Samuel O. Idowu
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Editors

Theory and Practice of Corporate Social Responsibility

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Springer

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This book is dedicated to all students and scholars of the field of CSR and its related disciplines who are hoping to make our world a better place both for this generation and future generations.

Foreword

Universities have been around for a millennium or so. Why they tend to survive, while businesses come and go, is because of their eye to the longer term: the value of research, the teaching of life-long skills, and the importance of scholarly reputation. Universities also are dedicated to the dispassionate pursuit of truth, relying in their argument upon logic and evidence, in contrast to the more partisan and immediate purposes of government, industry, or sectoral lobbies.

Idowu and Louche's edited collection of essays exploits these virtues of the university in its candid address of one of the critical issues of our time: how to be an effective business while still being socially responsible, ethical, environmentally respectful, sustainable, as well as being a good employer and corporate citizen. Drawing on the different intellectual traditions of Britain, Belgium, Greece, Australia, France, Finland and New Zealand, the book looks at the current fit of theory and practice of corporate social responsibility, with particular attention to the core values of strategy, governance, good management, and trust.

The danger in a period of economic downturn and uncertainty, such as our own, is that businesses look only to the immediacy of the bottom lines of their annual financial reports. It is all too easy to consider anything else as an optional extra or an unaffordable investment. But something more important – the longer-term future of the world, and the livelihood of millions of people – can be at stake if CSR does not become part of the embodied actions and trained managerial responses of corporate leaders.

BP's Gulf of Mexico disaster of 2010 makes it a lot clearer to us all that putting together CSR policy and promotion are not enough. A keen sense of responsibility for the consequences of actions, along with genuine empathy with those dispossessed through corporate irresponsibility, are needed. Otherwise, the wider public will reasonably believe that CSR is no more than corporate spin and that businesses have not yet embedded key aspects of CSR in their daily routines and their hourly decision-making.

Idowu and Louche's collection is particularly valuable in showing the benefits that can come from stressing the interdependency, rather than the opposition, between business and society. And it gives many examples of how "problems"

in the social or environmental domains can be turned into "opportunities", indeed new and profitable business. I commend *Theory and Practice of Corporate Social Responsibility* to you.

London Metropolitan University
London, UK

Professor Malcolm Gillies
Vice Chancellor

Foreword

It has been several years since we had a comprehensive overview of the field of Corporate Responsibility (Allouche, 2006). The publication of this book is both timely and highly relevant, not least thanks to its multi-dimensional summary of the state of the art.

It is also a comprehensive overview of the state of the art.

First of all it consists of contributions of both theoretical and practical orientation. The practice of Corporate Responsibility (CR) inspires the theorizing of it and theory based on new research challenges the pace and depth of CR practice. Both are important dimensions of a necessary dialogue as demonstrated in this book.

The book starts with a useful reminder that although the instrumental and control perspectives of CR are important for its practical application, the normative perspective remains the foundation. Managerial ethics is central to responsible corporate responsible practice.

Furthermore, the book provides all-important multidisciplinary perspectives.

Strategy, Governance and Global Supply Management are the focus of attention in Part I. Part II is appropriately about Environment and Sustainability dimensions of CR which have significantly grown in importance of late.

Part III addresses on social issues and leadership (with a remarkable contribution of Labour Issues and Human Rights) and is followed by a substantial Part IV on Accounting and Finance, which are issues often only dealt with in marginal or simplistic ways in other publications.

I congratulate the editors Samuel O Idowu and Céline Louche for their work in bringing together a distinguished set of novel contributions and recommend this book to students, practitioners and scholars in the ever growing field of corporate responsibility.

The Academy of Business in Society
Brussels, Belgium

Professor Gilbert Lenssen
President

Reference

Allouche J (ed) (2006) Corporate social responsibility, vols 1 and 2. Palgrave, London

Preface

Issues relating to Corporate Social Responsibility (CSR) have taken a centre stage in modern societies. It can no longer be denied that we are all expected to have a high degree of responsibility. This generation must ensure that future generations of living creatures enjoy the same standards of living; if not better standards of existence than theirs. In other words, we ought to create an environment that leads us towards sustainable development. This fact cannot be overstressed.

This book is based on the premise that corporate social responsibility should be taken directly to Business and Management Schools, Universities, Colleges and Communities around the world where issues relating to CSR are explored for learning purposes. Integrating corporate Social Responsibility into the curricular involves some challenges, one of which includes finding suitable teaching material and suitable books. To date, most of the available books in the field of corporate responsibility are either theoretically or practically focused, which perhaps make them less ideal for all purposes! This book has taken a different approach to that adopted by these other good quality books; in that it combines the theoretical aspects of CSR with the practical dimensions of the field in order to give our readers the opportunity to have a balanced understanding of how the field has evolved and continues to evolve from both angles; since its general acceptance worldwide.

The book focuses on fourteen relevant topics which are of interest to all business and management students, academics, researchers, practitioners, consultants, corporate managers, governments, non-governmental organizations and international organizations with special interest in issues relating to corporate responsibility.

Each chapter was put together by experts in different business and management topics with direct focus on corporate responsibility, sustainability and sustainable development hoping to make a difference in terms how our readers and those they interact with in their many life capacities treat the environment and issues relating to it. It is hoped that the book would meet all our readers' information requirements in each of the aspects it covers or at least get them thinking about all the issues covered in this edition.

London, UK
Gent, Belgium
Summer 2010

Samuel O. Idowu
Céline Louche

Acknowledgements

Getting this book to a complete state was a team effort of different individuals. Some of these individuals were directly involved in writing its chapters whilst some others contributed to its completion indirectly. We are therefore jointly indebted to them all and would like to show this indebtedness by acknowledging their assistance in realizing the goal of editing a book of this quality.

Our first thank you goes out to all our contributors; some of whom over the last few years; we have been so fortunate and proud to call our friends. Without these individuals' hard work and commitments despite their very tight professional and individual schedules in their various Universities around the globe; there would have been no book on *Theory and Practice of CSR*. To those of our contributors who have had to overstretch themselves or set aside some of their more important projects to complete their chapters; please accept our "thank you" several times. Your sacrifices are greatly appreciated. And these two Editors shall remain grateful to you all; for the rest of their respective lives.

There are also some others whose assistance were equally so vital in the preparation of this book and some other aspects of our lives that cannot be ignored in this section of the book. These individuals are so numerous to the extent that naming them all would make another book of the same length and size as this one! The following individuals deserve to be mentioned in the book, Michael A Idowu, Elizabeth A A Lawal, Joshua Ayoola Idowu, Samuel Olufemi Lawal, Adebayo R Idowu, Royston Gustavson, Karolina Windell, Louise Slater, Nada Kakabadse, Claudia Kipka Simon Pickard, Olufunmilola O Idowu, Rachael T Idowu, Mary T Idowu, Abigail O Idowu, Olaniyi J Idowu, Josiah A O Omogoriola Idowu, Olatoye Ojo, Andrea Dunhill, Christopher Hutchinson,, David Ogunlaja, Samuel Ogunlaja, Joseph Adesanya, Michael Soda, Denis Haffner, Christopher Soyinka, Anthony Brabazon, Dermot P French and Walter Leal Filho.

We are equally grateful to all our colleagues at London Metropolitan University and Vlerick Leuven Management School who have assisted us in their different ways to ensure the completion of the book.

Also our colleagues and friends at Springer: Christian Rauscher, lately Daniel Quinones and Stephanie Huegler equally deserve our thank you for their confidence

in us and for being enthusiastic and supportive of all our CSR projects, thank you many times.

It is believed that all possible steps have been taken to ensure that the facts presented in this book are error free. However, as it is impossible to completely avoid errors or omissions in any book, we therefore wish to apologize unreservedly for any error or omission that may appear anywhere in this book. No harm was intended either directly or indirectly to anyone.

Finally, we would like to take this opportunity to express our sincere condolences to one of our colleagues Dr. Elewechi Okike of the University of Sunderland, UK whose dear mother, Mrs. Sybil Elizabeth Iroche passed away during the process of writing up her chapter for the book. It was a very difficult period for her when she was faced with the option to pull out of the project but remained firmly committed to meeting all her obligations under it, we really appreciate her professional stance during what would have been a difficult and sad period for anyone.

Theory and Practice of CSR: A Concise View

Corporate entities of our age have accepted that social responsibility issues are corporate issues which consequently have now become part of their core activities. What is the rationale for making a statement like this? Or put in a different way; what does this statement really mean? These are two possible questions which anyone may wish to ask on hearing a statement like that. Corporate activities in CSR and its related fields; even during this current global financial crisis; when things are financially very tight in most nations of the world and in most corporate entities that operate in these nations is perhaps these authors' evidence for making a general assertion such as that. Apart from this, the interest which CSR generates and continues to generate amongst corporate entities, governments, international organizations, scholars, practitioners and a host of other interested parties is unprecedented! The financial crisis of 2008 has provided us with enough evidence to conclude that corporate social responsibility as a concept has come to stay, even at the height of the crisis CSR continues to thrive in most organizations

Some five or so decades ago the view taken by a large number of businesses and some sections of corporate stakeholders globally was markedly dissimilar to the view taken by the majority today. This perhaps is further evidence to home it in that; socially responsible we must all be; whether or not we like it. An increasing number of corporate entities regardless of whether these are profit seeking or not for profit are integrating ESEE – Environmental, Social, Economic and Ethical considerations into their strategies and practices (Jones et al., 2009). Jones et al. (2009) further argue that there are a variety of factors which have been cited by scholars as being responsible for building the current momentum behind CSR globally. They have cited three studies which have given credence to different compelling factors for integrating CSR ethos and principles into corporate activities. The first one they mentioned was Ernst and Young (2002) five key drivers for CSR which are:

- Greater stakeholder awareness of corporate ethical, social and environmental behaviour
- Direct stakeholder pressures
- Peer pressure
- Investor pressure
- An increased sense of social responsibility.

The second study they noted was Porter and Kramer's (2006) four prevailing justifications for CSR, namely:

- Moral obligation
- Sustainability
- License to operate
- Reputation

The final set of factors Jones et al. (2009) used was taken from Bevan et al. (2004) nine potential benefits of CSR which are:

- Improved financial performance and profitability
- Reduced operating costs
- Long term sustainability for companies and their employees
- Increased staff commitment and involvement
- Enhanced capacity to innovate
- Good relations with government and communities
- Better risk and crisis management
- Enhanced reputation and brand value
- Development of closer links with customers and greater awareness of their needs

A careful look at the items listed in each of these three studies would undoubtedly reveal that CSR is beneficial to both the entity engaging in its activities and society as a whole, which perhaps is tantamount to saying that what is good for all; must be very good indeed.

CSR, it has been argued has been practiced in one form or another for well over 200 years Idowu (2011), has unclear boundaries Lantos (2001), has many conflicting goals and objectives McWilliams and Siegel (2001), has no generally accepted definition, Carroll (1991), Idowu and Papasolomou (2007), means different things to different people Kakabadse et al. (2005), Idowu (2009), has a weak correlation with profitability or improved financial performance Margolis and Elfenbein (2008), was typified of counterproductive practices in its evolution Porter and Kramer (2006), Porter and Reinhardt (2007) and could be used as a remedy for improving the ethics of the organization Mostovicz et al. (2009). All these arguments which have been used by these different scholars in their various studies are probably true and accurate reflections of the field of CSR. But do these arguments negate the importance of CSR or make a compelling case for why CSR should continue to be part of corporate and individuals' activities? In other words, why are we all being encouraged to behave responsibly and embrace the field of CSR? These are perhaps relevant questions which immediately come to mind. A search of the literature has given us some pertinent leads as to where and how answers to these questions could be found.

Mostovicz et al. (2009) actually provide an acceptable answer to this question when they argue that *although, it is difficult to find other reasons for the increased recent interest in CSR apart from the realization that past practice has led to unethical behaviour, corporate meltdowns, fraud and corruptions* and of course some

other unacceptable practices by some corporate leaders on behalf of their organizations. Example of corporate scandals such as Enron, Mirror Group, World Com, Xerox, Parmalat and other similar corporate scandals immediately come to mind. That we must all ensure we take responsibility for our actions and inactions and be seen to be responsible in whatever we purport to do can only be good for all. That is perhaps enough justification for why CSR must flourish in societies! That's only the moral perspective of it; it is however much broader and deeper than that.

Burke and Logsdon (1996) in their attempt to answer the question "under what conditions does a firm serve its own strategic business interests and the societal interests of its stakeholders?" argue that unless top management understand the strategic benefits which may accrue to the organization for behaving responsibly, they are unlikely to want to invest their scarce resources in CSR practices which would contribute to the long term success of the firm. Burke and Logsdon (1996) further argue that unless a firm with good reputations for CSR; which for some reason encounters financial difficulties; not necessarily because of their CSR activities perhaps because of their competitive environment, embarks on a strategic reorientation of the firm's CSR philosophy, it might be impossible for CSR to support its financial interests as well as its other stakeholders' interests. This is the strategic perspective of CSR which undoubtedly justifies the strategic importance of CSR to corporate entities and their communities and other affected stakeholders.

Burke and Logsdon (1996) also contribute to the CSR debate by exploring the academic perspective of CSR, which they argue helps to clarify and quantify the benefits of CSR. Up to date, there is no consensus on the direct relationship between CSR and profitability; there may never be one, but scholars have made progress in proving that there is correlation between engaging in CSR activities and improved public image, in other words for a firm to generate good reputation for itself, Fombrun and Shanley (1990), Maignan and Ferrell (2004), CSR and better financial performance Cochran and Wood (1984), McGuire et al. (1988), CSR and its positive effects on the environment Milne (1996). All these are positive influences which make it impossible for corporate entities to want to ignore engaging in CSR activities in societies where they operate.

The 14 chapters that make up the book; *Theory and Practice of CSR* are focused on direct topics of interest to several stakeholders: scholars, students, practitioners, consultants, government officials, employees of international organizations, NGOs and others who are enthusiastic and concerned about issues relating to CSR and the future of our planet.

The book has been divided into four parts; grouping together topics in related disciplines to enable our readers to logically follow the trend in areas covered by contributors. Part I on Management contains four chapters, Part II on the Environment and Sustainability is also a four chapter section, Part III on Corporate Responsibility is made up of three chapters and the final section on Accounting and Financial Reporting has three chapters in it.

The opening chapter of the book by Cécile Rozuel and Nada Kakabadse on *Managerial Ethics as a Prerequisite to CSR: the person behind the role* argue that managers occupy a unique position in organizations which necessitates that they

must at all times be morally responsible for their own actions as well as the actions of their subordinates. Several theorists; the chapter notes, have unveiled a host of organizational and moral implications of managerial responsibilities each with their own ethical traps, but sustainable ethics can help to improve morality. The chapter also argues that sustainable ethics should enable managerial ethics to celebrate people instead of organizational actors or the role they perform which means that managerial ethics requires some self reflection and examination that encompass genuine CSR.

Laurence Eberhard Harribey writing on *The Strategic Value of Corporate Citizenship* argues that the fact that an increasing number of companies continues to integrate CSR and issues relevant to it into the heart of their strategies should be an impetus for anyone to want to question the strategic value of corporate citizenship. The chapter explores what corporate citizenship means and the extent to which an action by a corporate entity to move into corporate citizenship activities could be considered to be a strategic move. The chapter also analyses the evolution of different concepts of CSR and Sustainable Development. The chapter notes that corporate citizenship was popularized as a result of two factors.

Donald Nordberg in a chapter entitled *Corporate Governance and the Board* argues that as a result of a string of major corporate failures which has seen the boards of these companies blamed either for their failure to grasp the scale of the problems or to stand up to managers, the past two decades have seen corporate governance becoming a central theme in management. It has become important for stakeholders to call for actions to be put in place to prevent the recurrence of similar scandals. The chapter explores the role the boards of directors perform and the tensions they face in performing their governance function.

Whilst Nikolaos Panayiotou and Konstantinos Aravosis, two respected scholars who focus their chapter on the issue of *Supply Chain Management* argue that increased pressures from different groups of stakeholders have led to the adoption of more responsible business practices by corporate entities which these entities have expressed in terms of their corporate social responsibilities to society. These two scholars suggest that the change in the nature of business relations by companies from wholly manufacturing based to companies now engaging in supply chain and supplier based manufacturing across national frontiers has transformed the way and manner CSR is perceived and practiced. The change has consequently resulted in corporate entities now being held responsible not only for their own CSR practices but also for the socially responsible or irresponsible actions of their suppliers and other third parties that operate in the supply chain.

Global Environmental Issues, is the topic which Martin Brueckner and Christof Pforr explored. In the chapter, they look at the relationship between corporate social responsibility and global environmental change. These two scholars attempt to highlight the problems associated in the management's quest to devise effective responses to the problem of global environmental decline using CSR. By using CSR approaches, the chapter discusses the environmental efficacy of these approaches and the suitability of CSR in dealing with complex environmental problems.

Jeremy Galbreath in another interesting chapter on *Sustainable Development in Business: A Strategic View* proposes a definition of sustainable development in

business in terms of value creation for stakeholders drawing on three perspectives namely; corporate objective, corporate responsibility and corporate stewardship. The chapter suggests that sustainable development could create value to current and future stakeholders. Galbreath further argues that it is unreasonable for anyone to expect businesses to provide answers to all social and developmental problems. A strategic approach is what is required; the chapter argues.

Patricia Park and Michael Galley on *Environmental Issues in Business* argue that the globalization of production and services by multinational organizations has increased society's awareness of the potential environmental harm which accompanies these activities. These two scholars further argue in the chapter that a responsible international corporation may help to raise environmental standards in the less developed parts of the world by acting as a collection point of modern, environmentally sensitive, technology and as the most advanced experts in environmentally sound management practices. They have also highlighted some legal and operational issues in relation to the environment which should be of interest to multinational corporations in their quest to be environmentally responsible.

Pasi Heikkurinen in the chapter on *Environmental Strategy and Sustainability* describes two alternative approaches to environmental strategy namely instrumental strategy and awareness strategy. This author argues that in order to have a successful environmental strategy; values, actions and words must be aligned, and therefore it is vital that managers, leaders and academics identify the strategic approach required in a particular situation. Values based on utilitarian/duty ethics; passive/reactive/proactive actions; and pragmatic/image-driven discourses all characterize an instrumental strategy the chapter notes.

Chapter 9 on *Labour Issues and Corporate Social Responsibility* by Richard Ennals argues that CSR initiatives are of diverse kinds and they address the gap between current practice and what is seen as more appropriate conduct by corporate entities. The chapter notes that the employment relationship is at the heart of company operations, as well as of working life, and is undergoing radical change. It further argues that globalisation is having a major impact on labour issues, casting new light on human rights, and the role of migrant workers. Companies may choose to exclude labour issues from their model of CSR, but would mean that they are opting to operate outside the law of many countries, and forfeit their credibility. The way ahead is seen in terms of creating collaborative advantage, both internally and externally the chapter concludes.

In the tenth chapter of the book entitled *Between Trust and CSR: The role of Leadership* by Isaac Mostovicz and Nada Kakabadse these two reputable scholars argue that the aim of CSR was to restore trust (an essential ingredient for sustainability) between society and business. They argue that evidence from the current practice of the field of CSR suggests that it is difficult to decipher whether the current initiatives by corporate entities actually restore trust or relieve mistrust in the marketplace.

Philippe Callot in a chapter entitled *The Ecolabel Virtues in Tourism: The Case of Hotel Trade* argues that awareness of issues relating to environmental responsibility in the small business sector is well and alive. The chapter notes the case of *Hotel Les Orangeries* (the first hotel in the whole of France to go green and obtain

its Eco-label) as the beginnings of the concept of Eco-Labeling in tourism, since then the chapter argues; an increasing number of projects and strategies has got underway. The chapter discusses the main elements and milestones of an industry taking responsibility for itself and describes steps taken by a small provincial hotel business in its attempt to obtain an *Eco-label* status.

Paul Saw in Chap. 12 entitled *A Global Accounting Standard: The Holy Grail?* argues that the introduction of Financial Reporting Standards by the International Accounting Standards Board is the single most important initiative in the financial reporting world since its impacts affect many accounting and non-accounting decisions people make. The chapter notes that as a result of the enormous financial and non-financial interests of stakeholders in companies, the call for clear and concise guidance towards responsible accountability has never been louder.

Samuel O Idowu in a chapter on *Accounting for decision makers in a sustainable environment* discusses accounting for sustainable development using some traditional accounting techniques which accountants and corporate managers use when making short and long term decisions. The chapter considers the topics of Environmental Manager Accounting, Cost of Quality model and product costing using Activity Based Costing (ABC).

Elewechi Okike in the final chapter of the book entitled *Financial Reporting and Fraud* argues that investors until recently rely confidently on the information contained in the externally audited annual reports and accounts of companies when making investments and other financial decisions. But recent stories around the world of scandals and corporate failures as a result of some companies providing false and misleading information in their purported externally audited financial statements and reports; have badly shaken this confidence; the chapter notes.

It is hoped that our readers would find articles in this series of books on CSR relevant to their needs. Please feel free to contact the lead editor if there are issues in the book that you would like to help us with.

Having realized that there is a pronounced absence in the market for an official Encyclopedia of Corporate Social Responsibility (ECSR), the next book in the series will certainly be that. We want to take this opportunity to express our sincere appreciation and thanks to all our readers around the world for their continued support. We appreciate your continued patronage and hope that our efforts to advance knowledge in the critical field of CSR have been worthwhile.

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Part I
Management

Chapter 1
Managerial Ethics as a Prerequisite to CSR: The Person Behind the Role

Cécile Rozuel and Nada K. Kakabadse

Abstract Managers occupy a particular position in organisations that make them morally responsible for their own actions as well as key influences on the moral mindset of the staff they supervise. Nevertheless, the concepts of "manager" and "management" remain elusive. Successive management theories have unveiled various organisational and moral implications of managerial responsibilities, and a role-based analysis of managers' moral responsibilities has proved appealing to researchers, but comes with its own ethical traps. A sustainable ethic requires consistency of character, something a mere role-performer lacks. The moral point of view needs to examine the moral qualities of the self behind the roles, where the self pre-empts the role. In this chapter, we argue that managerial ethics should first and foremost celebrate people rather than organisational actors, selves rather than roles. Anchored in humanity and individuality, we offer a self-based approach to a more sustainable, fulfilling and authentic ethical practice in management. Managerial ethics thus calls for self-reflection and examination, with subtler but no less effective implications for organisational life, ethical business practice and genuine CSR.

1.1 Introduction

Many different people compose an organisation, but every organisation has managers, albeit they might not wear the title. Organisations grant managers a greater degree of responsibility to deliver activities, services and/or products to their markets, even when they operate at the first-line level. They face ethical issues everyday and in every dimension of their work (Carroll, 2002, p. 141; Cadbury, 2002, p. 11). Although the CSR literature generally gives priority to organisational or global

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concerns and dynamics, the various expectations organisations place on individual actors, including managers, are fundamental in nurturing sustainable business practices (Wood, 1991, p. 695). If business ethics research should integrate both "the person's internal awareness of ethical principles, the organizational contexts of thought and action, and the realities of combining ideals and work demands" (Kahn, 1990, p. 319), then individual managers are amongst the first in line for a serious ethical enquiry.

Although everyone should be ethically sensitive, managers are often expected to be role models and to set the tone in the organisation (Kantor and Weisberg, 2002; Morrell and Anderson, 2006). In fact, the higher the manager's position within the company, the more the company imposes expectations on him/her to be a role model. Studies in leadership have highlighted that top executives and leaders should play a key part in encouraging particular behaviours and attitudes towards ethical standards (see, for instance, Thomas and Simerly, 1995; Bass and Steidlmeier, 1999; Minkes et al., 1999; Kantor and Weisberg, 2002; Rendtorff, 2003; Treviño and Brown, 2004). Effective ethical leadership goes beyond the "do as I say, do not do as I do", and leaders are expected to embody the values they preach and inspire others to act as well (Wheststone, 1997; Treviño et al., 2000). Not all managers are leaders; nevertheless, managers occupy a moral ground at least as large as that of leaders. Whilst leaders promote good ethics in the organisation through their charisma and ability to inspire others, managers do so through their key position of authority and expectations of exemplarity (Carroll, 2002).

Yet, whilst we would value a person as a role model in a business environment we would not necessarily consider that person a moral exemplar in another context. We actually tend to have different conceptions of moral exemplarity (Walker and Hennig, 2004). In practice, we usually identify the pressure to achieve business (as opposed to social or environmental) objectives as a cause for moral failure (Bird and Waters, 1989). Solomon (2005, p. 111) however contends that opposing virtuous conduct to business performance is a mistake and that: "ethics is a way of life, a seemingly delicate but, in fact, very strong tissue of endless adjustments and compromises." This leaves greater hope for developing more authentic managerial ethics. The chapter first reviews various approaches to management and discusses their moral implications. One must examine the terms "management" and "manager" in order to grasp the extent of a manager's individual responsibility and discretion in relation to ethical practice. The second part of the chapter critically examines the value of using a role-based approach to analyse managerial ethical duties. The final part offers some directions for developing an organisationally sustainable and personally fulfilling managerial ethic centred on the person behind the role.

1.2 On Management, Managers and Ethics

Although Christopher Grey (1999) declares that "we are all managers [and] we always were", it is surprisingly difficult to define manager and, subsequently,

management. Managers and management probably fall into the category of those terms everyone understands, but no one can clearly define. More surprisingly, despite an impressive literature examining the whereabouts of management and managers, there appears to be no clear working definition of the terms (Thomas, 1993; Stewart, 1997; Hales, 2001b). This is partly because research has not examined consistently the issues of management; in particular, what is specific to managers, and how we should define managers (Hales, 2001a). Researchers also link it to the ideological framework in which they posit themselves and from where they define and reflect on management (du Gay, 1994; Grey, 1999).

1.2.1 Ethical Dimensions of Various Management Perspectives

Various waves of analysis and recommendations for effective practice have shaped contemporary management thought, from a system-based to a behavioural to a contingency approach (Kreitner, 2001, pp. 43–63). Each approach redefines management, examines managers' focus, but also provides interesting insights onto potential ethical concerns of managers. The responsibilities of managers for the employees they manage, as well as the relationship between managers and "*managee*" differ tremendously depending on the perspective one adopts: organisations who view employees as human resources, sadly, do not call for the same "ethical treatment" as organisations who view employees as emotional actors in need of recognition and support.

Henri Fayol, a French engineer-turned-administrator, whose 1918 opus *Administration Industrielle et Générale* (1987) remains a landmark in management theory, adopted in the early days a descriptive approach of the functions necessary to manage any organisation. Yet his fourteen principles of management, still referred to, demonstrate a fair apprehension of the human factor whereby organisations expect employees to be obedient and productive, but equally, ought to treat them fairly almost as a moral obligation. The following wave of theories aimed at improving the production process in terms of quality and efficiency (Kreitner, 2001). Frederick W. Taylor (1911) and his counterparts Frank and Lillian Gilbreth (1917) and Henry Gantt (1919) all contributed to this approach which scholars often pinpoint as the root of the dehumanised workplace. However, their scientific stance on work processes also brought significant improvements to the working conditions of employees, in particular less fatigue and wage incentives. The social and humane cost of this approach remains significant, and we can no longer morally accept its dialectic validity as we did in the early twentieth century. Psychosocial studies such as Maslow's (1968) indeed demonstrate that motivation is a more complex phenomenon than what Taylor assumed, and that workers seek more than a monetary retribution in their job.

Later on, sociologists and psychologists turned their attention to the organisation and put the workers' emotional needs and motivation patterns on the management agenda (Kreitner, 2001, pp. 51–52). People are the key resource upon which organisational success ultimately depends, argued Elton Mayo (2007), Mary Parker

Follett (1918/2009) or Douglas McGregor (2005). However, if managing people's needs is merely instrumental to achieve greater productivity and profitability, that model fails to be sustainable. There must be a moral commitment to treat people *as* people in order to nurture sustainable commitment from employees. Theorists who view the organisation as a system greater than the sum of its parts focus on organisational dynamics rather than organisational behaviour. Within this approach, managers assume that the organisation can learn (Kreitner, 2001, pp. 54–57). If we abandon the question of moral personhood of a non-physical entity, this approach has the merit to welcome the human ability to evolve, "sense" the change and engage with it in an almost intuitive manner. Here moral knowledge is as much emotional and intuitive as it is rational.

This brief review of some central management theories illustrates how the importance, meaning and focus of ethics can change depending on one's standpoint. None really addresses the ethical question, but all provide valuable material to infuse moral reflection on organisational life. Managers ought to understand the moral implications of a certain mode of organising onto their employees, themselves and the organisational collective. This understanding is an early but essential element of managerial ethics.

1.2.2 Locating the Manager in Management

Although the activity of management, understood as coordinating and controlling the work of others, is almost as old as mankind (Thomas, 1993), only since the Industrial Revolution has society given management a prominent status, and only since the beginning of the twentieth century has it been the object of extensive academic research. We generally understand management as "deciding what to do and then getting it done through people" (Armstrong, 1999, p. 2). Managers' expertise does not lie in a specialist or technical knowledge, but in the ability to oversee activities, coordinate people and draw a general plan of progress (Hannagan, 2005, p. 5). Not everyone is suited for such a role. Most people are familiar with the experience of management, but not everyone has experienced what it is to be a manager. Enteman (1993) speaks of "managerialism" to illustrate how nowadays everybody manages his/her life, from the family household to the workplace. Nevertheless, the manager-job (i.e. the job content and responsibilities) is quite different from the manager-mindset (i.e. the need to organise, plan, manage all aspects of one's life and relationships).

Management is not equivalent to the managerial role either. Actually, confusion reigns over what management really designates. Scholars have used "managerial work, jobs, behaviour, tasks or functions" interchangeably to represent management in research studies (Hales and Tamangani, 1996). Furthermore, management can refer to the process of managing, but might also refer to "the management" (team) of an organisation (Stewart, 1997; Grey, 1999). In the latter case, one needs to address questions about who to include in "the management" and whether the management possesses a distinctive dimension and responsibility (see Tsahuridu, 2004). Do we or should we anthropomorphise "the management" as we do with "the organisation'?

Intuitively, management seems to encompass more than a job description or more than the characteristics of the managers. In fact, organisations often hold responsible "the management" rather than individual managers for the adversities the activities of the corporation trigger. As Hales (2001a, p. 56, original emphasis) puts it: "individual managers may not make a difference because *no-one* does: organisational outcomes emerge, without evident authorship, from complex negotiated interactions – even if, after the event, participants and observers may try to make sense of these outcomes by attributing them to the actions of specific individuals."

Nonetheless, that no one makes a real difference at the organisational level is not a strong enough argument to relieve organisational actors from their individual moral responsibilities (Boatright, 1988, p. 306). We may extend the structure of our actions to the corporations we choose to build and within which we act as agents in decision-making. As decision-makers, managers' commitments include using discretion as a quality of collective endeavour. Therefore, individual choice or the autonomous expression of the human self is the power to affect decision-making by distinguishing between specific qualities using *discretion* to make choices among a number of qualities. Managers, as coordinators, supervisors or planners, have a clear role in the actions of "the management" and "the organisation" for which they are, at least, partly accountable. Furthermore, managers may do "what everyone does in managing themselves and their lives", but "they are paid to do it – and they are paid to do it because they manage *other people* (employees) as well as themselves and do so *on behalf of* others (employers)" (Hales, 2001b, p. 11, original emphasis).

Fayol and Mintzberg's works describe the general typology of the manager, which is centred on the tasks of planning, organising, motivating and controlling (Stewart, 1997). Hales (2001b, p. 10) lists the following as dimensions of the managerial job: acting as figurehead; monitoring and disseminating information; negotiating; handling disturbances; allocating resources; directing, monitoring and controlling; liaising; networking; innovating; planning and scheduling; and managing human resources. Other researchers have tried to capture the meaning of management and manager through the "role" approach (e.g. Pfeffer and Salancik, 1975; Boatright, 1988; Kraut et al., 1989; Fondas and Stewart, 1994). A role-based framework includes not only the functions, tasks or responsibilities but also the covert behaviours and implicit social and moral expectations related to the manager status or position. Role-based analysis offers the advantage of locating the individual within his/her social context, thereby facilitating a more complex and complete picture of the managerial position. The next part discusses whether a role-based analysis holds up to its explanatory potential.

1.3 The "Role" Framework

Several studies have used a role-based framework of analysis with a view to framing moral dilemmas. In the following section we review some of these studies and critically assess whether they provide a solid moral foundation for a sustainable managerial ethic.

1.3.1 Role Performance and Role Conflicts

Literature has widely discussed the concept of role, although often with varied preconceptions and implications (Neiman and Hughes, 1951; Biddle, 1986). Role-based analysis offers the advantage of locating the individual within his/her social context. It addresses the shaping and enactment of role expectations (Katz and Kahn, 1978). These expectations usually define the content of role obligations (Hardimon, 1994). Goffman (1959) provided a classic framework for understanding the extent and nature of role-playing in our lives. Drawing constant comparisons with dramaturgical features, in the tradition of psychodrama (Moreno, 1977), Goffman (1959) describes how we perform our roles, and work through and with various groups and props in front of an audience, how we deal with disturbances and disruptions, how we manage the transition from back stage to front stage, and how we learn to hide our self effectively. Roles encompass both social and moral expectations although to varying degrees (Downie, 1968; Boatright, 1988). In this purview, moral tensions result from the perception of a contradiction or a conflict between various moral expectations either within the boundaries of a single role (intra-role moral conflict), between the expectations of separate roles (inter-role moral conflict), or between role expectations and self aspirations.

When scholars discuss the concept of role in an organisational context, two broad levels of enquiry co-exist (e.g. see Bassett and Carr, 1996). One level focuses on the organisation as a unit of analysis. A role refers to a given task that an individual performs, for instance "the accountant" or "the marketing senior manager". The various role-players are expected to interact with one another to achieve the organisational goal. The roles may be constraining and interaction of the different roles may cause conflict, in so far as the objectives of the accountant may conflict with the objectives of the marketing manager. But the very existence of roles is understood as the pursuit of organisational effectiveness and there is ample room for developing "liaison and conflict management roles" or "buffer roles", if appropriate (Bassett and Carr, 1996). The system is based on the "one person-one role" principle, which implies that problems and conflicts can only occur between two roles, in other words, between two distinct people. From an ethical viewpoint, the conflicts that emerge between two people primarily involve interpersonal relationships, communication and negotiation. If the values of manager "A" conflict with those of manager "B", then an open and frank discussion would create a safe space to address the conflict. Yet the dynamics of this discussion, and whether the discussion takes place at all, very much depend on how each actor feels towards both the conflict itself and his/her values. A moral conflict is never just about two people, but also involves how these people conceive their respective role. Therefore, the first level of analysis cannot supply a thorough understanding of the moral dynamics of management, and we should turn to the second level of analysis.

This level focuses on the individual and analyses the relationships between the role and the self. Drawing mainly from psychology and sociology, such approach allows one individual to have several roles and defines conflict as the tension between the self and a role, or between different roles amongst which an individual

has to choose or by which an individual is influenced in a given situation. Moral dilemmas experienced at this level are more acute and potentially more traumatic.

For example, Athanasopoulou (2004) led a qualitative study amongst managers' role conflicts at work. Using a role-based framework she distinguishes inter-role from person-role conflicts and explains that inter-role conflicts (which is when the person experiences conflicting demands from different roles, for instance "as a manager" versus "as a community member') are more frequent than person-role conflicts (that is when the role expectations conflict with the person's values). She then lists the "rationalisation mechanisms" managers implement to cope with such conflicts, which consist of (Athanasopoulou, 2004, p. 18):

1. distancing oneself from the situation ("it is part of the job");
2. hoping that it is for the best ("I am protecting the jobs of other people"); or
3. taking a "deterministic approach" which implies that what happens is inevitable because "it is not entirely up to me to decide".

Overall, however, justifications (1) and (3) illustrate a tendency to mitigate one's responsibility by annihilating "the human" under "the manager", "the business" or "the organisational machine'. Justification (2) is more engaging, but is an example of a narrow utilitarian rationalisation and is certainly estranged from what John Stuart Mill had in mind when he refined the utility-maximizing doctrine (Mill, 1863/1992). That is not to say that a hopeful rationalisation is wrong in itself; however such reasoning likely weakens the intrinsic human value of those sacrificed, especially if the notion of dignity so dear to Mill is ignored. Besides, it is not certain under these circumstances that the decision is purely motivated by a desire to protect others rather than one's own interests and well-being first and foremost.

The above study illustrates how a role-based analysis fails to capture the underlying dynamics which motivate those "rationalisation mechanisms". In her study, Athanasopoulou (2004) only describes how managers justify their behaviour, but she does not dig into the rationale behind these claims. Yet in order to improve our moral behaviour, we need to understand what makes us act the way we do. We require a greater degree of self-knowledge to uncover the meaning and significance of moral experiences. Besides, the suggested lower frequency of person-role conflicts hides the fact that conflicts between self and roles most certainly lead to psychological imbalance and serious social and moral trauma. Conflicts of values or of expectations never merely involve two roles; it also always concerns the self of the person whether one is conscious of it or not.

1.3.2 Role Enactment and Virtuousness

Moral dilemmas do not only result from role conflict. Tensions in role enactment can originate from role ambiguity, role malintegration, role discontinuity, role overload as much as role conflict (Miles, 1977; Biddle, 1986). However, the point a role

perspective puts forward is that life is a play, people are actors and morality is a matter of expectations regulated by interaction with others. Such theory has undeniable descriptive qualities, but its moral qualities, as we saw above, are a different matter. First and foremost the very concept of virtues as a determinant of one's character is seriously challenged. From a role perspective, a person cannot *be* truly virtuous but only *acts as* a virtuous person since life is a socially constructed fiction. Let's consider, for example, the virtue of benevolence. The virtuous person is benevolent because it is in her character, that is, it defines her as a person. If life is a play, however, a person might very well be benevolent, but only through enactment. In other words, she can enact benevolence but she is not benevolent per se. If the social or moral expectations bearing upon a specific role include acting with benevolence, then the person who is benevolent simply is a good actress in the sense that she enacts what is expected of her (or what she perceives is expected of her). If the next role she enacts does not require acting with benevolence, she might choose not to be benevolent without people sanctioning her as immoral, wrong or non-virtuous.

Of course, one could argue that global social rules exist that require benevolence to be a compulsory feature of each possible role. In which case, we would consider being virtuous a global moral expectation against which we assess everyone. Yet, we would still address virtuousness as the feature of a role rather than of a character in the Aristotelian sense. Virtuousness in this instance is significant only because those are the rules of the play. In fact, virtuousness loses its intrinsic value. We may also argue that a person can decide to enact her role in a virtuous manner, in which case she chooses to act virtuously. Yet, this is far from obvious. Indeed, if she chooses to enact her role virtuously, say with benevolence, then her benevolence is relevant to what she enacts, not necessarily to who she is as a person. Furthermore, if we were to accept that she *is* what she enacts, we need to identify a permanent feature that links all roles and all enactments together, which serves as a unity of character that bears the moral responsibility. Otherwise, the person is just a puppet lacking moral strength to assert her convictions when pressured by social expectations attached to her role, as Goffman (1959, p. 87) illustrates.

Morally, the risk is high for individual autonomy and responsibility. As Vice (2003, p. 105, original emphasis) notices: "If we see ourselves purely in terms of roles, we both risk bad faith in the Sartrean sense – *mauvaise foi* – as well as losing sight of the individuality of persons.[. . .] And it is arguably a sign of maturity to outgrow "role-playing', to stop defining ourselves essentially with any role we may happen to take on and to become comfortable with or resigned to the kind of person we broadly are and to our inescapable limitations." Managers thus fulfil their duties as sensible beings by using discretion to delineate the value in the choices organisations present to them. According to Kant, virtue is the strength one exercises in using discretion and discretionary means by acknowledging the constraints under which we must make decisions (Kant, 1797/1996, p. 156). Thus, one exercises "free self-constraint, not constraint by other human beings", as a responsibility to others by using autonomous decision-making, rather than being subject to coercion (Kant, 1797/1996, p. 395). Managers have a duty, a responsibility to act as sensible beings because of one's mutual respect for humanity.

A role-based framework therefore proves insufficient on two essential accounts: first, it fails to explore the intrinsic motives for action of people; second, it reduces identity and individuality to a sum of socially constructed roles. Without any unifying core, the actual moral responsibility of the person becomes rather precarious. In other words, a self must exist as a platform upon which the conscious person wears the various masks and performs the various roles in reaction to social stimuli. However, the self must be of a different nature from the roles or the masks. Proponents of a role-based framework define the self rather ambiguously. Whilst the self refers essentially to our own sense of identity (Layder, 2004), some believe that it is constructed from our roles (e.g. Goffman, 1959) or that "we grow up on stories" (Vice, 2003, p. 98). One raises the question as to whether the self is per nature changing and emerging, or stable, essentially present at birth and constant throughout our life experiences. If, as most social psychologists believe, the self is the product of a social, interactive construction, then it cannot be that essential platform necessary for moral autonomy and responsibility. This is because we can never know who is responsible for a person's actions since that person's sense of who she is possibly changes everyday.

If, on the other hand, one conceives the self as different from roles, as an anchor that constitutes who the person fundamentally is, then we are capable of identifying a sound moral basis for individual responsibility. C.G. Jung's archetypal self, for example, is of that nature. Jung (1970) views the self as the archetype of wholeness, a collective figure at the core of everyone's psyche which individually determines our true nature, our potential as individuals. Our conscious-ego embraces various persona, various social roles depending on the circumstances, but our actual quality as a person lies with the self. Therefore we should be well advised to seek our self through our social roles, rather than attach various degrees of moral responsibility to factitious roles. A role-based framework, devoid of a significant and stable conceptualisation of self, is not morally conducive. A self-based framework, on the other hand, allows an in-depth exploration of our inner moral mechanisms and offers more solid moral foundations. It also resonates with virtuousness. Practical wisdom, the virtue that helps us determine the appropriate set of virtues in each circumstance, demands a consistent self. Thus, the self contains all that makes us human beings, all that makes us who we are and who we could become. It raises the value of personhood and individuality. Yet, the organisational context is often insensitive to the call for individual expression and self-authenticity. On the contrary, it cultivates roles and anonymity, with serious moral compromises at stake.

1.3.3 Organisational Roles: Bureaucracy and the Person

Organisational studies closely attach the concept of role to bureaucracy. Even if in recent years organisations have placed much effort into moving away from bureaucracy towards a more entrepreneurial model, most large companies still display some degree of bureaucratic stiffness. Traditionally, bureaucratic organisations have

epitomised the "impersonal machine" in which detached and interchangeable actors perform their tasks rationally and withdraw their personality (Ladd, 1970 quoted by Metzger and Dalton, 1996). Scholars have extensively criticised this model, sometimes caricatured, on the grounds that it allows for immoral behaviour to occur because it cultivates impersonality (see, for instance, Jackall's depiction of the roots of American bureaucracies, 1988, p. 11). Popularised by Max Weber, the bureaucratic model displays a hierarchical structure, a strict division of labour that separates different professional experts, and emphasises extensive reliance on rules and procedures (Buchanan, 1996). The bureaucratic structure sets the roles, not allowing personal characteristics to come into play, so organisations can easily replace and interchange agents. Eventually, of course, one becomes an expert in his/her role, but he/she does not do so by making the role his or hers; rather it is the role that formats the person into a stereotypical character, which reflects and defines the position, the tasks and the organisation itself (Merton, 1940).

Personality, individuality and creativity are absent from bureaucracy to the extent that they impede the efficiency of the management and production process. In his analysis of French bureaucracies, Crozier (1964) concluded that impersonal rules, centralised decisions, isolation and subsequent group pressure and power relationships regarding the control of "areas of uncertainty" create a "vicious circle" that leads organisational members to solve problems by elaborating more rules and engendering greater isolation. This ultimately contributes to reinforcing the bureaucratic characteristics that might have initiated the problem in the first place. Bureaucracy reproduces itself as well as its members according to a similar, constant profile (Dugger, 1980). It is therefore unsurprising that Johnson (1981, p. 56) insists on the need to review bureaucracies' organisational structures and processes "in order to reduce the anonymity of decision making", whilst Buchanan (1996) contends that strengthening the ethical commitments of bureaucratic actors would limit the agency problem and offer a better outcome than alternative models of corporate responsibility or bureaucratic roles. Paradoxically, this confirms that emotions (of which bureaucratic actors are deprived de facto) are significant in moral behaviour (Hine, 2004).

Dyck and Schroeder (2005) take even more distance with the bureaucratic model. Inspired by Weber's ideal-types, they argue that managers should shift their moral-point-of-view from the conventional to a radical model characterised by compassion, stewardship and critical approaches to practice and thinking. It is probable that altering the conditions of moral perception by modifying the context (that is the organisational structure, the moral climate and culture and so on) or the social expectations we attach to defined roles is likely to affect people's moral behaviour. The key to this programme, though, is to make people aware of the changes before implementing them, because it is people who initiate the basic structures of the social world. Yet, why would people do so? In spite of numerous talks about ethics in business and its relevance to develop sustainable growth, and in spite of much active lobbying to integrate stakeholders" concern into strategic management and to prioritise good management practice over profitable practice, ethical misbehaviour still occurs in organisations and corporate scandals seem to reproduce. It is not that

business people are morally insensitive, or unwilling to merge their personal morality with their work ethic. There may be impediments at the institutional level, which fall within the arena of politics. One might question, for example, what goals business should pursue, which ontological obligations business has towards society, and whether our consumerist capitalism nurtures actual happiness, progress and dignity. These questions deserve open reflection and an informed public debate, as well as a willingness to consider challenging alternatives. There may also be impediments at the individual level, and these are the realm of managerial ethics.

1.4 Towards Managerial Ethics

1.4.1 Foundations

In order to establish the concerns of managerial ethics, we shall clarify from the previous discussion what managers do. Managers are in charge of a variety of tasks that often involve other people, either subordinates or other managers; they are accountable for the efficient running of the organisation at different levels; they are submitted to a certain degree of tension due to conflicting duties, situations or demands; they make decisions both rationally and intuitively or emotionally; and organisations tend to define them by what they do or what they achieve. We may draw several ethical obligations from this description. First, managers deal with people; therefore, they have an obvious moral duty to respect them as such and to act fairly. Management is primarily about people, not about process, output or resources. Second, managers are de facto subjected to tension and pressure in order to meet performance expectations, especially as agents for the organisation's owners. This pressure brings them closer to the ethical/unethical borderline (Carroll, 2002). Moral dilemmas are part of the manager's life; consequently, "moral thinking" is an "essential capability" for managers (Paine, 1996). It takes practice and reflection prior to a confrontation with a moral dilemma. Finally, we notice that emotions and intuition influence decision-making alongside rationality. Compassion and stewardship are not rational expressions; rather, they display an emotional sensitivity and a deep desire to act in accordance with one's actual beliefs, in accordance with one's self.

So what does this mean? We suggest that a solid managerial ethic lies on two essential pillars: the full recognition of the humanity of the people who work in an organisation; and the acceptance of one's individuality and individual responsibility even when one is engulfed by the social machine. A general tendency to anthropomorphise organisations proves damaging for the real people who work in these organisations. Referring to "organisational beings" as commonly as we do today is pernicious and has "the potential to distract attention from the real decision-makers, perhaps enabling them to evade responsibility for their actions" (Ashman, 2005). More importantly, we humanise abstract entities, whilst we dehumanise real human beings whose decisions and actions are no longer accounted for but instead

are transferred to the organisation as such (McKenna and Tsahuridu, 2001; Bakan, 2004; Ashman, 2005). Both personal responsibility and human respect lose out, because no one seems to make a difference and no one feels that they matter. Views that describe the organisation as "a shared community of purpose" (Warren, 1996), or as a member of a wider community and "inconceivable without that community" (Ewin, 1995) are kinder to humanity. They acknowledge that people come to work for a purpose, and that "to earn a living" may not really fulfil that purpose. Responsible organisations treat their employees as dignified, worthy people, irrespective of their position and performance. Responsible managers embody this motto without hiding behind their powerlessness at changing the rules of the game.

Of course, the systemic process that turns organisational outcomes into something more than the sum of individual acts renders impractical the unambiguous pinning of the responsibility on one specific link of the chain (Hales and Tamangani, 1996; Tsahuridu, 2004). Nonetheless, the possible responsibility of the organisational entity does not alleviate organisational members from their accountability and moral responsibilities (Paine, 1996; Berthouzoz, 2000). Individuals are actors, active or passive, and that is usually enough in the eyes of the law and social custom to hold each one of us responsible for what we do or do not do. In Peter Singer's four-dimensional world, one action at one point in time in one specific place does matter, even when nothing else changes after that (Singer, 2000). At our modest level, this means that one manager taking a stand for something he believes in, or for someone he wants to support at one point in time does matter, even if nothing happens or no subsequent changes take place, providing one does not cause equivalent pain by doing so. It matters neither because his conscience is clear, nor because it is cool to be a hero. It matters because this manager acts as an individual in the noblest sense, therefore resonating with forces that extend beyond the organisation. To be an individual is perilous, but it is the only responsible way in the distance.

1.4.2 Developing a Good Character to Live the Good Life

Virtue ethicists have been prominent in the management ethics research field recently, either to support Virtue Ethics as a comprehensive moral framework for managers or to argue that management cannot be virtuous (Dawson and Bartholomew, 2003). In the footsteps of Plato and Aristotle, contemporary virtue ethicists ask what sort of life a good person should live, and argued that this life should be a virtuous life. Ethics is about developing a good character, which refers to a natural disposition to practice the virtues appropriately and an understanding that this participates in achieving our purpose and a deep sense of fulfilment (Aristotle, 1992; Solomon, 2002). The chief good in life is *eudaimonia* or happiness, personal flourishing, that which makes our life and our moral actions worthwhile.

Yet, pursuit for *eudaimonia* is not equal to achieving it because we generally lack a "very specific program of action" (Dierksmeier and Pirson, 2009). Since Aristotle

refuses to deduce morality from principles, we simply must "work from experience and develop an understanding of different customs and mores so as to learn, gradually and habitually, to employ wise judgment in the management of [our] affairs" (Dierksmeier and Pirson, 2009, p. 420). A community of virtuous exemplars helps us define what the virtuous life is, and makes the good life a desirable goal (Aristotle, 1992). For Aristotle (1992), friendship (*agape*) is an essential virtue without which life lacks value. Friendship is a basis for social interaction and community-building, therefore Aristotle claims this virtue is a regulator of community life and relationships. Virtuous friends or "the paragon of concrete persons (*phronimoi*) who excel in judgment and wisdom" (Dierksmeier and Pirson, 2009, p. 420) challenge our actual character and encourage us to aspire to greater moral exemplarity.

Living the good life thus requires developing a good character in the first instance. What character means is not uncontroversial and some virtue ethicists do not even refer to the concept (Statman, 1997). Watson's (1997) outline of the concept illustrates some of the misunderstandings that occur in the field. Watson (1997) argues that we should not confuse the character-based virtue approach with character utilitarianism (i.e. developing a virtuous character in order to achieve happiness), nor with perfectionism (which remains consequentialist in essence). These views reminisce of virtue as a role rather than an authentic character trend. For Watson (1997), the proper notion of character embraces a non-consequentialist view without necessarily implying a purpose to which we direct human actions. Nonetheless, Aristotelian virtue ethics is teleological.

