since this will then make it easier for the principal to properly assess his actions in the future. This is known as 'information impactedness'.

The existence of 'information asymmetry' means that for owners to obtain relevant information concerning the manager's effort, they must either rely on the communications received from the managers themselves, or must incur monitoring costs. An example of monitoring costs would include the annual audit of the firm's financial statements; indeed such auditing of financial statements was instituted as a means of safeguarding such investments in firms made by those who had no part in the operational activity of the firm. In the context of the agency relationship between top management and divisional management, such monitoring costs would include the cost of employing head office staff to monitor the performance of divisions. One approach to this problem is to get managers to commit to acting in the best interests of the owners, but in this situation the owners will incur a bonding cost to effect this relationship. Even in this situation however since managers may not share the same beliefs and preferences as the owner, there may still however, be a 'residual loss'.

Information asymmetry can be depicted as follows:



**Fig 10.12:** Information Asymmetry

Agency theory, as applied in practice, is concerned with the design of employment contracts which reduce shirking and the consumption of perquisites, so that instead of managers acting in their own interests they are encouraged to act more in the interests of the owners of the firm. Solutions to agency problems are often described as 'second-best'. This is due to the conflicting implications of the incentive-effect and the risk-sharing aspect of the agency relationship. These should be interrelated as follows:



**Fig 10.13:** Risk sharing

On the one hand, the optimal contract should achieve optimal risk-sharing. As the owner is able to hold a diversified portfolio of shares, it is usually assumed that he is risk-neutral and will not take risk into account in deciding between one course of action and another. The manager, on the other hand, clearly cannot diversify his job, and is more likely to be risk-averse and hence to make risk minimising decisions. In this situation therefore optimal risk-sharing would imply that the owner of the firm should bear the most risk, since the manager will require compensation for risk-bearing, whereas the owner will not.

A flat fee paid to the manager irrespective of performance achieves this, since the manager's salary is shielded from the uncertainty which affects expected outcomes. Such a flat fee as remuneration for the manager's effort, however, provides no incentive for the manager to exert optimum effort. Due to the fact that the manager's effort cannot realistically be observed, then only if the manager's income is linked to performance will the manager be motivated to contribute more effort. This, in turn, exposes the manager to risk. A double-edged sword is evident. The more a manager's income is dependent upon performance, the greater the incentive effect, yet at the same time, the sharing of risk becomes increasingly sub-optimal.

**Brain power**

By 2020, wind could provide one-tenth of our planet's electricity needs. Already today, SKF's innovative know-how is crucial to running a large proportion of the world's wind turbines.

Up to 25 % of the generating costs relate to maintenance. These can be reduced dramatically thanks to our systems for on-line condition monitoring and automatic lubrication. We help make it more economical to create cleaner, cheaper energy out of thin air.

By sharing our experience, expertise, and creativity, industries can boost performance beyond expectations. Therefore we need the best employees who can meet this challenge!

The Power of Knowledge Engineering

Plug into The Power of Knowledge Engineering.  
Visit us at [www.skf.com/knowledge](http://www.skf.com/knowledge)

**SKF**

The 'first-best' solution would be to pay a flat fee to reward 'conscientious' managers who do exert optimum effort. Such a 'first-best' solution is not viable, however, since it is not realistically possible to judge whether or not a manager has acted 'conscientiously' in any particular set of circumstances.

### 10.14 The Limitations of Agency Theory

While Agency theory offers a number of advantages in the way in which it explains managerial behaviour in organisations it is necessary to recognise that it also suffers from a number of limitations:

1. It is based on a single-period model. In other words, it is not a dynamic model, and may not be applicable in more realistic multi-period settings.
2. Its assumption that both principal and agent are rational utility maximisers is questionable.
3. The analysis is limited to one principal and one agent, and therefore the results may not be applicable in multi principal and multi agent settings.

### 10.15 Conclusions

We have covered a lot of ground in this chapter, but leadership is a complex subject and crucial to the understand of the operation of CSR in an organisation. There are a lot of leadership theories which have some application and relevance. Equally Agency Theory is an important aspect of understanding organisational behaviour.

### 10.16 References

Bachrach P. and Baratz M. (1974) Decisions and non-decisions: an analytical framework; *American Political Science Review* 57, 532–542.

Emery F.E. & Thorsrud E. (1963); *Form and content in industrial democracy*; London; Tavistock.

Etzioni A. & Etzioni E. (1964) *Social Change: sources patterns and sequences*; London; Basic Books.

French J. and Raven B. (1959). The bases of social power; in D. Cartwright (ed), *Studies in Social Power*, Institute of Social Power; Ann Arbour Michigan.

Handy C. 1983 *Understanding Organizations* Harmondsworth Penguin.

Hardy C. (1994); *Managing Strategic Action*; London; Sage.

Hersy P. & Blanchard K. (1977); *Management of Organizational Behaviour: Utilising human resources*; Prentice Hall; Englewood Cliffs NJ.

Herzberg F. (1966); *Work and the Nature of Man*; London; Staples Press.

Jacques R. (1996); *Manufacturing the Employee*; London; Sage.

Knights and Wilmott (1982); Power, values and relations: comments on Benton; *Sociology* Vol 16 No 4 pp. 578–585.

Lukes S (1974) *Power, a Radical View*; Macmillan; London.

McGregor D. (1960); *The Human Side of Enterprise*; London; McGraw-Hill.

Miles R.E. & Snow C.C. (1978); *Organisational Strategy, Structure and Process*; New York; McGraw-Hill.

Mintzberg H. (1983); *Power in and around Organizations*; Englewood-Cliffs, NJ; Prentice Hall.

Ouchi W.G. 1979; A conceptual framework for the design of organisational control mechanisms; *Management science* Vol 25 No 9 pp. 833–848.

Peters, T. and Waterman, R., (1982) *In Search of Excellence*, Harper and Row, New York.

Rockness H.O. (1977); Expectancy theory in a budgetary setting: an experimental examination; *The Accounting Review*, 52, 893–903.

Ronen J. & Livingstone J.L. (1975); An expectancy theory approach to the motivational impact of budgets; *The Accounting Review*, 50, 671–685.

Rowlinson, M. (1997); *Organisations and Institutions: Perspectives in Economics and Sociology*; London; Macmillan.

Schiff M. & Lewin A.Y. (1970); The impact of people on budgets; *The Accounting Review*, 45, 259–268.

Vroom V.H. (1964); *Work and Motivation*; New York; John Miley.

Williamson O.E. (1964); *The Economics of Discretionary Behaviour*; London; Prentice Hall.

### 10.17 Further reading

Petrick J., Scherer R., Brodzinski J., Quinn J. & Ainina M.F. (1999); Global leadership skills and reputational capital: Intangible resources for sustainable competitive advantage; *The Academy of Management Executive*, 13(1), 58–69.

Michael B. & Gross R. (2004); Running business like a government in the new economy: lessons for organizational design and corporate governance; *Corporate Governance*, 4(3), 32–46.

Paine L.S. (1994); Managing for organizational integrity; *Harvard Business Review*, 72 (2), 106–117.

### 10.18 Self-test Questions

1. What leadership styles are there?
2. Why is feedback important?
3. What is moral hazard and why is it important?
4. What is emergent strategy?



"I studied English for 16 years but...  
...I finally learned to speak it in just six lessons"  
Jane, Chinese architect

ENGLISH OUT THERE

Click to hear me talking before and after my unique course download

# 11 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.
13. An example is the Cadbury Report.