The notion of character helps redefine the boundaries of personal responsibility in a business setting. For instance, Sundman (2000) examines from a virtue ethics perspective whether a good manager is also a moral manager, and suggests that the demands of morality are external to the business practice, so that a good manager ought not to be a moral manager. In particular, he provides the example of excellent managers who work for companies that produce harmful goods. Yet, as Dawson and Bartholomew (2003, p. 135) rightly point out, a virtuous manager would still be concerned with what the organisation for which he works produces. Hence, working for an arm manufacturer would raise serious moral issues that contravene the ideal of the good life and human happiness. Besides, pleading ignorance would not obliterate one's responsibility because the virtuous manager would be wise enough to know the implications of working for such an organisation. Which was probably why (Dawson and Bartholomew, 2003, pp. 135–136) argue that "Virtuous business people have the interest of society in mind and knowledge of the human goods to which their work contributes"

Alasdair MacIntyre provides another example of the use of a character in management. As interpreted by MacIntyre (1985), a character is more than a social role. It demands that role and personality fuse so that the distinction between what is specific to one individual and what is specific to his social role disappears. Therefore, the character stands for the moral representation of the culture to which it belongs. Besides, "the requirements of a character are imposed from the outside, from the way in which others regard and use characters to understand and to evaluate themselves" so that ultimately, "the character morally legitimates

a mode of social existence" (MacIntyre, 1985, p. 29). MacIntyre identifies three characters representative of modern society, but scholars have commented particularly on his depiction of the bureaucratic manager (see Deetz, 1995; Mangham, 1995a, b; Nash, 1995; Dawson and Bartholomew, 2003). The bureaucratic manager is "manipulating others and manipulated by the system he has created" and "his area of expertise is efficient management which, for him, has no moral dimension" (Vardy and Grosch, 1999, pp. 103–104), and indeed may itself be illusory (MacIntyre, 1985). A controversial picture of manager, MacIntyre's character depiction is an ideal-type, although we are unclear as to how much MacIntyre himself believes it mirrors reality.

MacIntyre's (1985) character of the bureaucratic manager echoes what Carroll (2002) has dubbed "amoral management". Whilst immoral managers deliberately ignore and transgress ethical rules to serve their own interests, moral managers are attentive to the letter and the spirit of the law, and their strategy encompasses moral standards (Carroll, 2002). Yet the vast majority of managers are likely to qualify as amoral managers, either unintentionally or intentionally (Carroll, 2002). Intentional amoral managers consciously avoid thinking about ethics when at work; whereas, unintentional amoral managers are simply ignorant of the fact that what they do has moral consequences. Carroll (2002) suggests that at the individual level each manager goes into phases that range from the immoral to the moral management model, depending on the circumstances. Overall, however, organisations are likely to be filled with amoral managers who "are basically good people, but they essentially see the competitive business world as ethically neutral" (Carroll, 2002, p. 148). The conclusion is that organisations should make more efforts to raise managers" awareness of the ethical challenges in the business environment and explain to them how they can benefit from being ethically proactive. In other words, most managers have not actually developed a virtuous character. The same individual can act ethically 1 day and unethically the next because the circumstances have changed his/her perception of the situation.

1.4.3 Practical Implications and Expectations

We can draw two conclusions from the discussion above: first, that people possess dual characteristics and are equally capable of good and evil. Second, the key to understanding why people behave as they do (rightly or badly) lies in their internal deliberations, which reflect the perception they have of the situation. This concurs with what Treviño and Brown (2004, p. 70) underline as a lack of "moral awareness, ethical recognition, or ethical sensitivity". Basically, managers are not necessarily able to detect the moral component of a situation, hence to act in a morally considerate way. But as Treviño and Brown (2004) specify, moral awareness is just the first stage in the wider process of decision-making. When it comes to ethics, these authors argue that people are likely to be equally good and bad depending on their environment. They question the autonomy of moral agents by arguing that most

adults are followers and reproduce what they observe amongst their peers (Treviño and Brown, 2004). There is no denying that the culture and the personal qualities of leaders and managers set the tone within the organisation, and that they must practice their ethical commitments, not just hang them on the wall, if they are to be meaningful. Yet individuals are rarely coerced into doing something with which they disagree. Certainly, examples exist where management threatens to fire people if they do not follow the orders, and the fear of unemployment may count as a mitigating circumstance. But it cannot qualify as an excuse for denying one's moral agency because it is always a matter of choice. To make the decision in agreement with one's conscience represents a challenge which announces the critical importance of self-knowledge.

Moral motivation and moral character are both acts of will. They imply a choice (i.e. to be willing to do something rather than something else) and the effort necessary to concretise it (i.e. the will-power to implement the choice). Roberto Assagioli, founder of the psychosynthesis movement, believed that "the will's function [consists] in deciding what is to be done, in applying all the necessary means for its realisation and in persisting in the task in the face of all obstacles and difficulties." (1974/2002, p. 6). The will is essential to our actions in life, but we must train it. The training occurs in three phases, argues Assagioli (1974/2002, p. 7 – original emphasis): "first, is the recognition that *the will exists*; the second concerns the realization of *having a will*. The third phase of the discovery, which renders it complete and effective, is that of *being a will* (this is different from 'having' a will)." In any case, the will is located at the "central core of our being" so that "the self and the will are intimately connected" (Assagioli, 1974/2002, p. 9). Therefore, the willing self appears as the ultimate source of moral decision and moral action. It is the self who practices wisdom and we rely on our self, and not just on rational thinking, to assess our choices and to choose our course of action.

We can now propose a more complete picture of managerial ethics (see Fig. 1.1). The foundations consist, as exposed previously, in an assertion of humanity and individuality. Both are essential in sustaining good ethical practice, virtuous management. Both require taking time to know oneself, not superficially but deeply, painfully. This is no positive thinking or self-delusion, but true self-knowledge: a clear perception of who one is, what one is capable of, what one purports to become, how one fits within the universal frame. Without self-knowledge, each pillar is frail and lacks authentic expression.

We argued that managers should always view their colleagues and subordinates as people, and should always view themselves as people. This means that we do not just tolerate, but instead welcome and encourage emotions and intuition. Self-knowledge may unleash unconscious surges which we also need to welcome, with careful compassion and a readiness to understand their dynamics. This helps us make more creative decisions. Reaching out for the humane in organisations also means that we acknowledge that people seek fulfillment and meaning. Industrialisation has deeply transformed society, but crushed the hopes of thousands of men and women to realise their calling. Some may find fulfillment in low-skilled or repetitive jobs and deserve respect and dignity. Others are able to contribute

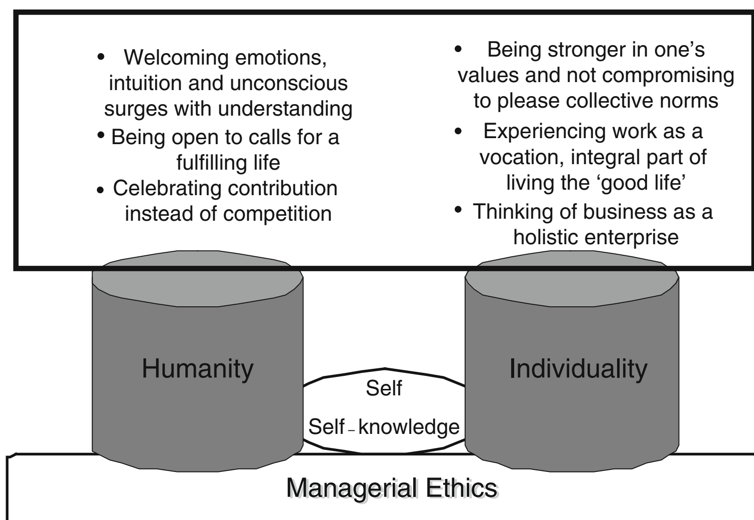

Fig. 1.1 Self-based managerial ethics. Source: compiled by authors

differently and the organisation should offer the space and time to express this. This goes far beyond what the HR department may offer. It is the manager's responsibility to know his/her employees and colleagues enough to facilitate such developments. It is especially our responsibility to give ourselves the space and time to express our own calls for a fulfilling life. This may concern the personal life, the content of the job or the job itself; either way, it is too important a human need for us to neglect or ignore. Organisational life thus emphasises talent contribution rather than talent competition.

Affirming one's individuality in the face of an anonymous collective entity also brings about significant changes. Instead of learning to compromise, we learn to embody our values. This does not imply that we shall be heroic fools every time organisational goals squeeze our values. On the contrary, we may discover more powerful, clever ways to address the dilemma without compromising the ethics. We respect others and respect ourselves, but we also know that CSR is more about values than about profits. It takes courage and a great sense of grounding to be the lonely, independent voice of morality, promoting a different type of management, of business, of organisation. But sometimes it is the only choice, and it is the salutary choice. When one acts true to one's self, work recaptures its vocational dimension, and fully contributes to the good life. The organisation evolves, and the business world opens up to the interconnectedness of all things. Business no longer pursues profit, but a holistic integration with its social and natural environment. This, after all, is the ambitious meaning of Frederick's CSR4, where cosmological, scientific and religious or spiritual inputs reshape both management research and practice (Frederick, 1998).

1.5 Conclusion

In this chapter we have exposed some of the essential groundwork to build up a sustainable, personally fulfilling and socially just managerial ethic. We have discussed how our interpretation of management influences our perception of the organisational actors, and called for a rehabilitation of the human, the person in the organisation. As such, a role-based framework reinforces a partial, mechanical, artificial or manipulative view of human beings in a social context. We argued that such framework is neither morally workable nor desirable. Instead we proposed to welcome and encourage the expression of the self, thereby instilling greater authenticity in human relationships. Managers have much to gain, both personally and professionally, by asserting humanity and individuality in their practice. It does not prevent them from "getting things done", but it makes them reflect on how they actually could "do things" better for everyone, not simply for the organisation.

Managerial ethics is a prerequisite for genuine CSR because it has the power to redefine the corporation, what responsibility entails and how much in harmony we live with society at large. In his *Politics*, Aristotle (1998) made a clear distinction between *chrematistike* (sheer money-making) and *oikonomia* (economics). Of the two subjects, he deliberately favoured the study of economics (*oikonomia*), that is "the concern for morally adequate individual and public household management" (Dierksmeier and Pirson, 2009, p. 418). Aristotle's concerns sharply contrast with current discourses on the moral neutrality of economics. Not even Adam Smith (1790/2010) would support the contemporary narrow interpretation of the purpose of economics. Thus, we need to move away from what Aristotle calls *chrematistike* to embrace an economic system that does not put humanity's survival at stake. Equally, we need to use our insights and understanding to envisage alternative business organisations (e.g. social enterprise) that help us to create healthy and sustainable wealth that is conducive to *eudaimonic* happiness. This, in turn, requires a mind shift from a currently widely accepted business goal, as to maximise shareholder value, which leads to (Kakabadse and Kakabadse, 2010):

- Value for shareholder;
- Corruption in achieving shareholder value;
- Increasingly polarised society of haves and have-nots; and
- Market imperatives.

We shall instead conceive the goal of business as to create products and services that add value to society, which in turn leads to:

- Products/services that customers value, need and are willing to pay for;
- Maximisation of shareholder value;
- Decreased corruption – managers are not incentivised to deal illegally and/or unethically just to maximise shareholder value;
- Less polarised society; and
- Balance between market and non-market forces.

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Chapter 2
Strategic Value of Corporate Citizenship

Laurence Eberhard Harribey

Abstract The fact that an increasing number companies continues to integrate corporate social responsibility into the very heart of their strategy means that we have to question the strategic value of corporate strategy. This is the subject of this second chapter looking first at the definition of a corporate citizenship and then determining to what extent a commitment to corporate citizenship is a strategic move. From the analysis of the evolution of the different concepts as corporate social responsibility, then sustainable development and global corporate social responsibility, the first part of the chapter argues that corporate citizenship is both the result of societal change and an undeniable constraint. Then, in a second part of the chapter through concrete corporate examples draws the four areas of commitment to founding the basis of the strategic value of corporate citizenship.

2.1 Introduction

During this first decade of the twenty-first century, more and more companies have clearly set out their firm strategic position with regard to social responsibility. It is now becoming commonplace to produce Sustainable Development reports and many companies have frameworks of reference for corporate social responsibility. In 2007, CorporateRegister.com listed 4,147 companies worldwide that had published a report, of which 1,750 had followed the Global Reporting Initiative (GRI) principles. The UN announced 4,600 companies and other contributors participating in the Global Compact. The World Business Council for Sustainable Development (WBCSD) includes about 200 companies, mainly in Europe, North America, Mexico, Japan, Korea, and CSR Europe includes 70 major European companies, all concerned with different aspects of CSR and Socially Responsible

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Investing.[1] As the second decade of the twenty-first century dawns, a company is almost taking a risk if it is not part of what has now become the mainstream by incorporating a framework of sustainable development and corporate social responsibility. Between Friedman's assertion (1962) that, "The social responsibility of business is to increase its profits" and that of the *World Business Council on Sustainable Development* (WCSB, 2001) which in contrast states that "companies cannot remain on one side, they are an integral part of our societies and cannot continue to produce wealth if the society surrounding it is collapsing", there is at the very least a fairly wide discrepancy. Nevertheless, a company continues to be assessed mainly in terms of its economic performance and many authors have struggled to reconcile the link between this performance and the implementation of a social responsibility policy (Wood and Jones, 1995). This being the case, the fact that today many companies have integrated corporate social responsibility into the very heart of their strategy means that we have to question the strategic value of corporate citizenship. This is the subject that we will tackle in this chapter, looking first at the definition of a corporate citizen and then determining to what extent a commitment to corporate citizenship is a strategic move. In particular, we will show that the corporate challenge differs according to the company's competitive environment, its sector of activity and its size. We will then try to show which types of strategic positioning are available to companies and to what extent there is a resulting value creation.

2.2 From Corporate Social Responsibility to Corporate Citizen

2.2.1 Corporate Citizenship, Result of a Societal Change

While it is beyond the scope of this chapter to present a complete analysis of the literature relating to the concepts of corporate social responsibility and corporate citizenship, it is nevertheless necessary to define them. Jose and Sison, comparing the emergence of these concepts in the Anglo-American and the Continental European context of the firm, insist on two different cultural and philosophical approaches (Jose and Sison, 2009). They explain that the tendency within the Anglo-American tradition of Corporate Social Responsibility (Bowen, 1953; Eells and Walton, 1961; McGuire, 1963) was first to reduce rights and duties to the strict minimum set by law. More recent contributions now tend to appeal to a corporate commitment to transcend the legal sphere (Sehti, 1975), to improve the welfare of society (Davis and Blomstrom, 1975). In contrast, according to the Continental European perspective of business, companies are institutions like any other, and are thus embedded in society. Analysis of the European Commission texts from the first Green Paper (European Commission, 2001, 2002) to the Communication in 2006 (European Commission, 2006) suggests that the emergence of the concept of Corporate Social

[1] These details taken from the Good Planet.info website, Wednesday 10 June 2009.

Responsibility in the European Union is centred on the need to increase a sense of solidarity and cohesion (Eberhard-Harribey, 2006). CSR becomes a business contribution to sustainable development (European Commission, 2006). Hence it follows that the firm as socio-political actor like any other organization is accountable not only to its stakeholders but to the wider society, as underlined by Crane and Matten (2004) with the concept of Corporate accountability.

The significance of Corporate Citizenship and the degree of citizenship that can be applied to a corporate entity is therefore dependent on these two approaches. In the first, a corporation, like a citizen, would be expected to be protected in their right to exist, while in the second, a corporation becomes a corporate citizen who has to take its stakeholders into consideration and who can be challenged by its stakeholders regarding choices that are made. Whichever approach we consider, the company is indeed a stakeholder in society, by virtue of the role that it plays. This role has evolved both because companies have developed and also due to societal changes (Dubouloy and Eberhard-Harribey, 2008).[2] Since the first industrial era, companies have responded to the challenges of society by pushing responsibility into the political sphere: it was the responsibility of companies to create value, and that of States to regulate the market and ensure that it operated smoothly. Whether we consider globalisation to be the inexorable integration of markets, nation states and technologies (Friedman) heralding a global age (Albrow, 1996) or whether instead we see it as an ideology which tends towards ultra-liberalism (McMichael, 2004; Hirst and Thompson, 1999), globalisation has made this traditional sharing of responsibility obsolete. Now that companies have become transnational actors, they move in the global arena in the same way that they use their domestic space. International bodies, NGOs and networks of actors inevitably set themselves up as participants in changing the balance of power with their attempts at regulation. States struggle to coordinate all aspects of international regulation, allowing private self-interest to have the upper hand with nothing in return for the general interest. Now that the traditional types of regulations (local and national government) have run out of steam and there are so many malfunctions, this has started to threaten the very system itself (Eberhard-Harribey and Dubouloy, 2008). Globalisation presupposes global responsibility, which includes all actors, including companies. In fact, this global responsibility goes beyond the four types of societal responsibility described by Carroll (1979)[3] who sees the company a global citizen actor in society. It is to

[2]In the next paragraph we look at some of the points raised in a presentation given at the RIODD (International Network of Organisations for Sustainable Development) Congress in 2006 in Paris and which were published in part in the journal "Finance et Bien Commun" n°30, I-2008.

[3]We should remember that Carroll distinguishes four types of societal responsibility: economic responsibility, which corresponds to the traditional function of the company, in other words its ability to produce under profitable conditions goods and services which correspond to the needs of society. Legal responsibility, which means respecting legislation and norms in force; ethical responsibility, which society expects the company to assume and which responds to ethical values. Lastly, discretionary responsibility, left to the discretion of each individual and which comes under the heading of philanthropy.

a certain extent in agreement with the view developed by Crane et al. (2008), who define a corporate citizen as one that contributes to the life of the civil society in which it evolves and explore three dimensions: the company as citizen, as citizenship administrator and as a citizenship arena for stakeholders. This definition is in line with the thinking of Aristotle, for whom a citizen is a person who puts a lot of themselves into the community of the city and who participates in the life of the city (Aristotle, 1990).

2.3 Sustainable Development and Corporate Global Responsibility: An Undeniable Constraint

Thus when we consider the demands of sustainable development, along with those of corporate social responsibility, and incorporate them into corporate strategy, we see that this is in no way just a fashionable craze, for four main reasons:

First reason: urgency of the environmental stakes. At the end of 2006, the publication of the Stern Review (Stern, 2007) alerted the entire world to the danger of a serious economic recession if nothing were done with regard to the environment across the entire planet. The report was commissioned by the British government, and in combining studies by economists with the work of environmental scientists it marked an important step in the appropriation of the global warming debate by the economic world. The link between climate crises and economic crises was of course not a new issue and studies have shown how in the past the response of economies to environmental change has been dynamic rather than merely defensive (Bassino and Van der Eng, 2010). However, the Stern Review did highlight the urgency of the threat, and as a result, the link between economic activity and climate was perceived differently. Multinational and corporate institutions are now regarded as playing a specific role due to their global influence through their activities and their responsibilities towards their stakeholders (Kolk and Van Tulber, 2010). Moreover, environmental matters do not relate only to the environment but also and especially to the deep rift that has been revealed between the developed and the developing countries. The urgency of sustainable development relates to the inequalities in development between countries in the North and those in the South as well as inequalities within countries, and these are issues with which companies, multinationals in particular, are very closely tied up (Matthew and Hammill, 2009).

Second reason: economic and social challenges link companies, States and the civil society together. In the absence of supranational regulatory systems, the demands of sustainable development require new relationships to be created between individuals, groups and organisations that can influence or may be affected by a company's strategy (Lauriol, 2004). While the essential responsibility of companies has for a long time been limited to the creation of economic value through maximising profit, the stakeholder theory forces us to look beyond this concept. Company directors can no longer be content to declare "We are making money and we sub-contract to the State to regulate social injustices. To deal with all the outcasts that our world produces" (Nash, 1990). The company, while being answerable to its

"shareholders", also has a wider "accountability" –from *shareholders* to *stakeholders* – because economic aspects cannot be isolated from the rest (Freeman, 1984). Thus the company is no longer accountable only to its shareholders but also to its stakeholders, first of all the contractual stakeholders (employees, clients, suppliers), then the non-contractual stakeholders (local communities and communities in the broader sense, which are affected directly or indirectly by its activity). Once again, as Laura Nash emphasised, we must develop ethical behaviour based on the creation of value, not on profit. (Nash, 1990) Moreover, this responsibility becomes a-temporal as it implies obligations to future generations who although they do not yet have obligations do have rights. This is the principle of responsibility put forward by Hans Jonas (1990) which is both a-temporal and a-spatial.

Third reason: the gradual change in the political and legal framework shapes the corporate environment and also that of other actors. The increase in legal and convention-based constraints can be seen at all levels: national, European and to a lesser extent international. At European level, two examples illustrate this increased intensity: in the area of waste, European legislation has evolved considerably since the middle of the 1970s (1975 Directive on waste, amended in 2006 and complemented by a dozen sectoral directives adopted in the 1990s). The result is that today almost 60% of waste from major companies is recovered, creating a wealth-creating economic sector in itself. The second example is the REACH European programme (integrated system for registration, evaluation, authorisation and restriction of chemicals, 2007) which aims to achieve product traceability in the chemical industry and which places responsibility on manufacturers in case of injury. It is no longer the responsibility of the victim of a substance to prove the link between the injury and a given substance; it is up to the producer to prove that his product is not harmful. These new European regulations in fact oblige the chemical industry to carry out a complete overhaul of their product strategy and their approach to risk. As well as the purely legal constraints, the improvements in standards and the many international agreements in place are all factors that are gradually ensuring that company stakeholders must inevitably take these matters into account in their strategy.

Fourth reason: increasing pressure from the civil society. Opinion drawn from surveys, pressure from NGOs and growth of the eco-citizenship and eco-consumption phenomena are gradually transforming market data. Successive surveys by Corporate Responsibility Monitor (2001–2007) in about twenty different countries show public opinion moving steadily towards being in favour of companies being accountable for their social responsibility. In particular, these surveys stress two interesting points:

> Significant numbers of investors take a company's social performance into consideration when making investment decisions. In the USA, where 61% of people own shares, more than a quarter said they had bought or sold shares on the basis of a company's social performance. A similar picture emerged in Canada, Japan, Britain and Italy.[4]

[4] 2001 survey undertaken by *Environics International,* and involving interviews with around 1,000 people in each of 20 countries including the USA, Canada, Mexico, Britain, France, Germany, Japan, India, Russia and Nigeria.

> In wealthy countries, social responsibility makes a greater contribution to corporate reputation than brand image. In 20 developed countries surveyed, CSR-related factors collectively accounted for 49% of a company's image, compared with 35% for brand image and just 10% for financial management.

A number of studies have also shown that consumer preferences are increasingly turning towards products and services offered by companies that are socially responsible, transparent and honest (Willmott, 2001; Mitchell, 2001). This pressure from consumers and also from civil society has certainly enhanced the rush to implement standardisation and quality labels (e.g. ISO standards and EMAS – European environmental management system) which have gradually created international competitive advantages.

Sustainable development and Corporate Global Responsibility are therefore much more than a fashionable craze and do indeed make up the groundswell of opinion, thus becoming a strategic issue for companies. CGR, which defines sustainable development policy within a company, is moving gradually from a merely symbolic status with a low level of integration (Capron and Quairel-Lanoizelé, 2004), the status that predominated until the middle of the previous decade, into a format that is becoming a more and more integral part of a company's management strategy. When faced with the major changes that are taking place in society, sustainable development does indeed appear to provide companies with a potential for opportunity, with strategic forward planning a necessity.

2.4 Four Areas of Commitment: The Basis of the Strategic Value of Corporate Citizenship

Four notions outlined in the diagram below form the basis on which CSR is seen as a strategic issue that must inevitably be integrated into corporate global management (Fig. 2.1).

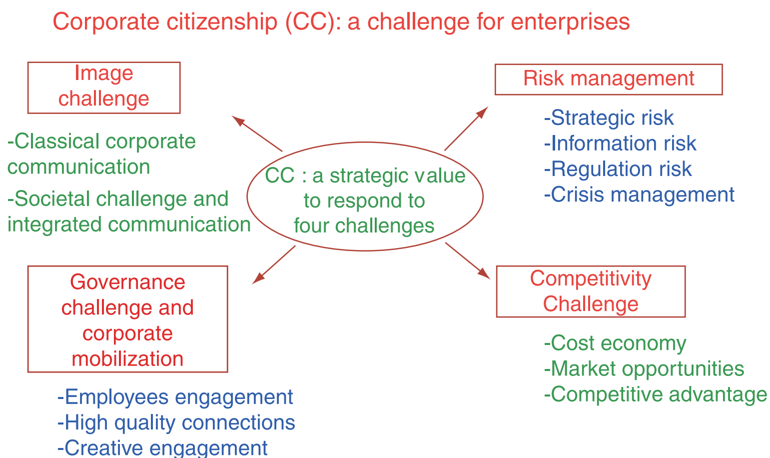

Fig. 2.1 Corporate citizenship: a challenge for enterprises

2.5 Competitiveness

Corporate eco-citizenship: cost economy or supplementary costs. At first glance, the constraints that have emerged in the form of social and environmental legislation and regulations may appear to represent an obstacle to corporate competitiveness because of the cost involved in meeting the required standards. This has led to debate as to whether, rather than significantly changing their attitude to corporate strategy, companies were concerned to make a commitment to social and environmental responsibility policies and to make this commitment known merely as a strategy to sidestep regulations that were too restrictive and a desire to enhance their reputation; this has been described by some authors as institutional isomorphism (Di Maggio and Powell, 1983).

Although there may be some justification in this suggestion, it is nevertheless also clear that a CSR strategy can provide companies with some tangible benefits. If we interpret CSR in terms that keep as close as possible to the definition of sustainable development in the Brundtland report (1986) – "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" – then it can be interpreted as the search for eco-efficiency. Eco-efficiency is at the same time a contribution to sustainable development and also a source of cost reduction for the company and hence in some way of value creation. However, this concept is not entirely self evident (Erhenfeld, 2005). The key notion is to produce more while consuming less by organising production processes around a three-fold strategy: "reduction in the consumption of resources, reduction in the impact on the environment and improvement in the quality and value of the product". However, this approach is also controversial and many companies point out that for them supplementary costs are involved. The debate in France in 2009 on the carbon tax, for example has led to some of the most polluting industrial sectors obtaining tax exemptions (e.g. transport, chemical industries, nuclear industry) on the pretext that they felt that they were being doubly penalised because of the major very costly measures they have already put in place in their efforts to reduce greenhouse gases. More generally, eco-efficiency can present a risk of inefficiency (Korhonen and Seager, 2008). Indeed, in an eco-efficient strategy, there may be criteria that must be taken into consideration which are temporally dependent and evolve over time (Robert et al., 2002), and others that are culturally and socially dependent (Pongracz, 2002).

2.5.1 When Constraints Create Market Opportunities

Constraints can also create market opportunities. The diagram below (Fig. 2.2) attempts to summarise how the constraints created by environmental legislation and regulations, like the enhanced requirements for quality labels, audits or evaluation and notation processes, can create market opportunities. For the European Union, these new activities represent almost two million jobs and have seen growth of around 5% per year.

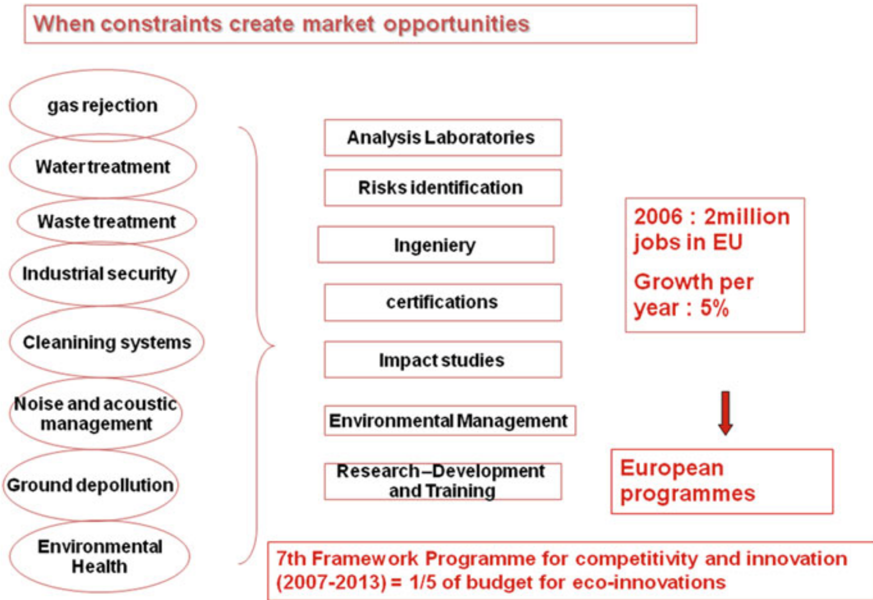

Fig. 2.2 Corporate citizenship: a competitive advantage, creating value

Porter (1985), then Porter and Kramer (2006) have shown that CSR, based as it is on company strategy, is motivated by the search for competitive advantage. If CSR presupposes that the impact of corporate activity on society is taken into consideration, then we need to identify those areas in the value chain where the company and society come into contact. On the one hand we see the impacts of the company on society, which may be positive or negative (inside-out links) and on the other hand, the impacts of society on the company (outside – in links). As companies do not have a responsibility to solve all society's problems, a CSR strategy that can create value for the company will involve favouring particular actions not because of their value to society, but in accordance with the impact of this action on their own value chain. Thus we understand better, for example, that a company like Lafarge (cement works) should pay particular attention in its CSR policy to the question of occupational accidents, which represent a considerable risk for the company. In parallel, Lafarge also concentrate on environmental issues insofar as their activity does have a major impact on the environment. On the other hand, actors in the automobile sector have put other strategies in place in terms of CSR, once again because the issues were different. The automobile sector is faced with the dual mounting pressure of, on the one hand, environmental standards that are more and more exacting and on the other, stricter road safety regulations, especially in European countries. CSR-related policies in this sector have been dictated by innovation in terms of less

consumption and better security, and at the same time by researching new materials. Indeed, this approach is definitely more environmentalist than in other sectors. Due to innovation, the strategies of actors in the automobile industry have also created value for the manufacturers. The most traditional example here is that of Toyota and the success of the Prius, a pioneering hybrid car which gave Toyota a competitive advantage over their partners.

Similarly, it is understandable that a bank should become interested in the development of micro-credit by supporting NGOs specialised in this field or by creating specific foundations. In this way they are responding to a strong social demand, while at the same time they have control over the risk represented by a clientele whose financial base may not be solid. A number of studies have shown to what extent some partnerships between major companies and NGOs were in fact strategic partnerships. ORSE (2005), for example, shows such a strategic link in a study carried out on behalf of the French Ministry of Youth, Sports and Associations in 2005, when Carrefour embarked on a firm partnership over several years with FIDH (International Federation for Human Rights), after the company had been particularly singled out over its international locations. The development of such cases illustrates the growing preoccupation in the world of business with human rights issues in their Corporate Social Policies. "This is despite the absence of a clear link between involvement in support for human rights and specific organisational gains" (Ankani and Theobald, 2005, p. 203).

Similarly, Lafarge, a cement company which is particularly cencerned with environmental issues in those parts of the world where they have their quarries, has developed a longstanding partnership with WWF on these specific issues. Different types of corporate citizenship tend to develop, according the economic sectors and the types of pressure the company is experiencing. Thus, Timonen and Luoma-aho try to specify three main types of corporate citizenship: cultural citizenship, environmental citizenship and technological citizenship (Timonen and Luoma-aho, 2010). These examples suggest that when corporate social responsibility is integrated into a strategy that is responding to environmental pressures, we have moved into the area of "C*orporate Social Responsiveness*" (Carroll, 1991). This is the ability of companies to respond to social pressures; an ability that Crane and Matten classify into four possible types of responses: reaction, defence, accommodation and pro-action (Crane and Matten, 2004).

2.5.2 When CSR Becomes a Niche Strategy

Some companies have gone further than merely seizing market opportunities; they have chosen a niche strategy by their very specific CSR positioning. This may be due to a company's basic principles. The example of Patagonia is very explicit on this point. This company was created in the United States in the 1960s and its positioning from the outset was based on an approach that respected the environment. They

originally produced climbing pitons, and from the 1970s on the company developed the concept of "clean climbing". After a crisis in 1991, they refocused their activities, and adopted a business model that was very much concentrated on values linked with the environment and a lifestyle that favoured values such as family spirit, strong social policies within the company (in-house child care, vegetarian cafeteria, flexi-time, job-sharing), support for environmental associations. This example confirms the theory that socially responsible companies tend to attract better talent by sending out a strong signal to potential employees (Turban and Greenings, 2000).

Still in the textile industry, but in another type of action, Lafuma, part of the OXBOW group, firmly took the sustainable development strategy and social responsibility route, once again anchored initially in concern for the environment. Lafuma's slogan can be summed up in four words "offer more with less". Advocating neither political militancy nor opportunism, The company's aim is to manufacture products that respect the environment by promoting eco-design as innovation and differentiation. As they use fewer materials, less energy and produce less waste with products that are more polyvalent, longer-lasting, more reliable and more comfortable, their strategy was to improve productivity while working towards social well-being.

A third example of a company that has focused on CSR and which is often talked about is Bodyshop. What Bodyshop offered was a great many social and ecological commitments (refusal to support animal testing, ingredients guaranteed to be from fair-trade companies, refilling and recycling packaging, using 100% renewable energy, etc.). This is an example of what Fombrun and Shanley (1990) call vertical product differentiation, by which a company can both meet a particular segment demand and enhance their reputation.

2.6 CSR: From Image Risk to Global Risk Management

2.6.1 From Image Risk to Global Risk

Image risk, legal risk, financial risk, risk of social disputes, these are all risks that the company must be able to appreciate in order to anticipate crises. Many companies have established risk management systems, often originating with the implementation of quality, health and safety and environmental standards such ISO9000,[5] OHSAS18000 and ISO14000 (Dawn and Price, 2006). By implementing a CSR policy, which means analysing the impacts of a company's activity in relation to all

[5]ISO 14000 directly addresses an organization's impact and responsibilities towards the local, regional and global environment while addressing legislative compliance and business opportunities. ISO 9000-2000 is mainly concerned with the assurance of quality products and services. H and S Management Standards and HR procedures provide the structured framework to control exposure to occupational hazards and ensure continued safety, health and well-being (from Dawn and Price).

of its stakeholders, a company may be able to assess any threats hanging over its external and internal environment. If we take the example of the risk to reputation, the textile sector offers examples to illustrate particularly how CSR policies can both result from an attack on corporate image and also be the means of understanding risks to reputation that may occur in future. The case of Nike has become something of a classic (Bernstein, 2004). After being very heavily criticised and destabilised by the anti-sweatshop campaigns, the scandal of the child workers in the 1990s, then the Nike-Kasky affair in 2003,[6] Nike made a commitment to finance independent audits at their suppliers' premises and also to put in place education programmes and support for the Fair Labor association, where a panel of actors assess the working conditions and practices in their contract factories. In 2005, Nike chose to produce a list of their production workshops giving locations so that an independent evaluation of working conditions could be carried out. As we see, this image risk is a telling indicator of global risk. In fact, in order to reduce this risk, the company has to be considered in terms of its relations with the supply chain. It takes just a single link in this chain to be questionable for the company to become the perfect target.

2.6.2 From Global Risk to the Strategic Value of Integrated Communication

As a continuation of the risk to reputation, a CSR policy can form the basis of a company's communication policy on two levels: first of all by using the traditional form of communication intended to forge a company message that corresponds to the aspirations of the customers. No company that commits to a strategic CSR positioning can succeed without this communication "effort". A systematic analysis of communication produced by major companies shows how significant a communication that hammers home the company's environmental and social commitment can be. The second level of communication is already more differentiating: it consists of communicating first of all about the recognised impact of the company's activity on its social environment and then on corrective action. Using this approach, the aim is to show that the company is aware of the risk that its activity creates and is assuming responsibility by preventive action to limit this risk, or compensatory action to "pay for" its impact. As an example, we look in detail at the case of a French SME, PIERRE and SOL, dealer and supplier of quality cladding for the building trade.[7] On the company website, the visitor's attention is drawn to the company's responsible policy in terms of environmental issues: *Manufacturing a product, transporting it, using it, destroying or recycling it at the end of its life ... The life cycle of a product generates impacts on the environment.* The page then points out all the

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[6]Nike was prosecuted for misleading advertising for a campaign on public relations campaigns about working conditions in their sub-contractors' factories.

[7]http://www.pierreetsol.com

actions in place to "manage" this impact. *Our logistics programme enables us to improve transport efficiency in all our activities and reduce energy consumption per kilo of product transported. It is also our aim to reduce the environmental impacts of our supply chain network by replacing heavy goods trucks with sea or rail freight as soon as this proves possible.* Then at the end of this policy statement is a proposal to compensate for CO_2 emissions by favouring projects supported by approved organisations.

2.7 From Staff Mobilisation to the Emergence of Another Corporate Governance Creating Value Beyond Profit

2.7.1 Corporate Citizenship: A Federating Philosophy to Create Value

Mobilising the staff of a company in a corporate citizenship project based around shared values, strategic projects and a broader opening to the exterior can help reduce social risk and create a progressive dynamic force. From a model tested on a sample of 347 employees in North America, Glavas and Piderit set up three possible effects of corporate citizenship on employees (Glavas and Piderit, 2009): high quality connections, employee commitment and creative involvement.

The success of any corporate social responsibility initiative depends on the degree to which employees come together to create an association. Company values are therefore the result of interiorisation, by organising the values of the main stakeholders (Thomsen, 2004). A symbiosis creates internal value and this in turn tends to make the company more attractive (Turban and Greening, 1997, Willard, 2005). Pfeffer and Veige (1999) thus argue that employees are a company's most valuable asset. If a company is to successfully implement corporate citizenship then it must modify its management systems. A CSR initiative involves changes in the way that work, behaviour and habits are organised and such a project requires a combined perception of CSR and its consequences. For the staff to appropriate the CSR strategy in this way they need first to understand the issues involved at company level then to be mobilised around programmed actions with fixed deadlines and evaluation indicators. Such action programmes should cover not only involving employees in new practices (waste management, energy saving, etc.) but also recruitment or integration policies (developing employability, insertion, managing handicap, diversity, senior/junior interaction), not forgetting participation in local life (common patronage actions, NGO partnership, insertion into the local economic and social life). This echoes what Kochan and Osterman (1994) describe as a vision of partnership performance and distribution of profit for the benefit of the organisation's different stakeholders. This supposes practices that are likely to favour social dialogue and which will encourage HR management to move towards innovation so that intangible capital becomes a source of value creation, as Amabile et al (1996)

showed by demonstrating that creativity is influenced by work group supports, challenging work, organisational encouragement, freedom and sufficient resources. For this to be a federative philosophy there has to be coherence between the company's external actions and its internal practices. Mere financial logic and management by cost cannot be the guiding force. As emphasised by Pfeffer (1994, 1997), the impact of social practices is a key factor for the company and the effectiveness of these practices relies to a great extent on the degree to which they are coherent with and complement corporate strategy.

2.7.1.1 Towards Pluralist Governance for Global Performance

Thus we see that CSR gradually modifies the balance of power between the company's partners. Investors, rating agencies, shareholders, governments, NGOs have a great need for transparency. Corporate governance standards are becoming more and more rigorous and the need to take environmental, social and societal impacts into account is being more and more keenly felt. An approach via the stakeholder route may facilitate ethical governance by promoting a new form of relational contract in which managers and employees share more realistic visions of the others' expectations (Simmons, 2004). When a company commits to corporate citizenship it must necessarily be more transparent vis-à-vis its social contract with its stakeholders. Governments have to some extent forced companies into this with, for example in France, the 2001 NRE Law (Nouvelles Régulations Economiques) which obliged joint stock companies to produce a sustainable development report, and this was followed by the 2003 Financial Security law. In the United States the Sarbanes-Oxley (SOX) act requires all public companies to present accounts to the United States Public Company Accounting Oversight Board (PCOAB) that have been personally certified by the director, who is thus responsible under criminal law for his company's accounts.

However, the very notion of pluralist governance goes further than this. As the creation of value is not limited only to the creation of financial value for investors, maximising the company's value cannot be to the detriment of the other stakeholders, who are at the heart of value creation. Creating value for all stakeholders means striving towards a system of governance where management anticipates risks and listens to stakeholders. Thus we clearly see the emergence of participative governance, not only internally, by bringing together the internal stakeholders, but also to a certain extent externally by joining with external stakeholders. This puts the manager at the centre of a contractual network composed of internal and external stakeholders (Driscoll and Starick, 2004).

Economic efficiency, social well-being and preservation of the environment, the stakeholder theory puts corporate citizenship into a pluralist form of governance where performance is no longer determined by the shareholders alone. Today, the notion of governance encompasses much more than just financial indicators and is now looking towards global performance, defined as a combination of economic, social and environmental performances (Reynaud, 2003; Capron and Quairel, 2005; Baret, 2006).

2.8 Conclusion: From the Fragmented Approach of CSR to the Integrated Approach of Corporate Citizenship

If we look again at what has been said throughout this chapter, we are reminded that more and more companies have included Corporate Social Responsibility as a strategic factor and have developed a position that is more and more citizenship-based. We have demonstrated that not only has the concept of Corporate Social responsibility emerged in different philosophical and business approaches all over the world today, it is already also part of the debate surrounding the role of companies in terms of their insertion in society and their relationship with their stakeholders. This role has evolved within changing socio-ecological and socio-political contexts. Indeed, we have noted that sustainable development, corporate social responsibility and citizenship are very closely linked. Corporate citizenship has become a core element of business strategy to meet economic as well as social and political demands but it serves another purpose and that is to enhance the role of companies in the decision-making process. So this begs the question of the strategic value of corporate citizenship. Here we have demonstrated three key points. First of all, corporate citizenship clearly offers a market advantage in differentiation and cost reduction, even if this is sometimes controversial. The fact remains that a corporate citizenship policy, when it is verified by the facts, ensures a better perceived value for the brand, thus enhancing company image. Anticipating constraints and preventing risks is a second key point, enabling the company to develop pro-active rather than defensive strategies. However, what we have shown in particular is that corporate citizenship is based more on a company's ability to meet the needs of the environment than on bringing about a transformation of the company's essential nature. It is because the environment has changed that the role of the company too seems to be evolving. As Simon Zadeck stresses, "The role of business in society is one of the most important and contentious public policy issues of our age. Public cynicism about corporate power, fuelled by NGO campaigns, has reached levels that not only leave companies vulnerable, but also threaten the consensus for globalization itself."

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Chapter 3
Corporate Governance and the Board

Donald Nordberg

Abstract What is a board of directors to do, in the face of competing demands on the resources of the company and conflicting perspectives on what their roles are and should be? Corporate governance has become a central theme in management in the past two decades owing to a string of major corporate failures and evidence that the boards of these companies either failed to grasp the scale of the problems or failed to stand up to managers. Those corporations might have set out upon the wrong strategy, or engaged in fraud, or unethical behaviour, or simply suffered from bad luck. Their failures have led to a debate both with industry and in public policy about what mechanisms might prevent a recurrence, not least because they show how great the influence of the corporate sector is on society at large. In this chapter we consider how boards contribute to governing the corporation, the tensions they face along the way, and how theories of corporate governance point to the persistence of those tensions.

3.1 Introduction

When a business is working well, newspapers will usually give the credit to the chief executive and senior management. When exciting new developments appear on the horizon, the focus shifts to research and development, and how large consumer demand will be. When the economy is weak and a whole industry is suffering, the workforce and suppliers become the focus of attention and concern. But when the term "corporate governance" appears, chances are that something has gone seriously wrong.

The seemingly innocuous phrase "corporate governance" conjures up names like Maxwell, Enron and Parmalat; Polly Peck, WorldCom (detailed in Wearing, 2005)

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and more recently Lehman Brothers and others involved in the subprime crisis. We think of "fat cats" and "poison pills", of the fictional line from the 1987 movie "Wall Street": "greed is good," or of the 1986 real-life version from the corporate raider Ivan Boesky, later convicted of insider trading: "greed is healthy" (cited in Stewart, 1992, p. 261).

Behind those headlines is, of course, something more complex and subtle than the caricatures, or even the real-life snapshots of corruption and excess. Corporate governance involves the tensions and tough decisions about how the business deploys the resources it controls, what purpose it serves, and in whose benefit it operates. Those involved in deciding those issues face a series of trade-offs: between value preservation and value creation; between protecting the corporation against weak or rapacious managers and assisting those managers to do the best job possible; between understandable demands for shareholder value and growing calls for corporate social responsibility and sustainability, whatever different people think those terms might mean.

In a broad sense, corporate governance deals with the way that businesses work at the very highest level. The boundaries are somewhat unclear as a result, because the very top of a corporation interacts with all the elements that affect performance, both internally and externally. Inside the company, choices about the organization's structure and purpose are the stuff of governance. Who appoints and pays the chief executive, and who selects the people who do? What internal controls operate? Who audits its finances? To whom do auditors report? What rights do shareholders have? From outside come questions concerning regulation and compliance, but also ones concerning how best the company can get access to finance, partners for business ventures, or the best minds to build the business further.

Beyond those concerns, corporate governance deals with the role of business in society, its responsibilities, and how it accounts to the constituencies its serves. Even more broadly, corporate governance can be viewed as the way the leaders of a company put their stamp on corporate culture and ethics. At the heart of corporate governance is indeed an ethical debate: on what basis do directors choose between the competed demands on the company's resources? Answering the question "What is the right thing to do?" presupposes an ethical stance where the utilitarian approach implicit in neo-classical economics confronts the Kantian or communitarian notions behind some views of social responsibility, itself an area of heated debate (Nordberg, 2008).

Corporate governance is all these things and less: it could be just the mechanisms, structures and processes through which these larger issues come to manifest themselves in day-to-day operations. But wherever we draw the boundaries around the field, what sits in the middle is the board of directors, the people charged with responsibility for the actions of the corporation. In this chapter we consider the issues that boards face, the theoretical perspectives that help explain them, the remedies often proposed, and the shortcomings those remedies entail. Finally we seek to link these problems with the theme of broader corporate social responsibility through the board's role in setting the ethos in which the company works.

3.2 Corporate Governance in Practice

When crisis strikes, corporate governance concerns the ways we monitor performance of the executives and control their actions: What laws does society have in place to limit corporate excesses? What regulations, codes of conduct and contracts constrain the managers that run the business? What was the board of directors doing when the managers they employed messed up?

As a result, corporate governance can be viewed as coming in several layers. Though often overlooked, first among them is the market for its raw materials and for its goods and services, which limit what a company can and cannot do. Powerful customers limit the profit potential for a company, and therefore the extent to which managers have leeway to use the company's money – shareholders' money – in their own self-interest. But markets are not always efficient, so law and regulation come into play. They are not always responsive, so industries often develop codes of conduct and self-regulation to prevent excesses and put competition on a fairer basis.

Capital markets, too, play a role by setting the cost of loans the company might raise, or providing a way to raise more equity capital through bringing in new owners to share the risks and rewards. Convincing investors to take on that risk means the entrepreneur has to give up some of the control. So investors, industry partners, customers and suppliers, regulators and the law itself demand that someone – real people, not the fictive "legal person" of the corporation – be held accountable. That someone is the board of directors.

Boards are ultimately responsible for the performance of the business and therefore for its financial results, operating strategy and decisions over its very future, whether to take over another company or to recommend that the company be taken over itself. Boards may not bring companies into existence, but they decide when it is time to close up shop. They also set the tone for the rest of the business, and can be held accountable – in law and in the court of public opinion – when the corporation falters.

Boards play four interlocking roles: they (1) set direction, (2) marshal the resources needed, (3) monitor and report on the resulting actions, and then (4) evaluate the result so as to enhance future performance by adjusting the direction (Nordberg, 2007). These roles serve two main purposes that need to find a balance but can frequently come into conflict: controlling the performance of managers and contributing to the creation of value. If the emphasis of corporate governance falls too heavily on the side of value creation, managers and directors may ignore the growing risks. If it falls too heavily on monitoring and control, then innovation and creativity may suffer, and so too the potential for growth.

3.2.1 Board Structure, Composition and Independence

There was a time when for many companies, the board of directors was a more a legal formality than an integral part of the business. At some companies it may still

be that way. At such companies, board members might be selected from among the ranks of retired politicians, sports personalities, diplomats and others sometimes disparagingly called "trophy directors" (Branson, 2006; Hamilton, 2000; Leblanc, 2004). Boards were often populated by individuals with close personal ties to the chief executive who might lack the critical perspective to challenge their friends (Brick et al., 2006). Moreover, the chief executive might sit on the board of another company whose CEO sat on his. Such interlocking directorships are sometimes seen as creating too cosy a relationship in the boardroom (Caswell, 1984; D'Aveni and Kesner, 1993; Hallock, 1997). But as concern over the effectiveness of corporate governance had grown, so too have calls for greater professionalism among directors, especially among those who join the board from the outside (Fram, 2005).

For many years, boards had little by way of a fixed structure, either. One company might adopt approaches they had seen in operation elsewhere, perhaps introduced through the influence of an outside director with experience at another company. But then in the early 1990s the UK witnessed the near-simultaneous failures of the fruit and textile trading company Polly Peck and two listed media companies controlled by Robert Maxwell, which led to creation of a code of corporate governance in 1992 and began a global re-examination of how boards work. Then in the early 2000s the US saw the collapse of Enron, WorldCom and several other large corporations. The ramifications included some of the biggest changes in US company law since the Wall Street Crash of 1929, as well as a worldwide review of codes of conduct. Directors, institutional investors, professional advisers, legislators and academics all sought to identify which structures served the purpose of preventing future corporate failures and abuse by executives of the control they had over shareholder money. They examined the overall shape and size of corporate boards, how they organized their work in committees, what processes they used, and how the selection of directors might increase the independence of the board from the managers they employ.

3.2.2 Overall Board Structure

How should a board be structured to best achieve its purpose of monitoring management and created value? If we look around the world we see a variety of different sizes and shapes of corporate boards. Corporations in some countries, including the United States and United Kingdom, as well as Italy and Spain in continental Europe, have a unitary board, where senior managers join other, part-time directors, who do not hold executive positions, in the boardroom. In other countries a two-tier board structure – a management board, in effect the most senior managers, overseen by a supervisory board made up in part of outsiders – is in evidence: in Austria and Germany, such dual boards are mandatory. German supervisory boards often have affiliated with shareholders or the company's main bank and in part by members of the workforce (Dittmann et al., 2008; Fear, 1997). In other countries

(e.g. Switzerland, the Netherlands) such dual board structures do not give direct voting power to employees, and their roles often become more deeply involved in business policy than in Germany. In still others like France, the choice of dual or unitary boards is left up to the choice of shareholders themselves, and some with hybrid dual boards have executives sitting on the supervisory board (Albert-Roulhac, 2009; Hopt and Leyens, 2004).

Whichever form it takes, however, the board oversees the work of the managers. In companies with two-tier arrangements, the supervisory board directly oversees the work of the managers. In a unitary board the outside directors – sometimes called non-executives – can hold the executive directors to account, challenging their recommendations and even reversing their decisions. But these non-executives – or supervisory board members in a two-tier system – can perform another function as well. They often come from background in senior management, government or other professional backgrounds that could make them good judges of strategy. They might have previously worked for important suppliers or customers, or perhaps for a regulatory body that oversees important parts of the company's business. They can provide insights about how to direct the business, open doors in important places, or find easy access to the best new recruits. They may also lend credibility to the business by putting their names and reputations behind it.

Each form has its advantages and drawbacks. Two-tier boards seem to provide a clear framework for accountability. They review the work of the management without having been directly involved in it. The operating head of the business has, therefore, a direct reporting line to the supervisory board. In practice, however, the situation is less clear. In Germany, for example, in about half the cases of listed companies, the chairman of the supervisory board is the former chief executive, and so someone with close ties to management (Albert-Roulhac, 2009). Moreover, the presence of worker representatives on Germany supervisory boards is sometimes seen as inhibiting free and frank discussion of certain issues. In other European countries with dual boards – and in Germany with its traditional reliance on bank finance – members of the supervisory board may well be formal representatives of a single shareholder, or perhaps a major creditor. This makes it less clear that their votes will be cast in the interest of the business as a whole. Supervisory boards with no direct input from management become highly reliant on the information they receive from management.

Supporters of the unitary board argue that this form brings greater expertise into board discussions. In the US most boards of companies listed on the stock market have just a few executives on their unitary boards. Such outsiders cannot know the business as well as the executives, however. Moreover, non-executive directors – like members of a supervisory board – often depend heavily upon the executives for their information. But they have a chance to challenge the executives closely and participate in the formulation of strategy and other business policies. Moreover, with other senior managers on the board – the heads of marketing, human resources or operations may be board members – there is some chance that outside members will grow to have a much deeper understanding of the business and the issues it faces.

3.2.3 Board Size

What is the optimum number of people to serve on a board? Some companies have more than 20 perhaps even 30 people on their boards. Others might have only three or four. A small number might be easily dominated by a powerful chief executive, in possession of intimate knowledge of the company and seemingly complete command. A large board might bring together a wide range of talent, knowledge and experience, but lack the ability to hold a meaningful conversation, thus allowing the CEO, once again, to dominate. Some of the early thinkers in the field, working in the context of the large boards there were commonplace in the US, thought fewer than 10 directors the right size (Jensen, 1993; Lipton and Lorsch, 1992). While most codes of corporate governance stop short of trying to specify an answer to this question, institutional investors generally seem to prefer the formulation in the UK code of governance, which states: "The board should not be so large as to be unwieldy. The board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business" (Financial Reporting Council, 2008, p. 7). The emphasis is again here on ensuring the board is able to monitor and challenge management as much as to marshal resources.

3.2.4 Board Composition

What people should sit on the board? What balance does a board need between executives and non-executives, between experts and generalists, between men and women, home-country nationals and foreigners, ethnic minorities and the dominant ethnicity in a culture? Despite their many similarities, UK and US practices diverge over board composition. A typical US board of directors might include as its only executives the CEO and the finance director. UK practice generally seeks more executives to bring a greater range of expertise into the boardroom – and to help the board identify possible candidates for succession to the post of CEO. Practice in other countries depends on the overall structure of the board and for unitary boards whether they stand on the issue of expertise versus connections that non-executive directors offer to the outside world.

Boards of multinational corporations have often tried to widen the national backgrounds of their boards, to reflect the nature of the business. Doing so can create logistical issues, but companies in some countries (e.g. the traditionally trade-oriented economies of the UK, the Netherlands and Switzerland) manage to achieve it better than others (Albert-Roulhac, 2009).

Gender and racial diversity have proved more vexed. While many companies pay at least lip service to the question, boards of major corporations remain largely what some critics call "pale, male and stale" (Johnston and Phillips, 2005). Many studies have highlighted the difficulties that women face in reaching the boardroom (e.g. Sealy et al., 2008; Singh, 2007), while official reports, including two for the UK government (Higgs, 2003; Tyson, 2003) stressed the importance of diversity on boards

as a way of making boardrooms less cosy. Since 2008 boards of Norwegian companies are required by law to have women occupying at least 40% of the directorships. The ambitious target (the 2005 level was only 16%) was met, giving some credence to the notion that legislation might work better than voluntary codes. But the number of women occupying those positions was not as great: the individual women were much in demand, holding multiple mandates from different companies and making them among the most powerful people in corporate Norway (Opsahl and Seierstada, 2009). Moreover, another, US-based study shows having women on the board seems to enhance the board's ability to monitor executives, as they seem to attend board meetings more regularly than male directors and join committees that engage in monitoring roles. That study suggested drawbacks, however: "the average effect of gender diversity on firm performance is negative.... Our results suggest that mandating gender quotas for directors can reduce firm value for well-governed firms (Adams et al., 2009, p. 291).

3.2.5 Board Committees

Who should do which jobs on the board? The failures in the cases of Maxwell and Polly Peck concentrated on accounting issues that hid the growing problems from investors, suppliers and the workforces. Accountants, stung by the assault on their professional integrity, created a committee of experts to explore what might be done to avoid a repeat. Led by Sir Adrian Cadbury, the panel recommended that corporate boards create audit committees made up largely of non-executive directors without close ties to the chief executive or the finance director. But the Cadbury Code (1992) went further, seeing its brief as wider than accounting and audit. It recommended that boards create other committees: one for nominating new directors – including the chief executive and other executives to be promoted to the board – and another to make recommend about how much the executives should be paid. It did so with the blessing of the London Stock Exchange, which at the time controlled whether a company could have its shares listed for trading, and the implicit backing of the Bank of England, which regulated financial markets and lent support to the panel's work. But Cadbury, who came from a family of industrialists, recognized that some boards would find the code too restrictive, and so he proposed that those choosing not to follow his suggestions should explain why they had not. This "comply-or-explain" provision became enshrined in the listing rules, and was copied in subsequent years if many countries in Europe.

These committees got a further, unexpected and perhaps unwanted boost when two large American corporations collapsed under the weight of accounting fraud: Enron in 2001 and WorldCom in 2002. The US legislated to require companies to change at least the "audit partner" – which person they dealt with at the external auditors – and both the Nasdaq Stock Market (2002) the New York Stock Exchange (2003) required that audit committees be made up of directors with no ties to management. Countries across Europe and around the world either revised their codes

of corporate governance or wrote new ones that emphasized the need for audit committees to be made up entirely of independent, non-executive directors. The Higgs Review (2003) in the UK went further, urging that at least one person on the audit committee should have recent financial experience, making the committee better equipped to challenge the reports presented by the finance director and better able to manage directly the relationship with the auditors.

The corporate governance reforms of the past 2 decades have also led to strong recommendations that nomination committees exclude the incumbent chief executives and other executives on the board as a way to ensure that the board does not become dominated by people dependent on the CEO. Remuneration committees that meet to review the pay level of the CEO and other executives are now widely made up entirely of non-executive directors, perhaps assisted by a non-executive chairman, to avoid having a CEO involved in setting his own level of pay. It seems surprising in hindsight that this was not always the case.

3.2.6 Chair-CEO Duality

Should one person be in charge of the company, or should there be some sort of check on power in the boardroom? The all-powerful CEO seemed the most important cause of the collapses of Maxwell and Polly Peck in the early 1990s. The recommendation of the Cadbury Code with the greatest impact was call for a separation of the roles of chairman and chief executive. It was a recommendation heartily endorsed by many institutional investors and became a focal point for debate in corporate governance around the world ever since. Many investors went further, urging that a chief executive who retires shouldn't remain on the board, let alone become the chairman. What is less certain from empirical studies of the issue is that separating the posts of chairman and CEO actually helps (Carapeto et al., 2005; Dahya and Travlos, 2000; Elsayed, 2007; Tuggle et al., 2008). Some show evidence that a single person in charge gives the company as a whole stronger direction.

3.2.7 Board Processes

How often should boards and their committees meet? How do we know whether they are doing a good job? The workings of corporate boards are almost confidential, so the evidence is often anecdotal, and its relationship to corporate performance less than clear. Because of its importance, how boards work has nonetheless featured prominently in the debate over corporate governance. Companies around the world now often give statistics about the board in the governance disclosures in their annual reports. Since Enron and WorldCom, boards around the world have begun to meet more regularly, no longer just once a quarter and often as much as monthly. Committees meet more frequently as well (Albert-Roulhac, 2009). Moreover, codes of corporate governance, inspired by the Higgs Review in the UK, increasingly call

for boards to undertake a regular performance appraisa, l and at least sometimes facilitated by an external consultant.

3.2.8 Board and Board Member Independence

How do we make boards more independent of management, and how do we know when a director is indeed independent? This demand lies at the heart of virtually all the corporate governance reforms we have seen in the past 20 years. Indeed, all the other elements feed into it: the debate over board structure and size concerns how collegial or interrogative the proceedings will be. The makeup of committees has transferred power from executive directors to the non-executives and especially to non-executives without ties to management or major shareholders. Demands from investors for closer scrutiny of management through more frequent board meetings and regular evaluations of board performance seek to introduce ways to help boards challenge the managers who run the business.

These are formal mechanisms that run the danger of being too mechanical. What investors who advocate strong monitoring really want is that outside directors exhibit strong independence of mind and judgement. Because investors cannot know what goes on in the mind and cannot see what happens in the boardroom, they suggest proxy measurements instead: Directors shall not be considered independent if they (1) have been an employee of the company or done any substantial amount of business with it, say, in the last 5 years; (2) are related to the CEO or other senior manager; (3) represent a major shareholder; (4) have been on the board for a long time, say, 9 years; or (5) answer yes to the question: "Are they now or have they ever been CEO of this company?"

None of these tests precludes the possibility that an individual director might be independent of mind and willing to challenge management, whatever his past or current connections. Passing a formal test of independence can be quite a different thing from possessing the knowledge and resolve to challenge a senior manager. Practitioners and theoreticians alike have begun to worry that too much of the emphasis in corporate governance has fallen on the side of independence of the board and of outside directors. The financial crisis of 2007–2009 underscored the problem as it became clear that many directors of banks were insufficiently familiar with the products and services provided and the risks they entailed. A review for the UK Department of the Treasury of governance in the financial sector suggested revisiting the definitions of director independence, and the balance needed on boards between independence and expertise (Walker, 2009).

3.2.9 Monitoring and Control Versus Value Creation

Although the reforms have borne in mind the perceived need of boards to contribute to the creation of shareholder wealth, the weight of this discussion has fallen on the

side of monitoring and control, protecting the value of shareholders from a disaster caused by managerial excess. Board and director independence have increased in the past 2 decades, and the need for such independence is now widely recognized around the world, even in countries that needed to make up an expression for corporate governance in their own language or import the English term directly. In developing economies and those that emerged from domination by the Soviet Union, the development of capital markets came with advice from the World Bank and its International Finance Corp. affiliate, from the Organisation for Economic Co-operation and Development and from other multilateral bodies the good corporate governance makes sense. To consider how it makes sense, we turn now to the theoretical perspectives that led to these conclusions.

3.3 Theoretical Perspectives on Corporate Governance

In theory, a well governed company ought to be more efficient than a poorly governed one, and therefore more profitable. Investors therefore ought to reward this by providing finance to the corporation at a cheaper rate than similar businesses that are less well governed. An oft-cited study by the consultants McKinsey and Co. (Newell and Wilson, 2002) compared developing countries' governance systems, and found that investors would pay up to 28% more for the shares of companies that were well governed. The main reason for this governance premium has to do with what is called the "agency problem" associated with a typical corporation. But other notions of what drives the actions of directors – or what some people think ought to drive them – offer contrasting views when we consider a resource-based approach to corporation, a stakeholder perspective on the nature and purpose of the corporation, and the stewardship of managers and directors.

3.3.1 Agency Theory

Corporations – the large companies quoted on stock markets and with many shareholders – suffer from what scholars have identified since the 1930s as the separation of ownership and control (Berle and Means, 1932/1991). The "modern corporation" has owners – shareholders – who are distant and widely dispersed and therefore unable to monitor closely what management is doing. Left unchecked, self-interested managers might divert the corporation's resources to their own use. The resulting cost to the business came to be called an "agency cost", caused when the interests of the principals of a business (the shareholders) get out of line with those of their agents (the managers) and where the agents control the resources (Fama, 1980; Fama and Jensen, 1983; Jensen and Meckling, 1976).

Agency theory led to the conclusion that to preserve value and to keep managers focused on value creation as well, shareholders should (1) seek to enhance monitoring and control of management, and (2) align the incentives of managers with those

of shareholders. The former provided theoretical justification for stepping up board independence and vigilance, the latter for making the pay of managers – and in particular the most senior managers – linked to value of the company's shares on the stock market. The effects of the first are evident in the changes in board composition and processes. The effects of the second resulted in an explosion of pay to top executives through the award of stock options, which turned out to be easily manipulated by self-serving managers (Bebchuk et al., 2009; Lee, 2002). The "recurring crisis" in corporate governance that Paul MacAvoy and Ira Millstein (2003) identified suggests that shareholder value may not have been protected let alone enhanced. The conclusions arising from agency theory have dominated both scholarship and policy actions in the field. But not all corporations are like the ones that Berle and Means identified. Indeed, the corporation with no strong shareholder and a large number of small ones is rare outside the US and UK. It is not clear, therefore, that solutions to the agency problem will work the same way.

3.3.2 Resource Dependency

Building on a resource-based view of strategy (Penrose, 1959; Wernerfelt, 1984), organizational theorists have suggested that one of the most important tasks of directors is to provide the company with access to key scarce external resources (Hillman et al., 2000; Pfeffer and Salancik, 1978). A justification for having trophy directors on the board was their ability to give the company access to preferential regulators, legislators or potential business partners. Having bankers on the board might provide introductions to financiers, lenders and potential new shareholders, as well as detailed knowledge of the benefits and drawbacks of financing options. These contributions fall squarely on the side of value creation, though can sit uncomfortably alongside the responsibility, identified in agency theory, of directors to monitor and control the actions of managers.

3.3.3 Stakeholder Rights

The term "stakeholder" entered the corporate lexicon thanks largely to the American scholar R. Edward Freeman. He sees strategic success as arising from the development of human resources as well as its relationships with suppliers, customers and other affected by the company's operations (Freeman, 1984). Corporate governance becomes balancing those interests, and indeed recognizing the rights of stakeholders in a similar way to those of shareholders (Freeman and Evan, 1990). The notion that these stakeholders hold such a "stake" informs most of the development of the field we call corporate social responsibility. Few business people, strategists from the resource-dependency camp or even agency theorists dispute the notion that treating customers, suppliers and employees well is a good thing – if doing so is instrumental to value creation. Michael Jensen, whose work provided much

of the early understanding of agency theory, has written about seeing a need for an "enlightened" stakeholder approach, which he called identical to "enlightened value maximization" (Jensen, 2001, p. 9) because it sees the long-term value of the corporation as its goal. Calls for directors to engage in corporate social responsibility as an expression of stakeholder rights, however, can often look like a claim on corporate resources and clash with what many directors see as their primary duty to shareholders, whether for value creation or value protection.

3.3.4 Stewardship

So far, the role of the board has been seen in terms of struggles in which the need to control self-serving managers is pitted against the imperative to work with those managers to create value; or where the need to protect shareholder interests confronts competing claims on resources from stakeholders. Some theorists have wondered whether the actions of most managers and boards, most of the time, might be better explained by a different approach with a more "optimistic" view of the nature of corporate direction. In this view, business people set out to do a good job with the resources they have available, balancing the competing claims for the best possible outcome, feeling a sense of responsibility to look after the best interests of the business, as stewards of the enterprise (Davis et al., 1997; Donaldson and Davis, 1991). If this view is correct, then the outcomes it predicts have in many ways the opposite implications for corporate governance than those in agency theory, and they complement the approaches we see from resource-dependency and at least an instrumental view of stakeholder theory. If monitored and controlled too closely, managers inclined to act as stewards may well be de-motivated and either perform badly or leave the company. If monitored as stewards, however, managers inclined to act as self-serving agents might exploit the company's resources as though they owned them outright. A steward might be the ideal person to be Chairman *and* CEO (Muth and Donaldson, 1998). This view suggests that boards have to make the judgement call in each individual case, making a one-size fits all approach to corporate governance looking less appropriate than ever.

3.4 Boards and the Ethos of the Organization

Whatever else they do, boards set the tone of the corporation, signalling what is and is not acceptable. The debate over corporate governance and boards for the last 20 years suggests that it matters too, even if we cannot be sure yet in what ways, and through which mechanism. Boards face competing and conflicts demands, on the resources of the company and on their own attention and motivation. The evolving theory of corporate governance suggests that it will remain a balancing act. Corporate failures of the scale of Maxwell, Polly Peck, Enron, WorldCom, Parmalat and others suggest there is a need for heightened vigilance in the boardroom. The

sources of those failures might well be that the directors of the companies were too close to the managers, too easily persuaded, too easily blinded by the managers' command of facts and figures. The sources of the failures in the global banking system in 2007–2009 may have been similar, but at the same time different. Perhaps bank directors were too independent to understand the complexities of the businesses they nominally directed. Perhaps they needed more wise old hands who had seen it all before.

These corporate failures show that corporations have an impact on wider society, too, giving evidence of some sort of social responsibility for their actions, though perhaps not quite the sort of responsibility that often features in the typical company's annual CSR report. The board may indeed need to balance the demands of all these parties. Among them are the managers themselves, especially those trying in earnest to do a good job, and who fear being tarred with the same brush that blackened the reputation of a relatively small number of corporations, and that gave corporate governance itself a bad name.

In seeking to achieve the right balance, directors collectively set an ethos for others in the organization to follow. A corporation with a strong internal culture may well ignore such signals from the board, of course, especially when senior executives are out of synch with the board or when corporate governance is just a code, just a list of mechanisms, rather than a way of corporate life.

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Chapter 4
Supply Chain Management

Nikolaos Panayiotou and Konstantinos G. Aravosis

Abstract Increased regulatory citations, consumer complaints, and special interest group pressures, led to the adoption of more responsible business practices, expressed in the context of Corporate Social Responsibility (CSR), which is defined as the deliberate inclusion of public interest into corporate decision-making that goes beyond the corporation's statutory obligation to comply with legislation. As the nature of many business relations is changing from companies manufacturing goods within wholly owned facilities in national operations to companies engaging in supply chains and supplier-based manufacturing across national borders, the concept of CSR is likewise transforming. Except from their own corporate practices, companies are also held responsible for environmental and labour practices of their global trading partners in their supply chain such as suppliers, third party logistics providers, and intermediaries over which they have no ownership. As a result, the relationship of CSR with the whole supply chain of a corporation becomes very important. This chapter presents basic concepts and definitions concerning the relation of Corporate Social Responsibility with Supply Chain Management (SCM) and provides a short literature review on the subject. The most popular practical applications so far are described, such as Purchasing Social Responsibility (PSR), sustainable packaging, sustainable warehousing, sustainable transportation and reverse logistics. The role of the implementation of codes of conducts based on international social standards by the larger organizations is explained as a means for implementing a system that ensures the compliance of all the involved supply chain stakeholders in common social and environmental principles. The chapter closes with a discussion concerning the expected trends in the subject and the potential benefits as well as the existing barriers for a full implementation of CSR in the supply chain domain.

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4.1 The Concept of Supply Chain

Various definitions can be found in the literature about supply chain. These definitions change with the industry and the context. A simple and rather generic definition defines supply chain as the flow and management of resources across the enterprise for the purpose of maintaining the business operations profitably (Sehgal, 2009). Resources can be people, materials, information and other organizational assets such financial resources and machinery. The scope of supply chains extends through the organization from the demand side to the supply side Traditionally, supply chain management has focused on efficiently integrating supplier and customer activities so that products are produced and distributed in the right quantities, at the demanded quality, at acceptable prices, to the right locations, and on time, in order to minimize system-wide costs while satisfying service-level requirements (Visser et al., 2007).

The scope of the supply chain can be analyzed by recognizing two categories of function: core and extended (Sehgal, 2009). The core supply chain functions primarily relate to the demand and supply management processes directly controlled by the enterprise. The core supply chain functions can be classified as planning functions or execution functions. The planning functions project a longer-term view of enterprise plans, allow what-if analysis, and provide the impact of these plans on corporate financial/operational metrics.

These planning processes primarily serve as decision-support tools for managers. Examples of the supply chain planning functions are network planning, demand planning, and supply planning. The execution functions provide the schedule of daily operations, and help the enterprise execute the selected supply chain plans through purchasing, manufacturing, distributing, and sales operations. Typical examples of the supply chain execution functions are transportation and warehousing operations. The extended functions enable the extension of the supply chain towards the customers and the suppliers.

Customer Relationship Management (CRM) extends the demand end of supply chains and provides processes for including demand by managing customers, prices and marketing strategies. On the supply end, Supply Relationship Management (SRM) processes extend the supply chains by managing sourcing and suppliers to ensure reliable sources for fulfilling the existing demand. Finally, supply chain collaboration processes enable sharing the planning and execution process data and information with the supply chain partners with the intention of enhancing the responsiveness and flexibility of the supply chain. Typical examples of collaborative processes are demand and supply collaboration with the suppliers or carrier portal to monitor and track shipments.

The strategic importance of supply chain management has been growing during the past two decades due to the fact that information technology and improved organizational structures have enabled very efficient results (Lee and Kim 2009). The literature on supply chain management recognizes the growing importance that strategic management of the supply chain has in organization. (Croom et al., 2000; Macbeth and Ferguson, 1994; Cox, 1997). Companies in general do not

seek to achieve cost reduction or profit increase at the expense of their supply chain partners. Rather, they utilize the supply chain to make themselves more competitive as a whole through collaboration with other companies of the market (Macbeth and Ferguson, 1994; Croom et al., 2000). Traditionally, suppliers have a large and direct impact on cost, quality, speed, and responsiveness of buying companies (Ragatz et al., 1997). However, the modern competitive business environment requires reconsideration of the whole supply chain and products. As a result, active collaboration with the supply chain stakeholders can provide benefits, such as reduced cost, increased responsiveness to changes, and visibility across the whole process with no organizational boundary constraints. Supply chain collaboration processes help in identifying, establishing, and managing such opportunities.

4.2 Corporate Social Responsibility (CSR) and Supply Chain Management

4.2.1 Introduction into CSR

Over the past years, there has been an apparent shift from adopting more responsible business practices as a result of regulatory citations, consumer complaints, and special interest group pressures to proactive research exploring corporate solutions to social problems and incorporating new business practices that will support these issues (Idowu, 2009). Corporate Social Responsibility (CSR), also known as corporate responsibility, corporate citizenship, responsible business or corporate sustainability, refers to the obligation of a firm beyond that required by law or economics, to pursue long-term goals that are beneficiary for society (Robbins and Decenzo, 2001). CSR is essentially the deliberate inclusion of public interest into corporate decision-making that goes beyond the corporation's statutory obligation to comply with legislation. In fact, it is only in recent years that the number of organisations engaging in social behaviours and activities has increased markedly (McWilliams et al., 2006; Stainer and Stainer, 2003; McIntosh et al., 2003). According to Pryce (2002), the current focus, is driven by five forces: customer pressure, changes in business procurement, government legislation and pressure, the rise of socially responsible investment, and the changing expectations of employees.

The Triple Bottom Line (TBL) concept, coined by John Elkington and now common currency recognizes that corporations not only add economic value, but also impact on social and environmental value added (Richardson, 2004). These concepts correspond to the three pillars of sustainable development which have often been interpreted by economists as economic, social and environmental capitals. Figure 4.1 depicts the three dimensions of CSR decomposed into the common sub-areas in which it is evaluated.

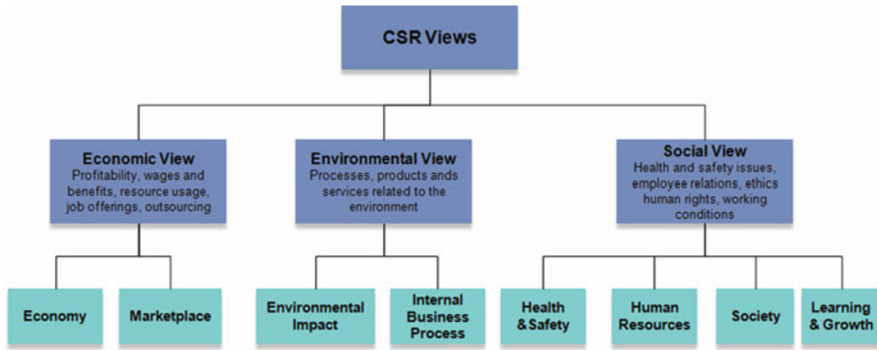

Fig. 4.1 CSR views and performance dimensions (Panayiotou et al., 2009)

4.2.2 CSR in Supply Chain Management

As the nature of many business relations is changing from companies manufacturing goods within wholly owned facilities in national operations to companies engaging in supply chains and supplier-based manufacturing across national borders, the concept of CSR is likewise transforming (Andersen and Skjoett-Larsen, 2009) to encompassing the entire supply chain of a company. Except from their own corporate practices, multinational companies are also held responsible for environmental and labour practices of their global trading partners such as suppliers, third party logistics providers, and intermediaries over which they have no ownership (Jenkins, 2001; Maloni and Brown, 2006; Business for Social Responsibility, 2001; Pedersen and Andersen, 2006; Jørgensen and Nielsen, 2001; Roberts, 2003). The calls for CSR in global supply chains should particularly be seen in light of the fact that a large part of global trade is conducted through systems of governance which link firms together in various sourcing and contracting arrangements (Gereffi, 1994; Sobczak, 2006; Nielsen et al., 1997).

The concept of governance implies that the key actors in the supply chain – often large multinational corporations – take responsibility for the inter-firm division of labour and specific participants' capacities to upgrade their activities (Gereffi, 2001). Thus, they are able to control production over large distances without exercising ownership (Jenkins, 2001). These key actors are typically located in developed countries and include not only multinational manufacturers, but also large retailers and brand-name firms. The "power" held by these corporations stems from their market "strength and control over key resources needed in the supply chains of which they are part. Given their power, these actors play a significant role in specifying what should be produced how and by whom (Gereffi, 1994). The companies adopting such principles hold themselves accountable for the social and environmental impacts arising along the supply chain. Moreover they are compelled to integrate ecological and social aspects into their decisions and actions along their supply chains.

The corporations might also provide technical support to their suppliers to enable them to achieve the required performance. Jenkins (2001) argues that the growth of "global value chains", through which Northern buyers control a web of suppliers in the South, has led to calls for them to take responsibility not only for aspects such as quality and delivery dates, but also for working conditions and environmental impacts.

Despite the history of CSR, applications of CSR concepts to Supply Chains have only emerged in the last few years (e.g. Klassen and Awaysheh, 2006; Maloni and Brown, 2006; Roberts, 2003; Seuring et al., 2006; Spence, 2006). Many different terms are used in order to describe the social responsible management of the supply chain under a cross-functional perspective, with the most dominating being Sustainable Supply Chain Management (SSCM) (Carter and Rogers, 2008) and Logistics Social Responsibility (LSR) (Ciliberti et al., 2008; Carter and Jennings, 2000). Sustainable Supply Chain Management is defined as the strategic, transparent integration and achievement of an organization's social, environmental, and economic goals in the systemic coordination of key interorganizational business processes for improving the long-term economic performance of the individual company and its supply chains (Carter and Rogers, 2008).

Taking into account that logistics is an aspect of supply chain, it can be argued that SSCM is a broader concept than LSR. However, a literature review in the subject shows that the notion of sustainability is not consistently perceived and defined because some authors describe it differently than others and there is not a common definition (Carter and Rogers, 2008). At the same time, the majority of the reported corporate practices concerning the supply chain refers to CSR applications included in the LSR area, so in the next paragraph, a classification scheme of LSR is used in order to present the most popular practices of social responsibility in the Supply Chain.

Supply Chain Management encompasses several processes, i.e. inbound and outbound transportation management, warehousing, inventory management, management of third-party logistics service providers, sourcing and procurement, packaging and assembly, and customer service. In accordance, the literature on LSR examines a selection of these processes based on their relation to CSR issues, classified in five main categories: purchasing, transportation, packaging, warehousing (related to the forward flow of materials), and reverse logistics (related to the reverse flow) (Ciliberti et al., 2008).

4.2.2.1 Purchasing Social Responsibility (PSR)

Purchasing Social Responsibility (PSR) can be defined as the involvement of the purchasing function on socially responsible logistics activities advocated by organizational stakeholders (Carter and Jennings, 2002; Maignan et al., 2002). The activities related to PSR include environmental purchasing, sourcing from minority-owned suppliers, human rights, safety and philanthropy issues relating to supply management.

If a company adopts social and/or environmental standards, the purchasing function can be used to transfer them to suppliers. This way the company will be generating a chain effect by which quick and deep social and environmental changes can be caused (Green et al., 1996; Preuss, 2000). Carter and Jennings (2004) found that a people-oriented culture leads to higher levels of responsibility in accomplishing purchasing activities. Carter (2005) found no direct relationship between the adoption of PSR practices and the costs incurred by a firm. According to his study, organizational learning and firm performance act as key mediating variables. Environmental Purchasing (EP) can be considered as a subset of PSR (Carter and Jennings, 2004). EP deals with the involvement of the purchasing function in activities aimed to facilitate recycling, reuse, and resource reduction (Carter and Carter, 1998). PSR practices can be classified as organizational (Maignan et al., 2002) and managerial (Wood, 1996; Motwani et al., 1998; Carter, 2000; Carter and Jennings, 2000, 2002b, 2004; Carter et al., 2000). The most relevant PSR practices (as cited in the literature) are reported by Ciliberti et al. (2008). They are included in Table 4.1, grouped in seven main topics, covering at the same time the CSR dimensions presented in Fig. 4.1.

Table 4.1 PSR Practices (Ciliberti et al., 2008)

Topic	Practices	
1. Organizational practices	Defining CSR objectives for the purchasing function	Designating organizational members in charge of PSR
	Educating suppliers to CSR topics	Communicating achievements to stakeholders
	Monitoring suppliers	Receiving stakeholders' feedbacks
	Sanctioning suppliers	
2. Managerial practices ethics	Not accepting gifts from suppliers	Not accepting travels or meals or other free goods/services
	Not pushing illegal pressures on suppliers or exaggerating a problem to gain concessions (e.g. price cut)	Not spreading information to suppliers (e.g. reveal competitors' offers and allow suppliers to reply on them)
	Not treating in a different way a supplier who is preferred by higher-level management	Not favouring certain suppliers because they are also good customers
	Not allowing other departments than purchasing (e.g. production) to purchase directly without respecting professional purchasing standards	Not allowing personal likes or dislikes to interfere with supplier selection process
	Not inventing a second supply source to gain a competitive advantage	Not using unclear contractual terms to gain a competitive advantage

Table 4.1 (continued)

Topic	Practices	
	Not deceiving a salesman in a negotiation	Not defining specifications that favour a certain supplier
3. Environment	Cooperating with suppliers to ensure that their processes and products are environmentally sustainable	Analyzing product life cycle to evaluate the environmental compliance of products and packaging
	Requesting suppliers to commit in waste reduction	Purchasing goods with reduced, recyclable, and reusable packaging
	Participating to design of products for disassembly, recycling, and reusing	
4. Diversity	Purchasing from suppliers belonging to ethnic minorities or women-owned	Elaborating formal programs to favor procurement from suppliers belonging to minorities
5. Human rights	Analyzing labor conditions of workers in supplier companies and ensuring that forced or child labor is not carried out and that wages are reasonable	
6. Safety	Verifying safety conditions in suppliers' plants	
7. Philanthropy/ community	Defining programs to support local supplier development	Organizing bids, donations, and other charitable initiatives

Different empirical studies (Carter and Jennings, 2002) suggest that the adoption of PSR increases trust with the suppliers. Moreover it improves the communication and cooperation process with them and finally it leads to channels' increased performance.

4.2.3 Sustainable Packaging

Sustainable Packaging can be defined as packaging that (i) is beneficial, safe and healthy for individuals and communities throughout its life cycle, (ii) meets market criteria for performance and cost, (iii) is sourced, manufactured, transported, and recycled using renewable energy, (iv) optimizes the use of renewable or recycled source materials, (v) is manufactured using clean production technologies and best practices, (vi) is made from materials healthy in all probable end-of-life scenarios, (vii) is physically designed to optimize materials and energy, and (viii) is effectively recovered and utilized in biological and/or industrial closed loop cycles (Sustainable Packaging Coalition, 2009). The packaging industry has been under pressure for

more than 20 years to reduce the environmental impacts of its products (Ciliberti et al., 2008). In some countries, take-back legislation on packaging has made the packaging operation and planning a critical green logistics issue. The traditional narrow focused paradigm of waste reduction and recycling is losing its validity within the context of packaging sustainability and a more holistic supply chain approach is beginning to be perceived as essential for meeting future community and industry challenges. (Sonneveld et al., 2005; Sarkis, 2003).

4.2.4 Sustainable Warehousing

Sustainable Warehousing is a component of the sustainable supply chain. It includes activities such as terminal and warehouse location, proper storing and disposing of hazardous materials, donation of excess or obsolete inventory to local communities, improved working conditions in warehouses and training to safely operate forklifts (Carter and Jennings, 2000, 2002a). Most warehousing companies have little regard for the environmental impact of their actions and do not understand the social consequences of their business activities. These companies consider factors such as cost effectiveness and customer satisfaction as the main performance indicators connected with their operation. In many cases, sustainable warehousing is closely connected with cost effectiveness, as in the case of reduced safety costs, lower recruitment and labour turnover costs resulting from safer warehousing (Brown, 1996; Carter and Rogers, 2008; Carter et al., 2007).

4.2.5 Sustainable Transportation

Sustainable Transportation is defined as transportation that meets mobility needs while preserving and enhancing human and ecosystem health, economic progress, social justice now and for the future (Deakin, 2001).

According to Black (1996), sustainable transportation has an even deeper and important meaning defined as satisfying current transport and mobility needs without compromising the ability of future generations to meet these needs. Lund and Clark (2008) state that in order to achieve a sustainable developed infrastructure that does not harm the environment and yet meets the power demand and mobility needs of the supply chain, a synergy of combining necessary technological changes in the transport sector with the better integration of fluctuating renewable energy sources into the electricity supply must be created. Substantial interest in Sustainable Transportation can be dated back to the early 1990s (Banister and Button, 1993; Nijkamp, 1994). The focus of early research was mainly on the economic and environmental dimensions of sustainability (Feitelson, 2002). The main environmental impacts are associated with (i) emissions of greenhouse gases, (ii) emissions of compounds that thin the stratospheric ozone layer, and (iii) transport-related production of persistent organic pollutants and their effects on biological systems. As to social issues related to transportation, Corsi et al. (1982) studied the

promotion of minority motor carriers. Various methods and models have been developed to assess economic, social and environmental consequences of transport plans. However, at present, only few social indicators are being considered, because of the lack of knowledge and valid methods, tools and techniques for assessing relevant social impacts (Steg and Gifford, 2004).

4.2.6 Reverse Logistics

Reverse logistics stands for all operations related to the reuse of products and materials. It is "the process of planning, implementing, and controlling the efficient, cost effective flow of raw materials, in-process inventory, finished goods and related information from the point of consumption to the point of origin for the purpose of recapturing value or proper disposal. More precisely, reverse logistics is the process of moving goods from their typical final destination for the purpose of capturing value, or proper disposal. (Rogers and Tibben-Lembke, 1998).

It includes all issues related to source reduction, recycling, substitution, reuse, and disposal of materials (Stock, 1992). Reverse logistics management consists of managing the flow of merchandise from stores and customers back to the supplier. This returned merchandise may pass through a consolidation center. The complete returns transaction can contain a few shipment legs, warehousing, packing, handling, and other warehouse activities (Sehgal, 2009). Due to the complexity of managing the reverse flow, many companies prefer to subcontract the reverse logistics to a third-party logistics provider. These contracts may be limited to transportation and warehousing, or may include all services, such as disposition determination, disposal, and supplier credit reconciliation. The reverse logistics definition has evolved through the years, including environmental aspects besides the initial coverage of the reverse flow of materials from their typical final destination for the purpose of capturing value or proper disposal.

Lately, its scope has been widened (de Brito 2003) considering reverse logistics as part of CSR, since it deals with the implementation, at the company level, of processes that guarantee the use and re-use (efficiently and effectively) of the value put into products (de Brito 2003).

4.3 Codes of Conducts, Standards and CSR in Supply Chain Management

In trying to respond to the increased pressure (mainly by consumers and non-governmental organizations (NGOs)) and stakeholders expectations concerning social responsibility in the whole supply chain, the larger corporations (mostly the international ones) implemented systems and procedures to ensure that their suppliers comply with social and environmental standards. Such systems can be used to transfer socially responsible behaviours along the chain, in particular to influence the practices of their business partners and to provide a baseline of social

and environmental principles to be fulfilled (Andersen and Skjoett-Larsen, 2009). Although firms choose their own approach to embody the CSR efforts in supply chains, there are studies that reveal that the most visible element in the approach of large multinational companies is the employment of corporate codes of conduct. The number of codes of conduct has grown spectacularly since the early 1990s (Hopkins, 1999; Welford, 2005; Welford and Frost, 2006; Jenkins et al., 2002). Whereas companies in the USA introduced such codes in the early 1990s, the use of codes did not become widespread among European companies until the mid-1990s (Jenkins, 2001). A code of conduct is a document stating a number of social and environmental standards and principles that a firm's suppliers are expected to fulfill (Mamic, 2005; Jenkins, 2001). Codes of conduct are increasingly introduced in contracts between a buyer company and its suppliers (Welford, 2005). In the majority of cases, their principles are based on local legislation (if existing) and international conventions such as Social Accountability 8000 (SA 8000), *AA* 1000, ISO: 14001, Global Reporting Initiative (GRI) and UN's Global Compact Initiative. In many large multinational companies, the codes are accompanied by appropriate managerial systems for formulating, enforcing and revising the standards outlined in the codes (Organization for Economic Co-operation and Development, 2001). However, empirical evidence (Leigh and Waddock, 2006) has shown that the implementation of effective codes of conducts covering global supply chains is not an easy task. In the following paragraphs, the most influencing international conventions in the development of corporate codes of conduct are presented.

4.3.1 The UN Global Compact Initiative

The UN Global Compact Initiative aims to create a more sustainable and inclusive global economy. Companies, especially multinational, were called upon to undertake to adhere to ten principles in their sphere of influence, in the areas of human rights, labour policy, environmental protection and anti-corruption policy. All of these are derived from the Universal Declaration of Human Rights, the International Labour Organisation's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development and the United Nations Convention against Corruption.

The UN Global Compact is a voluntary initiative and thus not a substitute for government measures, including the duty to ensure decisive laws for legal safety in sensitive areas.

4.3.2 AA 1000

AA 1000 is a quality framework that aims to create a transparent and responsive sustainability accounting framework, that describes who has been included in the information gathering process and more importantly who has been included on its

design. Its goal is to secure the quality of sustainability accounting, auditing and reporting. It is continually under development by Account-Ability, an international membership-based professional institute established in London in 1996.

4.3.3 SA 8000

SA 8000 is the first global certification system for supply chain labour standards. It is a voluntary and auditable certification standard based on international workplace norms of International Labour Organization (ILO) conventions, the Universal Declaration of Human Rights and the UN Convention on the Rights of the Child. SA8000 offers a stand-alone certification solution for managing aspects of corporate responsibility and certifiable standards that is delivering auditable compliance for manufacturers and purchasers in the supply chain.

4.3.4 ISO: 14001

ISO: 14001 is one of the most widely adopted standards in the area of CSR and is recognized as an international standard for environmental management. It was first published in 1996 by the International Organization for Standardization (ISO). ISO 14001 defines an environmental management system as that part of the overall management system of an organization that includes organizational structure, planning activities, responsibilities, practices, procedures, processes and resources for developing, implementing, achieving, reviewing and maintaining the environmental policy. Currently, an ISO social responsibility standard (*ISO 26000*) has been proposed and scheduled for second half of 2010. ISO 26000 is the result of a still ongoing international and multi-stakeholder process based on the consensus and consolidated results of science, technology, and best practice to assist an organization in addressing its social responsibilities. The standard intends to provide guidance related to: operationalising social responsibility; identifying and engaging with stakeholders; enhancing credibility of reports and claims made about social responsibility; emphasizing performance results and improvements; promoting common terminology in the social responsibility field; and promoting sustainable development through the supply chain.

4.3.5 Global Reporting Initiatives (GRI)

The Global Reporting Initiative is a voluntary quality-driven initiative established in September 2002. It is multi-stakeholder in structure, emphasizing on corporate social responsibility issues. It is a “practical expression” of the Global Compact, and those businesses that wish to report on their CSR performance can use the GRI

guidelines as a template. The reporting framework covers vision and strategy, profile, and governance structure and management systems, plus the “three pillars” of sustainability: economic, environmental and social. More than 500 companies across 45 countries have adopted the GRI’s sustainability reporting guidelines.

The standards used as a basis for the development of codes of conduct influence their effectiveness and credibility but they are not the only ones. Other factors affecting the codes are the diversity of supply chain participants, the scope of issues, the level of detail in substantive provisions, the effective implementation and ongoing management, the resources devoted to training, the monitoring and enforcement, the transparency and disclosure, the real or anticipated costs of compliance, public relations factors and performance measurement (Mamic, 2004). There are many difficulties involved with the assessment of the effect of the developed corporate codes of conduct. Like other private-sector initiatives, codes of conduct are developed and negotiated against a backdrop of international and national laws and regulations within the context of the management and operations of the enterprise (Mamic, 2004). The fact that the developed codes cannot be enforced in the same way as legal requirements, has led to some skepticism concerning their effectiveness (Klein, 2000; Sethi, 2002).

4.4 Conclusions – Future of CSR in Supply Chain Management

A large concern related with the supply chain of businesses takes place in the last years. People are concerned about social responsibility issues such as human rights, environmental issues in logistics and ethics. It is no longer acceptable for a company to only guarantee its social responsible operations. She also has to guarantee such a behavior for its suppliers and the suppliers of their suppliers. It is no longer acceptable for the companies, not to take responsibility for the conditions under which the actors of their supply chain operate.

SMEs and Multinational corporations are more aware (and start paying attention too) that they are not only responsible for sound environmental and social practices within their own premises, but increasingly also for the environmental and social performance at their suppliers, and ultimately for the entire supply chain. The driver of such a change in corporate practices is the involvement of a variety of stakeholders. Increasing numbers of investors, shareholders, NGOs and customers are watchful of corporate activities regarding CSR performance and activities. In the long term, an increasing number of companies will be forced to take into account the demands of stakeholders regarding issues of environmental and social problems, not only in their markets but also along their supply chain. To survive and be competitive in the market, companies will have to extend CSR through the whole supply chain. Through the development of CSR standards and codes, companies can minimize reputational risks, market risks and sourcing risks by identifying risks and problems in the supply chain, and avoiding or, at least, reducing the consequences of problems in the final products or services. CSR can lead to programs of collaborative waste reduction, environmental innovation at the interface, cost-effective environmental

solutions and the rapid development of innovation in environmental technologies which allows firms to better understand the environmental impact of their supply chains.

Tremendous opportunities exist to influence the operating practices and technologies of SMEs to incorporate environmental and social initiatives. Taking advantage of such opportunities to incorporate sustainable practices can be very effectively achieved through sustainable supply chain management. Increased involvement by purchasing managers in socially responsible activities leads to improved trust in and commitment to suppliers and to increased supplier performance. These suppliers may be in a better competitive position due to an increased commitment by their customers and improved performance as measured by lead times, quality, and efficiency.

CSR improvements, can also lead to economic benefits for companies. One advantage is the reduction of excess inputs and wastes throughout the supply chain, thereby lowering costs and promoting sustainable development. Other benefits include reducing accident risks and lowering emissions, each of which leads to lower cost in the long run. Environmental prudence throughout the supply chain lowers costs not only for the company, but also for customers and vendors. By reducing pollution, wastes and the overall production and logistics costs, CSR can also promote reduced costs and better products for the customers.

In summary, investment in social responsibility activities is capable of increasing profit, reducing risk and environmental impacts. CSR can potentially decrease production inefficiencies, reduce cost and risk and at the same time allow companies to increase sales, increase access to capital, new markets, and brand recognition.

The question of how to develop CSR implementation steps and strategies integrating different business functions and departments (e.g. marketing, procurement, manufacturing, design, planning and strategy) into corporate management systems should be answered at an early stage of CSR adoption in supply management. Practicing CSR in supply chains requires that CSR is embedded within the entire organization. It should not be just another corporate functional of staff activity at headquarters. It has to be disseminated to all functional areas, subsidiaries abroad and offshore suppliers. For SSCM it is important to find the process of setting environmental and social demands favouring a collaborative relationship between buyers and suppliers. By doing this, managing supply chain and CSR is both cost effective and efficient, because it enables both the buyer and supplier to identify the most important issues to address.

It is true, however, that many problems and challenges still exist, for full implementation of CSR in the supply domain. It is notable, for example, that many organizations focus on one element of CSR (ie. sustainability, social, environmental, or business ethics) to the partial exclusion of other factors. Current issues and concerns relating to social responsibility (for which special attention has to be paid) concern some confusion driven by multiple terms and definitions, poor data measurement and integrity, a lack of risk management, a need for further integration of CSR in procurement, low levels of data sharing, differing levels of motivation and perception of CSR value.

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Part II
The Environment and Sustainability

Chapter 5
Global Environmental Issues

Martin Brueckner and Christof Pforr

Abstract This chapter addresses the uneasy relationship between the concept of corporate social responsibility (CSR) and global environmental change. By way of mapping the drivers of global environmental decline, we highlight the problems associated with devising effective management responses under the banner of CSR. We present a critical discussion on the environmental efficacy of contemporary CSR approaches, addressing also broader conceptual questions about the suitability of CSR for dealing with messy and increasingly complex environmental problems.

5.1 Introduction

The world is changing at an increasing rate (Butler, 2008). The acceleration of globalisation, innovation and development has transformed the market place but also affected the work of government, social dynamics and environmental integrity (Saul, 2005). In this sense, the business environment has become more varied and complex. Particularly, non-economic issues pose a formidable challenge for corporate managers who are charged with the invidious responsibility to achieve high financial returns whilst needing to demonstrate "civic virtue" (Regan, 1998) by being law-abiding, ethical, good corporate citizens (Amaeshi and Adi, 2007; Carroll and Buchholtz, 2009). Not only are companies expected to be profitable but also to be sensitive to the social, cultural and environmental aspects of their operations.

Global environmental changes, which have become more visible and pressing in recent decades, are the focal point of this chapter. We will explore current attempts to address global environmental problems under the banner of corporate social responsibility (CSR) and gauge their effectiveness. By way of highlighting prevailing discrepancies between CSR rhetoric and practice we question the suitability of

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dominant CSR theory for the management of increasingly stressed environmental systems and call for a rethink of assumption underlying CSR theory and practice.

In what follows, we will describe the process and impacts of globalisation, today's principal driver of global environmental change, which has given rise to today's environmental agenda for business, followed by a critical examination of CSR theory and practice.

5.2 Globalisation

Since the 1970s, globalisation has been the subject of much debate and contestation (Diaz-Bonilla and Robinson, 2002; Economic Commission for Latin America and the Caribbean, 2002; Friedman, 2000; Kolodko, 2002; Saul, 2005; Stiglitz, 2002; World Bank, 2000a, 2000b). Despite a plethora of definitions seeking to describe globalisation, much debate continues to be had in the literature about its dimensions and character. Broadly speaking, globalisation reflects a complex process towards a widening, intensifying and increasingly faster world-wide interconnectedness. Hence, it may be defined as "a process (or set of processes) which embodies a transformation in the spatial organisation of social relations and transactions, expressed in transcontinental or interregional flows and networks of activity, interaction and power" (Held et al., 1999, p. 16). Economic globalisation has been the engine of this development, characterised by the global expansion of multinational and transnational firms. Global institutions such as the International Monetary Fund (IMF), the World Bank (WB), Asian Development Bank (ADB) and the World Trade Organisation have been in key actors in shaping today's global economic system. The interplay of these institutions over the last decades has brought about the coalescence of many economic and financial markets. In the words of Smith (2009, pp 285–286):

> the world we live in today entails a progressive march towards the development of a global economy – that is, what happens in Tokyo today impacts markets in London tomorrow. Multinational corporations have expanded their operations to include every corner in the world, with few restrictions on how they go about defining new, undiscovered markets.

Despite the economic emphasis of the globalisation enterprise, other non-economic spheres have also been affected by the global economic expansion. All aspects of society and certainly also the environment are increasingly impacted by globalisation pressures. Hence, the frequent reduction of the contemporary debate on globalisation only to economic aspects neglects other significant socio-cultural, environmental and political developments, which have gone hand in hand with the continuing deregulation and internationalisation of the world economic system. It is the environmental impacts of globalisation in particular that we will address in more detail later on.

Conceptually, three schools of thought on the nature and direction of globalisation can be noted according to Held et al. (1999): Hyperglobalists see globalisation as the natural progression of capitalism towards a single global economic system

(e.g., Beck, 2000; Ohmae, 1990, 1995; Reid, 2003), whereas skeptics argue that globalisation will ultimately lead to major economic and political blocks featuring different nuances of capitalism (e.g., Hirst and Thompson, 1999). The middle ground is taken by the so-called transformationalists who consider globalisation as a process that creates new economic, political and social situations transforming the traditional roles of the state (Dunning, 1997; Giddens, 1990; Held et al., 1999; Rosenau, 1997; Stiglitz, 2002).

Irrespective of the viewpoint taken, globalisation has challenged undoubtedly the common understanding of nation states and governments through the emergence of multilayered governance structures. In the light of increasingly frequent "intermestic" issues, the role of government is more and more reassessed, not only with the view to move beyond national spheres, but also to redirect some powers to the local political level, a phenomenon aptly encapsulated in the term "glocalisation" (Swyngedouw, 1997). However, since "globalisation" "rarely, if ever, involves the full structural integration and strategic coordination across the globe" (Jessop, 1999, p. 22), some prefer the notion of "internationalisation" or "denationalisation" for more detail on the debate as well as on processes and consequences of globalisation see Walters (1995), Zürn (1998), Walter (1998), Grande (1999), Beck (2000), which in the same way challenge the traditional understanding of the role of nation states and governments. Every policy sphere is affected by these developments to varying degrees. This includes environmental policy-making which is under increasing pressure to adapt to globalisation pressures and to move beyond national spheres.

5.3 Global Environmental Issues

The call for more global environmental governance, however, is problematic as the general revaluation of the international and local tiers often seems to create a political vacuum. This is because the requisite political structures and processes needed to function adequately on these global and local stages are not yet in place. The lack of clear competences and political powers, for instance in dealing with environmental issues of a global scale, means that a multilevel structure to tackle global environmental issues and to implement successfully global environmental policies is yet a distant reality (Saul, 2005).

In recent decades society had to realise that the human economy does not operate in a vacuum and that it ought to be seen as an integral part of ecosystem dynamics and as such susceptible to environmental changes. Today's human impact on environmental systems is so immense that it affects environmental flows and services across all scales (Ahern and McMichael, 2002). In economic terms human impact translates into considerable costs, a focal point of the current climate change debate (see Garnaut, 2008; Stern, 2007). The enormity of these thus far largely unaccounted costs is attested to also by a yet be released UN-commissioned report, which estimates the combined annual environmental costs incurred by the world largest 3,000 companies in 2008 to be in the order of US$ 2.2 trillion (Jowitt, 2010). This figure

Table 5.1 A snapshot of the state of the environment

- Species extinction rates are now 100-1,000 times above the background rate
- 60 per cent of world ecosystem services have been degraded
- Global average surface temperature is projected to increased by 1.8 to 4°C over the current century
- By 2025 1.8 billion people will live with absolute water scarcity
- Even a slowing of current development trends may not help prevent the crossing of environmental tipping points

Source: Millennium Ecosystem Assessment (2005), United Nations Environment Programme (2007)

dwarfs the GDP of all but the world's seven largest economies and clearly indicates that environmental impacts can no longer be ignored.

The levels of affluence realised by developed nations following World War II are enjoyed today by a growing middle class in transition economies. During the last decade, the size and affluence of the middle classes in countries outside Europe, North America, Australasia and Japan grew substantially. It is estimated that the middle classes of 17 developing and transition countries now have a population in excess of one billion people, with a combined purchasing power equivalent to that of the US. Yet, billions of people remain in poverty, and it is highly doubtful that a transition to western style affluence for a population larger than the current six-and-a-half billion would be possible in light of the planet's carrying capacity and existing environmental limits (Arrow et al., 1995; Butler, 2008; Meadows et al., 2008).

Humans now occupy most easily inhabitable parts of the world, and it is more than likely that further global environmental change will be required to enable future human development. However, humanity is currently exhausting available stocks of recoverable resources such as coal, oil and gas which have made possible the industrial revolution and modern civilisation (Butler, 2008). Humans are greatly reducing the stocks of available fresh water, including that in aquifers. Fertile soil, fish stocks and biodiversity are also in decline, and pollution "sinks" and a wide range of other environmental global public goods are deteriorating or becoming increasingly scarce (Millennium Ecosystem Assessment, 2005). The human impact on these resources is of such magnitude that many aspects of the planet's agricultural, biological and even industrial productivity are being reduced, leading to potential long-term ecosystem collapses (United Nations Environment Programme, 2002, 2007). It can be concluded here that environmental issues today are a matter of immense and critical importance.

It is easy to agree that effective environmental management is *sine qua non*. However, the management of global environmental changes is problematic for a number of reasons. Firstly, environmental problems do not respect national borders. Transnational rivers, for example, cause widespread pollution across countries or wind freely distributes toxins over large areas beyond national boundaries. Indeed, the nature and scope of environmental problems can vary as some are of a local, others regional and some global in nature and dimension. The first category includes phenomena that are geographically confined, affecting only a small and defined area

(e.g., groundwater contamination). The second category of regional environmental problems affects transnational areas but their extent is still clearly delineated (e.g. acid rain in Europe). Global environmental problems, in contrast, affect many countries which may not even share common boarders (e.g., climate change, marine pollution or the deforestation). Attempts at classifying the scale of environmental problems is largely academic, however, as regional or even local issues often lead to chain reactions with ultimately global effects (Johnston et al., 1995; McNeill, 2006; Turner et al., 1990). In this regard, it may be more useful to speak of global environmental problems not only when they are global in scale but also when a direct relationship can be established between environmental changes and the process of (economic) globalisation. This includes phenomena such as climate change, which is a direct consequence of, and significantly exacerbated by, globalisation.

To illustrate, global economic activity is premised on the use of fossil fuels. Their combustion, however, comes at considerable environmental costs as both transport and power generation give rise to pollution and environmental damage. The aviation industry in this regard is one of the world's largest contributors to fossil fuel emissions and climate change (Peeters, 2007). As a result of globalisation air traffic is expected to increase by 2025 by a factor of 2.6 with anticipated increases in aviation fuel consumption by a factor of 2.1 and associated CO_2 emissions of 1.4 billion tons of CO_2 per year (Metz et al., 2007).

Secondly, global environmental problems require global, political solutions. (McNeill, 2006; Weder, 2003). We hinted earlier at the absence of adequate regulatory processes and political structures to deal effectively with global environmental change, militating against swift policy responses to acute environmental problems as can be seen, for example, by the protracted international negotiations on climate change. For one, international negotiations are complicated by the sheer multitude of stakeholders and their respective agendas, beliefs and priorities they bring to the negotiation table. This is compounded further by different perceptions of the problems environmental issues pose, varying economic and political abilities to address them and ethical arguments in favour of asymmetric responsibilities for environmental dilemmas. The recent round of climate negotiations in Copenhagen in 2009 clearly illustrated the stand-off between developed countries arguing in favour shared responsibilities and developing countries that saw climate change to be chiefly the responsibility of affluent nations. It becomes evident that a common, global environmental governance framework is required; ideally matching the degree of interconnectedness of the economic and financial markets, able to respond to a range of environmental problems and to implement far reaching strategies and regulations. Today's international policy vacuum, however, as we will argue further below, leaves corporate decision-makers without requisite regulatory guidance for the management of environmental responsibilities, in turn raising the stakes for CSR. Before turning to the uneasy relationship between CSR and global environmental change, we will explore first the rise of the environmental agenda for business to further highlight the significance of an effective environmental management performance by body corporates.

5.4 Sustainability

It is interesting to note that environmental protection entered the international political scene only relatively recently. This was marked by the 1972 United Nations Conference on the Human Environment in Stockholm, which led to the United Nations Environment Programme (UNEP) aiming to bring the most urgent environmental problems to the forefront of the political agenda of both governments and organisations (Basagio, 1995; International Institute for Sustainable Development, 1997). This conference made an attempt to initiate, for the first time, international co-operation in the field of environmental protection (Grubb et al., 1993), creating awareness for the connectedness of global environmental risks and the danger of destroying the life support systems on earth. With the publication of the *World Conservation Strategy* by the International Union for Conservation of Nature and Natural Resources (IUCN) (1981) the economy-environment dichotomy was discussed more systematically, launching the concept of sustainable development on the global stage as a model for future development. Further, in 1983, the UN General Assembly appointed the World Commission for Environment and Development (WCED) as an independent body to analyse the conflicting nature of the environment-development relationship. Its findings were presented in the *Brundtland Report* (World Commission on Environment and Development, 1987) with the title "Our Common Future". A central idea was that of sustainable development, defined by the Report as "[a] development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (World Commission on Environment and Development, 1987, p. 43). Since the release of this Report, its concept of sustainable development has won wide support in so far as it has contributed to a degree of consensus-building and common ground. In political terms, the Report marked the point at which the concept of sustainable development came to be embraced globally as a new normative frame shaping contemporary discourses of development. With the identification of major global problems and general recommendations of how to deal with them, the Report developed an important strategic perspective (Sachs, 1993). Thus, it emerged as a crucial document creating the foundation for much of the sustainability paradigm currently agreed upon (Pforr, 2004).

The *Brundtland Report* was, however, the product of intense negotiations between different positions and therefore, right from the beginning, a political compromise that aimed to balance the demand for ecological sustainability and that of economic growth. It positions economic development and environmental protection as complementary rather than conflicting, a view which seems more and more to dominate the sustainability debate (Hunter, 2002). The strength of the pragmatic global framework of sustainable development based on the *Brundtland Report* is that it brings together a plurality of different perspectives and interests. It offers, at least in principle, the opportunity for change and for a further specification of the concept on a more practical level of action in national and sub-national contexts (Grubb et al., 1993).

This consensus-oriented process continued to the 1992 UN Conference on Environment and Development in Rio de Janeiro, Brazil, the so-called "Earth Summit", at which the international debate on sustainable development reached its zenith. The conference resulted in five agreements being reached, of which two were legally binding, the *Climate Convention* and the *Convention on Biological Diversity*. The remaining three non-legally binding declarations were the *Rio Declaration*, the *Agenda 21* and the *Statement of Forest Principle* (Grubb et al., 1993). *Agenda 21* was the Summit's blueprint for action with respect to the implementation of the principles of sustainable development (Pforr, 2004).

A decade later, the second Earth Summit followed in 2002, held in Johannesburg, South Africa. Despite what can only be described as a meagre success in achieving measurable outcomes of international attempts at operationalising sustainability principles, the convention was able nonetheless to bring global environmental issues back to the forefront of the international political debate and to recognise the business realm as a pivotal stakeholder. A shared vision of sustainable development can be seen as a driver for the more than 190 nations which signed a detailed list of action programs that should provide a suitable frame for more specific bi- or multilateral agreements in the years to come (United Nations Environment Programme, 2005). However, recent setbacks on the global stage such as the Copenhagen Climate Summit (2009), which was widely seen as a failure of the international community to effectively respond to one of today's most pressing global environmental issues, renewed questions on the effectiveness of the currently existing governance structures (UNSW Climate Change Research Centre, 2009).

5.5 Sustainability and Corporate Social Responsibility

The many existing definitions of sustainable development have their conceptual foundation in what is designated as the sustainability *trias*, which embraces economic, social and ecological criteria with equal importance (Daly, 2002; Lele, 1991); the aim should be that, ideally, none of the three domains dominates. In a business context, the "triple bottom line" (i.e., people, place and profits) reflects these three pillars of sustainability and expresses the vision to optimise a business" contribution to economic, social as well as environmental sustainability (Elkington, 1997; Loew et al., 2004).

Over centuries, business has become expert in generating profits whilst the management of ecological and social challenges can still be considered *new turf* (e.g., Schmitt, 2005). While recent times saw the widespread adoption of the language of sustainability by the corporate sector, a shift can be noted of late towards the language of CSR, with both concepts often used interchangeably (Gustavson, 2008) and their convergence widely accepted (Málovics et al., 2008; Rondinelli and Berry, 2000; Schmitt, 2005; Wolff and Barth, 2005).

While from a business perspective either paradigm offers companies a business case making their adoption attractive to firms (Campbell, 2006; Holliday et al.,

2002; Hopkins, 2003; Perceval, 2003; Wallace, 2001; World Business Council for Sustainable Development, 2000a), from the point of theory it remains questionable, however, to what extent both concepts can be treated synonymously; especially, since both concepts to this day remain operationally vague and hotly contested (Ayres et al., 2001; Barth et al., 2007; Beckerman, 1995; Brueckner and Mamun, in print; Daly, 1995; Daly and Cobb, 1989; Derwall, 2007; Diesendorf, 1997; Dobson, 1996; Hopkins, 2003; Howarth and Farber, 2002; Jacobs, 1991; Middlemiss, 2003; Neumayer, 1999; Pearce and Atkinson, 1995; Solow, 1992; van Marrewijk, 2003). Sustainable development is overtly ecological and social in tone and orientation, considering equity concerns, futurity and environmental thresholds (Basagio, 1995; Beder, 1996; Giddings et al., 2002). CSR, in contrast, while catering for social aspects of business operations, addresses environmental concerns only by extension or indirectly. Since the mid 1990s, there appears to be tacit recognition in the literature of environmental dimensions as a legitimate CSR issue (e.g., Starik, 1995). This is based on ethical arguments for the extension of stakeholder theory to give the natural world standing in company boardrooms. Beyond the extension of stakeholder theory, environmental concerns are also being registered by companies in response to stakeholder pressure in the form of government regulation, shareholder activism, consumer boycotts or NGO campaigns. This means, however, that environmental responsibilities still remain on the fringes of companies'CSR agendas. This is also evidenced by the fact that many CSR definitions to this day fail to include environmental issues or merely make reference in terms of "reduced harm", "having concern" or "environmental stewardship" (Dahlsrud, 2006). In other words, CSR and sustainability can indeed be poles apart, especially since the environment represents a stakeholder with no voice of its own and is thus prone to be ignored or overlooked. Nature in this regard can be regarded as what is called a "dependent" stakeholder with legitimacy and urgency but limited power (Agle et al., 1999; Mitchell et al., 1997)

The aforementioned business case for both sustainability and CSR exacerbates the theoretical dilemma outlined above, for the case is made on the basis of commercial considerations and the assumed convergence of social, environmental and business interests (Hoque, 1985; Porter and Kramer, 2006; World Business Council for Sustainable Development, 2000a). In other words, social and environmental concerns are interpreted through the economic lens of commercial decision-makers, which regards these non-economic issues to be compatible with "enlightened" corporate value maximisation (Jensen, 2002). This line of argument is supported by research that seeks to link good company conduct to various direct and indirect business benefits (e.g., Gunningham et al., 2004; Hillman and Keim, 2001; Holliday et al., 2002; Hopkins, 2003; Kotler and Lee, 2005; Lewis, 2003; Orltizky, 2005; Porter and Kramer, 2006; Sparkes and Cowton, 2004; Turban and Greening, 1997; Wallace, 2001). However, not only have many of these asserted "links" remained tenuous (Griffin, 2000; Griffin and Mahon, 1997; Margolis and Walsh, 2003; McWilliams and Siegel, 2001; Orlitzky et al., 2003), profit-orientated approaches to CSR are also inherently self-limiting. This means that legitimate CSR issues that prove irreconcilable with commercial interests and fall outside companies" legal

obligations are prone to be sidelined by corporate decision-makers (Banerjee, 2007; Newell, 2001). It can thus be argued that the modern CSR concept has so far been unable to challenge the entrenched economic mindset, which in turn does not bode well for complex social and environmental problems which dominant economic rationalities over many years have been ill-equipped to capture and address (Dryzek, 1996; Fergus and Rowney, 2005; Hamilton, 2002; Özel, 2002).

5.6 Business Responses to Environmental Change

Despite the above critique on the environmental effectiveness of modern CSR, we acknowledge the uptake by companies internationally of environmental initiatives and CSR instruments. These include the implementation of cleaner production (United Nations Environment Programme, 1994) and eco-efficiency measures (World Business Council for Sustainable Development, 2000b) and ISO 14001 certification (International Organization for Standardization, 2004) as well as the adoption of the Global Reporting Initiative (GRI) reporting guidelines for non-financial reporting (Global Reporting Initiative, 2004). It is steps such as these that were promoted strongly at the Johannesburg Summit in 2002, which called for more sustainable patterns of consumption and production, sustainable best corporate practices and better support for company initiatives through appropriate institutional arrangements. While this can certainly be seen as a step in the right direction, critical voices express their concern about the "soft laws" emanating from such international gatherings (see for example Stockholm, 1972, Rio de Janeiro, 1992, Kyoto, 1997, Johannesburg, 2002) (Seyfang and Jordan, 2002) which may allow rhetoric to prevail over meaningful action (Friends of the Earth International, 2002).

Over the last 10 years, various CSR instruments have emerged and gradually been adopted by companies internationally (Chahoud, 2005), which include the UN Global Compact and the Caux Principles as well as Global Sullivan Principles, the Principles for Global Corporate Responsibility: Benchmarks, Social Accountability 8000 (SA 8000). These instruments spell out to varying degrees principles and guidelines on questions of human rights, labour standards and the environment as well as corruption and transparency. While the adoption of these principles is voluntary and non-binding, a growing number of companies have started to subscribe to them. For example, more than 1,300 companies, amongst them the world's 40 largest businesses (such as Shell and Rio Tinto), have committed to the Global Compact and now encourage greater corporate responsibility as well as corporate citizenship (e.g., engagement on the local level to improve environmental laws and regulations). In a similar vein, sector-specific guidelines and principles have been developed and adopted by industries in areas such as banking (e.g., Equator Principles), the chemical industry (e.g., Responsible Care Program), or investment (UN Principles for Responsible Investment (PRI)). While the founding principles of such initiatives are often well developed in conjunction with NGOs and other industry stakeholders, the mechanisms to monitor compliance and ensure

effective practices generally trail far behind (e.g., Hawken, 2004; Richardson, 2003; Whitehouse, 2003; Williams, 2008).

The problems arising from a lack of monitoring are compounded further by the tentative nature of firms" commitment to CSR instruments. A company's commitment to programmes such as the Global Compact merely implies committing to the Global Compact in annual reports, mission statements and similar documents, publishing at least annually examples of best practice and collaborating with the United Nations on various projects. It is argued that the publication of examples of best practice not only stimulates an open and global discussion but encourages learning and adoption by others, hence best practice instead of systematic monitoring. The lack of stringent standards and the inability to enforce them as well as the absence of a regulatory framework in the Global Compact are frequently criticised (Soederberg, 2007). The controversy regarding this approach is reflected also in the foundation of an alternative strategy, Citizen Compact, by some NGOs such as Corpwatch or Global Exchange.

Arguably a more robust CSR instrument represent the OECD Principles for Multinational Companies. They are a multilaterally recognised codex devised by governments to guide multinational companies operating from or within OECD affiliates countries, comprising voluntary principles and standards on employment, human rights, the environment, freedom of information, corruption, competition, science, technology and taxation as well as child and forced labour. In environmental regards, businesses are encouraged to improve their environmental standards, introduce environmental management systems, reduce environmental impacts and to ensure appropriate reporting. The significance of the OECD principles mainly lies in their relevance for those countries which are responsible for and also for those which receive most of the global foreign investments. The monitoring of the OECD principles is carried out by a wide range of national and international stakeholders including governments, businesses and NGOs which report annually to the OECD Committee on International Investment and Multinational Enterprises (CIME) (Organisation for Economic Cooperation and Development, 2001). The OECD principles are widely seen to be more effective than the Global Compact in promoting CSR, but a lack in transparency for the general public is also criticised for preventing more systematic scrutiny (Chahoud, 2005; Soederberg, 2007).

In the end, however, irrespective of the CSR instrument used, it can be anticipated that the commitment to environmental standards in the main depends on the respective national legal framework. A global improvement of those standards is probably best achieved by an improvement of the existing monitoring instruments, better information on the standards of the OECD principles and their underlying mechanisms (Chahoud, 2005). The arrival of the long awaited ISO 26000 standards for social responsibility to be released in 2010 may provide a new global benchmark for CSR and deliver comparability and uniformity in the CSR field. However, based on the ISO 14001 experience (Hamschmidt and Dyllick, 2001; Hertin et al., 2008; Yoxon and Sheldon, 2008), the question remains whether the adoption of the ISO 26000 standard will drive CSR excellence and help deliver environmentally and socially effective outcomes.

5.7 Concluding Comments

With a particular focus on CSR rhetoric and its implementation in the real world, seven European research institutions under the umbrella of the RARE program investigated CSR's impact on sustainability, in particular the benefits of CSR for societies and to what extent businesses are indeed able to put into practice *via* CSR sustainability goals set by the respective political actors (Wolff and Barth, 2005). They acknowledged the inherent difficulties in measuring the real world impact of CSR activities but suggested a three staged approach, accounting for CSR output, outcome and also impact, complemented by an investigation of the added value of CSR. Not surprising, the RARE program found that the commitment to CSR differed substantially across sectors reflecting changing perceptions of environmental and social responsibility within particular contexts. It also highlighted the apparent gap between rhetoric and reality in some of the investigated companies which featured a lack in specific CSR implementation measures (despite expressing their commitment) and also in effective monitoring mechanisms to account for their own CSR performance. Nonetheless, the researchers acknowledged the obvious contributions CSR can make, particularly when CSR strategies are embedded in a business" overall strategies, when the firm has a tradition of social and environmental responsibility, when CSR related activities are seen as an opportunity or advantage over competitors, when external stakeholders exert pressure and when the company's CSR is embedded into a broader policy framework. Interestingly, although a voluntary concept, it was found that one of the great contributions of CSR to sustainability is that it improves adherence to mandatory policies, hence enhances compliance with and implementation of social and environmental standards. CSR is also seen to foster stronger societal governance as external stakeholder pressure can lead to CSR measures which go beyond voluntary reporting and adopting of codes of conduct, such as socially responsible investments. Nonetheless, the real world impacts of CSR on sustainability are still limited. We thus join the choir of researchers who conclude that "CSR rhetoric is still stronger than its reality; that the reality on the other hand is strong enough to allow for some rhetoric; and that there still is a potential to improve reality" (Barth et al., 2007, p. 34). What concerns us in this regard is that global environmental changes may outpace the responses of a global society that is recognising only slowly the need for, and potential of, effective CSR approaches.

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Chapter 6
Sustainable Development in Business: A Strategic View

Jeremy Galbreath

Abstract This chapter addresses sustainable development in business. Drawing upon corporate objective, corporate responsibility, and corporate stewardship perspectives, a definition of sustainable development in business is proposed as "creating value for current stakeholders – without compromising the ability to create value for future stakeholders – by ensuring that economic growth is achieved through the demonstration of environmental integrity and social responsiveness". The definition suggests that firms take on a broader objective beyond that of a singular focus of maximising profits. However, businesses cannot be expected to solve all of society's problems or its development needs, nor bear the full cost of doing so. Thus, a strategic approach is required. This chapter lays out an approach to engaging in sustainable development strategically, and describes how the automotive giant Toyota leverages market-based, regulatory-based, and operational-based actions to achieve sustainable development.

6.1 Introduction

According to futurist Willis Harman, "business has become [in the twentieth century] the most powerful institution on the planet. The dominant institution in any society needs to take responsibility for the whole" (Harman, cited in Hawken, 1992, p. 100). Taking Harman's view to its logical conclusion suggests that business firms have a hefty responsibility, to support, care for and look after society. Is this too big a responsibility to place on business? Some would suggest so.

Nobel laureate economist Milton Friedman was perhaps the staunchest advocate for limited corporate responsibility in society. Friedman's central argument, which he espoused throughout his career (Friedman, 1962, 1970), is that business firms have only one responsibility to society: maximize profits for shareholders. While he

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suggests profit maximization must be pursued within the law, ethical customs and the rules of competition, firms have no further societal responsibilities. This view has been widely debated and rejected by many.

A common argument against the Friedmanite position suggests that the supremacy of a shareholder perspective of firms, and thus profit maximization as firms' sole responsibility, is out of touch with the reality of modern societies and their expectations of businesses (Turnbull, 1994; Blair, 1995; Cadbury, 1999; Tirole, 2001; George, 2002; Freeman et al., 2004; Huse et al., 2005; Benn and Dunphy, 2007; Jamali et al., 2008). Further, the view of the firm as more than an extension of shareholders is substantiated by legal authority (Blair and Stout, 1999; Bainbridge, 2002, 2003). Most legal jurisdictions clearly recognise that top management needs to act in the interests of the company as a whole and not merely of its shareholders (*Corporations Act 2001* s181 in Australia; *Companies Act 2006* s172 in the United Kingdom; *Delaware Code Title 8* s121 in the United States). Since the company is a separate legal entity apart from its members (see, for instance, *R v Goodal* (1975) 11 SASR 94), firm management is able to take the interests of stakeholders into account when it makes decisions. Thus, an argument is made that management must act in the interests of all its key stakeholders, and not just shareholders (Freeman, 1984; Clarkson, 1995; Tirole, 2001; Freeman et al., 2004, 2007).

What does acting in the interests of key stakeholders mean? It means that firms need to move beyond narrowly defined, money making self-interest by focusing attention and resources on the environmental and social consequences of their economic activities (Porter and Kramer, 2006). But this means more than accounting for the environmental and social consequences of their economic activities. Firms need to consider the environmental and social capital necessary to sustain their economic function as well. In this sense, there is a symbiotic and dynamic relationship between the economic, environmental and social dimensions necessary to ensure *sustainable development* (Steurer et al., 2005; Konrad et al., 2006; Nidumolu et al., 2009).

In this chapter, the concept of sustainable development in business will be explored. Of importance is an attempt to explain and clarify the concept, as exact agreement on what sustainable development is has yet to be achieved (Montiel, 2008). For example, some scholars tend to define sustainable development as ecological in nature, mainly concerned with the environmental dimension of business (Shrivastava, 1995; Starik and Rands, 1995). Others include the social dimension (Gladwin and Kennelly, 1995). To cut through much of the confusion, this chapter relies on multiple perspectives to explore sustainable development in business. By doing so, a theoretically grounded treatment is put forth in order to offer a more precise and coherent definition.

After conceptual development and a definition are offered, the focus will be on *how* firms can respond to sustainable development. The "how" question is an underdeveloped topic in discussions of sustainable development in the business literature and one that requires further advancement. For example, while scholars call for increased responsibility of business in society beyond that of the economic function and shareholders (e.g., Freeman et al., 2004, 2007), and evidence does suggest that society has high expectations that businesses address sustainability (Bacon, 2007),

many businesses are struggling with exactly how to respond to these expectations (AMA, 2007; KPMG, 2008; Pohle and Hittner, 2008; Riddleberger and Hittner, 2009). Unfortunately, scholars have been relatively silent on how businesses can respond to the challenge in a strategic manner. That is, viewing sustainability as a responsibility is one thing; *responding* to sustainability *strategically* is an entirely different matter. This chapter responds to a research gap by taking a strategic approach, developing a salient pathway for addressing sustainable development. After a strategic approach to sustainable development is discussed, a real-world example is presented. Lastly, concluding thoughts are offered.

6.2 What Is the Centrality of Business?

Henderson (2005) argues that private business acts as the sole vehicle for wealth creation in society. Governments do not. Non-profit firms do not. The church does not. Neither does non-governmental organizations (NGOs) or activist organisations. Business firms are thus the necessary mechanism for the wealth creation of nations and their on-going prosperity. Evidence seems to bear this fact out. In market economies, where business firms constitute innovative and entrepreneurial activities in response to competitive pressures, wealth has been created at extraordinary rates. For example, the poorest 25% of people living in the year 2000 were on average richer (as measured by GDP per person) than all but the richest 25% of those alive in the year 1900. Put differently, 75% of the world's people alive in the year 2000 were richer than the richest 25% alive a century earlier (Harper, 2003). This standard of living rise is largely associated with the value-creating activities of business firms operating in free and open markets. However, the benefits of such economic activity of firms and the process of value creation are not easily captured.

Market forces, competition, regulatory frameworks, and scarce resources place significant pressure on firms to survive and contribute to societal welfare in the form of economic growth. However, complications arise in the process of value creation by firms, as natural resource depletion, environmental degradation, disruption of communities, worker displacement, and problems with health and safety can be negative by-products. While some of these negative "externalities" are dealt with through the pricing/allocation mechanism of the market (e.g., carbon emissions) and others through regulation (e.g., or worker health and safety), many are unpriced so-called "exploitations of the commons" (e.g., loss of natural habitat, disruption of communities, worker displacement) (Boehlje, 1993; Tirole, 2001).

Given the many unpriced externalities that arise out of firms' value-creating activities (Tirole, 2001), firms genuinely interested in sustainable development need to move beyond pure market mechanisms to voluntarily address environmental integrity and social responsiveness. This is because these two aspects are tied intrinsically to ongoing, sustainable economic activity (Schmidheiny, 1992; Steurer et al., 2005). That is, economic progress should not be achieved by knowingly externalizing costs onto others, but rather by assuring that a firm's specific forms of economic activity are compatible with the maintenance of the natural environment

and with social improvements that affect stakeholders and non-stakeholders alike (Konrad et al., 2006).

6.2.1 *Sustainable Development in Business: Themes and Definition*

If one assumes that in the process of value creation businesses impose externalities on legitimate stakeholders that, technically, may be considered indiscriminate or negative (Tirole, 2001), then understanding sustainable development in business starts to become clearer. Specifically, following the work of corporate governance scholars (e.g., Tirole, 2001), stakeholder theorists (e.g., Freeman et al., 2004, 2007), corporate social responsibility advocates (e.g., Davis, 1973; Kotler and Lee, 2005) and religious writers (e.g., Friedman, 2000), three key themes must be considered: (1) corporate objective; (2) corporate responsibility; and (3) corporate stewardship (Table 6.1). The corporate objective will be examined first.

Table 6.1 Themes of sustainable business development

Theme	Core aspects	Key authors
Corporate objective	Maximizing profits for shareholders as sole corporate objective is incongruous, out of touch with modern reality. Firms must internalize externalities for key stakeholders. Profit maximization must be balanced with environmental and social objectives	Turnbull (1994), Blair (1995), Cadbury (1999), Tirole (2001), George (2002), Freeman et al. (2004), (2007), Huse et al. (2005), Benn and Dunphy (2007), Jamali et al. (2008)
Corporate responsibility	Actions that further some social good, beyond those of the exclusive interests of the firm. Generally includes philanthropic activity and firms' ethicality in conducting business	Davis (1973), Davis and Blomstrom (1975), Carroll (1979), Wartick and Cochran (1985), McWilliams and Siegel (2001), Waddock (2004), Kotler and Lee (2005), Matten and Moon (2008)
Corporate stewardship	Firms are constrained by, and dependent upon, natural resources. Minimizing impact on, and use of, natural resources is demonstrating stewardship. Firms are part of the basic structure of society, and accordingly, they are not exclusively private institutions but are also inclusively social institutions. Firms expected to act as stewards in society, contributing to the common good and building social capital	Hart (1995), Fligtsein (2002), Steurer et al. (2005), Konrad et al. (2006)

6.2.2 Corporate Objective

A growing body of scholars and board members believe that the almost axiomatic status of the shareholder perspective of the corporate objective is out of touch with the reality of modern societies and their expectations of business (e.g., Turnbull, 1994; Blair, 1995; Cadbury, 1999; Tirole, 2001; George, 2002; Freeman et al., 2004; Huse et al., 2005; Benn and Dunphy, 2007; Jamali et al., 2008). While it is clear that firm decisions do impact shareholders, it is also clear that decisions exert externalities on other stakeholders associated with the firm. This includes stakeholders who bear some form of risk as a result of having invested some form of capital (including but not limited to financial capital) in a firm, and stakeholders who are otherwise influenced or affected by the firm. Thus, stakeholders are not limited to shareholders and investors, but include employees, customers, suppliers, the natural environment, governments and communities, among others (Freeman, 1984; Clarkson, 1995). Stakeholders have innate relationships with firms and externalities imposed on them may be substantial; for example, employees who lose a salary through layoffs – employees who have invested their human capital in the employment relationship – in the name of gains in short-term profit; local suppliers – suppliers who have invested in the relationship and foregone alternative opportunities – who lose a contract in favour of overseas suppliers; communities who suffer from the closure of a plant; the natural environment – and by extension society – that is degraded to the point of climate change; and so on. Thus, as Tirole (2001, p. 24) suggests, firms should "internalize the *externalities* of various stakeholders" (emphasis in original). By addressing economic, environmental, and social dimensions, firms place themselves in a position to maximize the sum of the various stakeholders' surpluses, thereby affecting sustainable business development.[1]

The view of the firm as more than an extension of shareholders is substantiated by legal authority (e.g. Blair and Stout, 1999; Bainbridge, 2002, 2003). Most legal jurisdictions clearly recognise that top management needs to act in the interests of the company as a whole (*Corporations Act 2001* s181 in Australia; *Companies Act 2006* s172 in the United Kingdom; *Delaware Code Title 8* s121 in the United States). Since the company is a legal entity that exists apart from its members (see, for instance, *R v Goodal* (1975) 11 SASR 94) firms are able to take the interests of other stakeholders into account when decisions are made. Thus, firms must act in the interests of their primary stakeholders, a topic that has recently been the subject of extensive scrutiny by a lengthy Parliamentary review in Australia, for example (Parliamentary Joint Committee on Corporations and Financial Services, 2006). As a result of this deliberation, the Parliamentary Joint Committee (2006: 52) concluded that:

> 6.2.3 The committee considers that this interpretation [i.e. shareholders' interests being paramount], like the shareholders' restrictive interpretation and the short term interests

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[1]By "surpluses", I mean internalizing the negative externalities imposed on stakeholders from economic activities.

> interpretation, is too constrained . . . . the committee does not agree that acting in the best interests of the *corporation* and acting in the best interests of the *shareholders* inevitably amounts to the same thing. (Italics in original)

In sum, the pure shareholder value approach is too narrow for the corporate objective (Freeman et al., 2004). According to Cadbury (1999), corporations must strike a balance between economic and social goals and between individual and communal goals. Further, Tirole (2001, p. 3) argues that the function of corporate governance (and the oversight of the corporate objective), is better viewed as "the design of institutions that induce or force management to internalize the welfare of *stakeholders*" (emphasis added). Based on Tirole's (2001) assessment, firms must account for their impact on the utilities of primary stakeholders. Thus, a modern view of the corporate objective – one held by many scholars and practitioners – suggests that the economic function be supplemented to include environmental and social dimensions as well, and focuses on stakeholders beyond shareholders.

6.2.3 Corporate Responsibility

The business corporation in America, for example, was originally developed as a public institution (Deber, 1998). It was created by the government and was held accountable to serve the public interest with short-term charters and an obligation upon application for continuation to justify how the corporation had served societal welfare. In 1809, the Virginia Supreme Court wrote that if the intention of the corporation is merely private or selfish; if it is detrimental to, nor not promotive of, the public good, they have no adequate claim upon the legislature for the privileges (of a corporate charter) (Derber, 1998, p. 123). Interestingly, this follows the concept of the father of modern capitalism, Adam Smith, who suggested that while "self-interest", is good for wealth creation; individuals should never make decisions outside of what is good for the commonwealth (Smith, 1776).

Smith, for example, asserted that individuals (broadly defined to include owners, workers, and consumers) should be free to pursue their own interests (i.e., seek personal economic gain) in economic exchanges – within a moral and legal framework. Smith believed that individuals freely pursuing their own interests (as opposed to having their economic activity dictated or controlled by elite) would be guided by an "invisible hand" to promote the public good. That is, individuals who pursue their own self interests interact to create the greatest aggregate wealth for a nation and therefore the maximum public good. However, Smith did not endorse the greedy, non-tuistic economic individual that many neoclassical economists of the twentieth century attributed to him (Werhane, 2000). Smith did not discuss the concept of self-interest as if individuals have the license to radically and unconditionally pursue self-gain for its own sake. Smith's view can be more accurately portrayed as self-command. "Self-command means that the individual should never regard him or herself as something isolated, but as a member of a vast commonwealth of nature.

Individuals must always be willing to sacrifice their own interests when these collide with the interests of the commonwealth" (Rossouw, 1994, p. 559). Thus, not only was Smith interested in private gain, but also in the public good, something that was picked up on in the establishment of the business corporation in America and reflects a broader responsibility of firms in society.

Today, there is much debate over corporate social responsibilities (CSRs). Davis (1973, p. 312), an early writer on the subject, suggests that firms' social responsibilities include those beyond "narrow economic, technical, and legal requirements . . . [that] accomplish social benefits along with the traditional economic gains which the firm seeks". Later, he suggests that firms have a "managerial obligation to take action to protect and improve both the welfare of society as a whole and the interest of organizations" (Davis and Blomstrom, 1975, p. 6). Others hold similar viewpoints. In their assessment of corporate social responsibilities, Matten and Moon (2008, p. 405) posit that CSRs "consists of clearly articulated and communicated policies and practices of corporations which reflect business responsibility for some of the wider societal good". Similarly, McWilliams and Siegel (2001) suggest that CSRs are actions that further some social good, beyond those of the exclusive interests of the firm. Lastly, Kotler and Lee (2005) argue that CSR is a commitment to improving community well-being.

Perhaps one of the most popular writings on CSR comes from Carroll (1979). Carroll conceptualizes CSR as encompassing economic (profit), legal, ethical, and philanthropic responsibilities. Carroll does not dismiss the profit motive and its necessity for wealth creation, but rather suggests that firms need to act ethically (e.g., abide by society's moral rules) in conducting their business as well as look after the broader interests of society through discretionary, or philanthropic, activities (e.g., investing in community development, fair treatment of employees). According to Waddock (2004), the modern view of CSR tends to be associated with Carroll's philanthropic dimension and firms' ethicality in conducting business. What the work of Carroll and other CSR scholars ultimately suggests is that firms have responsibilities to society beyond profit maximization.

6.2.4 Corporate Stewardship

The scale and scope of human activity, and more specifically, activity in the pursuit of economic growth, have had and are having profound global impacts. For example, greenhouse gas emissions (argued as the main culprit of climate change) from industrial and agricultural activity rose by 70% between 1970 and 2005. This is perhaps not surprising given that in a single lifetime, the population grew from 2 to over 5 billion, as compared to the 10,000 previous generations it took for the population to reach 2 billion (Gore, 1992). The level of economic production required to sustain such population growth is enormous. Some question whether Earth's natural resources can meet the ongoing demands of a growing population.

According to organizations such as the International Institute for Sustainable Development (IISD), Earth's resources (land, air, water) are assumed to have limited

regenerative capability and carrying capacity (IISD, 1995). Given that economic activity can have a negative impact on the natural environment including, but not limited to, decreased biodiversity, ozone depletion, increased greenhouse gas emissions, waste, and deforestation (Doering et al., 2002), then, if the natural environment is degraded, basic and necessary resources for meeting the needs of future generations are also potentially diminished.

The stewardship approach suggests that firms (markets) are constrained by and dependent upon ecosystems (nature) (Hart, 1995). That is, economic growth and wealth creation are only viable if access to natural resources continues. However, if access to natural resources is constrained, or is in fact harmed by economic activity, then the ability to support humanity's future needs comes into question. As Hart (1995) suggests, strategies that address the natural environment may become the most critical in the future to sustain economic growth. He suggests that to meet the challenge, firms need to engage in certain activities, such as pollution prevention and minimization of the environmental life-cycle costs of their products/services. Thus, there is an element of "stewardship" in that firms should attend to the protection and use of natural resources. This line of thinking, however, is not new. For example, in ancient Israel, the Israelites were given many principles for looking after the natural environment (Friedman, 2000). As the earth and everything in it belonged to God, the people were called to be good stewards of all that He had created, including nature. While important, the concept of stewardship extends beyond just the natural environment.

Based on Fligtsein's (2002) assessment, the dominant view of the firm as an entity built for the satisfaction of private interests has begun to abate. More specifically, firms are seen as part of the basic structure of society, and accordingly, they are not exclusively private institutions but are also inclusively social institutions. As such, firms function as societal units. In this sense, firms would be expected to act as stewards in society, contributing to social capital for the common good (Konrad et al., 2006). For example, to ensure competitiveness and to function properly, firms need access to skilled employees, quality infrastructure, and well-functioning governments and communities, among other things. This has internal and external implications for firms. Internally, firms can demonstrate social responsiveness through promoting diversity, by ensuring a work-life balance for employees, and improving health and safety (Konrad et al., 2006). Externally, firms can demonstrate social responsiveness by reaching into the community through donations, volunteering, and sponsorships (Konrad et al., 2006). Thus, the idea of social responsiveness suggests that firms have a role as stewards in society and can help build social capital, which is ultimately likely to affect their ability to be sustainable economically.

6.2.4.1 A Definition

There is no universally accepted definition of sustainable development in business (Montiel, 2008). However, picking up on the themes and theories presented in this chapter, some common aspects become apparent. First, a definition of sustainable

development in business needs to include a stakeholder perspective. That is, for firms to contribute to sustainable development, they need to take into consideration requirements of actors beyond just shareholders. Firms certainly depend on shareholders for capital and investment. However, they also depend on human capital (employees) to create and deliver value, suppliers for inputs, customers for revenue, governments for infrastructure, among others, to generate economic returns for their shareholders. Second, for firms to engage in sustainable development, they must have access to natural resources. Thus, firms need an ongoing and stable resource base that does not deplete, and may even expand, natural resources or ecosystems. Lastly, firms operate and function in society. In fact, they are now the most powerful institution in society, and according to Harman (Harman, in Hawken, 1992), need to take some responsibility for society as a whole. Given their position, firms need to contribute to an ongoing and stable social system that creates or preserves just standards of living and security for all. A definition then, of sustainable development in business, is as follows: *creating value for current stakeholders – without compromising the ability to create value for future stakeholders – by ensuring that economic growth is achieved through the demonstration of environmental integrity and social responsiveness*. This definition expands, yet is consistent with, that provided by the World Commission on Economic Development (1987, p. 43), who defined sustainable development as that which “meets the needs of the present without compromising the ability of future generations to meet their own needs”. A representation of sustainable development in business is presented in Table 6.2.

Table 6.2 Dimensions of sustainable business development (SBD)

Dimension of SBD	Representative stakeholders	Core aspect	Key examples
Economic growth	Shareholders, investors	Creating value in a way that enables a company to remain economically viable for an indefinite time	Sufficient cash-flow to ensure liquidity; persistent returns to capital providers; R&D investment; an asset base that the market evaluates as having future value-creation potential
Environmental integrity	Natural environment and ecosystems, customers, communities, suppliers	Limiting impact of firm activities on the natural environment while minimising the use of natural capital	Various emission reduction actions in company facilities and processes; various resource-saving actions in company facilities and processes; energy efficiency in operations; risk-assessment of impacts on natural environment; reduced environmental impact of products/services

Table 6.2 (continued)

Dimension of SBD	Representative stakeholders	Core aspect	Key examples
Social responsive-ness	Employees, customers, communities	Continually contributing to the social well-being of society and individuals	Job evaluation systems; fair trade; work-life balance; human rights; gender mainstreaming; codes of ethics; employee training; health and safety precautions; product safety; sponsorships and donations

6.3 Sustainable Development in Business: A Strategic View

In the larger context of its roles and responsibilities, it is unfair to suggest that firms can solve all of society's problems or its development needs, nor bear the cost of doing so. Therefore, businesses must approach sustainable development – and its internal and external implications – strategically. Following is an outline one such proposed strategic approach.

A definition of sustainable development in business recognizes that the long-term health of a firm is inextricably tied to the well-being of society and the planet on which we live. Thus, to engage in sustainable development, businesses need to embrace a new objective: optimizing their operations to minimize environmental impact, improve social outcomes, and expand markets in a manner that supports economic growth. To do so, firms need to understand clearly the industries they operate in, the social issues impacting their stakeholders, and the actions they need to take to address sustainable development strategically.

First, when one thinks of the natural environment and society-at-large, there are many issues that occupy public attention. For example, climate change is on the minds of most citizens, and whether one believes in – or understands – the science of climate change or not, institutional forces are at play that are driving business firms to take the issue seriously. Similarly, human rights and AIDS are issues that continue to confront countries and citizens around the world. However, as has been mentioned, businesses cannot realistically be expected to solve all of society's problems nor bear the cost of doing so. They must be strategic.

Second, to focus on sustainable development strategically, firms need to sort through the myriad issues confronting society to uncover those that are "generic" versus those that are "strategic". For example, the operations of a manufacturer of plastic bags in Australia likely has little impact on AIDS around the world, nor is AIDS likely to materially influence its long-term competitiveness. However, the impact of the firm's operations on the natural environment is potentially significant. While the firm might make financial contributions to a local AIDS charity, this act would at best be categorized as good "citizenship" and responsive in nature (Porter

and Kramer, 2006). On the other hand, developing alternatives to plastic (such as biodegradable materials) or significantly reducing its carbon footprint in the manufacturing process not only mitigates harm from operations, but also potentially improves its long-term competitiveness, thereby making a strategic contribution to sustainable development.

Third, given the above example, to sort through the many issues in society today and to derive a strategic focus, firms need to place social issues within the context of the industry they operate in. In the mining industry, air and water pollution would be considered key social issues. In the apparel industry, safe working conditions and fair pay would be considered key social issues. In the food industry, obesity and healthy ingredients would be considered key social issues. These examples illustrate that not all social issues are equally important across all industries. The objective for firms is to ascertain which issues are most relevant to the industry they operate in. Similarly, firms need to understand which social issues are of importance to their primary stakeholders. This is because primary stakeholders can wield substantial power and can significantly impact a firm's ability to continue as an ongoing concern if they withdraw support in full or in part (Clarkson, 1995). Once important social issues are identified, firms can place them in a prioritization matrix – similar to that of the GE-McKinsey or Boston Consulting Group growth matrices – to ascertain which ones need to be addressed in the short, medium, and long term. Such prioritization offers firms a better view with respect to how they can approach sustainable development strategically. By example, Fig. 6.1 demonstrates a representative matrix outlining some of the social issues that might affect companies operating in the oil industry.

Lastly, to address sustainable development strategically, firms need to take action. Three such actions are prescribed: (1) market-based; (2) regulatory/standards-based; and (3) operational-based. Market-based actions include those actions that directly affect economic growth through the development and sales of

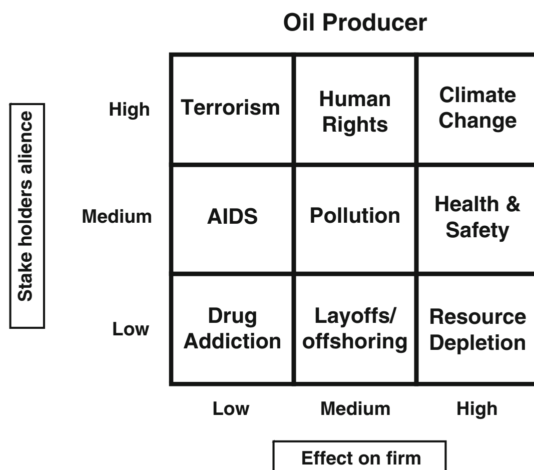

Fig. 6.1 Representative issues matrix of the oil industry

products or services that address social issues (McWilliams and Siegel, 2001). Regulatory/standards-based actions include those actions that must be put in place to satisfy legal requirements (Carroll, 1979). However, from a strategic perspective, firms that anticipate legal or regulatory requirements and adopt voluntary standards before they become law, or who go beyond compliance, would be viewed as responding to sustainable development proactively. Lastly, operational-based actions look into firms' value chains (Porter and Kramer, 2006). Because value chain activities impact directly on a firm's ability to demonstrate responsibility towards society by internalizing externalities (Porter and Kramer, 2006), strategically addressing these activities is an imperative for sustainable development.

In summary, market-based, regulatory/standards-based and operational-based actions are particularly important because they address three key aspects of strategy. First, by addressing sustainable development through product-markets, firms can seek to create value for specific target segments and in the process, differentiate themselves while contributing to economic growth. In today's highly competitive and globalized markets, differentiation through means such as addressing social issues appears to be important to long-term survival and to delivering economic growth (Porter and Kramer, 2006). Second, regulations and standards shape industries and the activities of firms – and their strategies (Porter, 1990). In many cases, regulations or standards are put in place by governments and other legal authorities as a response to social issues. Firms who figure out how to anticipate such regulations and standards – standards that will ultimately address or enforce social issues – can contribute to sustainable development, particularly by demonstrating environmental integrity and social responsiveness. Third, Porter (1996) argues that operational excellence is a necessary condition of competitive strategy. By viewing a firm's operations through the lens of social issues, a variety of opportunities can be explored. The key here is to align operational actions to those social issues that are most pressing and most strategic to a given firm, its industry, and its primary stakeholders.

6.4 Sustainable Development in Business: Example

Toyota Motor Corporation (Toyota) is a good example of an organization engaged in sustainable development. The company today is one the world's largest automobile producers, with 53 production sites around the world, automobiles sold in more than 170 countries, and 300,000 employees (Reinhardt et al., 2006). In spite of the recent economic downturn, the firm appears to be in a good industry: private vehicle ownership is expected to be as high as 3 billion around the world by 2050, up from 500 million vehicles in 1996 (Saperstein and Nelson, 2003). Given that Toyota aims to reach 15% global market share over the next decade (Reinhardt et al., 2006), the company is a substantial contributor to the world's transportation needs. However, such a massive contribution raises some concerns.

Automobile manufacturers are among the largest consumers of steel, aluminium, copper, glass, zinc, leather, plastic, platinum, and rubber. Unfortunately, the manufacturers of these products are responsible for a large carbon footprint, contributing substantially to global greenhouse gas emissions (Ryan, 2006). Further, everyday vehicle use is also one of the major contributors to greenhouse gas emissions (Malaczynski and Duane, 2009). From a sustainable development perspective, this places the automobile industry squarely in the firing line as a key contributor to climate change, one of the most prominent social issues today. Recognizing this fact, Toyota has taken strategic action.

Toyota, while certainly not the first to develop an environmentally-friendly car, has demonstrated the kind of commitment and investment necessary to build a new market segment. With the introduction of the Prius in 1997, Toyota almost single handily created market demand for hybrid vehicles, which combine existing technology with environmentally conscious technology. The company had sold 1 million Prius models by the first quarter of 2008, capturing two-thirds of the global hybrid car market, with an 80% market share in the US (Reinhardt et al., 2006). Toyota aims to sell 1 million hybrid cars per month during the next decade and has committed to expand hybrid technology in all vehicle series by 2020 (Toyota Motor Corporation, 2008a). Because the Prius offers 100% improvement in fuel economy over standard combustion engines and is claimed to emit fewer greenhouse gases, Toyota is contributing to sustainable motoring (and sustainable development) through creating and building a new market segment for automobiles. Based on the proposed framework in this chapter, this would be considered a strategic, market-based action. However, Toyota's strategic actions do stop here.

In Japan, Toyota's world headquarters location, the government established fuel economy standards under its "Top Runner" energy efficiency program in 1999. Fuel economy targets are based on weight class, with auto makers allowed to accumulate credits in one weight class for use in another. If targets are not met, penalties apply. In December 2006, under the new 2015 Fuel Efficiency Standards initiative, the government revised the fuel economy targets upward, from 13.6 km/L (kilometres per litre) in 2004 to 16.8 km/L in 2015. Through the Prius model, Toyota was the first automobile manufacturer in the world to not only meet the 2015 Fuel Efficiency Standards, but exceed them (delivering 35.5 km/L compared to the standard of 16.8 km/L). Carroll's (1979) arguments suggest that firms can reject or merely meet standards such as the 2105 Fuel Efficiency Standards in Japan, or they can take a proactive stance by doing more than required. In the case of Toyota, clearly the Prius exceeds the target standard and in the process, demonstrates a proactive response towards standards that contribute directly to sustainable development.

Lastly, the production of automobiles is a complex, energy-intensive task that has the potential to generate substantial greenhouse gas emissions. In its commitment to sustainable development, Toyota employs the Sustainable Plant Concept. In order to incorporate the concept of sustainability into manufacturing operations, Toyota plants in Japan, USA, Europe and Asia are being built or modified to incorporate greener technologies. In the Tsutsumi Plant in Japan, for example, the company has installed an innovative gas engine cogeneration system which translates into a

reduction of approximately 140,000 tons of CO_2 emission annually (Toyota Motor Corporation, 2008b). The Plant also has a polysilicon-type photovoltaic power generation system, one the largest in the world, which is capable of supplying approximately half the electricity needed for the assembly process (Toyota Motor Corporation, 2008b). Part of the generated electricity is also stored in batteries and is used for powering the streetlights surrounding the Plant. However, Toyota extends sustainable practices beyond just manufacturing plants.

The company's South Campus expansion of its North American headquarters in Torrance, California was the largest facility in the US to earn LEED gold-rating in 2003.[2] The building was a pivotal project for the green building movement because it dispelled the myth that LEED certified buildings were more expensive to operate than conventional buildings. Each building has long narrow wings with north-south orientation, so nearly 90% of offices enjoy natural light and views. Rooftop photovoltaic panels combined with highly efficient air-handling units, and gas-powered chillers contribute to 31% less energy consumption. Recycled water is used for watering, toilet flushing and cooling, saving 20.7 million gallons of potable water per annum. The South Campus enjoys high employee retention rates, strong productivity and workers who are rarely absent (Lockwood, 2006), suggesting that addressing environmental integrity in operations can, in fact, facilitate social responsiveness towards employees. Further, as high levels of employee retention and productivity have been found to directly benefit financial performance (Huselid, 1995; Guthrie, 2001), economic growth is positively impacted.

6.5 Conclusion

Business firms are the wealth creators in society. In fact, the economic function of firms is an important social responsibility (Friedman, 1970; Carroll, 1979; Henderson, 2005). However, for firms to create wealth in the long run, they must grasp the interdependencies between stakeholders, natural resources and society. In this sense, firms need to pay careful attention to the externalities they may impose on key stakeholders (including the natural environment) and society-at-large as a result of their economic activities. Economic activities are not cost free to firms, their stakeholders or to society. Thus, in the sustainable development scenario, business firms seek to create value for current stakeholders – without compromising the ability to create value for future stakeholders – by ensuring that economic growth is achieved through the demonstration of environmental integrity and social responsiveness. Such an approach, while noble, does require strategic focus and tough choices and trade-offs.

Strategy is concerned with the actions and choices firms take to position themselves in the industries they compete in (Porter, 1996). Accordingly, all firms face a myriad of social and environmental issues in their given industry. Yet, business firms

[2] LEED is the Leadership in Energy and Environmental Design green building rating system.

cannot be expected to solve all of society's problems or be held solely responsible for looking after the natural environment – nor bear all the cost of doing so. For a firm to be sustainable, resources must be focused on aspects of the natural environmental and social issues that are most relevant and important to its industry – and its stakeholders. For example, mining firms must address air and water pollution and worker health and safety. Alternatively, in the petroleum industry, firms face varying issues across countries: in the US, they must demonstrate better environmental practices; in developing countries, they may be challenged to alleviate poverty while stabilizing difficult political situations. By strategically addressing the most pressing environmental and social issues of stakeholder and industry concern, firms position themselves not only to demonstrate environmental integrity and social responsiveness, but also to create a context in which economic growth and its wealth creation function can be sustained over the long term.

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Chapter 7
Environmental Issues in Business

Patricia Park and Michael Galley

Abstract The globalisation of production and services by international corporations has heightened awareness of the potential for trans-national environmental harm that activities of such companies may create. Alternatively a responsible international corporation may also help to raise the environmental standards in developing countries, by acting as the main repository of modern, environmentally sensitive, technology, and as the most advanced experts in environmentally sound management practices. This chapter aims to highlight some of the legal and operational issues with regard to the environment, which multinational corporations will need to consider during their operational management.

7.1 Introduction

The globalisation of production and services by international corporations has heightened awareness of the potential for trans-national environmental harm that the activities of such companies, in addition to national ones, may create. Alternatively a responsible international corporation may also help to raise the environmental standards in developing countries, whose environmental regulation may be somewhat lower than that which would be expected in a developed state, by acting as the main repository of modern, environmentally sensitive, technology, and as the most advanced experts on environmentally sound management practices (Muchilinski, 2009) This chapter will consider environmental issues in business for both national and, in particular, for multinational corporations and how the responsible company may use Corporate Social Responsibility (CSR) to promote environmentally sustainable development.

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Legal regulation of the environmental activities of international companies is based on the concept of "sustainable development" with more specific elements of environmental protection. With regard to the specific responsibilities of both national and multinational corporations, attention must be given to other concepts such as "the polluter pays"; the "preventative", and the "precautionary" principles; the first two being enforceable in law, whereas the third one will go to "due diligence" if things go wrong. The most widely recognised definition of "sustainable development" is that of the Bruntland Commission which called for development that, "meets the needs of the present without compromising the ability of future generations to meet their own needs." The emphasis is on *needs* rather than *wants*, and inter and intra-generational justice. This approach is based on an accommodation between economic growth, environmental concerns, and the wider social effect of economic activity. CSR would support methods and processes of economic growth which ensure the survival of a sustainable ecosystem that can last for generations. Equally, the social effects of environmental protection, or damage, if that is so, need to be taken into account as part of the complex range of interactions that characterise the concept of sustainable development.

Following on from the concept of sustainable development is the idea of environmental protection. This being a wide concept which cannot be exhaustively defined, but includes key issues such as the preservation of the quality of the air, water, and soil; the sustainable use of natural resources; the preservation of human, animal and plant life and health, and of the ecosystem more generally (UNCTAD, 1972). These goals form the bedrock of environmental regulation policy, both at national and international level. They do not only apply to states but to non-state actors such as corporations. These goals have been progressively developed in both national legal instruments and international conventions relating to, inter alia, the atmosphere, pollution of the sea, the protection of freshwater resources, the preservation of biological diversity, the control of hazardous substances and activities, the regulation of waste creation and its disposal, and the preservation of the Arctic regions (Sands, 2008). In addition to international law, those companies operating within the European Union must also be aware of European Union environmental legislation. This is based on both environmental and economic rationales, attempts to ensure free access to, and the dissemination of, environmental information held by public authorities. Most European environmental legislation is based on the international treaties but becomes mandatory within all of the European Member States under the regional Treaty of Rome, as amended.

7.1.1 Environmental Regulation of International Corporations

The main point to make here is that environmental regulation does not distinguish between international corporations and domestic companies as a matter of principle, however, certain international regimes are emerging concerning environmental protection which focus on the international corporation in particular, and in the case of

developing countries, the activities of international companies, may in some cases, be the main or significant area of industrial activity that can lead to environmental degradation. Therefore, international companies can be seen as major subjects of responsibilities in this field. (Muchlinski, 2009).

Although there are differing kinds of environmental regulation including informal or self regulation, which includes CSR, these will be addressed later in the section on environmental management and auditing (which is based on a case study of Vauxhall Motors). Here we wish to address the more enforceable aspects of formal regulation of the environmental practices of international corporations. These "formal" regulations refer to those mandatory requirements imposed by governments and regional organisations with law-making powers, as well as standard-setting environmental agreements aimed at both environmental protection and the furtherance of sustainable development, commonly referred to as Multinational Environmental Agreements (MEAs). Equally, the interaction of International Investment Agreements (IIAs) with national regulations and with MEAs should be considered.

7.1.2 National and Regional (EU) Regulation

National and regional regulations are the principle way in which the standards within the MEAs are established. Furthermore, it is at national level where corporations actually operate, and where legal claims will be brought against the firm. (EC Fifth Environmental Action Programme, 1993). National standard setting and enforcement is an essential part for ensuring that corporations actually meet the levels of environmentally sound practice needed to protect the environment efficiently (Muchlinski, 2009). Clearly explicit standards, backed up by effective enforcement measures does change corporate behaviour. The more stringent carbon dioxide emissions standards in national legislation (under the EC Directive) has led to the development of new technologies in the car industry that reduce such emissions in addition to the development of more efficient cars. Fiona Harvey (2005) notes that, in the first three months of 2005, companies in countries that have ratified the Kyoto Protocol, including EU Member States, Canada and Japan saw their shares rise by an average of 21.9%, while shares in companies specialising in renewable energy in Australia, a non signatory of the Protocol, rose by only 4.2%. Shares in US (also a non-signatory of the Protocol) renewable energy companies actually fell 13.8% on average. More stringent environmental standards, therefore, should give rise to cleaner forms of commercial activities. As to corporate environmental governance, the EU has taken a lead with the Eco-Management and Audit Scheme. Equally, liability rules, especially in the US under their Comprehensive Environmental Response, Compensation and Liability Act 1980 (CERCLA) can be particularly harsh, with strict liability for environmental damage extending to corporate directors, officers, lenders, and shareholders. In 2004 applicable principles for EU Member States were laid down in the Directive on Environmental Liability.

Turning to the substantive content of international instruments covering international corporations responsibilities in the environmental field, two voluntary codes are of particular importance. Firstly, the continuing importance of Agenda 21 in this area was affirmed at the World Summit on Sustainable Development (WSSD) in Johannesburg in 2002, and secondly, the OECD Guidelines on Multinational Enterprises. Both of these instruments emphasise the furtherance of sustainable development through the transfer of environmentally-sound technology and management practices.

7.2 Innovation/New Environmental Technology

7.2.1 Introduction

Effective and timely development of new environmental technology is crucial for a concerted global action towards the reduction of greenhouse gas emissions. Environmental technologies provide solutions to decrease material inputs, reduce energy consumption and emissions, recover valuable by-products and minimise waste disposal problems. They also support the application of environmental management systems and make production processes cleaner by collecting information about the environment; monitoring and data gathering to identify the presence of pollutants. According to the European Environment Agency, environmental technologies have the potential to contribute to the reduction of greenhouse gas emissions by 25–80%; to the reduction of ozone depletion by 50% and to acidification and eutrophication by up to 50%.

7.2.2 Transfer of Environmental Technology and CSR

Under a number of international environmental conventions there is a general requirement for the transfer of environmental technology to developing countries.

Given the numerous forms which technology can take, it is not surprising that there are as many methods and devices for effecting the transfer of technology, however, the principal mode of transfer to developing countries is on commercial terms as a business transaction between enterprises or institutions in different countries. Not only will the complexity of the technology which is to be acquired have an important influence on the method of transfer but also the nature of the domestic legislation and legal practices in the recipient country. Financial considerations will inevitably play a part as foreign exchange considerations will invariably have an important role. There will also be the issue of the technological sophistication of the acquirer. For the less experienced transferee, then technical assistant agreements will need to be in place. However, all of the methods by which technology is transferred will need a legal agreement.

7.2.3 *Theory, Intellectual Property Rights, and Technology Transfer*

A striking correlation has been noted between industrialisation and the protection of industrial property rights (Beier, 1980) the express objective for the first grants of patent protection in Europe in the Middle Ages was to encourage industrial development (as in Beier 1980). The subsequent industrialisation of Europe and the United States of America is now taken to be evidence of the causal nexus between industrial property protection and industrialisation. However, this assumption cannot be as easily made due to the strong movement in Europe for the abolition of patent protection, influenced by free trade theories (Machlup and Penrose, 1950). At that time patent protectionism was ideologically linked with tariff protectionism and both were anathema to the free trade spirit of the time (Blackeney, 1989). In the patent debate of the nineteenth century, four lines of argument were advanced against the free trade opponents of the industrial property systems. Blakeney claims that it was asserted that man had a natural property right to his own ideas; that patent protection was a just reward for the useful service performed by inventors; that the prospect of reward was an incentive for invention, and finally that in the absence of protection against the immediate imitation of novel technological ideas, it was asserted that an inventor would keep his invention secret and thereby delaying, at least, technological progress. The contemporary relevance of these arguments is present in the debate on the transfer of technology to developing countries.

In the contemporary debate on the transfer of technology to developing countries the status of the natural rights justification of industrial property protection is very much subordinate to the various economic arguments. In fact, the concept of private natural property rights in the creations of the intellect exists in uneasy tension with countervailing public rights such as the "universal human right to share in scientific advancement" and the "right to development" (Freinreider, 1981 in Blakeney) as the "right is only a limited one (Prager, 1944). The current way in which property rights are defined as "socially recognised economic rights to act, to dispose and use" (Lehmann, 1985) asserts the ascendancy of the economic touchstone of private rights and compels an evaluation of the alleged economic justifications for the protection of industrial property.

The assumption of almost all the proponents of the transfer of technology is that such transfer is a prerequisite, even an imperative, for the desirable economic and social development. Solow (1976) attributed 87.5% of the growth of per capita income in the United States in the first half of the twentieth century to technological progress and the remainder to the use of capital. In respect of developing countries the deprivation and poverty suffered by the indigenous peoples has been attributed almost entirely to their technological dependence (Patel, 1974). To try to address the question of the technological transformation of developing countries an UNCTAD report in 1980 noted that industrialised countries spent 17 times more of their gross national product on research and development than developing countries. The WIPO Licensing Guide for Developing Countries (1977) commences with the assertion that "Industrialisation is a major objective of developing countries as

a means to the attainment of higher levels of well being of the peoples of such countries. . . ." These statements reflect the philosophy animating the Declaration on the Establishment of the New World Order adopted by the General Assembly of the United Nations in December 1974. Interpreting the Declaration Fikenstscher (1980) asserted the right of access for all nations to "the universal heritage" of technology. This right was to be secured through the institution of an appropriate legal regime to facilitate technology transfer to developing countries on an "equitable" basis.

This was an article of faith that the transfer of technology to developing countries would improve their material circumstances to levels approaching those of the industrialised countries. The theory itself proceeds on the assumption that the transfer of technology can facilitate the more productive use of resources and provide a technology base from which the development of indigenous technology can proceed. This is undeniable, but it is questionable whether it is possible or prudent to use technology which has been developed for markets in industrialised countries. Hansen (1980) explains, "the realisation of developmental objectives is crucially dependent on whether the mechanism of transfer is rightly adapted to the absorptive capacity of the economy". So where does this leave the international corporation with a strong CSR Policy and a desire to assist the development of its suppliers from the developing countries?

It is now a given that global warming is one of the most pressing problems faced by the international community. It has also been accepted by the IPPC that a large proportion of these greenhouse gas releases are due to anthropocentric activity. Should patent law help cool the planet? This is the question asked by Estelle Derclaye (2009). The main goal of patent law is to create incentives for industry to develop new technology, which in turn may create pollution including greenhouse gasses. However, despite the perceived neutrality of patent laws, they in fact already address the issue of protection of the environment through Art.53(a) of the European Patent Convention (EPC) and the corresponding national provisions. In addition under the European Community Treaty patent laws must take account of environmental laws. Therefore, any new technology developed by corporations with a view to protecting the ideas through patent, must take account of environmental principles and legal instruments.

7.2.4 Marketing/New Markets

According to Choudhury (2010), consumers sensitivity to environmental issues do not always translate into purchase behaviour. He claims that it is, therefore the responsibility of marketers to use their communication and promotional skills to convert this latent desire for environmental quality of life into action. Marketing practices should redirect customer needs towards ecologically safe products by re-orientating the marketing mix to develop and promote ecologically safe products. When companies themselves come up with environmentally friendly innovations, they can access new markets, enhance their market share and increase profits.

7.3 Audits

7.3.1 Introduction

The term "audit" is often used to cover a wide range of situations, but in this chapter the term is used in the narrower sense to refer to studies and examinations of a situation or process against the requirements of a defined standard, policy, or regulation. The main audit systems to be referred to will be the International Standards Organisation environmental management scheme (ISO14001) and the somewhat less widespread European Eco-Management and Audit Scheme (EMAS). Because certain elements of each scheme overlap it is difficult to find clear lines of distinction between each scheme hence there will be no examination of the audit process itself but rather a discussion on the different types of audits employed in businesses and the reasoning behind each type within the context of policies and regulations. A range of audit types that were encountered by one of the authors whilst at Vauxhall Motors is illustrated in Fig. 7.1, whilst Fig. 7.2 summarises the commonality of drivers in different audit types.

The rapid growth of legislation, particularly from the European Union, requires that companies demonstrate regulatory compliance. Under UK legislation (*Environmental Protection Act 1990*) environmental wrongs are part of the criminal code and can attract substantial fines, or if an individual is found guilty of negligence then even a spell in custody can be the outcome. As far as civil matters are concerned since the UK *Empress Car Company* case in 19xx environmental wrongs have become the subject of strict liability. This can also extend to the personal responsibility of Directors for environmental and health and safety issues.

(a) *Legal audits*
Compliance audits may be divided into audits based on existing legislation and regulations, (legal audits) and audits based on the requirements of the international standard(s) to which sites may be certified or registered (environmental management audits).

Legal audits are undertaken to demonstrate compliance with specific regulatory requirements, such as contaminated land, the presence of asbestos within a site and its structures, or the quick response that was required to verify the presence or absence of PCBs on site.[1] Such audits are mandatory and may be required to meet the obligations of specific regulations within a defined timeframe. Although these audits are often undertaken by an organisation's own staff, they may be undertaken by third parties on behalf of the company and subject to formal confirmation by the appropriate regulatory body.

[1]For example, *the Control of Asbestos at Work Regulations 2002* and *the Environmental Protection (Disposal of Polychlorinated Biphenyls and Dangerous Substances) (England and Wales) Regulations 2000.*

Other legal compliance audits may be less prescribed or even optional, but are nevertheless employed by many organisations to show recognition of, and adherence to, regulatory requirements. Typical of this group are Duty of Care audits of waste contractors, undertaken at their own sites of operation, to ensure that the contractors are receiving, handling and disposing of wastes, especially hazardous wastes, in an appropriate manner, and with the requisite paper audit trail, since it is no defence in law to state that any contractor who may be found to be operating inappropriately has been duly authorized by the Environment Agency.

An increasing amount of legislation regarding the duties of Directors, such as the *Health and Safety at Work Act 1974*, the *Environment Act 1999*, and the extensive *Companies Act 2006*, has spotlighted the role of Directors in terms of the responsibilities and liabilities that they carry. As a result, it may be of relevance to undertake a periodic, general compliance audit to assess the major pieces of environmental legislation appropriate to the site in question, and examine their relevance to the organisation, determine who within the organisation individuals bears relevant responsibilities, the current level of compliance, any known shortfalls, and action deemed necessary to correct any deficiencies highlighted. Such proactive reviews are applicable to a whole range of subjects – finance, data protection, etc., – as well as environment.

(b) *Environmental Management Systems (EMS) audits*
There is a growing expectation (particularly from customers) that industrial companies will introduce formal environmental management systems; detailed questionnaires on these matters are often issued to companies invited to tender for contracts.

Under ISO 14001, the audit is a fundamental component of a formal environmental management system. Its aim is to ensure firstly that any defined procedures are sufficient to meet operational requirements, and secondly, that activities are carried out in accordance with those procedures. The 2004 version of ISO14001 requires that an organisation not only demonstrate that it has identified the environmental legislation appropriate to the site's activities, but also that it has identified the relevance or impact of that legislation upon the site. In addition, the organisation must also demonstrate that it is aware of any forthcoming legislation and its implication for the company within the process of collation; interpretation; dissemination and the company reaction.

Environmental management auditing may be undertaken at three distinct levels; firstly at internal level, where the audits are carried out by appropriately trained plant personnel; secondly at external level, by independent, accredited third parties; and finally by Corporate auditors, who may audit operational plants on a narrower but deeper basis than the other groups. Although little of the audit process is prescribed within the ISO standard and the actual content, format, and frequency of the local audits is left to each organisation to determine, the scope and frequency needs to be such that it meets the expectations of the other (external) auditing bodies.

Regular audits are employed to demonstrate that an organisation is consistently meeting the requirements of the standard and exhibiting the continual improvement that is fundamental to ISO14001 and EMAS. Environmental management audits also seek to ensure that site activities are undertaken not only in compliance with legislation and the site's own procedures, but also in accordance with the site's own environmental policy. Allied to environmental policies are any other standards and agreements to which an organisation may voluntarily subscribe; General Motors has, for example, defined its own Environmental Performance Standards (EPS) for various activities relating to waste, emissions etc., which are binding on all GM manufacturing sites globally, and which sit alongside the international environmental standards. All such voluntary standards should be equally subject to audit.

The audit is the base level and any findings should be incorporated into the company's environmental policy, periodic review meetings, operations procedures, corrective action plans, impact assessments, and future audit plans. A regular failure of an organisation to demonstrate to external auditors that it is meeting the requirements of a standard can lead initially to an increase in the rate of such external audits (and costs) and ultimately to the withdrawal of the site's certification if non-compliances (to legal requirements) or non-conformances (to the standard) are not adequately addressed.

7.3.2 Efficiency Audits

Specific areas may tend to be of increasing importance in the EMS audit programme, particularly in the areas of energy consumption, where a closer examination of emissions reflects a growing awareness of carbon footprints and environmental control, whilst the rapidly increasing cost of energy warrants a close examination for purposes of financial planning and control. These audits covering the use of utilities and the generation of waste are known as resource or efficiency audits, and may be undertaken voluntarily or, increasingly, as mandatory requirements.

The growing focus of concern with regard to greenhouse gases and their contribution to global warming has resulted in increasingly close control over emissions from industrial plants. Limits to a site's emissions are set by the Environment Agency for companies subject to the provisions of the *Pollution Prevention and Control Regulations* (PPC) as part of that site's permit to operate. Energy use is to be reported annually to the Agency and subject to audit. PPC also covers waste and water minimisation audits. This year, the *Environmental Permitting (England and Wales) Regulations 2010* will add groundwater and water discharge consents to activities currently permitted as a further step towards a unified permitting regime.

Climate Change Agreements (CCA) are voluntary arrangements completed with government by industry bodies on behalf of their member companies[2] to allow

[2]CCAs do not emanate from any environmental legislation but were included under the provisions of the *Finance Act 2000*, to allow rebates from the Climate Change Levy for organisations

rebates from the climate change levy for those performing at or below defined energy use targets. Verification auditing of site performance against government-defined targets is undertaken by the Environment Agency on behalf of the Department of Energy and Climate Change; verification of any over-performance that a company wishes to convert to CO_2 allowances is by approved independent third party and at the cost to the company.

The European Emissions Trading Scheme (ETS) is a mandatory annual verification of direct CO_2 emissions against specific allowances granted by government to individual organisations. Reports are subject to an independent verified opinion statement. Whilst a failure to meet targets under CCA can result in loss of Climate Change Levy over a two year period (representing at times a considerable sum), a failure to meet ETS targets results in fines, plus the subsequent need to make good shortfalls in performance.

All three of the above schemes involve some overlap of monitoring, reporting and auditing/verification – each with their own cost burdens – of site performance with regard to emissions, yet each is based upon different factors and criteria of inclusion and output, ETS being based upon 20 mW plants, for example, whilst PPC is based, upon 50 mW combustion plants, plus any directly associated activities.

Specific areas of waste operations, especially hazardous waste and wastes regulated under producer responsibility provisions, are not only regular candidates for audit under EMS requirements, but are also subject to periodic or random audit by the Environment Agency and documentation must be maintained for the periods prescribed by law.

7.3.3 Other Audits

Specific industries or processes may require their own particular form of environmental audits; prominent amongst organisations involved in mergers or acquisitions is likely to be Due Diligence audits, which are in-depth examinations of the target business with particular emphasis on the present and historic impacts of that business upon its surroundings, and the possible liabilities that may be inherited as the result of acquisition. The cost of subsequent remediation may prove to be well in excess of any anticipated acquisition price; for this reason, Due Diligence audits are often carried out in association with legal staff.

7.4 Communications/Environmental Information

7.4.1 Introduction

Transparency is a new force rising in business; one that has far reaching implications for most corporations. Nascent for almost half a century, transparency in

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performing at or below the (reducing) site targets set every two years by government for each participating company for direct emissions and emissions related to electricity usage.

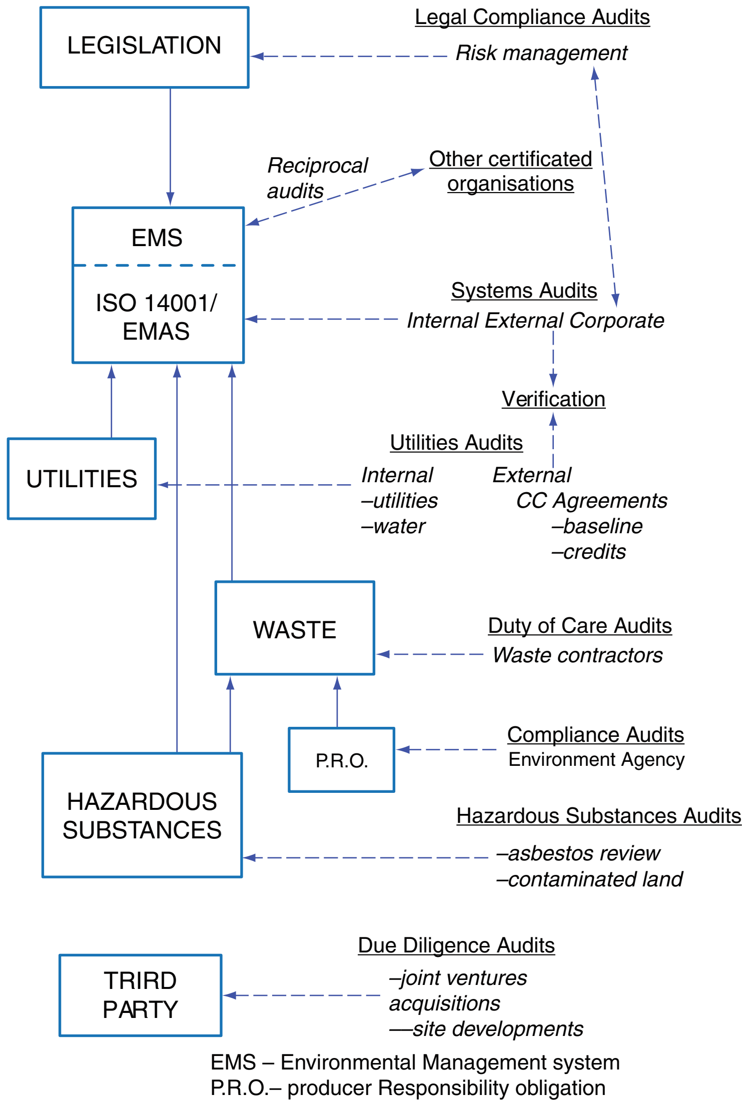

Fig. 7.1 Environmental audits

business has quietly gained momentum through the last decade and is triggering profound changes across the corporate world. Firms that embrace and use the power of transparency will thrive; those which ignore or oppose it will suffer.

Transparency is far more than the obligation to disclose basic financial information. Stakeholders that interact with corporations are gaining unprecedented access to all sorts of information about corporate behaviour, operations, and performance.

COMMONALITY OF ASPECTS/DRIVERS IN DIFFERENT AUDITS

Audit type / Aspect	Legal	EMS	Resources
Compliance	✓	✓	✓
EMS	✓	✓	✓
Energy	✓1	✓	✓
Water	✓2	✓	✓
Waste	✓3	✓	✓
Hazardous materials	✓4	✓	✓
Waste contractors	✓3	✓	
Due diligence	✓		

Notes 1. E.g. PP, Climate Change Agreements, Emission Trading
2. E.g. Water Industry and Resources Acts 1991
3. E.g. Duty of Care
4. E.g. Asbestos, PCBs.

Fig. 7.2 Commonality of aspects/drivers in different audits

Armed with new tools to find information about matters that affect their interests, stakeholders now scrutinise the firm as never before, inform others, and organise collective responses. Corporations are becoming naked (Tapscott and Ticoll, 2003) in a world of instant communications, whistle-blowing, inquisitive media and social networking, corporations are routinely put under the microscope by competitors and communities alike. The corporation, therefore, has no choice but to rethink its values and behaviour and to be more open and effective with communicating their environmental information.

7.4.2 *Effective Communication*

The OECD Development Cooperation and Environment Working Party, set up an interest group in 1997 to work on Environmental Communication. In their Report (Environmental Communication: Applying Communication Tools to Sustainable Development, 1999) OECD they concluded that many environmental projects and action plans are not fully "owned" by the people concerned; that the assumptions on

the part of environmentalists believed that scientific facts and ecological concerns are convincing and compelling on their own; but what influenced people most were emotions and socialisation as well as reason and knowledge. The inflated expectations that the "cognitive power" of the word and the image alone will solve a given problem, and by taking a shortcut between "Said" to "Done", communication barriers are often disregarded. Therefore, conflicts of interest which are fought by stakeholders are not negotiated by shareholders, and confrontational approaches lead to one-way information dissemination disregarding understanding, instead of relying on two-way communication towards "shared meaning" and "win-win" situations.

> Said is not heard; Heard is not understood; Understood is not accepted; Accepted is not yet done. (OECD Report. p.6)

The Group produced a management tool Environmental Communication (EnvCom) which is a planned and strategic use of communication processes and media products to support effective policy making, public participation and project implementation geared towards environmental sustainability. This tool could well be modified by corporations to fit their specific requirements, but also highlights the necessity for corporations to be effective in their transparency.

7.4.3 Legal Requirements

The most comprehensive multilateral scheme for giving environmental information to the general public is the 1998 Aarhus Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters. Signatories to the convention include the European Union Member States and most of the former Soviet States, but the Convention is open to any state to participate. Under Article 4 of the Convention anyone ("the public") is entitled to environmental information covered by the Convention, including NGOs "promoting environmental protection" in accordance with national law. Access is not dependent on being personally affected or having some right or interest in the matter. In this respect it simply reflects the many national laws on the subject, including US Law and EC Directives. (Gavouneli, 2000). Environmental information is very broadly defined and includes, inter alia, information about activities, administrative measures, agreements and policies which may affect the environment. Information which may be classed as "commercially sensitive" may be excluded, although a Protocol on Pollutant Release and Transfer Registers adopted in 2003 will require industry to collect and report information about pollution emissions which parties must then make publicly available.(Sand, 2004).

7.4.4 Environmental Reporting

Apart from the need for financial reporting many corporations also report on social and environmental performance. However, many social and environmental reports are selective and self serving marketing tools. One problem is that standards for

social, environmental and governance reporting are immature with international standard setting only emerging within the twenty-first century.

The UN Norms provide a template for a stakeholder sustainability report including a vision strategy for sustainability, including a statement from the reporting organisation's CEO. Environmental indicators should concern an organisation's impacts on living and non-living natural systems, including ecosystems, land and water. In a responsible multinational organisation these indicators should be presented in both absolute figures and normalized measures; that is resource use per unit of output. In this way the absolute figures provide a sense of scale or magnitude of impact, while normalised data illustrate efficiency and support comparisons from one organisation to another. Such indicators would include materials use; energy use; water; impacts on biodiversity; greenhouse gas emissions; rate of recycling, and indices of fines for non-compliance with environmental regulations.

> A cautionary word needs to be inserted here by referring to the *Kasky v Nike* case in which Nike was sued under Californian State Law for false advertising.

Kasky claimed that information on Nike's social performance was false and did not reflect the poor working conditions in its foreign factories. Nike defended the claim by addressing the First amendment of the US Constitution on freedom of speech. However, the court of first instance ruled that the company's statements should be classified as "commercial speech" and thus were subject to the stricter standard of truth required by advertising law. The case itself illustrates that companies' statements can be challenged for misrepresentation, and so illustrates the need for complete veracity in CSR reports.

7.4.5 Summary

The best firms build transparency and integrity into their business strategy, products and services, brand and reputation, technology plans and corporate character. Apart from the legal requirements for transparency and communication/reporting there is a strong business case for corporations to embrace the new order. Research by Tapscott and Ticoll (2003) demonstrates that transparency and corporate values enhance market value by focussing strategies on stakeholders and sustainability. Good firms that optimise the needs of all their stakeholders are looked upon favourably by investors. Employees of an open enterprise have greater trust in one another and their employer, which results in better innovation and loyalty. Corporations that align their values with those of the communities they touch can develop sustainable business models.

7.5 Conclusions

Organisations are increasingly expected to deal with environmental pressures caused by their operations and although a number of environmental standards have

been designed to enable them to achieve their environmental goals, many organisations have struggled with the implementation of these standards. This chapter aimed to highlight some of the legal and operational issues with regard to the environment, that corporations, and in particular multinational corporations, will need to consider during their operational management.

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Chapter 8
Environmental Strategy and Sustainability

Pasi Heikkurinen

Abstract This chapter describes two alternative approaches to environmental strategy, namely instrumental strategy and awareness strategy. In order to have a successful environmental strategy values, actions and words must be aligned, and therefore it is vital that managers, leaders and academics identify the strategy approach at issue. Values based on utilitarian ethics; passive/reactive/proactive actions; and pragmatic/image-driven discourses all characterize an instrumental strategy. Values based on virtue/duty ethics; entrepreneurial/creative actions; and reflective/identity-driven discourses all characterize an awareness strategy. In the instrumental strategy the environmental responsibility is mainly a tool to achieve economic gains, whereas in the awareness strategy the environmental responsibility is a tool to achieve environmental gains. As both of these approaches can be classified under corporate environmental responsibility the strategies can be seen to contribute to environmental sustainability. However, the awareness strategy maximises to contribution to sustainability.

8.1 Introduction

The debate on the relationship between the natural environment (henceforth environment) and business activities is still going strong. The buzzword(s) that describes the phenomenon is currently "corporate environmental responsibility", a third of corporate responsibility (henceforth CR). CR also consists of corporate economic responsibility and corporate social responsibility (Goodpaster, 1983; van Marrewijk, 2003), or socio-cultural responsibility (Ketola, 2008a). By CR firms can contribute to sustainable development that can be defined in the following manner: "Sustainable development is development that meets the needs of the present

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without compromising the ability of future generations to meet their own needs" (Brundtland Report, 1987). Sustainability then again is the objective and mission of sustainable development.

The different standpoints on the environmental responsibility and CR discussion can roughly be categorized into three camps. In 1998, Reinhard distinguished two of them: the first group of executives and academics emphasize that firms exist to serve merely their shareholders, whereas the second group asserts that it pays to be green. The third and emerging group of executives and academics consider the natural environment valuable per se. These three groups are parallel with models for *classical*, *neoclassical* and *sustainable economics* (DesJardins, 1998). In the *classical economics* – or shareholder oriented ideology – this "Friedman's (1970) camp" separates business from societal and environmental issues (Clarkson, 1995). In the *neoclassical economics* – or stakeholder oriented ideology – this "Freeman's (1984) camp" considers societal and environmental issues part of business activity through stakeholders. In CR literature, this stakeholder oriented paradigm seems to be the dominating view. A stakeholder can be defined as "any group or individual who is affected by or can affect the achievement of an organization's objectives" (Freeman, 1984, p. 46). The impetus behind stakeholder theory was to build a framework beyond shareholder theory that is more responsive to the concerns of managers caused by unprecedented levels of environmental turbulence and change (Freeman and McVea, 2005). In the *sustainable economics,* the "emerging camp" without a clear front figure continues the evolution of merging the environment and business together. Starik (1995); Stead and Stead (2000); Ketola (2005); Haigh and Griffiths (2007) suggest a wider perception of stakeholders including the natural environment (planet earth) as a direct stakeholder. Hence in the sustainable economics a stakeholder is anything (nature, species, culture, a group, an individual) that is affected by or can affect the achievement of an organization's objectives.

Strategy is often related to chess and warfare. These strategic activities aim at winning or achieving a specific end that is not in the interest of the other party, resulting in a win-lose or stalemate situation. In the business context, this type of rhetoric and thinking is being partly superseded by alternative solutions that do not consider competition anymore as a zero-sum game. Network theory, critical theory, business ethics and concepts such as co-opetition are increasingly prevailing. Therefore the metaphors of chess or warfare do not seem as apt anymore. But there are arguably as many definitions for strategy as there are strategists. If *strategy* is perceived as an action oriented concept, it closely relates to the concept of *strategic activity*. Peter Drucker defined strategic activity as activity that insures that the firm *does the right thing* while operating activity makes sure that the *thing is done right* (in Ansoff and McDonnell, 1990). His explication is highly applicable for also defining what environmental strategic activity is. The general management of this strategic activity can then be referred as *strategic (environmental) management*, as Ansoff and McDonnell (ibid) phrased it.

In the CR literature, "writers on environmental strategy have largely tended to rewrite the corporate strategy literature in environmental terms" (Agarwala, 2005) and traditional strategic management theories have been implemented and adapted

for strategic environmental strategies – for example Total Quality Management (Waddock and Bodwell, 2007), Balanced Scorecard (Figge et al., 2008; Länsiluoto and Järvenpää, 2008), SWOT (Ketola, 2005), Maslow's Hierarchy of Needs (Tuzzolino and Armandi, 1981), and 7-S framework (Ketola, 1992). If firms treat environmental strategies as part of their normal corporate strategies it is worthwhile to build them on traditional management theories and models, however another option is to make the environmental strategy the corporate strategy (Ketola, 2005, 2007).

Even thought plenty of literature has dealt with strategies within the field of CR and environmental responsibility, a more holistic classification that presents alternative strategy approaches is missing. The purpose of this chapter is to introduce the reader into the literature by describing the two and alternative strategy approaches, namely instrumental strategy and awareness strategy. The chapter presents the characteristics and differences of the approaches to serve the needs of young scholars in the academia to position their CR research in the expanding body of literature. For practitioners the classification is relevant as many business pundits struggle conceptualizing what kind of environmental strategy they currently have and how it could be developed in order to meet the needs of the present without compromising the ability of future generations to meet their own needs. Throughout the text a "means-end" analysis is utilized to highlight the differences on these two dissected strategy approaches. The focus of the chapter is on the strategic activity to provide a framework for operational, more specific and contextual CR activity (cf. Dahlsrud, 2008, Halme et al., 2009).

This framework for strategic environmental management consists of the same pillars as the holistic corporate responsibility model that integrates firm's values, discourses and actions (Ketola, 2008a). Each of these pillars is dissected in separate subchapters and can therefore be read in random order and separately for current interests. The Sect. 8.2 discusses the *values* and ethics of firms as they are they are the core of activity. The Sect. 8.3 concentrates on firms' (strategic) *actions*, as they should be in line with the values and come chronologically before the marketing communication. In the Sect. 8.4, *words* and discourses are considered with an emphasizing on corporate image and identity.

8.2 Environmental Values

Values are the core of activity. In practice the definition of the concept can be seen as 2-fold:

1. What is the monetary value of something = economic value and
2. What is perceived important, good and moral = ethical value (Ketola, 2005).

But because not all people perceive same things important, the concept of ethical value does not have a single, explicit definition. For example, for some people

the ethical value is the economic value as they perceive money as important, good and moral (Ketola, 2005). In the corporate context the definition for value is often rather clear, whether you call it a euro, dollar, Yuan or squirrel skin (was used for exchange of goods back in the days). The economic value orientation is so strong in the business-life that it is often a synonym for value. Let's take the value chain analysis (Porter, 1985) as an example. In this strategic tool, the value adding activities are traditionally analyzed merely on monetary terms. Some analyses consider a longer time horizon than others (see Porter and Kramer, 2006) and therefore seem as decisions that would be based on other than economic value or economic competitiveness. Seldom are firms conducting ethical value chain analyses that dissect the firm's activities based on the ethical value – *what is perceived important, good and moral*. This could be due to controversy about what is perceived important, good and moral within the firm.

The term *corporate/business ethics* has been around for a quite some time and is still used rather extensively among practitioners and academics. For some it is a synonym for corporate (social) responsibility, whereas some aim at making a managerial synthesis of the concept (Lewis, 1985) or a unified conception (Donaldson and Dunfee, 1994). The often dichotomous nature of corporate ethics contrasts polarized utilitarian (cf. Mill, 1861) and duty (cf. Kant, 1785) ethics approaches, in which the preceding approach describes corporate reality much better than the latter (Ketola, 2008b). However, the current discussion has neglected virtue ethics (von Wright 1997, cf. Aristotle, 348 B.C.) that could provide a practicable value basis for businesses (Ketola, 2008b). In the context of *corporate sustainability and responsibility*, values can be classified in accordance with the Triple Bottom Line (TBL) approach (Elkington, 1997) as depicted in Table 8.1. As the focus of this chapter is on *environmental* strategies, the *bio*-centric values are dissected in detail.

It has been proposed that "there is a tendency in corporations for greening to be accompanied by a process of amoralization, i.e. a lack of moral meaning and significance for organization members in relation to the natural environment" (Crane, 2000). This supports the claim that environmental values are not really embedded within firms but only adopted due to external stakeholder pressures. On the other hand, it has also been proposed that these myths of amoralization are breaking down (Kujala, 2001). This supports the claim that environmental values are embedded in firms and not merely discourses due to external pressure to do so. It is of course impossible to prove that it is one way or another but the taboo of amoral business still awaits more serious debate (Kallio, 2007).

Table 8.1 Values related to TBL and CR (adapted from Ketola, 2005, 2008)

Type of values	Triple bottom line (TBL)	Corporate responsibility (CR)
Biocentric	Planet	Environmental responsibility
Anthropocentric	People	Socio-cultural responsibility
Plutocentric	Profit	Economic responsibility

As there are different ideologies behind environmental actions (Takala, 1989, 1996), there are also different types and approaches to values. Firms that have not really embedded bio-centric values in their corporate culture use the values as a communication tool for their stakeholders. These firms have *bio-centric values as means to achieve plutocentric ends*. An example for this can be taken from Sampo Group, a corporation with its main business areas in insurance and investment activities. "Sampo Group is aware of its corporate responsibility and is committed to developing its operations to further economic, social and environmental sustainability" (Sampo, 2009). However, as "Sampo Group aims at anticipating changes in society and the capital market, and adapting its operations to these changes" (Sampo, 2009), the environmental values seem to be merely an instrument to maximise shareholders economic value. In addition, in the spirit of Milton Friedman Sampo's distinguished board member Björn Wahlroos states that ". . . the mission of companies is merely to yield capital for their owners" (Talouselämä, 2008) and the firm breaks the law if it thinks anything else than shareholder's benefit (Tekniikka and Talous 2008) – the values do not seem to be based at least on virtue ethics, nor duty ethics. This is an example of the instrumental approach (as the values are an instrument), in which the values are based on utilitarian. But not only Sampo Group has plutocentric values as their ends, in fact most of the companies and banks follow the exactly same pattern of instrumental use of bio- and anthropocentric values as the recent credit crisis witnessed. Their actions refer to values based on utilitarian, if ethics at all.

However, as mentioned, not all firms have instrumental approach to values. Firms that have embedded bio-centric and/or anthropocentric values in their corporate culture perceive these values as ends (something to strive for). An example for this can be taken from Grameen Bank, a bank with its main business areas in micro-credits. This bank "has reversed conventional banking practice by removing the need for collateral and created a banking system based on mutual trust, accountability, participation and creativity" (Grameen, 2010). The business idea of "banking for the poor" seems to have an anthropocentric value proposition per se. The founder of the bank, Professor Muhammad Yunus has been awarded with numerous medals and also Nobel Peace Prize in 2006. He explained that the access to micro-credit brings out the potential in human beings, the ability to care for themselves (The Washington Times, 1999). The founder's mission to create a world without poverty (Yunus, 2008) does not refer to utility as the main drivers of this bank's business. In this case the anthropocentric values are ends, instead of means. This approach to environmental strategy is the awareness strategy, in which the values are based on virtue and duty ethics.

8.3 Environmental Actions

The plethora of actions taking place on different system levels within firms are aimed at different objectives. Strategic activity is aimed at strategic objectives and operational activity is aimed at operational objectives, which both should be in line

with the mission, vision and values of the firm. As the focus of the chapter is on environmental strategy, the stress is on the strategic actions that relate to environmental responsibility. But before diving into the literature of *strategic environmental activity*, general environmental issues and actions are addressed.

Environmental actions or inactions have both local and global effects. Companies, and individuals within them, face a myriad of environmental issues that require decision making. These environmental concerns may relate e.g. to climate change, eutrophication, acidity, diminishing biodiversity, ozone depletion, natural resource depletion, pollution, emissions, noise, light, waste reduction, packing materials, product disposability, usage of renewable energy, recycling, conservation of raw materials, logging roads, usage of chemicals, animal testing, personnel transportation, logistics, production emissions or energy consumption. With these current environmental issues firms can align their environmental actions accordingly. However, firms' approaches and strategies differ widely on how they address these environmental issues. Even today, the most common environmental strategy is the compliance approach that cannot even be categorised as strategic activity. If the firm has no interest in environmental concerns what so ever – its actions are likely to be *passive* towards environmental issues. Reasons for passive actions are diverse but often relate lack of motivation due to unwillingness to change, lack of information, denial or inability to find benefits or meaning from environmental consideration. A passive firm acts merely on direct economic objectives and lacks environmental and socio-cultural objectives. Being so, environmental responsibility is not seen as an important or strategic issue. The predominant perception that firms' economic activity is on total crash course with the protection of the environment has evolved somewhat, and currently environmental considerations have become a fundamental part of business practices (Giménez Leal et al., 2003) – at least in smart and wise enterprises.

8.3.1 Reactive and Proactive Actions: Instrumental Approach

As environmental responsibility is often defined as action that goes beyond the level compliance, it can be considered voluntary. "A voluntary environmental strategy represents a consistent pattern of company actions taken to reduce the environmental impact of operations, not to fulfil environmental regulations or to conform to standard practices. Rather, according to strategic choice theory, such actions would be the product of a wide range of organizational and managerial choice" (Sharma, 2000). If the firm is responsive to external pressures that relate to taking the environment into consideration – its strategic activities can be considered as *reactive* towards environmental issues. By external is meant the external stakeholders that can be for example customers, suppliers, vendors, non-governmental organizations (NGOs) or even media. Reactive actions are a response to stakeholder demand. This demand can be communicated to the firm through customer questionnaires,

supplier-vendors' contract terms, industry standards, NGOs' pressure, or negative media coverage. The reactive firm then reacts to these direct demand signals and aims at maintaining its competitive advantage with a reactive environmental strategy (Heikkurinen, 2010). But if the demand pushes the firm to react as its only lifeline, can it be considered voluntary? Be that as it may, it is important that there is a change in the way environmental problem is viewed and hence firms should strive to progress along the continuum of corporate environmental strategies towards a proactive and really voluntary environmental strategy (Agarwala, 2005). In a *proactive* environmental strategy the firm anticipates the external signals mentioned above, foresees the problems that may occur and acts based on the expected demand. These firms act largely as a result of consumer pressure and to a lesser extent by public pressure groups (Piacentini et al., 2000).

While reactive or passive firms tend to have a more inward looking, sales oriented approach to their business, the proactive firms recognise the benefits of being perceived as a responsible company (Piacentini et al., 2000). Especially this separates proactive actions from reactive actions. In addition, on the proactive level of environmental actions firms aim at enhancing their competitive advantage with CR, whereas on the reactive level they merely aim at maintaining their competitive advantage (Heikkurinen, 2010). Hence the proactive actions refer to a more sensitively responsive strategy approach than reactive. The managerial implications of proactive strategies are to identify environmental situations, to investigate actual and potential changes in environmental stakeholders and issues and to develop strategic environmental responses to current situations (Starik et al., 1996). As firms are anticipating the rise of demand for environmental responsibility, the stakeholder dialogue enables the firm to time its responsibility actions right. Hence timing becomes vital in executing the strategy successfully.

In the CR literature the *reactive versus proactive* strategy discussion has received notable attention (inter alia Sharma and Vredenburg, 1998; Sharma, 2000; Nicholls, 2002; Winsemius and Guntram, 2002). The developed typologies of these two strategic postures regarding to natural environment are based on making distinctions along the continuum ranging from the most reactive to the most proactive postures (Aragón-Correra, 1998). Instead of focusing on the effects on the natural environment, most of the studies are focusing on the effects on the firm's financial performance (e.g. Klassen and Laughlin 1996; Wagner and Schaltegger, 2004) and hence the reactive and proactive strategies approach environmental issues from an *instrumental* point of view. Environmental actions are an instrument for profit maximization. Many of the studies dissect the relationship between environmental and economic performance, and the environmental strategy posture is based on the economic utility it can deliver. These approaches have a high reference to corporate values based on utilitarian ethics.

"The positive effects of proactivity on the development of natural environmental approaches (both preventive and corrective) define a new area of possible competitive advantage. This competitive advantage will result in consistency among strategic proactivity, approaches to the natural environment and other

organizational characteristics (such as contextual, structural, and strategic factors)" (Aragón-Correa, 1998). The reason why "firms in high-impact industries (chemicals, utilities, and pharmaceutical) seem to have integrated environmental issues into strategic actions to a greater extent than other firms" is the stricter legislation impacts that these firms confront (Banerjee, 2001, p. 42, also Peng, 2006) and arguably a greater stakeholder pressure. "While smaller firms are less likely to undertake as many proactive environmental practices as larger firms, they are more responsive to perceived pressures from value chain, internal, and regulatory stakeholders" (Darnall et al., 2009). In order for firms to shift from passive, reactive and proactive levels to an empirically significant, higher level of proactiveness, several simultaneous improvements in various resource domains are required (Buysse and Verbeke, 2002). These higher levels of proactiveness are presented next.

8.3.2 Entrepreneurial and Creative Actions: Awareness Approach

The higher levels of proactiveness are here based on Ansoff and McDonnell's (1990) work on "Matching Triplets". These identified levels of strategic aggressiveness – stable, reactive, anticipatory, entrepreneurial, creative – (Ansoff and McDonnell, 1990) have been adapted and applied to environmental strategies (Ketola, 1992, 1993, 1996, 2007). The range of strategies essentially tends to move from resistance to compliance (passive) to pre-emptive strategies (reactive/proactive actions) and to innovation (entrepreneurial and creative actions) (Banerjee, 2001). In this context, *entrepreneurial* actions refer to firms that seek new business opportunities from environmental responsibility with a competitive aim to detect new competitive advantage (Heikkurinen, 2010). The interest in entrepreneurial environmental strategy comes from the internal stakeholders (e.g. entrepreneur, owners, employees, managers).

If the firm's actions to environmental concerns are innovative – the strategy can be called as a *creative* environmental strategy (Heikkurinen, 2010). These firms' environmental strategies aim at creating entirely novel ways of doing business (Ketola, 2005, 2008c) and create new competitive advantage (Heikkurinen, 2010) by crafting a strategy that redefines the old business environment (cf. Kim and Mauborgne, 2009). An example for the is Scandic, the Nordic region's leading hotel chain and winner of numerous responsibility prizes and accolades (e.g. the SKD Euroconfs Miljöpris, IMEX Green Meetings Award, Global Tourism For Tomorrow Award, Best CSR Programme, The Sustainability Award, and the Best Environmental Work). When Scandic's Roland Nilsson and rest of the management team came up with the idea of CR in early nineties, demand for CR in Sweden did not exist. The environmental actions can be considered entrepreneurial and creative since CR was not driven by external stakeholders (e.g. customers, suppliers, guests) as it is increasingly today. "No company can avoid taking responsibility for the environment and focusing on environmental issues. Scandic shall, therefore, lead the way and work continuously to promote both a reduction in our environmental

impact, and a better environment. Our goal is to be one of the most environmentally friendly companies in the hotel industry and to conduct our business on nature's terms" (The Natural Step, 2009). Actions over reactive and proactive strategies are not associated with a rising importance of environmental regulations (Buysse and Verbeke, 2002) thereby suggesting a truly voluntary cooperation between firms and the natural environment. "Managers should realize that the adoption of a few environmental practices or a proactive environmental approach for a limited period of time will not necessarily lead to competitive advantage" (Aragón-Correa and Sharma, 2003). Rather, it is important to adopt a long-term, consistent strategy that fosters:

(a) continuous outside-in learning from multiple stakeholders, so as to reduce the complexity and state uncertainty of conflicting environmental issues;
(b) development of managerial and organizational knowledge for managing the organization and effect uncertainty at the business-natural environment interface; and
(c) generation of continuous improvement and innovation (Aragón-Correa and Sharma, 2003).

In the entrepreneurial and creative CR actions the emphasis is on the generation of creative business models and communicating the solutions from the firm to the stakeholders (inside-out). And in this era of dynamic competition, it is possible for companies to find innovative solutions to environmental problems and meet the environmental challenge (Agarwala, 2005). But in the CR literature the "entrepreneurial and creative" strategy discussion has been in outnumbered by the responsive (reactive and proactive) instrumental strategy discussion.

In Gago and Antolín's (2004) classification on environmental strategic options over reactive and proactive levels were, namely: hyperactive by Ford (1992), leading edge by Roome (1992), innovative by Schot (1992) and Newman (1993), innovator by Steger (1993), and strategic by Vastag et al. (1996). Hart (1995) proposed "a natural-resource-based view of the firm, based upon the firm's relationship to the natural environment". This is in line with the sustainability ideology presented in the beginning of the chapter suggesting a wider perception of stakeholders (Starik, 1995; Stead and Stead, 2000; Ketola, 2005; Haigh and Griffiths, 2007). Emergence of this new more environmentally-focused approach, in which firms are more aware of the environmental issues and act beyond responsive, is called the awareness approach. In the higher level of proactiveness the environmental issues are addressed and perceived as ends of action, whereas in the instrumental approach they are perceived as means. Passive, reactive, proactive, entrepreneurial and creative CR actions' characteristics are summarized in Table 8.2.

The managerial implications of entrepreneurial and creative strategies are that if the firms are impacted by environmental pressures more significantly than others, then they need to be more proactive in their response to environmental issues (Banerjee, 2001). Hence the firms that have the greatest impact on the environment need to be more entrepreneurial and creative in their actions to environmental

Table 8.2 CR actions' characteristics (adopted from Ketola, 1992; Ketola, 2005; Heikkurinen, 2010)

CR actions	Posture on CR demand	Competitive aim	Type of strategic activity
Passive	Complying with law	No competitive aim	Inactions
Reactive	Responding to CR demand	Maintaining competitive advantage	Instrumental actions (environment as means)
Proactive	Anticipating CR demand	Enhancing competitive advantage	
Entrepreneurial	Enhancing CR demand	Detecting new competitive advantage	Awareness actions (environment as ends)
Creative	Creating new CR demand	Creating new competitive advantage	

issues. "Strategic environmental alliances will not only help increase awareness in the industry but also help develop new environmental initiatives that can reduce the firm's overall environmental impact" (Banerjee, 2001). In addition, the possible opportunities for co-opetition should be explored as the competition is increasingly taking place between industries. When firms and chains act together, they can create a much larger and more valuable market than they ever could by working individually (Brandenburger and Nalebuff, 1996) and more value for the environment and society. Scandic's view was that by becoming perceived as a leader within CR they will also become more profitable. A hotel and corporate image are important factors, and maintain a relatively high score rating among loyal customers (Heung et al., 1996). Kandampully and Suhartanto (2000) suggested that "a desirable image leads to customer satisfaction and customer preference, while an undesirable image may lead to dissatisfaction". But how should one create a desirable, responsible image? This will be addressed next.

8.4 Environmental Words

Firms are increasingly establishing and communicating their CR agendas (Cleverdon and Griffin, 2008) as they have become more concerned about their image and reputation (Heikkurinen and Ketola, 2009). Also the number of CR rankings, reporting and measuring institutions is increasing (Morsing and Schultz, 2006) that aim at maximizing transparency and minimizing greenwash. Greenwashing can be defined as "any form of marketing or public relations that links a corporate, political, religious or non-profit organization to a positive association with environmental issues for an unsustainable product, service, or practice" (Sustainability Dictionary, 2010, cf. Greenpeace 2010).

Corporate image is often considered as an intangible asset related to marketing and financial performance (Miles and Covin, 2000) and increasingly firms recognize it an as intrinsic part of their competitive success (Gray and Balmer, 1998) and strategy. As a desirable image can have desirable outcomes, an environmentally

responsible image is seen valuable in some corporate contexts. Identity of an organization, or corporate identity, is underlying the shallower concept of corporate image (Ketola, 2008b) and is formed of by cognitions, emotions, and aesthetic appreciations of its members (Hatch and Schultz, 2004). Bendixen and Abratt (2007) defined the difference between corporate identity and corporate image in the following manner:

(a) Corporate image = what the firm is perceived to be, and
(b) Corporate identity = what the firm is.

Therefore, as corporate identity refers to unique characteristics of the firm that are embedded in the behaviour and members of organization (van Riel and Balmer, 1997) and managers and employees tend to act in ways that are consistent with corporate identity (Fombrun, 1996) – corporate image should be the outcome of corporate identity.

8.4.1 Image-Driven Discourses: Instrumental Approach

The dominant view in the literature of the corporate communication and public relations is the stakeholder or customer oriented paradigm. The academia has been studying corporate identity as a strategic tool since the 90 s (Bendixen and Abratt, 2007) and the communication literature stresses the role of interactive dialogue with external stakeholders aiming at *creating an image* that matches with current external stakeholders' expectations. These image-driven discourses are lucid especially in reactive and proactive strategies. In *image-driven discourses*, environmental image is seen as a *pragmatic tool* for companies to be perceived as environmentally friendly firms. The corporate identity is also seen as manageable and something that is affected by the external stakeholders' expectations. The Strathclyde Statement of International Corporate Identity Group (ICIG) demonstrates this:

> . . . by effectively managing its corporate identity an organization can build understanding and commitment among its diverse stakeholders. This can be manifested in an ability to attract and retain customers and employees, achieve strategic alliances, gain the support of financial markets and generate a sense of direction and purpose. Corporate identity is a strategic issue. Corporate identity differs from traditional brand marketing since it is concerned with all of an organization's stakeholders and the multi-faceted way in which an organization communicates (van Riel and Balmer, 1997).

But the problem with managing an identity is the myriad external stakeholders' expectations that differ not only between contexts but also hugely within contexts. A responsible identity is even more complicated to manage since it requires more socially, dialogically embedded kind of practices and greater levels of critical reflexivity (Balmer, Fukukawa and Gray, 2007). In addition, the business norms, standards, regulations, and stakeholder demands for CR can vary substantially across nations, regions, and lines of businesses (McWilliams et al., 2006).

8.4.2 Identity-Driven Discourses: Awareness Approach

An alternative that Heikkurinen and Ketola (2009) propose for corporate identity management is that "companies should switch from managing their identity to being it".

> Instead of having the focus only on the external changes and trends of the business environment, such as stakeholders, this awareness approach concentrates on defining *what the firm is* without being dependent on external pressures or the lack of them. An example of an external pressure is customer demand for environmentally friendly products and services. An example of a lack in external pressure occurs in a situation when laws of societies allow insufficient waste handling (developing countries) (Heikkurinen and Ketola, 2009).

In the case of environmental responsibility the lack of demand for environmentalism on behalf of external stakeholders can create vast environmental problems. For example, a European based multinational company that begins to operate in the heart of Africa may not face any external stakeholder expectations to consider environmental issues. Governments, local customers, media and vendors in developing countries may prefer economic wealth over responsible business. Therefore, merely adapting an identity that meets the contextual stakeholder needs may result in environmental irresponsibility. If the firm does not create its image and identity based on external stakeholder expectations but adapts a responsible identity – it can operate responsibly in all contexts. Firms with *identity-driven discourses* also communicate actively with their stakeholders but emphasis is also placed on the inside-out communication that raises the environmental awareness among external stakeholders. They do not only receive impulses of demand for responsible business but send them to *create demand*. The aim of the communication is to increase environmental awareness among its stakeholders and hence detect and create new business opportunities for greener business (entrepreneurial and creative actions).

The form (or nature) of the communication is slightly different from image-driven discourses, in line with Pruzan's (2001) two complementary perspectives to corporate reputation and its relationship to success and credibility. These forms of communication are:

(a) Image-driven discourses, what Pruzan (2001) refers pragmatic, are based on financial rationality and it focuses on traditional notions of corporate success.
(b) Identity-driven discourses, what Pruzan (2001) refers reflective, employs a broader repertoire of measures of corporate success and focuses on organizational identity rather than the corporate image. This reflective perspective is more concerned with the inherent character of the organization, instead of the outer appearance.

As identity is abstract and multiform in its nature, concrete and practical examples are difficult to lie down. "In business literature, as well as in psychology, the definition of identity has been problematic" (Heikkurinen and Ketola, 2009) and therefore more case studies that dissect the differences between pragmatic and reflected communication are propounded. As managerial implication the following can be stated.

Considering the primarily *external image orientation* of the pragmatic perspective with the *internal identity perspective* can lead to increased corporate self-awareness; improved capability for reflecting on corporate identity; and to more realistic methods for measuring, evaluating, and reporting on the firm's impact on its stakeholders as a whole (Pruzan, 2001). As he suggests a combination of these perspectives, Heikkurinen and Ketola (2009) suggest on focusing on the latter one. (Sharma, 2000) suggests that "Managers who perceive environmental protection as an integral part of their corporation's identity may not need formal controls and incentives to act accordingly". Hence the endogenous, responsible corporate identities' constant auditing and management decreases. The management and dialogue with stakeholder can easily also become bottomless pits for corporate resources (Heikkurinen and Ketola, 2009) as for example surveying is difficult to saturate (Morsing and Schultz, 2006). The *identity-driven discourses* can then allow applying the managerial time and resources of strategic leaders to creative problem solving (Sharma, 2000; Heikkurinen and Ketola, 2009).

8.5 Conclusion

Plenty of literature has dealt with environmental and CR strategies, however a more holistic classification is missing. This chapter overviewed the environmental strategy literature based on three pillars: corporate values, actions and words by detecting two alternative strategy approaches, namely instrumental strategy and awareness strategy.

Throughout the text a "means-end" analysis was utilized to highlight the differences on how do these strategy approaches differ. Values based on *utilitarian passive/reactive/proactive actions; and pragmatic/image-driven discourses* all characterize the instrumental strategy (Table 8.3). This *instrumental environmental strategy* seems to belong to Freeman's (1984) ideological camp, as it is more responsive to the concerns of managers caused by unprecedented levels of environmental turbulence and change, than shareholder oriented passiveness (Freeman and McVea, 2005). The optimal amount of responsibility corresponds with the demand for responsibility, i.e. "as little as possible". Values based on *virtue and duty ethics;*

Table 8.3 Alternative approaches to environmental strategy

	Instrumental approach	Awareness approach
Values	Virtue ethics, biocentric values as ends	Utilitarian and duty ethics, biocentric values as means
Actions	Reactive and proactive actions, environmental actions as means	Entrepreneurial and creative actions, environmental actions as ends
Words	Pragmatic image, environmental image as means	Reflected image, environmental identity as means

entrepreneurial/creative actions; and reflective/identity-driven discourses all characterize the awareness strategy (Table 8.3). This *awareness environmental strategy* seems to belong to the emerging camp of sustainable economics, as it continues the evolution of merging natural environment and business environment together. In the instrumental strategy the environmental responsibility is mainly a managerial tool to achieve economic gains, whereas in the awareness strategy the environmental responsibility is a tool to achieve environmental sustainability. The optimal amount of responsibility is the maximal supply of responsibility, i.e. "as much as possible". Therefore the awareness strategy can be seen to maximise the contribution to sustainability. As a managerial implication for firms that aim at sustainable development, the environmental strategy should be in line with the awareness approach instead of the instrumental approach.

What are the concrete managerial implications? For creating an environmental strategy, this chapter suggests that business leaders and managers first adopt shared environmental values within the company. This enables the firm to then act and communicate its actions accordingly without being accused of greenwashing. After adopting the environmental values, actions and words in the single firm system level, the next challenge is to align them on the supply chain system level. In order to have a successful environmental strategy *values, actions and words* must be aligned, and therefore it is vital that managers, leaders and academics identify the strategy approach at issue. Alignment of *values, actions and words* enhances immunity to errors as the mismatch is likely to affect corporate success negatively (Ketola 2006, 2008b). For maintaining and enhancing competitive advantage, the instrumental strategy is propounded, whereas for detecting and creating new competitive advantage, the awareness strategy is propounded.

But why is it relevant to compare the two strategy approaches? The classification serves the needs academia by emphasizing the plethora of research regarding the instrumental approach and addressing the lack of research regarding the awareness approach. As a great share of research has examined the instrumental approach, the awareness approach offers new research avenues and artless grounds for multidisciplinary studies. For young scholars, the classification delivers an overview of the research in the field at issue (i.e. the big picture that is often difficult to outline) and helping them to position their CR research in the expanding body of literature – hopefully resulting as new research gap identification. The rather extensive needs of the practitioners are partly served by providing tools to conceptualizing what kind of environmental strategy they currently posses and how it could be developed in order to meet the needs of the future generations.

But do we need the awareness approach? In studying organizations (often people) ethical and political issues cannot be overlooked (Grey, 2005). The move toward environmental sustainability requires an overall value reorientation of both society and corporations, from the current economic rationality to a broader ecological rationality that will focus on long-term survival of the earth (Shrivastava, 1995). The instrumental strategies seem to lead and continue a "responsibility stalemate" (cf. Porter and van der Linde, 1995), as companies wait for stakeholder CR demand to rise and stakeholders wait for companies' CR supply to develop. The loser in this

lull is the natural environment. The awareness strategy suggests companies to aim at creative problem solving and ending the stalemate by starting to supply stakeholders with wider selection of green products and services, easier and more informative environmental solutions. Not only is it a necessity for the environment but also a new business opportunity to detect and create new competitive advantage. The focus of the chapter was on the strategic activity that insures that the firm does the right thing providing a framework for more specific and contextual strategic and operational activity insuring that the right thing is done right.

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Part III
Corporate and Social Responsibility

Chapter 9
Labour Issues and Corporate Social Responsibility

Richard Ennals

Abstract Corporate Social Responsibility initiatives, of diverse kinds, address the gap between current practice and what is seen as more appropriate conduct by companies. The theory and practice of CSR is linked to how companies are defined, and the diverse legal contexts in which they operate, which effectively determine the scope for market forces. The employment relationship is at the heart of company operations, as well as of working life, and is undergoing radical change. Globalisation is having a major impact on labour issues, casting new light on human rights, and the role of migrant workers. Companies may choose to exclude labour issues from their model of CSR, but may thus operate outside the law of many countries, and forfeit their credibility. The pressure of international information, and the fear of exposure, can influence corporate practice. If business is to have a "human face", CSR must address labour issues, including migrant workers and human rights. If sustainable improvement is to be made, new forms of work organisation must be embraced. The way ahead is seen in terms of creating collaborative advantage, both internally and externally.

9.1 Out of the Crisis

Handling the core employment relationship has radical implications for companies, and for what they then may regard as CSR. Should we assume an inherent division between employees and managers (who are themselves employees)? Alternatively, can we envisage partnership, "dancing" rather than "boxing" (Huzzard et al., 2004)? Perhaps this requires a context of relative social equality (Wilkinson, 1996; Marmot and Wilkinson, 1999; Marmot, 2004). This challenges assumptions about the operations of business, and the place of CSR.

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It is often assumed that the prime responsibility of company directors is to maximise shareholder value (Friedman, 1962). Much is made of the importance of market forces. We sometimes overlook the fact that markets are man-made, resulting from government decisions and legislation. There is no magic "invisible hand" behind the working of the market system, as was conceded by former chairman of the Federal Research Board, Alan Greenspan (2008). When companies, including banks, fail, there is often a continued unstated assumption that the state will intervene, and bear the risk. It turns out that private sector Corporate Responsibility has limits.

Fundamental questions for business arise afresh in the context of the Global Economic Crisis (Cable, 2009; Green, 2009). The international financial system, long dominated by the USA and UK, collapsed (Hare, 2009). The impact has spread to the "real economy", where most people are employed. Companies which failed to tackle their growing business problems themselves, such as General Motors, sought bankruptcy protection, or fell under government ownership. Even iconic national and international status has not saved them from disaster. New graduates face likely prolonged unemployment in advance of their first engagement in working life.

While the capitalist system appeared to be working smoothly, there was growing concern to develop good practice in CSR (Elkington, 1998; Henriques, 2005), which involved management going beyond minimum legal requirements, in the cause of developing "Capitalism with a Human Face". The CSR movement built on earlier work on Business Ethics, which addressed the individual manager, but arguably lacked a hard critical edge (Foster-Back, 2005). It was a timely voluntarist substitute for substantive reform, which was seen by employers as staving off pressure for legislation. It enabled some gaps to be filled, in a piecemeal manner, between where we are, and where we would like to be.

For many companies, this is a defining moment. Companies which had previously prided themselves on their reputation for CSR, such as Enron (Prebble, 2009), have already collapsed, as their business model was based on fraud, but their conduct had not been challenged by directors, auditors, accountants or lawyers. The functions of auditors and other consultants are under scrutiny. They appear to have neglected what others had thought were their responsibilities.

We have to be careful in our interpretation of consultancy advice. There may be more than meets the eye. McKinsey were co-designers, with Andersen, of the Enron business model, advising on the handling of off balance sheet activities, which enabled a positive picture to be given to prospective customers. The same team designed the framework for the Private Finance Initiative in the UK. This enabled major public services expenditure to proceed, in areas such as education, health and prisons, without taxes being raised. McKinsey continue to advice on reductions in public expenditure.

CSR needs to be more than virtual reality. In recent research for EABIS, McKinsey (2008) argued that CSR, in order to be sustainable, needs to impact on the culture and strategy of the organisation. Rather than being an optional extra, taking the form of corporate philanthropy, CSR should be a source of corporate rejuvenation and growth, enabling the organisation to take on new inputs, to learn

and develop. On this basis, CSR is not dispensable, suitable for abandonment in hard times. It is a vital ingredient for the future, drawing on external inspiration, enabling organisational learning, and helping to steer core strategy. It may be seen as integral to innovation (Josendal and Ennals, 2009).

9.2 Labour

Key questions need to be asked about labour issues, with major implications for CSR. This is at a time when Industrial Relations or Employment Relations no longer takes a major role in public or private policy. Answers will vary.

The labour of employees typically constitutes one of the highest costs for companies. How is that to be handled, especially in difficult times? Is this properly a matter for law and regulations (Donovan, 1968)? This raises major questions concerning the current situation, and the future of employment relations (Monks, 2008). Are there to be restrictions on the capacity of managers to manage, or is the issue of employment relations now generally regarded as falling within the area of management discretion?

Are workers entitled to be members of trade unions, and recognised by employers, for collective bargaining and employment rights? Does it make sense for employers who refuse to recognise trade unions to be able to declare themselves committed to CSR? Note the position of Body Shop, who were proud of their reputation on environmental and social responsibility, but refused to recognise trade unions, despite ILO conventions. Are companies entitled to choose their own definitions? The result may be confusion, as with food labelling.

Should we talk in terms of "Human Resource Management" rather than "Industrial Relations"? Is "flexibility" in the labour market to be defined by managers, and interpreted as adaptation by workers to the needs of employers? What happens when employment is not covered by a written contract? Should the role of government be minimised, removing layers of "red tape"? What should be the place of law, including European law? Is ignorance an acceptable defence for a corporate failure to comply with legal obligations?

How do we deal with the circumstances of Small and Medium Sized Enterprises, which are now the dominant form of work organisation, and find it difficult to stay abreast of legal changes? Does it make sense to look at regional structures, in which SMEs participate, and to examine their roles in programmes of regional development? Should we be considering CSR in networks, development coalitions (Ennals and Gustavsen, 1999) and clusters (Porter, 1990; Porter and Kramer, 2006)?

9.3 Competition and Collaboration

Such issues may be seen as posing challenges for governments, rather than for companies, and thus not raising problematic issues for CSR. If we choose to see the

key function of the corporation primarily in terms of maximising shareholder value (Friedman, 1970), we may manage to avoid the consideration of labour issues, and the role of organised labour, with associated trade union rights. We can focus on pursuing "competitive advantage", looking externally, and disregarding more local issues of working life.

The EABIS Colloquium in 2008 moved away from CSR, and adopted a narrower focus on Corporate Responsibility. This was interpreted n terms of more general environmental concern, and engagement in efforts to combat climate change (Gore, 2006; Porritt, 2007; Stern, 2006), thus avoiding discussion of sensitive "social" issues more directly concerning the business.

Alternatively, we may wish to see companies as engaged in creating "collaborative advantage", working with others to build social capital, achieve critical mass, and engage in sustainable development. With that perspective on corporate strategy, work organisation within and between enterprises becomes of central importance. CSR is not a separate element, but integral to organisational culture and strategy.

9.4 Anglo-Saxon Economies

There is a problem of language: in the EU Employment and Social Policy focus on working life. In the USA and UK, "social responsibility" has been more concerned with optional corporate philanthropy. In the USA and the UK, it has been common to identify a separate set of optional additional activities by companies, beyond what is required by law, and to place them in the public eye, under the management of public relations staff. Employers may have chosen not to recognise trade unions.

Thus supermarkets such as Tesco and Sainsbury have schemes to collect vouchers for schools, which can be used to pay for computers and sports equipment, complementing inadequate core public funding. At the same time, the companies may wish to avoid detailed discussion of their own employment policies, including outsourcing and off-shoring, which may involve dubious labour practices and low pay.

In the UK, private sector employers have been given prominence in the foundation of new City Academy Schools (Asavaroengchai, 2009). Nominally the companies make generous contributions to school funds, but in practice all such costs are often met ultimately by government, whose prime motivation has been to remove the new schools from the democratic control of local education authorities. Companies have been co-opted by government, while purporting to be providing a lead from the private sector.

9.5 European Union

What are the legal obligations of companies? Do we have to consider more than national legislation? In the European Union, which has taken various institutional

forms since the European Iron and Steel Community, and has included the UK since 1973, the legal starting point is different. There is a basis of Directives which, according to treaties, have to be transposed into the laws of member states. These laws cover companies based or trading in the European Union, including transnational companies. Employers are required to inform and consult employees in advance of major restructuring and down-sizing. European Employment and Social Policy gives a central place to Social Partnership and Social Dialogue. This assumes recognition of trade unions, in line with ILO conventions, and engagement in dialogue at company, regional, national and European levels. Corporate Social Responsibility thus constitutes a set of legal obligations, and a set of institutional frameworks.

On this basis, the European Framework Directive of 1989 (Walters, 2002; Ennals, 2000) sets out clear responsibilities of employers with regard to risk assessment, health and safety in the workplace, and the provision of necessary specialist services, such as occupational health (Rantanen et al., 2002; Elgstrand and Petersson, 2009). These represent legal obligations for the employer, and rights for the workers. Disputes continue with the UK, where traditions of voluntarism have been maintained, and employers are required to meet the European requirements only "in so far as is reasonably practicable". This is generally interpreted by employers as meaning that measures are optional if they involve significant financial expenditure.

The European Social Dialogue has brought about agreements and regulations covering many important areas of working life, including part-time working, parental leave, tele-working, work – related stress (Levi and Levi, 2000; Levi 2002, 2005; Cooper 2005). It has included the development and implementation of the Working Time Directive, for which the UK has continued to demand an opt-out. The outcome is that many employers, and government, choose to disregard EU Directives which, under treaty, have power in national law. Instead, the tradition has been to leave such matters to the discretion of employers. It has been popular to talk of "Work Life Balance", rather than complying with the Working Time Directive.

In Germany there have been strong arguments for extending the social responsibilities of employers. Where workers have been downsized, through major restructuring, it is maintained that the employers have the obligation to maintain the employability of their former employees, so that they are ready for economic recovery.

European Employment and Social Policy has pioneered an approach to policy development and implementation, known as "the Open Method of Co-ordination" (Larsson, 1997, 1999; Zeitlin and Pochet, 2005). EU heads of government have agreed overall policy goals, such as "more and better jobs". National plans are produced annually, for comments by European Commission officials. Their comments will include references to good practice cases, encouraging "social benchmarking". As a result, and without the need to impose major new legislation, there should be advances in working conditions and CSR, attributable to "soft law" (Bruun and Bercusson, 2001a).

If this approach is to succeed, both public and private sector organisations need to participate, sharing experience. In the UK, neither public nor private sectors have

fully engaged in EU processes. Good practice has been left to individual voluntary initiatives. Such consistent disregard of the law might be regarded as corporately socially irresponsible.

The field of Discrimination highlights the problem (Ennals 2001). The EU Discrimination Directive of 2000, for the first time, brought together the treatment of a whole range of forms of discrimination, based on age, gender, sexual orientation, disability, ethnicity and religion. This was recognised (Bruun and Bercusson, 2001b) as requiring changes in both legislation and institutional structures in each member country. As with the earlier Framework Directive, debates tended to be at national level, with little reference to European level decisions and legislation. This has meant inconsistency in practice, and discussion of appropriate CSR approaches in an area which is covered by legislation.

The question is then what happens in practice in times of recession and depression, when companies feel unable to deliver on commitments, and may not comply with details of the law. There is an urgent need for detailed monitoring, research and publications (Exton, 2009; Brenner, 2009), as well as inspection and enforcement at national level. Within the EU there is a wealth of good practice experience, offering scope for social benchmarking on CSR as defined in European law.

9.6 Partnership

There have been many changes in policy in the UK since 1997, and the election of the Blair government, which had declared itself, committed to partnership working, and signed the European Social Chapter. Anomalies have continued, such as the UK opt-out from the Working Time Directive. In practice the government have maintained better communication with the employers than with the trade unions, and have not engaged in Social Dialogue.

Government has continued processes of privatisation. The Private Finance Initiative, under the pretext of bringing private finance to public services, has in fact merely increased the costs of those services. Cost savings have been achieved by transferring employment to private contractors, who may have maintained salary levels but tend to have reduced pensions. Employees have had to bear the costs of change. Complex arrangements have been put in place to protect the interests of government and private sector employers, at the ultimate expense of employees. CSR can be co-opted to comprise part of a smoke screen.

This chapter draws on the work of the UK Work Organisation Network, founded in 1998, which brings together trades unions, employers' organisations, universities, research organisations, and government departments as observers (www.ukwon.net). There has been extensive work in the UK, across the EU, and with international partners, including in Korea (Totterdill, 2009; Exton and Totterdill 2009).

A key theme has been the development of a "high road" route to productivity and innovation, actively engaging employees. Companies have been linked through networks, enabling good practice to be transferred. However, it has been all too

evident that during the same period managers in many companies have preferred the "low road", with downsizing and deskilling. The low road has offered short term savings.

With an increased focus on "knowledge industries" and the "creative economy", manufacturing employment has continued to decline. There has been limited recognition to date of how exposed employers are in areas of knowledge work. When experienced workers leave, their tacit knowledge goes with them (Göranzon and Josefson, 1988; Göranzon et al., 2006). This does not apply only to computer-based work and offices. In general, explicit knowledge is only the tip of the iceberg, and is easiest to manage. Draconian down-sizing can have terminal effects. To neglect responsibility for employees is to risk the collapse of the organisation.

The missing link in policy has been work organisation, within and between companies (Gustavsen, 1992; Ennals and Gustavsen, 1999) which tends to be overlooked when considering single companies and CSR. UKWON argues that the real issues are at the meso level between individual companies and governments. In many countries there is organised regional development (Gustavsen et al., 2007). This involves key roles for intermediaries (Walters, 2001, 2002).

9.7 Nations

It is all too easy to act as if CSR has had a single definition around the world (Idowu and Leal Filho, 2009). It can then be simple for senior managers, despite the globalised economy, to apply "CSR in One Country", and regard national boundaries as limiting our areas of concern. When companies proclaim their CSR credentials, they may implicitly be referring to their conduct at home, while their offshore activities may escape scrutiny. As NGOs and trade unions become more effective in monitoring practice and sharing information internationally, nationally based approaches and protectionism should face challenge. We can see the impact on companies such as Reebok (Ennals, 2007), who acknowledged and addressed problems in their employment practices in developing countries, having seen what had happened to Nike when their deficiencies were exposed.

Multinational companies have broken down some barriers between the separate national silos, by erecting management structures which transcend borders. They face the challenge of complying with the law in each country where they work. In the EU, for example, there is a requirement to operate European Works Councils, but the mechanisms for employee participation vary. In Germany the tradition has been to use elected representatives, while in Sweden participative democracy has been favoured (Fricke and Totterdill, 2004). In principle multinational companies could become a force for raising standards, but in practice mere perceived compliance is seen as adequate. In the UK, companies may employ consultants who assess the likelihood of inspection and enforcement, making financial provision for potential prosecution, while continuing their previous practices. It is not so much a matter of complying with the law, but of avoiding being found out not to have complied.

9.8 Migrant Workers

As we go beyond national borders, we encounter fresh challenges, which may not be addressed in the analysis of single companies or countries. In the global context there are far-reaching questions of CSR. In the rich developed world of Northern Europe, there can be labour shortages, even at a time of recession in many countries. In developing countries the shortage is of paid work. Migrant workers can be seen offering as a low cost solution to labour shortages, for example in Scandinavia where the workforce is ageing (Ilmarinen and Lehtinen, 2004; Hilsen and Ennals, 2005, 2009), or in the UK, where there has been a shortage of workers willing to undertake low paid jobs. However, migrant workers may lead to long-standing migrant minority communities, presenting problems of integration (Abrahamsson, 2001; Bruun and Bercusson, 2001a). At a time of recession and mass unemployment, there are dangers of protectionism, nationalism and racism.

With the Enlargement of the European Union in 2004, 10 new countries joined, followed by 2 more in 2007. Existing EU member countries took different decisions on labour mobility. The UK adopted an open door approach in 2004, with restrictions on the new entrants in 2007. Thus there was a vast inflow of migrant workers from across the EU, happy to accept low wage employment in the UK, and not making claims on welfare services. Many of these EU citizens are now returning home. Labour markets have been distorted, and there have been challenges of demographic change.

In addition, there has been a flow of asylum seekers, whose claims for asylum as refugees, under international human rights law, may be rejected if they are classified as economic migrants. Where asylum seekers are not legally allowed to work, in practice they may accept jobs at below the minimum wage. Such flows are by definition harder to control, and efforts are needed to monitor human rights issues (Clark and Williamson, 1996).

9.9 Human Rights

Going beyond the rights to information and consultation, as set out in European law, there is an existing international framework of human rights, set out in the 1948 Universal Declaration of Human Rights, and in conventions of the International Labour Organisation (ILO, 2000).

International human rights law is not automatically enforced through the national law of individual countries. Thus it is possible for companies to take a selective view of the law, and still to declare themselves good citizens. One valuable approach to CSR would, in principle, be a concerted approach, across the world, to enforce human rights in the workplace (Kathrani and Ennals, 2008). This could be seen as an extension of recent efforts on Fair Trade, which have impacted on consumer perceptions. It could be taken forward through the United Nations Global Compact (Solomon, 2009), created to help implement the Millennium Development Goals. Companies engaging in UNGC as part of their corporate strategy could derive long term collaborative advantage. This transformation has yet to be achieved.

We cannot disregard the fact that modern forms of slavery continue (Ennals, 2007), despite the existence of sets of ILO conventions, and campaigning by NGOs. Slaves have no control over their own work, and no opportunity to participate in decisions (Karasek and Theorell, 1990; Sen, 1999). They reflect a much broader spectrum of experience, with a lack of democracy in the workplace. How do companies and governments respond? Do they simply look the other way, taking the view that when purchasing the products of work, there is no need to investigate the conditions in which it has been conducted?

9.10 Alternatives

Discussions of CSR tend to avoid discussion of ownership by shareholders. We can assume that the current patterns of capitalism are permanent. There is reluctance to explore controversial issues of power, as it is seen as important to maintain company good will. It is easier to focus on surface level practices, reinforced by public relations, and to debate issues of corporate governance.

However, there is a long tradition of co-ownership and co-operation in the UK, linked to effective partnership arrangements. The seventeenth century Quaker economist John Bellers (Bellers, 1696) argued the case for co-ownership and social inclusion, maintaining that society needed the contributions of all of its members. Modern partnership companies, such as John Lewis Partnership, continue to be successful.

The values and concerns expressed by recent advocates of CSR are not new, and can be traced back to 1759, and “A Theory of Moral Sentiments” (Smith, 1759; Sen, 2009), the work by Adam Smith which provided moral underpinning for his later account of the foundations of capitalism in “The Wealth of Nations” in 1776 (Smith, 1776). As a philosopher of the Scottish Enlightenment, Smith identified moral foundations for business in terms of interpersonal relationships and obligations. Smith recognised the human consequences of the division of labour, and urged enlightened employers and managers to address human needs. Indeed, he warned of the dangers which result when managers act as if they were owners.

Arguably the approach taken by Adam Smith has been maintained as the core of the Scandinavian approach to business (Josendal and Ennals 2009; Johnsen, 2011). Where there is a general commitment to values of social equity, consensus, respect for work, and workplace participation, the implication of a stated commitment to CSR is that one is going even further. This is not merely a matter of compliance, but of taking a lead. There is a strong business case for socially responsible innovation (Ekman et al., 2010).

Scientific management, developed from ideas by Adam Smith, could place workers under excessive pressure. In Japan, Ishikawa (1990) introduced Quality Circles, intended to give workers ownership of their work and craft skills, empowering workers to make their own decisions.

Taken to logical conclusions, Quality Circles provide a bottom-up approach to managing organisations, with ideas from individuals identified, developed and

applied. This contrasts with a top-down approach to management, where managers may have little experience or understanding of the work and form of life of those they manage. Quality Circles are based on valuing skill, just as we now realise the consequences of failing to do so. They also provide an alternative model for education. Hutchins (2008) and Chapagain (2006) have played a leading role in adapting the approach to education, with Student Quality Circles.

It has often been assumed that developing countries are seeking to progress by emulating the achievements and methods of industrialised countries. This is becoming less straightforward, as the deficiencies of the Anglo-Saxon model become more apparent. Developing countries want wealth and autonomy, but they do not want to mimic hierarchy and inequality.

Amartya Sen (1999) took this argument further, maintaining that freedom and democracy are vital features of the workplace. As Joseph Stiglitz (2002, 2006) pointed out, freedom and democracy have not been leading characteristics of globalisation to date.

9.11 A Norwegian Case

We can take elements which have been introduced above, and sketch out a new configuration for business, and by implication, for business education. This is best illustrated through a practical case (Claussen et al., 2008; Haga, 2009).

In the Sunnhordland region of South Western Norway, an industrial network, largely comprising SMEs, was formed with support from Enterprise Development 2000, a programme supported by the labour market parties (employers and trade unions), engaging researchers as development actors. Many of the SMEs were partners with Aker Stord, engaged in the offshore oil industry. Learning habits of collaboration and networking enabled the SMEs to operate at the leading edge, which would not have been possible alone.

In the intervening years, many SMEs in the region have found it harder to maintain collaboration with major enterprises, for example in foundries and smelting. Pressures of global competition have led many enterprises to resort to off-shoring, in order to reduce costs. New owners have been less engaged in the region, and it has been difficult to recruit staff to work in remote areas.

Over the same period, Aker Stord have extended their global operations. For years they maintained loyalty to Norwegian SMEs, and to the Norwegian Model which gave a key role to trades unions. Staff have had a role in strategic development, with representation on the board, and an expectation of decent working conditions and wages fixed under local and national agreements.

As Aker Stord have increased their activities in Poland, and other countries such as Ukraine, where salary levels are much lower, they have encountered dilemmas, which we can describe in terms of Corporate Social Responsibility. They remain a Norwegian owned company, but they operate across national borders. Why should they not take advantage of cheaper sources of labour, and deal with migrant workers

in a cost effective manner? After all, they are working in a global market, facing international competition.

This could be seen as a crisis of conscience for the company and others in equivalent positions. After all their years of public adherence to the moral values which were seen as underpinning the Norwegian Model, are they going to change for reasons of cost alone? If they abandon the model, and fall in line with emerging international business practice, could such a decision ever be reversed? What price human rights?

The experience of Norwegian enterprises has been that they have been under constant pressure to innovate if they were to survive against global competition. They could not hope to compete on price, but could not become more expensive than the global competition. They learned to seek competitive edge, through continuous improvement and by radical change, brought about by new forms of work organisation (Claussen et al., 2008; Haga, 2009). Can it be argued that the Norwegian Model is more conducive to such innovative outcomes? If so, it could be foolhardy to change.

Aker developed the International Framework Agreement (Aker, 2008), signed with Norwegian and international trade unions in October 2008. It sets out principles to be applied in all parts of the growing international Aker operation, with solid explicit foundations in human rights, trade union rights and the Norwegian model of employment relations. Implementation around the world may not be straightforward, as contexts and cultures vary. Basing the Framework Agreement on the Universal Declaration of Human Rights, ILO Conventions (ILO, 2000, 2006) and OECD Guidelines does not in itself assure success. There needs to be reflection on early experience around the world, where a firm set of principles encounters different cultural contexts.

The next step may be engagement by Aker, and other interested companies, in the United Nations Global Compact (Solomon, 2009), which was established as a means of taking forward the Millennium Development Goals, agreed in 2000. The argument was that the United Nations comprises its members, not just governments but also civil society, including private and public sector organisations. UNGC should be a global development coalition, bringing together motivated partners who wish to learn from the experience of others, thus strengthening their own organisational culture and strategy. Partners would have recognised the case for coming together to create collaborative advantage. Aker could be well placed to take a leading role, given the global spread of offshore construction, and the need for the energy industry to develop sustainable relationships with local partners. Caulfield (2007) argued a similar case for BP Asia.

9.12 CSR and SMEs

In our Norwegian case we have presented a picture of business where the majority of enterprises are SMEs. Many may choose to derive collaborative advantage from

relationships with a major enterprise. This enables the SMEs to gain access to global markets, but also to the pressures of global competition. Thus SMEs are faced with issues, around CSR, which might have been thought to be the concern of major enterprises (Josendal and Ennals, 2009). They are operating across national borders, and there can be the temptation to lower standards, away from close scrutiny.

More generally, we must recognise the reality that SMEs are prevalent internationally, yet discussion of CSR tends to be in terms of large enterprises and MNCs, often in terms of optional activities beyond what is required by law. SMEs often relate to regions rather than to nation states, and increasingly they operate across borders. The question is whether the advantages of seeking collaborative advantage, and prioritising CSR in the workplace, outweigh any additional costs incurred (Johnsen, 2011).

Where cost savings are sought and derived by enterprises, they tend to be at the expense of the weakest members of society. The result is a wider power distance in the organisation, and adverse consequences of lower relative social status, seen in terms of individual and public health outcomes (Karasek and Theorell, 1990; Marmot, 2004). The evidence is overwhelming in quantity and quality, but it may not convince decision-makers, if their focus is on short term financial results.

9.13 Conclusion

We will not arrive at a single "best practice" approach to labour issues and CSR which can be applied across the world, in diverse business contexts. We have however focussed attention on the human dimension, considering employees as well as managers, in the context of their working lives, and placed less stress on financial engineering and the primacy of market forces. Rather than an exclusive concentration on "competitive advantage", we have explored the creation of "collaborative advantage", and have seen this as central to sustainable corporate strategy. CSR is not simply a matter of the external focus of an organisation. It starts internally, with relations between employers and workforce. It is a mechanism whereby the organisation can learn and grow.

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Chapter 10
Between Trust and CSR: The Role of Leadership

E. Isaac Mostovicz and Nada K. Kakabadse

Abstract The aim of Corporate Social Responsibility (CSR) is to restore one of the most critical resources for businesses' sustainability: trust. However, the current practice of CSR begs the question whether CSR initiatives restore trust or simply relieve mistrust in the marketplace. Because people do not really understand what trust implies, they often use CSR activities as publicity stunts, trying to please the public. In particular, they perceive trust as a means of supporting organisational activities rather than a goal of its own. Following Rabbi Elchanan Wasserman, we trust those who fully commit to their goals and are ready to take responsibility for all consequences. Trust is a voluntary and altruistic act and independent of society. Trust, ethics and leadership are interlinked. Leadership requires choosing between two good options according to our Theta-Lambda worldview. Thetas are socially-motivated and seek affiliation and security whereas Lambdas are personally-motivated and seek challenge and achievement. Pursuing these worldviews helps us get closer to the ethical truth, and it is this self-investment in pursuing truth which builds trust.A review of various CSR theories shows that organizational CSR seeks a similar outcome, that is to demonstrate the responsibilities which the organisation is ready to assume.

10.1 Introduction

Scandals such as Enron and WorldCom on one side of the Ocean and Parmalat on its other side it destroyed wealth and made people redundant while leaving them without a pension protection and bailout was done with the help of tax-payers' money. The shock from these unethical failures led to advocating various Corporate Social Responsibility (CSR) activities and even the introduction of the debated legislation

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such as the Sarbanes-Oxley Act of 2002 as a way of building a more responsible society. All these activities were geared to restore a critical resource for business: trust.

The question we ask is not whether CSR initiatives, which try to restore trust or to relieve mistrust do their job since, in our opinion, these activities just fail to distinguish between activities for gaining popularity and those which gain trust. The main question under the assumption that organisations need to be trusted is what the nature of this trust is and how this trust can be built.

To illustrate the difference between popularity and trust we offer here an example. In early 2003, Israel was 6 weeks from being insolvent. At that time, current Prime Minister Benjamin Netanyahu was nominated finance minister, a position that was never making any of his predecessors popular even in better economic conditions. In addition, Netanyahu's political agenda was not popular among many Israelis who were brought up on socialistic values (Laurence, 1990). Netanyahu managed to restore Israel's financial strength at a social cost when many lost their work and more people went below the poverty line. Sacrificing social welfare for capitalism eventually sent Netanyahu to the political desert for some years. On the other hand, one popular commenter told one of the authors that: "I was never a fan of Netanyahu and I will never be. However, listening to him I was convinced that he is taking the right steps". This case might illustrate the difference between popularity and trust. Netanyahu's financial leadership was trusted but his popularity sank. Hence, to be trustworthy, one does not have to be liked but what takes to become trustworthy?

While trust captured the attention of scholars, the socio-economic literature sees trust as a social means only that helps greasing the socio-economic wheels (Spitzer, 2009). We will present our position, introducing the opinion of one of the greatest Jewish leaders before WWII, Rabbi Elchanan Wasserman, which sees trust as a value of its own. Claiming that CSR helps building trust, we will examine this statement through reviewing the literature into CSR to explain why CSR cannot be a trust-builder. We will then follow with examining what leadership implies to understand the link between leadership, ethics and trust as a personal activity. We distinguish between leadership, which is an unreachable ideal and the leader, which describe the human behaviour. Nevertheless, leadership and the leader have to be connected. We will offer a detailed explanation of the Theta and Lambda worldviews that people assume and illustrate the importance of these worldviews to the leader who wish to reach the leadership ideal. We will conclude with some general remarks that we find important to any manager to internalise.

10.2 Trust

In the socio-economic literature, trust is embedded in logic (Coleman, 1998; Deutch, 1962). It is considered to be a fundamental value in effective leadership and social necessity to overcome limitations of rationality. Trust in leader is protection from

anxieties of identity and existence (Dirks, 2000). Colman's (1998, p. 91) set of definitions, for example, is based on four principles: first, trust allows for actions that otherwise would not be possible. Second, if the trustee is trustworthy, the trustor will be better off (Exworthy and Robinson, 2001). Third, trust involves a voluntary transfer of assets without an explicit reciprocal commitment of the trustee and fourth, there is a time tag between entrusting and the result of that behaviour. Hence, for Coleman (1998), trust is a logical action that involves calculated risk. This approach to trust forms one of the axioms which relationship marketing is based on, saying that mutual understanding would lead to a higher value creation as part of a wider win-win system (Sheth and Parvatyiar, 1995). The latter axiom used the logic for an improved economic result. The economic aspect of trust is addressed also by Fukuyama (1996) who argues that nations compete better when they are socially united.

Similarly, Sako (2008) examines trust from economic perspective. Sako (2008) puts at the two extremes of the multi-dimensional spectrum the Arm's Length Contractual Relation (ACR) and the Obligation Contractual Relation (OCR) (Marchington and Vincent, 2004). ACR is characterized by a specific, discreet economic transaction, where duties of both parties are laid out in an explicit way and define the rules for any foreseeable scenario. In case of an unexpected event, parties would use the legal system for ruling. Therefore, all dealing is done at arm's length as to avoid familiarity or dependency of one party on the other. On the other hand, while OCR is also about an economic contract, is embedded in a social reality when the two parties enjoy a level of mutual trust (Marchington and Vincent, 2004). In such cases, it is possible that explicit contracts are not drawn and even when a contract exists, it is expected that both parties would do beyond their duties as spelled out in the contract. The two dimensions along which ACR and OCR are measured are the interdependence of the parties, which is pronounced in OCR but nonexistent in ACR and the time span of the relationship which is short for ACR and long for OCR (Markovits, 2008; Sako, 2008; Shiffrin, 2008).

However, CSR policies that are based on this type of trust call us to examine whether the role of those activities is building trust or mere popularity. When the aim of these activities is to achieve goals that are unachievable otherwise, when the activities are used as a means only to achieve better financial results and are using logic to calculate the risk involved, doesn't it man that the organisation would abandon those policies once it estimate that these financially logic goals are too risky or unachievable? Is the aim of those CSR activities to *be* nice or only to *show* a nice face? Even a value such as "responsibility" is a dependable variable since it implies an obligation to someone or something. Moreover, does the "responsibility" suggestion in CSR reflect truly the needs of the organisation's stakeholder or is it an academic invention that managed, at most, to brainwash the public which is not difference in that it looks for gaining popularity?

A different approach to trust provides Rabbi Elchanan Wasserman (Wasserman, 2006, p. 36) in commenting on the 1929 economic crisis. Wasserman (2006) argues that it would be illogic to claim that the reason for the economic crisis is the poverty that affected all of the sudden the entire world. He says, "It is possible that a person

loses his assets for various reasons, it might happen to a city and even to an entire state in case that the money moves to other places undertake for numerous reasons. But, it is impossible that the entire world becomes poor since the money did not move to another planet and was not destroyed, either. Where, therefore, is the money?" The answer, according to Wasserman (2006), is that although the money exists in the hand of individuals or in the vaults of countries, it does not move. The power of money and the basis of economy is the economic movement; money has to exchange hands. However, when people freeze their money and are afraid to transfer it to other hands, when people fear to provide credit, the money lies useless both to the world and to his owners.

But, why do people lose trust? We trust those who are committed and who undertake full responsibility for their actions (Bucholz, 1987; Gray et al., 1996). Wasserman (2006) illustrates it with the following example. Man's nature is to attribute all successful events, such as wealth and fame to his skills and ability while attributing failure to external reasons. On the other hand, when the Tribes faced the risk of criminal allegations by the unknown to them ruler, Joseph, they took the entire blame on them, claiming "we are verily guilty" (Genesis, 42, 21). Trust, therefore, is the ability to face failure and to put the blame squarely on one's shoulders. Only when assuming full responsibility for the failure, recognising his part in it one can commit to solving that failure. Hence, for Wasserman (2006) trust is not extrinsic, logic and social but an intrinsic, emotional and individual state of mind that has its own merit and not as a means to enrich a socio-economic interaction. The risk is not of the trustor who seeks to benefit from this risk undertaking but of the trustee who is fully responsible for his eventual failure. Trust for Wasserman (2006) is totally altruistic and voluntary; it is a one-sided act of the trustee who is not looking for any reciprocity. Trust results from the trustee's choice. If trust is a voluntary act that is independent of society, the question is double-sided: on the one hand, since CSR is perceived as a trust-building activity in a socio-economic sense, the question is whether this goal can be achieved. On the other hand, if trust implies commitment and undertaking self-responsibility, what steps should one assume to achieve this level and how can this activity help the organisation? To answer these questions, we will first examine the CSR literature to see whether socio-economic activities can build trust.

10.3 The CSR Literature

It is difficult to find other reasons for the increased recent interest in CSR apart from the realisation that past practice has led to unethical behaviour, corporate meltdowns, frauds and corruption (Jensen, 2002; Monks and Minow, 2004), and lost of trust in organizational leadership (Currall and Epstein, 2003), It also demonstrates how the "economic man" model (Smith, 1991) has thus far not fulfilled its promise of benefiting the common good. This realisation has led to two veins of research. The first addresses misbehaviour that can be measured financially such as fraud,

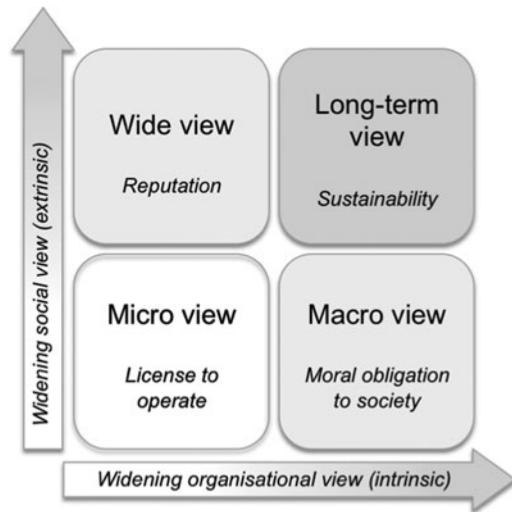

Fig. 10.1 The different views of CSR (Source: Mostovicz et al., 2009b)

bribery, graft and cheating (Anand et al., 2005; Ashforth and Anand, 2003; Ashforth et al., 2008) while the second addresses wider CSR issues such as the environment, the workplace, the marketplace and the community (Moir, 2001).

It is possible to sort out the literature of CSR based on two dimensions – the organisational and the social ones (Fig. 10.1). While the organisational dimension refers to the way the organisation sees itself intrinsically, the extrinsic social dimension views the organisation as part of the social canvass. However, the resulting four views are not mutually exclusive and are sometimes blended by authors in their analysis of CSR.

10.3.1 The Micro View

The scope of the micro view is limited to the shortened timeframe of the economic stakeholders. It is based substantially on the theory that managers and employees cannot be trusted and need to be monitored and controlled strictly (Manz et al., 2008). In particular, leaders are not viewed as necessarily ethical (Kouzes and Posner, 2003) but rather as driven by the traditional economic view of organisational profit maximisation (Friedman, 2002; Jensen, 2002). Agency theory, for instance, assumes that executive leaders are the agents of the principals (e.g., shareholders), who need to control these leaders to cater to their best interests (Manz et al., 2008). This relationship can lead to a conflict of interest as agents might be forced to act unethically in order to support the principals' interests (Jensen and Meckling, 1976).

However, many businesses are also loathed moving away from the economic model, believing that this model suits their business perspectives. Thus, they adopt the micro view in order to protect their "licence to operate" (Moir, 2001; Porter and

Kramer, 2006) by offering an improved version of their existing economic model or an additional social benefit to support it. Examples are the CSR views as defined by the World Business Council of Sustainable Development (WBCSD) which sees CSR as the business contribution toward sustainable economic development, or by Amnesty International Business Group (UK), which calls for companies to recognise that their license to operate and ability to create financial wealth depends on their acceptability in the eyes of society (Kakabadse et al., 2005).

Nevertheless, this view is to be found among scholars as well. Suchman (1995), for example, argues that legitimacy is a key issue for business, and he identifies three primary forms for how this develops in practice: pragmatic, based on audience self-interest; moral, based on normative approval; and cognitive, based on comprehensibility and taken-for-grantedness. Lindblom (quoted in Moir, 2001) proposes four strategies for organisations to overcome “legitimation threats”. The “Iron Law of Responsibility” (Kakabadse et al., 2005) is a social contract whereby society grants legitimacy and power to businesses but also removes this charter – at least, in the long run – from those who abuse it (Davis, 1973; Wood, 1991). Some (Davis, 1975; Takala, 1999) personify the virtual organisation and view it as any citizen of a society with public obligations. This micro view is to be found in Carroll (1979, 1991) who sees the corporation’s responsibilities – economic, legal, ethical and philanthropic – as mutually exclusive of each other (Kakabadse et al., 2005). To some (Carroll, 1999; Davis, 1973), CSR moves beyond immediate gains and minimal respect of the law and organisations should express a voluntary effort to comply with ethical standards. Nevertheless, the same authors argue that these efforts are rewarding financially in the long term.

10.3.2 The Macro View

The second view, called the macro view, argues that CSR is interwoven into the organisation’s fabric and cannot be addressed separately from the organisation’s other goals. In other words, this view claims that organisations have a moral obligation toward society (Porter and Kramer, 2006) and its goals range from economic to social and environmental ones. This “implicit” version of CSR is predominantly European.

It consists of values, norms, and rules that require corporations to address stakeholder issues and define proper obligations of corporate actors on collective rather than individual terms (Matten and Moon, 2008). Thus, “implicit” CSR is conceived of as a reaction to, or reflection of, a corporation’s institutional environment. This view is concerned with the wider social role of the organisation and is motivated by societal consensus of the norms, roles and contributions that major social players, including organisations, have in society (Matten and Moon, 2008). The questing of corporate responsibly is aligned with leadership responsibly and leadership style and competencies (van Tulder and van der Zwart, 2006).

This source of social responsibility is based on the power and influence that organisations exert in shaping the morality of a society (L’Etang, 1995).

Nevertheless, the view is an organisational and not a social one. Such an organisation considers itself "a living company" whose purpose is to fulfil its potential and perpetuate itself as part of an evolving community, contrary to the "economic company," whose concern is solely to produce wealth for a small group of individuals (De geus and Senge, 1997). Consequently, such a view implies that an organisation might sometimes sacrifice sound business objectives in order to achieve morally and socially accepted goals (Vinten, 2000). For example, Davis and Bloomstrom (1966) argue for the need to consider the effects of the decisions taken on the whole social system. In the same vein, Sethi (1975) posits that CSR implies a level of organisational behaviour which is congruent with the social norms, values and expectations of performance. Jones (1980) draws attention to the fact that CSR suggests a corporate obligation to groups in society other than shareholders and beyond legal concerns or union contract negotiations. Taking an historical perspective, Lantos (2001) suggests that the social contract evolved from the micro view of aiming to maximise profits within the legal boundaries and into the macro view of seeing social and economic progress as interwoven. Finally, Wilson (2000) argues that an organisation has a moral responsibility to help solve social problems, expanding the micro view's "licence to operate" to include social legitimacy as well as the mere maximisation of profit.

10.3.3 The Wide View

Contrary to the macro view, the wide view holds that the organisational goal is essentially economic. However, the role of CSR is not merely to afford a binding legal framework that prevents the organisation from acting asocially but to help the organisation outlining its economic goal. The wide view sees the organisation from its position within the society, claiming that CSR is about how companies manage their business to produce an overall impact on society (Haberberg and Rieple, 2001). The organisation is in a constant dialogue with the society in which it acts; it affects them and is affected by them (Haberberg and Rieple, 2001; Simmons, 2004). Hence, instead of trying to address the dilemma of whether CSR is good or bad for business, the question one should ask is under which conditions a firm's social activities could benefit society (Margolis and Walsh, 2003). While Haberberg and Rieple (2001) claim that no research was found to address this question, it is possible to observe this wide view when examining the three drivers behind the Social Corporate Initiatives (SCI) programmes (Kakabadse et al., 2005). The first driver is to enhance the organisation's reputation (Porter and Kramer, 2006) and to develop international expansion. The second refers to the moral pressure that organisations feel through social reporting or peer pressure, which drives them to improve their ethical behaviour. The third is the competitive advantage that private firms hold over government in implementing social and environmental norms and programmes. While the main driver behind the wide view is similar to the micro one in seeking legitimacy, the wide view claims that rules and regulations are not enough

and organisations need to act morally and ethically in the eyes of society while legal frameworks follow up by formalising these requirements through regulation.

The wide view is tightly linked to stakeholder theory (Haberberg and Rieple, 2001), which defines the specific groups and people to be considered in an organisation's CSR orientation (Carroll, 1991). This "explicit" version of CSR prevails in the US and comprises corporate policies that assume and articulate responsibility for some societal interests that are not necessarily linked to the core activities of the organisation. These normally consist of voluntary programmes and corporate strategies which are based on the organisation's perceptions of its greater social responsibility. This view of CSR is influenced by stakeholder pressure or implemented through partnerships with governmental and non-governmental organisations. Nevertheless, the practice of CSR rests at the discretion of the organisation (Matten and Moon, 2008).

However, although CSR outlines which responsibilities a business ought to fulfil, the stakeholders' concept defines those to whom the business should be accountable (Kakabadse et al., 2005). Contrary to the micro view which answers primarily to the financial requirements of the shareholders (Friedman, 2002), stakeholder theory requires the organisation to concentrate on a wide array of stakeholders which extend beyond shareholders (Haberberg and Rieple, 2001). However, the wide view still focuses on the wealth-creating capacity of the organisation which allows managers to manipulate stakeholders to reach the most favourable trade-offs (Post et al., 2002). Being extrinsically motivated, the organisation would not be really motivated to act morally (Deci and Ryan, 2000; Moller et al., 2006) and would lack the commitment to "good citizenship" (Goodpaster, 1991; Hummels, 1998; L'Etang, 1995). As a result, an organisation might see its social responsibility reputation as a public-relation front only while the ultimate aim still remains to pursue economic objectives (L'Etang, 1995).

10.3.4 The Long-Term View

Finally, the long-term view not only considers the organisation as an entity whose purpose is far beyond the narrow for-profit perspective but argues that the organisation's responsibility should be past, present and future oriented (Weiss, 2005). Taking this long-term perspective, the ultimate goal of an organisation is sustainability (Porter and Kramer, 2006; Schaefer, 2004). Such a long-term approach implies the creation of a "convergent" stakeholder theory which is both morally and socially sound as well as economically viable (Jones and Wicks, 1999; Jones et al., 2002). It would also require the impossible task of fully defining an organisation's list of stakeholders (L'Etang, 1995). Such a task challenges the value of stakeholder theory (Kakabadse et al., 2005) and its claim of being "inherently managerial" (Freeman, 1984) since accountability is rendered useless when the boundaries of the organisation are defined too broadly (Hummels, 1998; Vinten, 2000).

10.4 The Gap in the Literature

Arguably, no CSR theory can ensure trust building. A theory is a model that explains the social or individual phenomena of interest (Dubin, 1978; Whetten, 1989, 2002). As such, a theory is an academically rigorous interpretation (Dubin, 1978) where two contrasting criteria should be considered – comprehensiveness (the inclusion of relevant factors) and parsimony (factors considered of little additional value to understanding).

However, choosing these criteria is subjective. In the context of CSR, the theoriser must decide whether to relate to an organisation purely as an economic entity or as a more complex activity including psychological and social meaning as well. In this sense, all CSR theories are first a set of mechanisms that address two of the elements of theory – the What and the How – which describe the structure of the model (Whetten, 1989). However, while a theory should answer also to the Why question and explain the selection of those underlying factors that, glued together enable us to reach our purpose, CSR theories do not offer a sufficient answer to this Why question.

Saying it bluntly, trust is not the true purpose of CSR activities. At most, the activities chosen by the organisation are selected to demonstrate the responsibilities that the organisation is ready to assume. However, there is no guarantee that the organisation's stakeholder would accept the organisation's claim. In other words, CSR enables the truster to create an extrinsic, logic and socially for-benefit trust without any guarantee that the trustee would accept such an activity. Moreover, the chances are that being a means to a goal only, CSR activities would be regarded as a fig-leaf to cover the organisation's nakedness only.

The primary question, therefore, is not to understand how CSR works in practice but to understand the flaws in current economic models which require CSR in the first place. The micro, economic view says bluntly that an organisation does not need CSR to achieve its goals; instead, it views CSR as a tax or a liability it has to pay if it wishes to operate. The other views that adopt a Hobbessian (Hobbes, 1951) approach are not different either. Consequently, those organisations do not view CSR activities as a solution but as a remedy, healing the symptoms without solving the problem. In a different rhetoric, those organisations do not have the courage and the sincerity to resume responsibility for the indifference, irresponsibly or unethical behaviour of the organisation.

Seeking to address the problem of unethical action is not exclusively a goal of CSR. As we will show, this is a problem which leadership theory aims to explore as well. It is important to stress that leadership is not a hierarchical position. After all, "leadership is not merely a top-down process. Because leadership is defined as an influencing process it can also be exercised sideways, diagonally, and down-up throughout an organizational hierarchy" (Hunt, 2004, quoted in Antonakis, 2006, p. 6). Leadership is a set of personal qualities (Goleman, 1998) that needs to be explored and developed.

10.5 Leadership Imperative

Leadership is not about distinguishing between good and bad but about making choices (Kouzes and Posner, 2003), a binary action that divides good options into two sets, the desired and the undesired ones, according to a higher principle or value (Rawls, 1999). Thus, a choice implies that someone has weighed two equally valid options based on a higher principle. Mostovicz (2008) posits that people make these choices depending on their worldview, which is a manifestation of how they pursue their "ideal self" (Hinkle, 1965). This discovery is approached via one of two pathways: the so-called Lambda worldview which is driven by the need for achievement or the Theta worldview which is driven by the need for affiliation (Mostovicz, 2008). The worldview which a person embodies, in turn, affects his style as a leader.

Each worldview has its unique characteristics. While the Thetas' motivation is socially oriented and they look to affiliate with their society of choice (Pyszczynski et al., 1997, 2004), the Lambdas are individually motivated (Deci and Ryan, 2000). Consequently, their respective behaviour follows the fundamental modalities of human existence (Bakan, 1966); namely, Thetas' behaviour seeks communion and is focused on other people and relationships while Lambda's behaviour is based on agency and focuses on the self and autonomy. The different approaches seek different benefits. Thetas try to build respect within their society of choice while Lambdas look for personal freedom (Mostovicz, 2008). While it is argued that leaders should exhibit the personal quality of authenticity (e.g., Goleman, 1998; Kotter, 1990; Zaleznik, 1977), Thetas and Lambdas differ in the way they relate to authenticity. While Thetas are concerned with truthfulness and denounce fakes, Lambdas perceive authenticity as uniqueness and view negatively a "me too" practice.

Finally, the different worldviews have different ideas about what a true goal is. According to Kaplan (Kaplan, 1990), one relates to truth either as an objective or as a principle. If one relates to truth as an objective, the goal is to unite with it, as the Thetas perceive. If, on the other hand, one relates to truth as a principle, as a Lambda, truth then creates a set of challenges or guidelines to live up to. This difference in perception of truth also explains why different opinions exist about how leaders are transformed (Kakabadse and Kakabadse, 1999). To a Theta, a true leader is one who attains his objective or one who is able to act subconsciously (Lowen, 1975) and naturally – a born leader (Grint, 2000; Nietzsche, 1969) – while for a Lambda, a genuine leader is one who follows meticulously a proper set of guidelines (Henrikson, 2006) – leadership development (Kakabadse and Myers, 1996; Kakabadse and Kakabadse, 1999). Table 10.1 below outlines several of the characteristics which define these two worldviews and how they approach their practice of being a leader.

These two approaches clash fundamentally because the drive for achievement ends in separating oneself from others (or making oneself unique), while its counterpart seeks to affiliate itself with others and work in unison. As a consequence, this tension can lead to personal bias or a distortion of the paradox within leadership

Table 10.1 Characteristics of theta (Θ) and lambda (Λ) worldviews

	Theta – (Θ)	Lambda – (Λ)
Motivation	Socially oriented	Personally oriented
Behaviour	Communion	Agency
Goal	Seeking unity and certainty	Seeking challenge and creation
Benefit	Building respect	Looking for personal freedom
Leadership principle	Authenticity = truthfulness	Authenticity = genuineness
Inclination	Toward choice	Toward contrast
Perception of truth	As an objective	As a set of rules
Type of responsibility	security	Freedom

Source: Mostovicz et al. (2009b)

(Mostovicz et al., 2008). A Theta worldview tends to choose the alternative course of action whereby he dilutes the stakes by substituting a relative truthfulness for the ultimate truth or creates a lack of contrast by removing a strongly desired choice. On the other hand, in the Lambda worldview, the learning paradox can cause one to lose her own personality and to seek collectivism or even fanaticism in extreme cases whereby one disrespects others' interpretations of truth or argues that they are invalid (McGregor et al., 1998; see Frankl, 1986:xxvi for a similar idea).

Attempting to incorporate both approaches is paradoxical because this requires one to relate to the other despite being motivated in a different way (Mostovicz et al., 2008). This paradox implies that the leader is supposed to view a clashing code of conduct as both proper and good.

Humans need a purpose. As each person has his own individual personality, he therefore searches for a unique purpose (Frankl, 1963). This assertion, so basic to Judaism, claims that "the foundation of Judaism and the basis of all true religions is the realization that existence is purposeful, and that man has a purpose in life" (Kaplan, 1979, p. 1), and it is recognized nowadays by cognitive psychologists as well (Deci and Ryan, 2000; Pinker, 2003). While true purpose cannot be attained, man is aware that he has a purpose and should search for it (Frankl, 1963). For this reason, the Eastern approach concentrates on the way to attain truth since truth is unattainable (Nonaka and Takeuchi, 1995). Nevertheless, such an approach is risky since it presents a way to proceed, but not a destination. Therefore, while ideal leadership is not to be found in man, it presents an ideal for anchoring leadership theory. For Weber (1947) and Hekman (1983) "ideal" is used only as an aid to assist in explaining patterns of social interaction, institutional design and how we govern ourselves (Cutting and Kouzmin, 2000). Hence, "ideal" does not describe a particular behaviour as much as capture a benchmark for the logic of reality. We expand beyond this normative approach to view the ideal worldview or the leader as a particular entity and argue that this ideal is not a passive benchmark for measuring our success but an active part of the theory. Through the certainty of failure in reaching the ideal, we assure the dynamically successful development of the leader.

10.5.1 The Dynamic Theory of Leadership Development

As said above, getting to leadership is a process (Hunt, 2004, quoted in Antonakis, 2006, p. 6) or a set of qualities that need to be developed (Goleman, 1998). Recently, theories in social science have been criticised for being static (Ashforth et al., 2008) or for not taking into account the element of time. Theories that were considered correct in the past have become invalid over time (Pascale, 1990; Kalogeras, 2005).

Consequently, social science, in general, and the process of leadership (Baker, 2007), in particular, are looking for dynamic theories.

Leadership is not a philosophy but rather the expression of a set of activities. Hence, leadership consists of three levels (Table 10.2). The lowest level consists of a variety of tactics or actions (Amir and Ariely, 2007) based on principles such as logic, rationality, consciousness, measurability and replicability, and economics. The next level consists of strategic decisions and is a matter of interpretation and often involves the making of choices (Porter, 1996), which are themselves paradoxical (Mostovicz et al., 2008). This is the level of practical leadership (Kouzes and Posner, 2003) that is characterised by being emotional, unconscious, irrational and immeasurable and whose guiding discipline is psychology. However, this level is properly performed only when it is embedded within the highest level of true purpose and its leading discipline of metaphysics. While man cannot perceive truth, he is able to progress toward it. Nevertheless, he has to progress naturally and faithfully according to his Theta or Lambda worldview.

While the metaphysical ideal is used as an anchor for guaranteeing a leader's dynamic development, a leader gets closer to that ideal either by following the Theta or the Lambda pattern according to his worldview. Nevertheless, this worldview has to be expressed in tactical actions that fit (Porter, 1996) the particular worldview (Fig. 10.2). However, as we will explain, tactics have a dual role. Not only is it used as a means of expression of the leader's strategy, but it is used as a mirror that reflects the bitter truth to the leader, telling him what he is not doing properly.

We tend to believe that the selection of our tactical goals is based on logic. Nevertheless, Porter (1996) reminds us that not all actions should be accounted for since these actions should fit our strategic view. According to this approach, the tactical goals are the independent variables that dictate to us what to do while the strategic view helps us to select those goals more suitable to our capabilities.

Table 10.2 The three components of leadership theory

Theory question	How?	What?	Why?
Organisational component	Tactics	Strategy	Leadership
Leading discipline	Economics	Psychology	Metaphysics
Type of action	Logic, measurable and replicable. Conscious	Emotional, a matter of choice. Subconscious	Meta-action

Source: Mostovicz et al. (2009b)

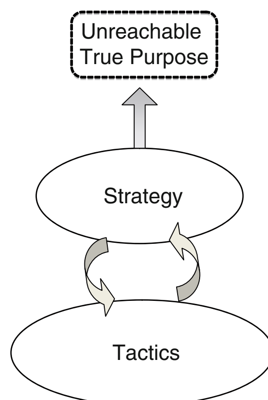

Fig. 10.2 The dynamic theory of leadership development (Source: Mostovicz and Kakabadse, 2009)

Inherently, this approach suffers from what might be called "objectivity fallacy" or the belief that we are able to collect data or define tactical goals objectively. However, we select subjectively only the data that fits our worldview (Mostovicz, 2008; Mostovicz et al., 2008). Thus, the tactical activities are dependent variables only. Hence, leadership development starts with clarifying the emotional, strategic worldview first before defining those tactical methods that can enhance the strategy.

Hence, what characterises a leader is his ability to invest himself emotionally in his activities. On the other hand, being led or following a dictum, people risk acting mechanically without investing any emotion in their practice. This lack of emotional self-awareness can lead to a wide range of psychological distortions ranging from moral deterioration, emotional paralysis and disengagement (Diamond and Allcorn, 1984) to other psychopathological phenomena such as neuroses, depression and schizophrenia (Frankl, 1986).

10.5.2 The Leadership Challenge

Why are there so few leaders? In Kakabadse and Kakabadse's (2007) study, only a handful of people in leadership positions actually led while the vast majority acted reactively, either seeing their role as pleasing the shareholders or being concerned with their reputation. Not only were there not enough leaders to fill existing leadership slots in management, but the gaps are even greater as some leaders decline to practice their leadership in the field of business management (Goffee and Jones, 2000). The result is that filling these leadership roles is a huge challenge.

Leadership calls for total commitment to the perpetual process of purpose seeking. While leaders are usually concerned with their legacies, their commitment to purpose has to go far deeper. It is not simply how a leader has lived his life but how he has defined a purpose for which he would have been ready to die if it could not have been pursued (Lévinas, 1994). This total commitment implies that, in reality,

leaders seek "either my way or nothing." However, this commitment is intrinsic; it calls for the leader to mobilise himself body and soul but in no way does it imply extrinsically that what is not "my way" is wrong.

This total commitment is not easy. The only tool left at the leader's disposal is motivation, which implies flux. A leader should be constantly on the move, trying to achieve the unachievable and relating to what looks like a means as a life goal. However, as this motivation is always extrinsically triggered (Gagné and Deci, 2005), it does not happen regularly, and a good leader should seek that extrinsic motivation constantly and even provoke it (Nonaka and Takeuchi, 1995).

A leader faces a challenge at the strategic level as well. It is not enough to pursue a goal and a leader has to follow it strictly according to his worldview while respecting the Other's worldview. Trying to hold the stick at both ends tends to lead to paradoxical distortion (Mostovicz et al., 2008) that the leader needs to fight constantly.

Finally, the tactical level has its challenges as well. While an organisation has one leader only to dictate its future direction, many fall into the trap of transactional leadership where they base their leadership on formal authority (Kakabadse and Kakabadse, 1999). Such behaviour is based on the logic of self-regulation while leadership should be based on a voluntary emotional concession of any competing goals by others in the organisation (Murnighan and Conlon, 1991). Thus, instead of mistakenly marginalising individual experience in the search for overall homogeneity, a leader should learn to "play through" (Murnighan and Conlon, 1991) any differences that individuals may have so that he does not deny "the right of individual people to have and interpret their own experience" (Cheng, 1995, p. 5).

This respect of the other is empathy or what Lorenz (1974) calls a bond and is associated with being both non-hierarchical and non-distancing. When leaders bond socially, they need to send a message that humans all share a common existence and a lack of self-awareness of the ethics required to search for a true purpose. While establishing empathy is a momentary act that is based on a complex unconscious process (Wilson, 2002), leaders are aware of this but try to unmask it or try to be more aware of themselves.

Empathy requires three qualities: avoidance of distancing, respect for the integrity of the other and harmonious aggression (Ohshima, 1998). Harmony may only be achieved by setting boundaries around the aggressive act while signalling respect for the adversary's integrity (Funakoshi, 1973). This ability to manage a spectrum of aggression may not be unique to humans. As Lorenz (1974) has pointed out, members of a given animal species also find it important to keep their aggression intact and to learn to avoid potentially dangerous repercussions by means of diverting mechanisms. Hence, proper empathy is being responsible for the Other or being ethical.

Organisational life presents a challenge. Not only do executives not necessarily lead emotionally but those being led can become mechanical objects. It is therefore not a surprise that organisations act unethically in spite of efforts to create new theories. Actually, this is exactly what ethics implies. Lévinas (2003, 2004) explains that ethics entails having responsibility for the Other. It is the personal care for the other

despite being different and having different goals, life purposes and worldviews. This ethical behaviour is based on the ability to defend our opinion wholeheartedly while recognising that another, equally valid opinion exists and only our choice that made our opinion ours. Our ability to choose can be manifested only when we are able to be equally responsible for both opinions.

Organisation members have to identify the executive's worldview, respect it and be responsible for it even when they hold different values. On the other hand, the executive has to be responsible to the worldview of the rest of the organisation as well. This responsibility is manifested within the organisation by dividing the strategic role of the leader from the tactical role of his subordinates. This division forces the leader to rely on his subordinates, allowing them a bigger say on what should be done and providing them with a better understanding of the bigger picture so they can see how their activities enhance the strategic view. Operating in such a manner contributes to people's intrinsic motivation (Deci, 1975) and thus enhances their self-esteem (Deci, 1975; Deci and Ryan, 2000).

Our data (Mostovicz et al., 2009a) shows that this responsibility is expressed differently according to the executive's worldview. A Theta cares for the security of the organisation's members and consequently takes the entire responsibility on his shoulders. On the other hand, a Lambda provides for the autonomy and freedom of each member allowing them to be responsible for their own actions.

Trust, leadership and ethics are three facets of the same entity. They all are based on intrinsic motivation to undertake full responsibility to own acts, to commitment to pursuing own worldview and to continuous awareness that one has always a choice. Following one's worldview is a choice only and one should respect that the other has his own choice which is equally valid.

10.6 The Role of CSR

Declaring "we are verily guilty" is not sufficient to create a leader since this declaration should be supported with tangible and logic evidence. On the other hand, pursuing logical, tangible and measurable economic goals might deprive the leader of emotional investment. CSR activities help bridging between the logical and the emotional dimensions. CSR invites anyone who can relate to the organisation to act as voluntary mirrors which reflect how the organisation's tactical activities could have an emotional meaning which would allow the organisation to act in a self-deceptive and unethical way. It is no surprise, therefore, that some authors view competitors (Post et al., 2002) and even terrorists (Scholl, 2001) as part of an organisation's group of stakeholders, since the organisation's reaction to such groups is emotional. Nevertheless, the organisation is not involved in a logical Socratic discussion with its stakeholders as some authors suggest (Liedtka, 2008). Such a discussion would lead to a heuristic (from Greek "to find") form of development, based on intuition, experience or simple common sense whereas the dynamic development of the organisation should be an algorithmic one, following a well-defined programme.

While researchers are aware of the lack of trust in organisations, they have not explained why this behaviour exists in the first place. Consequently, CSR practices seem not to help in achieving their goal (Kakabadse and Kakabadse, 2007). However, the question is not why trust is inexistent in organisation but what have we done to instil it in the first place. Do we point to organisational failures or are we brave and honest enough to point the condemning finger toward us? Are we ready to take the full blame knowing that this is the only way to empower us to commit to change?

Since leadership is a psychological state of mind or a personal quality and not a hierarchical position, we argue that trust is a leadership issue. People can choose between being their own masters and enslaving themselves. When people are enslaved, they tend to act automatically and do not invest emotionally. As a result, they are indifferent to the results of their actions and are bound to act unethically and indifferently while harming themselves psychologically (Diamond and Allcorn, 1984) and damaging the long-term organisation's financial performance (Collins, 2001; Collins and Porras, 2005).

Hence, a leader should act emotionally following either a Theta or Lambda worldview based on the drive for affiliation or achievement respectively. The leader's worldview dictates the various tactics or activities that the organisation eventually undertakes as they have to fit with the leader's strategic view.

Since leadership is not socially but personally and psychologically defined, everyone can strive to be a leader through constantly increasing one's self-awareness. Although the organisation's direction is decided by executives, all the members of the organisation should be responsible for allowing the executive reaching his emotional or strategic goal as dictated by the latter's worldview. This behaviour is ethical since it is based on the responsibility for the Other (Lévinas, 2003, 2004). Even when one holds a different worldview, he should be responsible that the other would be able to express authentically the latter's worldview.

However, Ideal leaders do not exist in practice. Thus, we can relate to leadership as a progressive development only. Alternatively, one has to engage in trust-building activities as a way to become an ethical leader. Since humans cannot be fully conscious of our emotions, *a posteriori* we cannot fully mobilise them in order to understand and attain our life goals and purpose. Because our purpose remains opaque at best, it follows that leaders will act unethically even when they do so unwillingly or unconsciously. The only way for leaders to improve their ethical position is to interact with others in society to help them reveal their hidden agenda over time. These agendas, in turn, are shaped by the particular worldview – either Theta or Lambda – that a person embodies in his search for greater self-awareness and contextualisation with his external environment.

CSR activities help the leader and his organisation to progress in building trust based on total commitment and responsibility. CSR neither pits the organisation against society nor does it become a liability or a constraint instead of a benefit as it is not integrated into or competes with the organisation's business strategy (Porter and Kramer, 2006; Porter and Reinhardt, 2007). Rather, society is used as a mirror to help the organisation recognise and achieve its goals.

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Chapter 11
The Ecolabel Virtues in Tourism: The Case of Hotel Trade

Philippe Callot

Abstract "Small is beautiful!" so said the leading economist Schumacher (Small is beautiful: une société à la mesure de l'homme, 1979) and we are tempted to use his slogan to announce what we believe to be good news, namely that awareness of environmental responsibility in the small business sector seems to be alive and well. When the hotel "Les Orangeries" (hotel-lesorangeries.com), in the region of Vienne, became the first hotel in the whole of France to go green and get its Ecolabel, we realised that the whole concept of Eco-labeling in tourism was actually beginning to take off, and since then an increasing number of projects and strategies has got underway. This paper intends, on the one hand, to discuss the main elements and milestones of an industry finally taking responsibility for itself; and on the other, to describe and follow the steps taken by a small provincial hotel business to gain Ecolabel status.

11.1 Introduction

Small is beautiful!' so said the leading economist Schumacher (1979) and we are tempted to use his slogan to announce what we believe to be good news, namely that awareness of environmental responsibility in the small business sector seems to us to be alive and well. The hotel "Les Orangeries"[1] in Lussac-les-Châteaux became the first hotel in France to go green and get its eco-label. We realised that the whole concept of ecolabelling in tourism was actually beginning to take off, and since then the number of projects and applications for ecolabel status has done nothing but increase (58 in November 2009, in France). The willingness of businesses to actually get involved goes well outside the definition of corporate social responsibility, as we know it. We have already moved into a different realm: a realm in which the individual citizen is demonstrating his commitment loud and clear in a sector riddled

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[1] www.hotel-lesorangeries.com in the local region of Vienne (France)

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with guilt (Babou and Callot, 2007; Callot, 2008; Lamic, 2008) about the things it stands accused of (Christin, 2008; Bardolle, 2008) – namely the huge carbon footprint of the developed world in the tourism sector. We are talking about responsible and sustainable tourism. This paper intends to reflect upon the main elements of an industry finally taking responsibility for itself; and to describe and follow the steps taken by a small provincial hotel business to gain eco-label status without sacrificing profitability.

11.2 Working Together for Responsible Tourism

So goes the slogan in a guide recently published by Comité 21 (a network of key players committed to sustainable development, September 2008). It puts the case for collectively (the sum of commitment by individuals) taking climate change issues extremely seriously.

The time for questioning or querying the cause or evidence has passed. What we need now is to raise awareness, educate and take action if there is to be any chance of making these concepts stick. Responsible or sustainable tourism is described by Comité 21 (2008)[2] as "A strategic ambition namely responsible methods of production and consumption applied to the tourist sector which have the fundamentals of sustainable development at their very heart". The development of this sector has direct links with the production of greenhouse gases as a result of CO_2 emissions. "An increase in tourist numbers automatically means an increase in the volume of traffic" (Comité 21, 2008) thus creating one of many dilemmas facing the tourist industry. The availability of cheap holidays (by virtue of low cost flights and budget package companies) extends the problem in the industry. In the same way, our dependency upon the automobile for our mode of transport means that we are guilty of rewarding ourselves with more and more trips away to take relaxing time out. It is easy to see how an ecologically aware citizen can become just another selfish tourist (Allemand, 2005). The questions of how to change, what kind of change and delay to do it are seriously complex. It will take some time to change the habits and behaviours of previous generations who equate this method of transport with freedom or status.

11.3 Key Players in the World of Sustainable Tourism

On the demand side, 77% of French citizens consulted say they would be happy to see tourism and sustainable development work hand in hand even if this affects the way they need to look at their own role as tourists.[3] This is an encouraging sign for

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[2] www.comité21.org and www.agenda21.org

[3] Market research survey LH2 canvassing some 600 people broadly representative of the French population aged 15 or over, conducted by Les Echos, from 28th February to 14th March 2008.

future commitment to responsible tourism. It would seem that the groundswell of public opinion is in favour although predictions and forecasts do not necessarily translate into real figures of course. Authors (Babou and Callot, 2008) demonstrated that only a very small percentage of people surveyed said they were bothered about sustainable and responsible ecotourism ($n = 4/122$ for example 3.3% of those canvassed). This confirms the very low use (5%) of the *French Railways Company* (SNCF's) CO_2; Travel Calculator – the "écocomparateur"- a comparison tool, which calculates and compares the impact on the environment of various modes of transport. On the supply side the "green wave" of interest takes different forms. Firstly there is the whole system of eco-labeling. A similar form of categorisation exists for tour operators with specific qualifications required of those who offer responsible tourism packages. Then special mention needs to be made of the *Association for Responsible Tourism* (ATR) whose Ethical Charter can be found at (www.tourisme-responsable.org) and in which the legacy and consequences of tourism for the environment, local people and local economies is very clearly set out. This charter gives specific guidelines and instructions about what to do and not do as a tourist in particular situations and in particular destinations. Then, of course, there is the European ecolabel – applicable to tourist accommodation that has undergone important renovations in order to minimize its impact on the environment and which covers some thirty seven different criteria (energy, water, waste).

Other labeling systems exist, for example *La Clef Verte* -The Green Key (applicable to hotels, campsites and gîtes), *Tourisme et Handicap* – Tourism for the Disabled (the aim of which is to promote inclusivity of products and services), *Le Pavillon Bleu* – The Blue Flag for municipalities, beaches and marinas – always a guarantee of high environmental standards. Over and above these specific examples, it would seem that every branch of the tourist industry is moving, thankfully, towards more responsible and committed practices. Lastly we would single out for attention the work of the French organization *Observation, Developpement et Ingenierie Touristique* (ODIT[4]) which is literally teeming with recommendations and examples which are easy to put into practice.

11.4 Ecolabel Criteria Seen as Contractual Terms and Conditions of a Project

Here we present the objectives and guidelines, as set out by *Agence Francaise de Normalisation* (AFNOR), the *French Standardisation & Certification Organization*:

"The European eco-label or ecological community label is relevant to any type of tourist accommodation which falls within the following definition:

Tourist accommodation means the provision, for payment, to tourists, travellers and boarders, of overnight accommodation in properly equipped rooms containing

[4]The ODIT (French Tourism Development Agency) is joined now with "Maison de la France" under the name ATOUT France.

the very minimum of a bed. The accommodation may or may not offer or include food, personal relaxation facilities, gardens or parks. This definition is specifically designed to limit the impact upon the environment of the three main components of the service industry namely bulk purchase of raw materials, services and waste. In particular they are intended to:

- Limit energy consumption,
- Limit water consumption,
- Limit production of waste material,
- Promote the use of renewable resources and products which cause as little harm to the environment as possible,
- Promote discussion of and raise awareness of environmental concerns"[5]

11.5 Case Study

The plan is to restore premises in strict accordance with eco-label criteria and, as a result, achieve eco-label status for its owners.

The hotel project (14 bedrooms) is located in a rural community of some 1,800 inhabitants in an area of France well known for its white wine. The owners attended a conference on responsible tourism, and as a result, took the decision to embark upon the eco-label process. For many years, the owners had been thinking about starting up a small hotel-restaurant business and when they inherited an Anjou manor house 2 years ago they jumped at the chance to get the idea off the ground and set themselves up. The building is a typical example of local architecture (tufa walls and slate roof) and has a beautiful orchard attached. The view out on to the vineyards is the thing which made them really believe the project would work. They had huge backing from the local Mayor[6] and various public bodies which included assistance from the local Chamber of Commerce and Industry, and a local tourist advisor; provision by the Local Authority of a grant specifically designed for the hospitality industry in rural areas; and finally, significant assistance with investment in renewable energies provided by the *Regional Tourism Committee* (CRT) and French *Agency for Environmental Development & Energy Management*[7] (ADEME).

The extent of their local knowledge and contacts amongst local producers in the area, as well as the couple's professional background (husband a chef and wife previously a marketing executive for a big company) also helped to persuade the local bank manager to finance the project. In order to apply for the eco-label (see document at www.ecolabels.fr), the project was entered into the ecological community label class for tourist accommodation (AFNOR), and then there were papers to be

[5]Footnote to ecological community label EC350, 14/04/2003, AFAQ/AFNOR Certification.

[6]There being only 3 recently opened B&B rooms offering accommodation in the local community.

[7]Agency for Environmental Development and Energy Management (see local links and Energy Information pages on www.ademe.fr for the answer to all your questions)

lodged with the local prefecture via the *Local Commission for Tourism Development* (CDAT) in relation to tourist classification.

The manor house is in keeping with local architecture and the immediate environment. In a prominent position as you approach the hotel, there is a special area reserved for bicycles. The orchard has been retained and in the summer months its north facing section permits clients to relax there in the shade.

During the renovation process the 37 eco-label criteria were[8] used more or less as contractual terms and conditions of the building works with eco-design carried out by an architect specifically qualified in Advanced Environmental Quality work as well as local artisans with particular appreciation of and sensitivity to the spirit of the project.

11.6 Energy Criteria (Criteria One to Ten for Ecolabel Application)

Using the Advanced Environmental Quality criteria as a guideline and taking the lay-out and orientation of the property into consideration, around 25 m^2 of photovoltaic solar panels were fitted to the south-facing side of the roof – capable of generating up to 30% of estimated electricity requirements (€7,000 grant from Ademe given towards total cost of €17,500). Top quality materials in keeping with the locality were used throughout – such as hemp/jute, chalk and sand grouting, wooden parquet flooring in all rooms including bedrooms, the restaurant and outbuildings. Automatic timers have been fitted to all bedroom lights – equipped with energy saving light bulbs, and the central heating system has a similar sort of timing device in operation which is triggered by the opening of windows. It goes without saying that the windows are all fully insulated. The boiler fitted is a gas condenser, chosen for its efficiency in line with EEC directive 92/42/CEE. The temperature in all rooms is thermostatically controlled. Heat regenerators are attached to all fridges, washing machines and dishwashers in the property, which in any event have been chosen for their "energy efficiency"[9] in the first place.

In relation to *water consumption* (criteria 11–20) a lot of major improvements have been made. For instance, domestic waste water (showers, mains water) regenerators have been installed at the property so that water can be recycled and used in the toilets and then ultimately used for watering the orchard. The flow of water from showers and taps is regulated so as not to exceed 12 l/min.

Staffs have been trained to carry out daily inspections for leaks on the system and a few notices placed discretely about the place ask guests to let the management know of any malfunction they come across. There is an underground storage tank

[8] Actually, June 2010, they are 29 obligatory criteria and 61 optional.

[9] Class A energy efficient fridges, domestic washing machines and dishwashers.

(1,000 l capacity) for the storage of rainwater. Being a new establishment, the property is of course connected to the local purification plant for the treatment of waste water.

Before the hotel opened, the owners organised staff training in the use and misuse of *detergents and disinfectants* (criteria 21–29). €2,000 was set aside for this in the business set up costs. Several other innovations at the property fall under the heading of *general management* (criteria 30–37). For instance, an Environmental Charter (ten or so paragraphs), visibly displayed throughout the property, clearly sets out the management's commitment to eco-responsibility issues. It emphasises the need for shared responsibility, draws attention to the energy saving devices installed in the hotel as well as the use of local produce wherever possible. Personal development plans (based on a carbon footprint for each individual) have been put in place for staff – to be reviewed annually over a 2 year period. Staff members are to sign an incentive scheme at the end of the first year and be assessed on activities and behaviours monitored by management.

Management recording charts have been devised. They record the following for example: energy consumption (in kilowatts) and water usage (in litres) as against customer numbers in the restaurant and overnight stays, per square meter of land used by the business. They also record the amount of waste material (in kilos) generated by the business as well as the amount of chemical products used. The results will be sent to AFNOR on an annual basis. Finally, the clientele are made well aware of green transport issues (bicycles available for use while at the hotel). Alternately guests can borrow a car through a car-share scheme run in conjunction with the local municipality. In addition, the hotel offers guests free transfers to the closest *Transport Express Régional*, TER (French national railways local services), station.

11.7 Business Plan

The depreciations on the investments are of €56,000 for the first 3 years, €54,000 after and the annual repayment of capital borrowed of €49,000 (during 15 years).

Comments: The bank rate indicated is the rate prevailing at the start of the project. It may fluctuate from time to time. Shareholder funds do not usually have to be repaid while the loan is still outstanding. The grant from ADEME and the Local Authority appear in the finance and borrowing section. It is advisable to take out a bridging loan to cover the period between submission of written request, final approval and receipt of funds into the account. The small rural hotel grant in this case is €3,200 per room (two stars) plus a one off payment of €5,200 upon successfully gaining eco-label status.

The cost of the licence may fluctuate. The current licence permits sale of alcoholic drinks with main meal only.

Comments: The figures here are fairly constant. The rate of room occupancy reflects local tourist figures for this particular area of the country (high between seasons, low in winter and average throughout the summer months). The number

Table 11.1 The financial plan is as follows (expressed in thousands of €)

Costs and borrowing		Finance	
Set up costs	7	Own capital	194
Training	2	As percent of total investment	24.8
Insurance	2	Capital	25
Miscellaneous legal	3	Shareholder funds	169
Licence fee	1	Bank loan	530
Refurbishment, network and mains connections, solar panels, legal fees	645	Rate percentage	4.50
		Repayment term	15
Material, equipment	110	Annuity	49
Start up stock	3	Grant from ADEME	7
Bank	15	Small rural hotel grant	50
Total costs	781	Total finance and borrowing	781

Table 11.2 Hypothetical turnover (expressed in thousands of €s) and calculation of main outgoings (raw materials and staffing)

Year	1	2	3	4	5>
Hotel days open for business	320	320	320	320	320
Number of rooms	14	14	14	14	14
Occupation rate (percent rooms let) (%)	50	55	60	62	65
Room frequency index	2	2	2	2	2
Average price in € per room (inclusive of VAT)	68	68	68	68	68
Turnover inclusive of VAT-provisional figure	152	168	183	189	198
Turnover exclusive of VAT (VAT 5.5%)	144	159	173	179	188
Restaurant days open for business	320	320	320	320	320
Number of meals served	25	28	30	32	34
Average price of meal (inclusive VAT)	22	22	22	22	22
Percent cost of raw materials (%)	35	34	34	33	33
Turnover inclusive of VAT-provisional figure	176	197	211	225	239
Turnover exclusive of VAT	162	182	195	208	221
Cost of raw materials	57	62	66	69	73
Breakfast					
Percent take up rate (percent clients) (%)	80	80	80	80	80
Price of breakfast in € (incl VAT)	5.3	5.3	5.3	5.3	5.3
Percent cost of raw materials (%)	25	25	25	25	25
Turnover inclusive of VAT-provisional figure	19	21	23	24	25
Turnover exclusive of VAT (VAT 5.5%)	18	20	22	22	23
Cost of raw materials	4	5	5	5.5	6
Summary turnover inclusive of VAT total	347	386	417	438	462
Turnover exclusive of VAT global	325	361	390	409	432
Percent staff costs/turnover exclusive of VAT global (%)	33.5	33.5	33.5	33	33
Staff costs in figures	109	121	131	135	143

Table 11.3 Statements of income over 5 years

Turnover exclusive of VAT	325	100 (%)	361	100 (%)	390	100 (%)	409	100 (%)	432	100 (%)
Materials	61		67		72		74		79	
Profit	264	81	294	81	318	82	335	82	353	82
Outgoings	52		53		55		57		58	
Added value	212	65	240	67%	263	67	278	68	295	68
Taxes	2		4		6		7		8	
Staff costs	109		121		131		135		143	
Ebitda	101	31	115	32	126	32	136	33	144	33
Finance/loan/interest charges	24	7	23	6	22	5	20	5	19	4
Other outgoings	2		2		2		2		2	
Corporation tax (33% rate)	6		12		16		20		23	
Cash flow	69	21	79	22	88	22	94	23	101	23
Repayments	56		56		56		54		54	
Net Results	13	4	24	7	32	8	40	10	47	11

of meals served is a direct consequence of this atypical profile and reflects heavy reliance on local custom as opposed to hotel guests or passing trade.

The percentage costs of raw materials are typical of the trade. The steady outcome for this section of the business is a direct result of using local producers. Losses incurred in relation to over-stock are thus minimized. Losses recorded on breakfast figures are higher than average for the profession (use of local fruit jams, compotes and organic fruit juices). Staff costs cover three full-time and one part-time member of staff. The elevated overall figure reflects incentive payments and bonuses offered. The breakfast take up figures relate to take up by hotel guests.

The external outgoings for year one are evaluated at €52,000 (including laundry, energy, cleaning materials, insurance, marketing/advertising, telephone and postage, upkeep and repairs, decoration, welcome pack per room...) with a growth of 3% per year after.

"Other outgoings" relates to television licence fee.

Performance ratios, presented in Table 11.4, here are as follows (note: Average Profit/Own Capital = Average turnover/Gross Investment × Gross Investment/Own Capital × Average Profit/Average Turnover)[10].

Comments: Return on own capital is consistent with and even slightly higher than average for the hospitality sector, repayment of capital costs being made over 6 years approximately.

Comments: The funding is spread equally over the 5 years. If the terms and conditions of the bank loan permit discretionary repayment in full, business partners can request this in the fifth year. We haven't carried out complex calculations to reflect any change of needs over the years given that this made very little difference to the working capital balance. Stocks and securities (VMP) appear as a fifth year cost thus optimizing funds available.

Table 11.4 Return on capital

Ratios	Le layon	Average
Turnover/gross investment CA/IB	0.508	0.66
Gross investment/own capital	3.89	3.33
Average profit over 5 years/turnover	8.13%	7.00%
Average profit over 5 years/own capital	16.06%	15.40%
Period of years	6.2 years	6.5 years

[10]Average turnover over 5 years: 383.4 K€; Gross investment: 755 K€; Own capital: 194 K€; Average profit over 5 years: 31.2 K€; Callot (1996, 2006)

Table 11.5 Financial plan over 5 years

Financial plan	1	2	3	4	5
Set up costs	7				
Costs	756				80
Intangible	1				
Tangible	755				
Other (VMP)					80
Increase in working capital (Virtually nil variation)	2				
Repayments	26	27	28	29	30
To bank others (shareholders equity)	26	27	28	29	30
Total required	791	27	28	29	110
Capital	25				
Shareholders' equity	169				
Cash flow	69	79	88	94	101
Grants/donations	57				
Bank loan	530				
Total assets	850	79	88	94	101
Closing balance	59	52	60	65	(9)
Cumulative balance	59	111	171	236	227

11.8 Conclusion

The project is consistent with sustainable development and also profitability aims. Since it involves the use of an existing building, no additional physical footprint is created. The eco-labeling procedure requires participants to take both environmental and social responsibility concerns into account. The creation of three full-time and one part time job helps maintain employment in a demographically vulnerable community. This is a real corporate social positive impact in a rural area. A strong network of links with local producers helps to support local industries at the same time as protecting the environment. Of course this is only a small hotel but it's an example of what could be achieved on a bigger scale. We would like to thank Olivia Gautier – the manager of the *Orangeries* hotel in Lussac-les-Châteaux (France), for all the encouragement and help she provided in compiling this report.

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Part IV
Accounting and Financial Reporting

Chapter 12
A Global Accounting Standard: The Holy Grail?

Paul Saw

Abstract The move to a global standard through the International Financial Reporting Standards is the single most important initiative in the financial reporting world as its impact stretches far beyond accounting to affect many key decisions people make. Trillions of dollars have been invested in companies globally and stakeholders are demanding greater transparency in stewardship accounting: the call for clear and concise guidance towards responsible accounting has never been louder. This chapter begins by looking at what international accounting standards are and how they come about through the work of the International Accounting Standards Board and its predecessor the International Accounting Standards Committee. Various leading writers in the field have highlighted similar reasons for and against the globalisation of accounting standards but the decision on which option to take was not an easy one since in some cases it was often difficult to quantify and measure the relevant variables. The chapter ends with some emerging issues of concern which if the IASB were to choose to ignore; it would have chosen to do so at its own peril.

12.1 Introduction

One of the most pervasive, dynamic, controversial and problematic accounting challenges of this century is the quest for a global accounting standard. As the world continues to become smaller as a result of several factors e.g. the speed at which information transfers from one end of the world to the other, global standards are being set for everyone and everything. Corporate social responsibility demands that all business enterprises monitor their accounting practice ensure their adherence to international norms and accept responsibility for the impact of their reporting

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practices to the stakeholders and the wider publics. The challenge has dragged in many participants and non-participants – willingly and unwillingly – into the process of modifying the twenty-first century accounting practices. A question that comes to mind immediately is "Is is possible to size fit all issues when it comes to global accounting standards?"

If accounting and financial reporting were identical in all business enterprises and/or throughout the world, it would make the above challenge a mockery. The fact that this is emphatically not the case forms the basis for the issues and concerns explored in this chapter. Various classification systems have been devised (see Seidler, 1967; AAA, 1977; Nair and Frank, 1980; Gary, 1988; D'Arcy, 2001; Nobes, 2004; Choi and Meek, 2008) to group together several countries' accounting methodologies, but the attempts have been oversimplified, as the accounting regulations, culture and changing economies within the identified clusters do not result in unified accounting practices. Carnegie and Napier (2002) added that accounting historians have long recognised accounting's international scope leading to the diffusion of accounting ideas, techniques and institutions.

There have been increasing attempts towards reconciling the world's diverse accounting practices through the work of the International Accounting Standards Board (IASB), which has led to a plethora of international accounting standards. Such standards remain on the forefront of the international accounting and reporting agenda because from 2005, listed companies in the EU (and gradually elsewhere) are required to prepare consolidated accounts according to them.

This chapter is organised into three sections. The first section provides the background information about international accounting standards – how they came about and where they are today. The second section explores the pros and cons of having a global accounting standard. The third section discusses emerging issues.

12.2 How Did International Accounting Standards Come About and What Are They?

12.2.1 Brief History of International Accounting Standards

The International Accounting Standards Committee (IASC) will always be commended for its noble attempt at the making of a global accounting standard as they started the journey actualising a world-wide vision in which countries will just use the same set of Generally Accepted Accounting Principles (GAAP). As noted by Choi and Meek (2008), companies seeking capital outside of their home markets and investors attempting to diversify their investments internationally were facing increasing problems resulting from national differences in accounting measurement, disclosure and auditing.

So in 1973, the IASC was founded by the professional accountancy bodies of nine countries: Australia, Canada, France, Japan, Mexico, The Netherlands, United Kingdom and Ireland, United States and West Germany (Benson, 1979). From its

humble beginnings with a few collections of various existing best accounting practices and many critics, the IASC started pioneering the complex process of standard setting on a world-wide basis through intensive technical and persuasive political negotiation (Camfferman and Zeff, 2007). Over the next 27 years of its existence, the IASC issued 41 sets of "accounting rules", which practice was regarded as the best and should become the world standard. The International Accounting Standards (IASs) were born and are here to stay.

But in 2001, the IASC was abolished and its rule-making function was taken over by a newly-reconstituted organisation based in London. The International Accounting Standards Board (IASB) was better funded, better-staffed and more independent. All meetings of the IASB are held in public and webcast. In fulfilling its standard-setting duties, the IASB follows a thorough, open and transparent due process of which the publication of consultative documents (such as discussion papers and exposure drafts) for public comment remains an important component.

Its members (currently 15 full-time members) are responsible for the development and publication, in the public interest of a single set of high quality global accounting standards. These are the International Financial Reporting Standards (IFRSs) and Interpretations of IFRSs as developed by the International Financial Reporting Interpretations Committee (IFRIC). The IASB works in close cooperation with stakeholders around the world such as investors, analysts, national accounting standard-setters, accountancy profession, regulators, auditors, academics, and others who have an interest in the development of high quality global standards (such as business leaders) towards corporate social responsibility. Progress towards this goal has been steady, even though the degree of participation from the stakeholders has been varied. It is interesting to note that Jorissen et al.'s (2006) research revealed that preparers (companies and banks) took a much more active role (ranked first) than the users (ranked last) in influencing the standard-setting process. The accounting profession (audit firms, accountants) and the national standard setters were ranked second and third respectively. The findings were based on the number of comment letters (on IASB's discussion documents and exposure drafts) sent to the IASB between 2002 and the summer of 2005.

The IASB adopted as legitimate all the 41 prior IASs in 2001. Since 2003, the IASB has worked tirelessly by revising some IASs with major amendments, replacing some IASs with the new label – International Financial Reporting Standards (IFRSs) and issuing some original IFRSs.

Most standards will continue to be revised since their original issue. If accounting standards are to make sense of reporting practices in a rapidly changing international environment, it has to evolve with revisions, in order to address the complexities of any reporting climate. Gernon and Meek (2001) emphasised that accounting is shaped by the environment in which it operates – i.e. accounting is context specific. Financial reporting, after all, must develop in and be nurtured by its environment, thus reflecting the richness and diversity of users and uses to which it is subject to. Any reporting standards – let alone global ones – are only effective when related to the context of the reporting environment itself, be it from a demand or supply perspective.

12.2.2 List of International Accounting Standards

A full list of the original international accounting standards is given in chronological order below. Where an international accounting standard is denoted in italics, it is because it has been replaced by a later international accounting/financial reporting standard or withdrawn.

- IAS 1: Presentation of financial statements
- IAS 2: Inventories
- *IAS 3: Consolidated financial statements (superseded by IAS 27 and IAS 28)*
- *IAS 4: Depreciation accounting (withdrawn)*
- *IAS 5: Information to be disclosed in financial statements (superseded by revised IAS 1)*
- *IAS 6: Accounting responses to changing prices (superseded by IAS 15)*
- IAS 7: Cash flow statements
- IAS 8: Accounting policies, changes in accounting estimates and errors
- *IAS 9: Research and development costs (superseded by IAS 38)*
- IAS 10: Events after the balance sheet date
- IAS 11: Construction contracts
- IAS 12: Income taxes
- *IAS 13: Presentation of current assets and current liabilities (superseded by revised IAS1)*
- *IAS 14: Segment reporting (superseded by IFRS 8)*
- *IAS 15: Information reflecting the effects of changing prices (withdrawn)*
- IAS 16: Property, plant and equipment
- IAS 17: Leases
- IAS 18: Revenue
- IAS 19: Employee benefits
- IAS 20: Accounting for government grants and disclosure of government assistance
- IAS 21: The effects of changes in foreign exchange rates
- *IAS 22: Business combinations (superseded by IFRS 3)*
- IAS 23: Borrowing costs
- IAS 24: Related party disclosures
- *IAS 25: Accounting for investments (superseded by IAS 39 and IAS 40)*
- IAS 26: Accounting and reporting by retirement benefit plans
- IAS 27: Consolidated and separate financial statements
- IAS 28: Investments in associates
- IAS 29: Financial reporting in hyperinflationary economies
- *IAS 30: Disclosures in the financial statements of banks and similar financial institutions (superseded by IFRS 7)*
- IAS 31: Interests in joint ventures
- IAS 32: Financial instruments: presentation
- IAS 33: Earnings per share
- IAS 34: Interim financial reporting

- *IAS 35: Discontinuing operations (superseded by IFRS 5)*
- IAS 36: Impairment of assets
- IAS 37: Provisions, contingent liabilities and contingent assets
- IAS 38: Intangible assets
- IAS 39: Financial instruments: recognition and measurement
- IAS 40: Investment property
- IAS 41: Agriculture
- IFRS 1: First time adoption of international financial reporting standards
- IFRS 2: Share-based payment
- IFRS 3: Business combinations
- IFRS 4: Insurance contracts
- IFRS 5: Non-current assets held for sale and discontinued operations
- IFRS 6: Exploration for and evaluation of mineral resources
- IFRS 7: Financial instruments: disclosures
- IFRS 8: Operating segments
- IFRS 9: Financial instruments

The full text of all the IASB's standards can be obtained from their annual volumes (IASB, 2010). Good summaries of IFRSs can also be found in www.iasplus.com/standard/standard.htm. For further guidance on how to use the above accounting standards, see Finch (2008) or Alfredson et al. (2007).

12.2.3 Some Confusion with Respect to Accounting Standards

To avoid any misunderstandings of usage in this chapter, it is necessary to clarify one term which has been misused in the global reporting arena.

The term IFRSs has both a specific and a general reference. Specifically, IFRSs refer to the post-2001 international accounting standards issued by the IASB. They are normally addressed by the abbreviation IFRS, followed by a number as seen above. This means that IASs would relate to the pre-2001 standards set by the IASC.

Generally, IFRSs refer to the IFRSs and also all the IASs. For the purposes of this chapter, the all embracing general reference of IFRSs is the one adopted as both IFRSs and IASs serve the same global reporting objectives. More than 130 countries require or permit IFRSs, while the remaining major economies have established datelines for convergence with, or adoption of, IFRSs (further details can be found at http://www.iasplus.com/country/useias.htm).

To be precise, IFRSs refer to the entire body of IASB pronouncements, including "interpretations" approved by the IASB and Standard Interpretations Committee's "interpretations" approved by the predecessor IASC. The "interpretations" serve to interpret the application of the accounting standards and provide timely guidance on financial reporting issues not specifically addressed in all the standards in the context of the IASB Framework.

12.3 Why Globalise?

The move to a global standard through the IFRSs is the single most important development in the financial reporting world since accounting standards were first introduced.

Various leading authors (Choi and Meek, 2008; Roberts et al., 2008; Nobes and Parker, 2010) have highlighted the benefits and problems arising from the globalisation of accounting standards. They are:

12.3.1 Globalisation of Standards: Benefits

- Investors and financial analysts would be better able to understand the financial statements and investment opportunities of foreign companies whose shares they might wish to or advise others to buy. Financial statements from different countries would become more reliable and comparable, or at the very least, be clear to users about the nature and magnitude of their differences. This would reduce the risk for investors and bring the cost of capital down (Saw, 2007).

  Otherwise, this process can be time consuming, costly and difficult as there is normally not enough information given to users to convert the divergent reported figures. This would tempt investors to make educated guesses on the limited financial information or stick to their home market. These inefficiencies would not lead to confidence in comparing wider, including cross-border opportunities leading to better investments and missed investment opportunities. Having a set of global standards would lead to more effective communication with investors and other international users of the accounts.

  Portfolio theory advocates that the benefits of diversification are maximised if investors have a proportionate spread across the entire international stock market (Timothy and Perera, 2007). The findings from Hirshleifer and Teoh (2003) revealed that individual investors who are less informed and less equipped to deal with different accounting systems will be more reliant on the financial statements, and thus will not be able to compete on equal terms with the professionals (see also Leuz and Verrecchia, 2000).
- Regulators would be interested in protecting investors within their spheres of influence. Due to the opening up of the capital markets, companies are issuing new shares beyond their domestic markets. When such shares are quoted on a foreign stock exchange, that stock exchange may demand those financial statements to be consistently prepared with the foreign accounting practices. This means incurring costs of re-writing financial statements using the other country's set of accounting standards. Globalising accounting practices would reduce such costs in the promotion of share issues and should increase the efficiency with which stock markets incorporate information in their prices.

  International credit grantors such as the World Bank would also face fewer problems in comparison. This would further reduce the cost of accessing the capital markets around the world. Active, liquid and stable capital markets fuel economic growth. After all, a thriving capital market demands a high degree of investor understanding and confidence (Nicolaisen, 2005).

- For multinational companies (MNCs), the tasks facing financial accountants to prepare and consolidate financial statements would be much simplified if statements from all around the world were prepared on the same basis. MNCs normally keep at least two sets of accounts: consolidated accounts using parent company generally accepted accounting principles (GAAP) for the whole group and individual accounts for each subsidiary using local GAAP. The latter requirement is destined mostly for tax measurement.

  These multiple reporting requirements on the same event create substantial direct costs (additional data collection, collation, dissemination and auditing) as well as extra indirect costs due to differences in reporting requirements. It begs the question that if there are two sets of figures, each claiming to measure the same event, which is the "correct" one?

  Furthermore, what should MNCs do if the two accounting systems conflict, whereby one system leads to increased reported earnings but reduced earnings reported in the other? This was demonstrated clearly by Nobes and Parker (2010) where the reported figures on the same financial item prepared under UK Accounting Standards, US GAAP and IFRS generated differences ranging from –227 to +8,876%!

  The task of preparing comparable internal information for the appraisal of the performance of subsidiaries and investment appraisal in different countries would be greatly facilitated too, due to reduction in the risk of uncertainty and misunderstanding by managers inside the company (see Bushman et al., 2007).
- International accounting and auditing firms (as well as MNCs) would find it easier to transfer accounting knowledge and skills from one country to another. They would save considerable costs for staff and auditors to learn and comply with the multiple sets of accounting standards. Academics and students would earnestly agree too.
- Taxes are payable on the total global income in a group of companies. Tax authorities face great complications when assessing foreign incomes due to differences in the measurement of profit in different countries. It should be pointed out that the tax authorities themselves are responsible for some of the differences, for example the influence on tax in continental Europe.
- Other organisations that would benefit from greater international comparability are employees of multinational employers and their labour unions when using financial statements in negotiations on salary or working conditions. Lenders, suppliers, customers would also benefit in gauging the creditworthiness or future prospects of foreign-owned subsidiaries.

12.3.2 Globalisation of Standards: Problems

- The size of the present differences within and between the accounting practices of countries remain the biggest obstacle. There is doubt that international backgrounds, deep-rooted traditions, and differing stages of economic developments. A common scenario is where a listed international company in country X follow the IFRSs but the large domestic company in the same country adopts the national GAAP.

Because of the different environmental influences, there could be an "appropriate" and "necessary" case for different accounting standards across countries (Choi, 1981; Ball, 2006). It is not difficult to see that the Marxist reporting practices in a Communist country (such as Cuba, North Korea) will be very different from an Anglo-Saxon country (such as UK, Australia) keen on reflecting the concepts of truth and fairness. If accounting is to remain context specific, should reporting practices not legitimately vary to reflect different countries' business and economic circumstances?

Does globalisation of standards not become more useful when it concerns similar users receiving information from companies in different countries? Can the IASB create a clear reporting global standard that is well understood in different languages and environmental contexts? The big question is whether international standards are too simple a solution for a complex problem.

- Whilst a national government still has the task of ensuring compliance with the global standards, it would also encounter loss of control over the nature and content of the accounting standards if globalisation takes place. What if a government does not believe that one system fits all?
- There would be the inevitable emotive problem of nationalism, with the fear of losing or diluting one's own identity or national sovereignty (Lehman, 2005). This might manifest in an unwillingness to accept compromises that involve changing accounting practices towards those of other countries. The USA is a good example.

  Sometimes this manifestation of nationalism may be caused by the lack of knowledge or interest in accounting or loss of power. Rahman (1998) concluded from his studies on the power perspectives that developing countries have "little voice" and may not be able to influence the global standard setting process to the same degree as developed countries.

  A subtle defence would be that it would be more difficult to alter standards set outside one's own country in response to a change of mind or a change of circumstances. It is a natural response to a political threat to national sovereignty.
- Another difficulty would be the effect of "economic consequences" in moving to IFRSs. Companies already subjected to an ever-growing array of national, social, political and economic pressures would have the added burden of complying with additional and costly international accounting requirements. There would be extra costs (such as the use of new accounting software and hardware, staff training, etc.) which might pose a substantial drain (being upfront and losing out on the economies of scale) on the financial resources of the smaller company. Socially responsible accounting needs to acknowledge the trade-offs between advocating increasing corporate responsibility and the costs or limitations of compliance with IFRSs.

  But large international accounting firms, being more resource rich would then become indispensable and even further monopolise the services needed by the international financial institutions and markets. Such an oligopoly would not be desirable.

- Globalisation would fail to take into account the different but effective role played by financial reporting in each case by upsetting the balances of interests which have been working well over a long time. National accounting rules evolved over time and are a reflection of the sociological, cultural, political and economic characteristics of a country. International standards would not be suitable for small and medium-sized companies, especially unlisted ones with no accountability.

  Standards written to meet the needs of a diverse range of users in the world's capital markets would be unnecessarily complex for these types of companies (such as on derivatives and hedging, foreign operations, business combinations). According to Pacter (2009), part of that burden has arisen because accounting standards designed for public capital markets are increasingly being "pushed down" to entities without public accountability, either because their jurisdiction has replaced its national GAAP with IFRSs or has been, little by little, converging its national GAAP with IFRSs. This would lead to an unwarranted standards overload.

  To counteract this problem, the IASB issued a version of "big GAAP/little GAAP" in July 2009 called "IFRS for SMEs" (small and medium-sized entities). It is essentially derived from the principles of full IFRSs but with limited disclosures and simplified treatment of items or exclusions such as consolidations. But should the new rules be voluntary or mandatory? Would "IFRS for SMEs" be suitable for a medium-sized company? This question is posed putting aside the debates on what constitutes a small or medium company.

  Christodoulou (2010a) noted that there were reluctance from a number of countries to require or permit the "IFRS for SMEs" adoption such as Canada, France, Germany, Mexico, Netherlands, Poland, Japan, Malta, Slovenia and Switzerland. He added that Germany and France both rely on their accounting systems for tax collection, which is fuelling reluctance to support the "IFRS for SMEs".

  As IFRSs are already widely used, so a very large number of small and medium-sized entities would be able to use a different set of standards from the larger counterparts – even for similar transactions. So, would using two different standards to disclose the same transaction a good idea? Would the confusion be a step backwards? What about a simplified but more useful IFRS for just the "small" enterprises?

The above reasons are by no means exhaustive but they do represent the key recurring arguments used from both standpoints. The decision on which option to take is not an easy one since it is difficult to quantify and measure the variables above.

12.3.3 Globalisation of Standards: Which Form?

If the arguments above convince us that there is a case for globalisation, there is still the question of "What kind of standards?" (Roberts et al., 2008). Should there be harmonisation leading to harmony, or standardisation leading to uniformity?

The terms "harmonisation" and "standardisation" tend to be used rather loosely and sometimes interchangeably (Emenyonu and Gray, 2004). But they are not the same, since the latter can be seen as a subset of the former.

Standardisation refers to a perfect world scenario of maximum harmony when all companies in the world use the same accounting policy for the same accounting item. This notion of uniformity implies obedience to a set of rules or standards. Standardisation thus ignores the possibility that companies may be subject to different environmental factors which arguably justify the adoption of correspondingly different accounting policies. Different commercial circumstances do indeed motivate the choices of different accounting methods (Archer et al., 2004).

This leads to the more flexible and plausible notion of harmonisation towards achieving compatibility. Harmonisation is a gradual process of increasing the comparability of accounting information by setting bounds to the degree of varying accounting practices. It reduces the risk of misunderstanding when financial statements are communicated nationally and internationally on a consistent basis. It is important to note that harmonisation does not necessarily imply replacing national standards with international ones – both could coexist.

However, the IASB prefers to use the term "convergence" instead of harmonisation. As noted by Bader (2009), the concept of harmonisation evolved into one of convergence in 2001 when the IASC had to be restructured. Convergence basically is a programme of harmonisation of national accounting standards with IFRSs towards a set of higher quality global accounting standards (Pacter, 2005). The IASB has expressed its determination to issue principle-based standards, meaning that it should generate fewer rules, less complex standards and provide more room for professional judgment in unspecified provisions.

Nevertheless, this does not mean that all the key players will agree on what this set of global standards should look like. This will be a problem inside any one country, but it will be a bigger problem in an international setting (Roberts et al., 2008).

12.4 Emerging Issues

- According to Roberts et al. (2008), it is important to be aware that harmonisation of rules *(de jure)* do not always lead to harmonisation of practices (de facto). The notion that having a global set of standards alone will produce consistently high quality financial reporting is naïve. In fact, Tay and Parker (1990) pointed out that de facto harmonisation is more useful than *de jure* harmonisation.

  Whilst the IASB's political efforts have lead to offers of endorsement to mandatory adoption of the standards, actual and consistent implementation is yet to be fully evidenced across all the adopting countries.

  Ball (2006) commented that it is not clear how much IFRS implementation in "actual financial reporting practice" would (or should) occur; as most political and economic influences on financial reporting practice remain local, not global

(see also Zeff, 2010). Examples of established local influences cited (which are unlikely to disappear overnight) include the status and regulation of auditors, the politics of government involvement in financial reporting practices, structure of corporate governance and, of securities regulation and regulatory bodies. He added that the widespread adoption of IFRSs will mislead investors *into believing that there is more* [*international*] *uniformity in practice than actually is the case and that, even to sophisticated investors, international standards will be hidden under the rug of seemingly uniform standards. . .by burying accounting inconsistencies at a deeper and less transparent level than* [more-readily observable] *differences in standards* (p. 26). This means that investors would be even worse off now, rather than benefitting them as discussed earlier.

There is also some latitude factored into the IFRSs to allow for judgment amongst alternative accounting methods – which is unlikely to be exercised uniformly within and across countries. The implementation of fair value accounting, IAS 36 and IAS 38 would further demand the subjective assessments of distant future cash flows, thus generating a range of possible reporting outcomes. Uneven implementation would further worsen the lack of uniformity in accounting practices within and across the adopting countries or companies, particularly those still struggling to emerge from the recession or in illiquid markets.

- Comparability of financial reporting practices would need consistency of compliance. Globalisation of reporting practices would not work without some form of enforcement. As Brown and Tarca (2005) pointed out, rule-making is not the same as rule-enforcing. However, the IASB is a standard setter, not a standard enforcer. Moreover, Hope (2003) compiled an "enforcement index" (based on audit spending, judicial efficiency, rule of law, insider trading laws and shareholder protection) for 21 countries and found that they do vary across nations with US, UK, Canada at the top and Italy, Spain and South Africa at the bottom.

  It is interesting that Ball (2006) points out that the IASB has not shown any interest in disallowing or dissuading "weak-adopting" or "free rider" companies or countries from using the IFRS brand name as a signal of quality. Such inattentive policy with no penalties exposes the IFRSs to the risk of adoption only. He added the very meaning of IFRSs adoption and the implications of adoption are not clear.

  If enforcement cannot be sustained globally, then the IASB's mission would not be successful. Currently the IASB as a private sector body is not backed by any national government. It has to rely on the goodwill of auditors, stock exchanges and its regulators, government departments and agencies, and other private-sector bodies to ensure the compliance and integrity of the accounting standards (Saw, 2002). As these are national or regional regulatory agencies, it is questionable how effective or independent they would be, given the recent spate of accounting scandals.

  Considering that the standards would be international, there is a lack of an international regulator that would be given enforcement powers. Weak legislation, lack of resources (financial and human) and an ineffective audit profession could make compliance with IFRS voluntary (Roberts et al., 2008).

- The global accounting standard would have to address the new challenge of how to communicate across national boundaries. It has become important to respect the financial information demands of users of other countries, especially those not represented on the IASB. According to Walton et al. (2003), there are generally speaking, different priorities and objectives given to financial reporting in different countries. Countries adopting the Continental Model (France, Germany and Japan) produce accounts with the primary objective of calculating distributable income which is linked intimately to computing tax or demonstrating compliance with the national government's macroeconomic plan. In contrast, countries adopting the Anglo-Saxon Model (UK, USA, Australia), the focus is towards the decision needs of the external capital market users, with extensive disclosures to judge managerial performance and predict future cash flows. The former will lead to conservative accounting and the exercise of choices which would tend to minimise profits, while the latter will encourage management to make choices which emphasize profitability. Differences as deep rooted as this cannot be made to disappear overnight, if at all, and will affect comparability deeply.

  This means that comprehensive globalisation could only be achieved if the environments (such as companies' source of finance, legal systems, political and economic ties, inflation levels, general levels of education, culture, tax regulations) are harmonised as well. IASB will continue to press for global standards convergence, whilst fighting against political interference in the standard setting process from the US and Europe. Interestingly, there is no firm adoption timetable from the US, which can fuel growing antipathy messages to the other countries regarding convergence. The EU could break away from the IASB and form a rival advisory "European Accounting Standards Board". Who knows, such a "competitor" may revive innovation and produce better quality standards than those of the IASB. Questions have already been raised on how long the IASB can continue as a private sector body, with no jurisdictional location and dependent on donations and subscriptions (Roberts et al., 2008).
- In spite of the drift towards international representativeness, the IFRSs currently resemble the Anglo-Saxon model of accounting. How long that could be sustained is another question. Ball (2006) commented that the current membership representatives and philosophy of the IASB are likely to encounter challenges in the longer term. He added that the IASB risks turning into a "politicised, polarised, bureaucratic, UN-style body".

  Membership of the standard-setting process could change to reflect more the diverse politically-legitimate representation of its 130 member nations from other accounting models such as the Islamic and emerging economies, even though that geographical equilibrium is not easily ascertained. This would strengthen the legitimacy of the IASB (Alexander et al., 2009). After all, the standards designed by the IASB have an impact on the member countries.
- Another aspect that needs to be revisited is whether accounting of all types of enterprises has to be globalised or whether globalisation should be limited to specific types which are listed or with limited liability or exceeding particular size criteria. Indeed it is not clear why reporting diversities should be overcome.

There are many non-participants on the international reporting arena who are affected (such as companies, preparers, users, regulators, auditors) but might be worse off through the imposition of the global standards.

Perhaps, a plausible way forward is to allow for a dual reporting model allowing two sets of rules (with tax implications in some countries): one for the domestic and another for international consumption, or one for parent statements and another for consolidated (Nobes and Parker, 2010). It would be useful for the international participants to provide a reconciliation statement which provides a bridge between the two on reported key accounting measures such as total comprehensive income, total assets and changes in equity. Having more than one figure for the measures above would also serve as a constant reminder that accounting is and can never be an exact science. The crucial point to remember is that globalisation of accounting standards cannot be expected to eliminate diversity in practice.

12.5 Conclusion

Though corporate social responsibility has been redefined throughout the years, it essentially boils down to the honouring of a triad bottom line: People, Planet and Profit. With that in mind, the goal to create a global accounting standard is desirable in an increasingly globalised world but not easy to achieve. Interest in responsible accounting will continue to grow among a broad range of business enterprises, investors and other stakeholders. The increased reporting transparency through the IFRSs can lead to greater accountability of the enterprise, thus increasing our understanding of an enterprise's performance and the quality of its management. There is the danger in expecting the IASB to conjure up a complete set of global rules or principles that can fully cover every feasible financial reporting contingency or is prescriptive to every small detail – both present and future. The IASB does not have a crystal ball.

The substantial differences in financial reporting requirements and practices around the world, and the increasing need of financial statement users to compare and make sense of company information from different countries, have and would continue to be, the driving forces behind the movement to globalise accounting (Choi and Meek, 2008). Evidence gathered by Daske and Gebhardt (2006) showed that disclosure quality has increased under IFRSs in the three European countries analysed (Austria, Germany, Switzerland). Importantly, the findings do not just hold for firms which have voluntarily adopted IFRSs, but also for those which mandatorily adopted such standards in response to requirements (such as the German Stock Exchange for specific market segments).

The perceived benefits of using a set of global accounting standards are based on having assurance about the comparability and the high standard of the accounting information provided (Roberts et al., 2008). It is difficult to believe that implementation would be of an equal standard in all the adopting countries (in varying stages of development in both accounting/auditing professions and capital markets), as long

as weak international IFRS enforcement mechanisms are in place. It threatens to annul many of the potential benefits of IFRSs adoption. It would become the "thorn in the flesh" for the IASB, painful and long-lasting.

The IASB aims to continue to improve accounting standards through amendments and issue of new ones, especially in reflecting the emerging reporting issues from the recession and financial crisis. In fact, the IASB would need to do more than that – it needs to be more proactive rather than reactive in the promulgation of the standards. Christodoulou (2010b) commented that the IASB's stubborn and determined push for convergence is because it has more to lose from walking away than it does from continuing.

The idea of making all accounting standards into one global set has not yet been generally accepted everywhere. From the discussions above, it is evident that things are not as clear-cut as what the IASB would like us to believe. Ball (2006) also concludes that most would agree that some degree of globalisation of accounting standards at every level – company, industry, country and world – is optimal. But exactly how much and what is feasible is yet to be answered.

There is a danger that the IASB's convergence project can lead to a one of divergence in the extent to which standards can be unevenly implemented. The road ahead for the IASB appears to be a long and windy one, if it perseveres. If so, then a question arises as to whether the IASB's pioneering vision is a quest for the Holy Grail or an unholy dash to an early grave?

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Chapter 13
Accounting for Decision Makers in a Sustainable Environment

Samuel O. Idowu

Abstract This chapter discusses accounting for decision makers in a sustainable environment using some traditional accounting techniques which accountants and corporate managers use when making both short term and long term financial decisions. The chapter discusses these accounting techniques not in terms of the traditional bottom line results focus but in relation to sustainability, corporate social responsibility and the future of planet *Earth* in mind. It explores how these techniques have been adapted to take cognisance of sustainable issues using some of the principles scholars have advocated that we should use when embedding issues relating to Social and Environmental Accounting (SEA) and Environmental Management Accounting (EMA) in planning, control and decision making activities of an entity. This was considered necessary since it has been argued that those companies adopting socially responsible ethos are likely to remain more competitive and therefore better able to satisfy the requirements of their traditional bottom line results and sustainable development than those companies which do not adopt these principles.

13.1 Introduction

Accounting has been described as the language of business, as it communicates both financial and non-financial information to corporate entities and individuals who have an interest in the activities of an organisation (Drury, 2000). It has also been variously defined. For instance (the American Accounting Association, 1966) defines it as *the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information.* (Lehman, 1995) describes it as "part of the public information given by a firm to 'others' to justify its behaviour"; (Lehman, 1995) also suggests that "Accounting

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is both the means for defending actions and the means for identifying actions one must defend" This suggests that Accounting plays a vital role in facilitating society's understanding of the effects of corporate actions on all and sundry, which hopefully enables society to decipher which of these actions have favourable impacts and should be encouraged and supported and which of them have adverse consequences and thus requires that a particular corporate entity or a group of them need societal sanctions for the adverse impacts of their operations.

Basically, accounting provides the information required by managers, investors, lenders, tax authorities and a host of other users of financial information in society (those who *The Corporate Report,* 1975) of the then UK Accounting Standards Steering Committee refers to as the *user* groups) in order to help them when making informed decisions about a particular entity at any given point in time. The issue of sustainability is now of particular interest to all the aforementioned user groups.

The phrase "Sustainable environment" has been used over and over when discussing issues that relate to the future of our planet and how man uses his nature endowed resources. What does it really mean? An environment is described as sustainable if those who live and operate in that environment; these include man and other life forms are able to continue their current way of life for an indefinite period without the possibility of causing hardships to future generations of all life forms. Unfortunately, it has recently been realised that man's past way of life is unsustainable, which has resulted in the call for man to change his attitude and behaviour towards the natural environment. This change includes a change in man's accounting practices; the way accounting information is prepared and used by users for planning, control and decision making.

13.2 Financial and Management Accounting

Accounting information is aimed at two classes of users; namely external and internal users. This consequently suggests that the field of accounting can broadly be divided in to two areas namely; financial accounting and management accounting. Financial accounting information is (normally in the form of the legally required in most nations of the world yearend annual report and accounts) prepared with the main objective of providing information to external stakeholders – these are users of this accounting information who are outside the entity's information *gathering*, *processing* and *decision-making* systems. The information derived for financial accounting has many market and non-market related implications to listed companies and some important implications to non-listed companies. Management accounting information (the main focus of this chapter) on the other hand; is aimed at internal users (those within the organisation) whose jobs require them to plan, control and make decisions – (which might be strategic, tactical or operational decisions in nature). Most of the decision guiding techniques used until recently by management accountants and corporate managers all over the world have evolved over several decades in the past; when issues relating to sustainability,

environmental pollution and degradation or corporate social responsibility were of little or no relevance to society. This was perhaps why (Milne, 1996) notes that corporate accounting and management accounting in particular, have ignored a wide range of non-market activities that are associated with private sector organisations and their impact on biophysical environment. Bloom and Heymann (1986) also argue that "traditional accounting procedures concentrate on quantitative measures of economic transactions and ignore the social costs of environmental pollution, of resource exhaustion or project impact on cultural and ethical values". (Ward, 2005) in his Presidential foreword to IFAC's *International Guidance Document: Environmental Management Accounting* also argues that there is a growing consensus that conventional accounting practices simply do not provide adequate information for environmental management purposes. Society's improved knowledge about the inadequacies of these old and out-dated techniques has resulted in the call for a better approach to inculcating sustainability principles into these techniques or finding replacements for them.

The last 2 decades or so have witnessed a significant change in expectations about corporate and individuals' attitudes to *sustainable development*. Sustainable development is used here in line with the Brundtland Commission's (1987) definition *meeting the needs of the present without compromising the ability of future generations to meet their own needs* We are all now expected to be socially responsible regardless of what we do, how, when and for whom we do whatever we profess to do without causing unnecessary production and consumption related hardships to the present and most importantly future generations of man and other life-forms. What is being suggested here is that; those issues which society considers as important non-market related – which have little or no direct effects on share prices at the stock exchanges, can no longer be ignored as they were ignored in the past. This consequently means that some or most of the traditional accounting techniques used up to date in decision making which paid little or no attention to corporate social responsibility, sustainability and sustainable development issues are now defunct and require revamping.

This chapter explores the literature in the area of environmental accounting and some of the techniques used in decision making with the hope of enabling the process of decision making to flourish in a sustainable business and natural environment. The chapter is structured as follows: it reviews the literature in terms of accounting and sustainable development; it discusses some of those accounting techniques used by organisations when making both short and long term decisions with sustainability focus and concludes the chapter.

13.3 Literature Review

Modern stakeholders who are concerned about the adverse impacts of corporate activities on the environment and society are increasing pressures on corporate entities to take appropriate measures that would either alleviate or totally remove the

adverse effects of these activities on the environment (Gul and Chia, 1994; Milne, 1996; Burritt et al., 2002). These pressures have led to many companies taking different courses of action to improve the social and environmental consequences of their operational activities on society (Porter and Kramer, 2006). These actions have been depicted in various forms; for instance (Montz and Dixon, 1993) note that as a result of the *New Zealand Resource Management Act* (1991) all applications in that country for resource consents must now include a detailed assessment of any actual or potential effects of the activity on the environment and how the applicants intend to mitigate these adverse impacts (Adams et al., 1998) note an increase in corporate disclosure activities by companies which operate in high risk industries (Tilt and Symes, 1999) as a result of government legislation note an increase in the number of Australian mining companies rehabilitating mining sites after depleting the mines (Idowu and Papasolomou, 2007) argue that it is now common practice for organisations in certain industries and in the more industrialised parts of the world to install environmentally friendly machinery, use recyclable raw materials, and rehabilitate sites which may have been damaged by their previous actions. (Idowu, 2005) also notes that stock exchanges around the world are compelling listed companies to provide information on the actions they are taking to reduce the adverse impacts of their operations on society and the natural environment.

These aforementioned actions albeit have some cost related consequences to those companies taking them and their bottom line results but are beneficial to the natural environment and contribute positively to the principles of sustainability. In any case (O'Kennedy, 2009) argues that there is an increasingly strong correlation between corporate sustainability and financial performance and notes four compelling reasons why businesses must focus on measuring and improving their environmental performance using the four Ps – Profit, Protection, Public image and Planet. Bearing this in mind, any corporate entity which fails to weave sustainability principles into its operational activities is likely to suffer in both financial and non-financial terms at the end of the day. It is therefore in corporate entities' best interest to take these actions.

Several scholars have argued that accounting; in particular management accounting in its current narrowly constructed decision usefulness form is inadequate and incapable of meeting society's increasing requirements in terms of its social, environmental and ecological concerns and therefore needs to change into a form which inculcates sustainable and environmental issues and capable of satisfying broader societal needs (Laughlin, 1990; Gray et al., 1991; Lehman, 1995; Milne, 1996; Burritt et al., 2002). These scholars for example note that the substantial increase in the social cost of these environmental impacts which corporate entities pass on to society is not currently being reflected in the decision making tools available in management accounting. This invariably makes it impossible for issues relating to CSR, sustainability and sustainable development to be adequately reflected in corporate entities' decision making process. This was perhaps the reason why (Lehman, 1995) argues that accounting in its nexus role should constrain organisational activities; especially those that involve environmental degradation. (Nelson, 1993) also supports this view and argues that if accounting fails to take this suggestion on board, it

runs the risk of losing its legitimacy and credibility in the eyes of non-accountants, If the accountancy profession were to allow this to happen, there is a strong possibility that accountants would lose society's trust and the unique role which the accountancy profession performs in society would be perceived as less credible with serious consequences for the profession and those who earn their living from it. In order to prevent this happening, those accountants who provide information either to external or internal users owe it to themselves and their profession to ensure that they are seen to be actively involved in the quest to address the universal problem of global warming, climate change, environmental pollution, depletion of man's natural resources and other consequential effects of these societal and environmental problems in order to ensure that our planet survives the test of time.

13.4 Environmental Management Accounting (EMA)

In an attempt to be actively involved in socially and environmentally responsible matters, accountants have taken a bold step by introducing the field of Social and Environmental Accounting (SEA) into their activities. (Tilt, 2009) argues that accountants' involvement in SEA stems from their traditional three areas of their profession namely financial accounting, management accounting and audit. The SEA field takes the view that shareholders are only one group of affected stakeholders in corporate activities whilst other stakeholders for example employees, local communities, the environment etc are also affected albeit in different degrees by the actions and inactions of a corporate entity. Thus in terms of the place of SEA in financial accounting (Tilt, 2009) argues that the financial accountant is primarily interested in social and environmental aspects of assets and liabilities and how to report on them in some standard way. The management accountant (Tilt, 2009) argues is concerned with costs and benefits associated with these issues whilst the auditor is concerned with providing verification or assurance of the social account produced. The environment which has been described as the one of the few silent groups of stakeholders, since they have neither a voice to protest with placards in hand nor a vote to cast at companies' annual general meetings (Solomon, 1994) but destroying it has some serious consequences; some of which are currently becoming apparent to us in various forms and some may still take several decades to manifest themselves. It is therefore important that whatever decision is taken by a responsible corporate entity must reflect the needs of all these stakeholders at least to the extent that the impacts the resulting actions have on each stakeholder groups is taken account of. There is therefore a three-dimensional inter-relationship between the Environment, Corporate Entities and Accounting as depicted in Fig. 13.1 below.

The field of Accounting has a role to perform on behalf of corporate entities with regard to what goes on in both the natural environment and business environment.

Environmental Management Accounting (EMA), which was introduced basically to address some of the shortcomings and criticisms of the traditional less

Fig. 13.1 A three dimensional inter-relationship

socially responsible management accounting practices, is an aspect of SEA. It provides socially and environmentally responsible information to internal users and decision makers. Unfortunately to date, Environmental Management Accounting (EMA) has no generally accepted standard definition, perhaps a charm of what EMA is all about! A search of the literature on EMA has revealed a few definitions; the following being some of them which this study believes would increase our readers understanding of what EMA is and how it attempts inculcate sustainability principles in the decision making exercise of corporate entities.

13.4.1 Definitions of EMA

Bennett et al. (2002) have defined EMA as "the generation, analysis and the use of financial and non-financial information in order to optimise corporate environmental and economic performance and to achieve sustainable business". The principles encompassed in EMA argue (Bennett et al., 2003) are relevant to both public sector and private sector organisations since managers of both organisations are charged with making decisions that involve the utilisation, allocation, co-ordination, acquisitions and divestments of resources at all levels of organisation.

Staniskis and Stasiskiene (2003) provide two definitions of EMA; (1) EMA is "the identification, measurement, accumulation, analysis, preparation, interpretation and communication of information that assists executives in fulfilling organisational objectives" (2) EMA "measures and reports for financial and non-financial information that helps manager make decisions to fulfill the goals of an organisation".

IFAC (2005) on the other hand defines EMA as "the management of environmental and economic performance through the development and implementation of appropriate environment-related accounting systems and practices". IFAC notes that when broadly defined, EMA involves the identification, collection, and analysis and use of two types of information for internal decision making:

- Physical information on the use, flows and destinies of energy, water and materials (including wastes) and
- Monetary information on environmental related costs, earnings and savings.

IFAC (2005) concludes its guidance on EMA by suggesting that EMA involves life-cycle costing, full-cost accounting, benefits assessment and strategic planning for environmental management.

Jasch (2006) defines EMA simply as management accounting with a focus on physical information on the flow of energy, water, products and materials as well as monetary information on environmental costs and revenues and projects related to environmental protection. Jasch (2006) suggests that an entity that launches a well designed and implemented EMA ensures that it would derive the following benefits from the exercise: better internal management and decision making in investment appraisal, cleaner production, improving eco-efficiency and calculating savings within organisations and also serve as a basis for financial reporting to external users.

Burritt et al. (2002) having noted that there are different perceptions and conceptions of environmental management accounting (EMA) adopted in practice and literature, propose a comprehensive framework for EMA which links business actors and EMA tools. This comprehensive framework they believe would help companies wishing to introduce EMA systems and outside groups such as the United Nations that are striving to promote the introduction of corporate EMA. At the end of the day (Burritt et al., 2002) argue corporate entities would be in a better position to decipher which EMA tools best meet their requirements and which of them could be useful for different business actors in different decision contexts.

From the above noted definitions of EMA, one could decipher a common theme of what EMA is all about. It is simply a tool providing both economic and ecological information at company level in order to support internal decision making and control activities (Staniskis and Stasiskiene, 2003). EMA attempts to provide a direction to helping management accountants when embedding environmental, sustainability and economic issues into their activities and consequently into the decision making process. EMA has an edge over the previously used management accounting systems which we now understand are detrimental to life.

13.4.2 Two Approaches of EMA

Cullen and Whelan (2006) argues that in the literature, there are two approaches of EMA in existence. These are Conservative Environmental Management Accounting and Critical Environmental Management Accounting, both of these approaches attempt to embed some aspects of sustainability in the decision making process. Scholars have argued that the Critical approach to EMA appears to be environmentally friendlier than the Conservative approach to EMA (Burritt et al., 2002; Cullen and Whelan, 2006).

The conservative approach takes the view that users of the information generated from EMA are mainly interested in improving their decision making mechanisms and integrating sustainability to the bottom line results of the entity. Cullen and Whelan (2006) argues that central to this approach is an assumption that "pollution equals inefficiency, not only in terms of the resources wasted but also in terms of the necessary activities required to dispose of such waste and discharges resulting from the exercise". Unfortunately, this approach has been criticised for treating the environment as being subservient to the corporate economic agenda (Cullen and Whelan, 2006; Milne, 1996) also criticises the approach as being exploitative and conservative as it fails to examine the rationale under which corporate economic interests and sustainability agendas could be integrated in line with the principles advocated by supporters of sustainable development.

The critical EMA approach takes a different view to that of the conservative approach as it works on the premise that unless a firm internalises where possible; all those environmental costs it imposes on society during the pursuit of its economic agendas, it would have failed totally to meet its social and environmental responsibilities to society. It thus questions the validity and ethics of the pursuit of business efficiency and profitability that does not take full responsibility for the environmental and ecological damage that it causes (Maunders and Burritt, 1991; Milne, 1996; Cullen and Whelan, 2006). The critical EMA according to (Cullen and Whelan, 2006) takes a wider approach to inculcating environmental accountability and sustainability in corporate agendas.

Those who argue that if critical EMA does not make provisions for internalising non-market or social costs, then governments should force them to internalise these costs e.g. Cullen and Whalen (2006) are probably not in tune with its requirements. The approach from this author's understanding requires firms to voluntarily internalise all those internalisable environmental costs they impose on society regardless of whether these are market or non-market related costs; that is perhaps one of the approach's charms. The resultant effect of this action can only serve to lower operating costs thereby increase profit and be better for the natural and business environment as demonstrated in Table 13.1 from (Staniskis and Stasiskiene, 2003).

From the Table 13.1 above, one can clearly see the benefits of installing a sustainability system in a manufacturing environment, nearly all but two the company's costs reduced and four remained unchanged. The two that increased by 0.01 and 0.02 – Amortization and Finance charges respectively were probably temporary increases. This goes to show that sustainability is not only good for the environment but it is also good for business.

13.5 Social Responsibility Disclosures in CSR Reports

Several scholars have noted increased social responsibility disclosures by corporate entities over recent years in different parts of the world (Simmons and Neu, 1996) in Canada (Idowu and Towler, 2004; Grant, 2007) both in the UK, Panayiotou et al. (2009) in Greece. The decision to disclose social information to stakeholders by

Table 13.1 Comparing one furniture manufacturing co's production costs before and after implementing a cleaner production scheme

	Before cleaner production project implementation (in 2001)	After cleaner production project implementation (in 2002)	Production costs reduced (difference between 2001 and 2002)
Production costs:	*As a % of sales*	*As a % of sales*	
1. Tcost of production	72.2	68.5	3.7
1.1 Prime (direct) cost	60.0	58.0	2.0
Direct material	45.2	43.7	1.5
Direct labour (wages)	11.3	10.9	0.4
Social insurance	3.5	3.4	0.1
1.2 Indirect cost	12.2	10.5	1.7
Indirect wages	3.5	3.0	0.5
Social insurance	1.1	0.9	0.2
Electricity	2.8	2.1	0.7
Amortization	1.8	1.9	−0.1
Other indirect costs	2.8	2.5	0.3
Factory fuel	0.2	0.06	0.14
Water	0.05	0.02	0.03
2. Selling cost	7.9	7.1	0.8
3. Management cost	9.0	8.1	0.9
4. Management salaries	4.6	4.1	0.5
5. Social insurance	1.3	1.3	0
6. Other management costs	3.1	2.7	0.4
7. Finance charges	1.5	1.7	−0.2
8. Taxes	0.8	0.75	0.05
Roads	0.4	0.4	0
Estate	0.3	0.3	0
Land	0.01	0.01	0
Ecology	0.01	0.005	0.005
Other taxes	0.08	0.05	0.03

Source: Staniskis and Stasiskiene (2003) page 66

listed companies and other corporate entities has come about as a result of several factors; (Gray et al., 1996) note the desire to provide an account of action or reckoning of those actions a particular corporate entity is held responsible – *accountability theory.* Another factor is the *decision usefulness theory* which states that investors find the social information disclosed by corporate entities helpful in their decision making exercise (Spicer, 1978; Buzby and Falk, 1979; Muhapatra, 1984; Idowu and Papasolomou, 2007) identified the motivations for disclosing CSR information corporate entities in the UK.

Several organisations are also requesting corporate entities to provide information on their environmental performance in order to assist users of this information in making good quality decisions about the entity concerned, some of these organisations are also providing standard formats which these entities should follow; for instance, the European Union's Fifth Action Programme on the Environment – embedded in the report *Towards Sustainability* (2002), the Institute

of Social and Ethical Accountability (ISEA) (1999), Sustainability Reporting Guidelines (1999), Global Reporting Initiative (GRI) (2000) and a host of other similar documents. There are also other institutions compelling their members and those they interact with to disclose information about their social responsibilities, Stock Exchanges, professional bodies, Institutional investors Associations and of course some companies are requesting suppliers in their supply chain to equally disclose information about their social responsibilities.

The information generated here is aimed at external users who have interest or are affected either directly or indirectly by the actions of a particular entity. This information unlike that generated from management accounting must comply with the guidelines provided by either national or international accounting standards, the relevant Companies Act and must have probably been externally examined and verified by independent external auditors.

13.6 Capital Investment Decisions and Sustainability

The competitive nature of the environment in which most organisations operate dictates that managers of these organisations must make capital budgeting decisions. A decision of this sort could involve expending a large sum of money and committing other scarce resources in terms of manpower and know-how etc of equally a large sum of money. This invariably means that capital budgeting decisions are crucial decisions to an organisation since the outcome could determine whether the organisation in question survives and prospers or declines and fails as a result, such decisions affect all aspects of the entity's structure. There are several reasons why an entity might wish to invest in capital assets of some sort, some of the possible reasons are noted below:

- To increase its production capacity
- To lower production costs and therefore benefit from the economies of scale.
- To extend its line of business into new products or diversify into in activities.
- To be more competitive in its industry.
- To enable it to make efficient use of energy and raw materials.
- To reduce the risk of environmental accidents and pollution.
- To make its products safer for customers' use.
- To increase its product yield.
- To make its production processes environmentally friendlier.
- To improve its bottom line results.

Before the issue of corporate responsibility and sustainability came to the fore, 70% of the above noted reasons were of major concern and addressed by a majority of corporations; doing so for economic and strategic reasons; but most of these organisations are now aware of the consequences of their failure to weave social, environmental and other sustainable issues into their capital investment decisions.

For example all socially responsible corporate entities now ensure that the machineries they invest in are environmentally friendly in all respects whilst ensuring that the raw materials they use in production are recyclable with no health hazards to employees and the ultimate users of the final product. McDermott et al. (2002) actually argue that as a result of the complexity of what is involved in the area organisation that aspire to be environmentally responsible must adopt the concept of the "best available technology not entailing excessive cost" (BATNEEC). This concept, they argue involves using the latest technology to prevent environmental damage which because necessary in the UK as a result of the Environmental Protection Act (EPA) 1990.

When appraising investment projects, accountants and business managers have traditionally used four different appraisal methods. These are Payback, Accounting rate of return, Net present value and Internal rate of return the last two being group under the discounted cash flow (DCF) methods. These methods are used to establish the different reasons why one project or one piece of equipment should be chosen instead of the other. The payback method helps the decision maker to establish how quickly it would take a stream of net cash inflows from the project to payback its original cost, the shorter the payback period the better. In a survey by the Association of Chartered Certified Accountants (ACCA) described by McDermott et al. (2002) they argue that because of the importance of cash flow, small companies using the payback method expected a short payback period of 2 years but the benefits of many environmentally friendly projects very often emerge after the period and, consequently are ignored in analysis. The Accounting rate of return establishes the possible percentage returns from the potential investment projects being considered. There are several variations of the method but most textbooks on Management accounting use the Average Accounting Profit/Average Capital Employed × 100. The higher the percentage return, the better.

The Net Present Value (NPV) method which is considered to be the most superior of these methods, uses the time value of money to work out the most profitable of the possible investment opportunities, all investment projects with positive NPVs are worthy of acceptance if there is enough capital to undertake them all. But in a capital rationing situation (that is a situation where there is a shortage of capital), it is the project which has the highest positive NPV out of the possible investment opportunities that would be undertaken. Whilst the Internal rate of return (IRR) method establishes the highest possible rates at which each of the potential investment projects could be financed without losing money from these investment opportunities. The higher the internal rate of return, the better it is that the entity would neither make nor lose money from undertaken the project. When this method is worked out manually, a trial an error method is used whereby two discount rates (a lower discount rate and a higher discount rate) are used to work out the NPVs of each project. The IRR of each project is established by substituting figures in the formula below:

$$IRR = A + \{a/a + b \times (B - A)\}$$

Where:

A = Lower discount rate which gives a positive NPV
B = Higher discount rate which gives a negative NPV
a = Amount of the positive NPV
b = Amount of the negative NPV.

It is possible for the financial manger to set a standard payback period required for a project to be considered worthwhile and also to set a minimum accounting rate of return for a project to be considered acceptable.

Prior to the issue of sustainability becoming of major concern, the financial manager was only concerned about the main driver of the company's share prices on the stock exchange – the short-term profit to be made from investment opportunities. As a result of government legislations, some institutional investors' insistence on social and environmental responsibilities on the part of corporate entities and other stakeholders' activities, several listed companies have had to re-model their capital expenditure decision making to take on board both short-term, medium and long term effects of environmental expenditures on capital projects. Companies have realised that taking this action can only improve their competitive and business performance in the long run whilst helping them to meet their sustainable development obligations to society.

13.7 Short Term Decisions in a Sustainable Environment

Management accounting provides the necessary information required by managers and other decision makers within the company when making short term decisions. The information required in a short term decision environment will often be generated using the technique of Marginal or Variable costing which uses the Contribution concept to determine the course of action to take in a particular decision scenario. Some examples of short term decision areas which companies make are Make or Buy, Accept or Reject, Shutdown, Pricing, Break Even Analysis and Product mix or Limiting factor.

Let us now briefly look at two of these short term decision scenarios to see how sustainability could be inculcated in them.

13.7.1 Make or Buy Decisions

Some manufacturing organisations are often in a position to produce some of the components they use in production. In a situation like this, managers would traditionally want to establish whether it is cheaper to make or buy the component. In the past, a decision of this sort would have been based strictly on financial grounds regardless of the consequential effect of the cheaper option on the environment. Today because of the issue of sustainability, a decision of this type would undoubtedly take into account the effects of the make or buy option on the environment and other stakeholders. This might necessitate looking at the raw material to

be used, the environmental consequences of the machinery to be used in processing the raw material and whether there are some human rights abuses from the sources of the raw material and other sustainability issues. In other words, managers would consider the social, environmental and economic consequences of the make or buy decision. A final decision would be made on the basis of the option that is both cost and environmental most effective.

13.7.2 Accept or Reject Decisions

There are also some occasions when a manufacturer could be faced with deciding whether to accept or reject a special lower offer price from a new customer who was intending to buy one of its products. Having established that it has the production capacity to meet the new order, that the variable cost of production is lower than the offer price and that the customer would not sell the product to any of its existing customers, managers would also want to establish the social, economic and environmental impacts and human rights records of this new customer as they would not want to be associated with customers that would tarnish their own reputation. They might also wish to understand what the customer would do with the product afterwards to ensure that there are no socially irresponsible issues associated with this, which could cost them dearly in both financial and non-financial terms afterwards.

13.8 Environmental Cost of Pollution and Its Implications

The provision of goods and services by corporations in order to satisfy customers' demands was one of the earliest social responsibilities of corporate entities (Idowu, 2005). This action had and still has some social and environmental costs which were originally ignored by entrepreneurs, business managers and society. These costs until recently were externalised – that is, they were made to be borne by the silent stakeholders – the environment and other life forms and consequently by society. The unfolding on man and other life forms of the consequences of these irresponsible actions has led modern stakeholders to continue to exert increased pressures on businesses to become more socially responsible and simultaneously become more competitive. Originally, it was the formal recognition of the "polluter pays" principle which pragmatically forced companies to start to internalise a reasonable proportion of these costs with the hope of internalising all of them in the long run. The "polluter pays" principle works on the understanding that whosoever causes pollution must pay the remedial costs of putting things back to their original positions.

This meant that manufacturers were held responsible for any pollution arising from their production processes, companies in the supply chain were held responsible for any pollution arising from the disposal of packing materials and publishers of free newspapers were held responsible for the disposal costs incurred by train and bus operators in the United Kingdom and perhaps in some other parts of the world. In the past, it was the customers who were ultimately responsible for

the disposal of products at the end of their useful lives. As a result of pollution and sustainability issues, an increasing number of manufacturers are now taking responsibility for the safe disposal of their products which have given rise to the idea of “product-take back” (Brabazon and Idowu, 2001). This idea of product-take-back requires a manufacturer to take back a product from the customer for disposal purposes or to recycle valuable raw materials at the end of their useful lives. Actions like this could only help to improve sustainable development and ensure that some of man’s natural resources would be available for use for a longer period of time.

Things have now moved on from the polluters pay principles to the “risk prevention” and “value creation” principles by corporate entities. It was realised that the polluter pays principle had some irresponsible connotations to it, which forced companies to voluntarily adopt the prevention and precautionary approaches to dealing with these issues.

13.9 Cost of Quality Model and Product Costing

For any organisation to succeed in taking a total control of its environmental costs, it is important for it to understand what these costs are. Accountants can play a part in doing this. The “cost of quality” model could be used; this model works on the premise that environmental costs arise as a result of poor environmental quality or as a result of unnecessary use of resources (Brabazon and Idowu, 2001). The model allows its users to divide environmental costs into four categories: Prevention costs (which prevent these costs from occurring in the first place) Detection costs (which detect whether operational activities are in line with the desired environmental standards, Internal Failure costs (which ensure that there are no lapses within the firm that could lead to irresponsible disposal of waste and contaminants into the environment) and External Failure costs (which are the resulting costs of putting right internal failure costs, for example cleaning up toxic spills or settling legal claims as a result of polluting land, sea and water).

Let us now look at a numerical example in order to fully understand the component parts of cost of quality model

An example of an Environmental Costs Report incorporating these categories is shown below in Fig. 13.2

Classifying environmental costs on this basis helps to highlight the relative balance of the expenditures between prevention/detection activities and internal/external failure costs. Interested readers (both internal and external) of this report would find it more informative as it identifies the relevant areas of concern and the costs of putting things right in these areas.

13.9.1 Activity Based Costing (ABC) and Environmental Costs

Activity Based Costing (ABC) is a product costing method which uses cost drivers. ABC was developed in an attempt to reflect advanced manufacturing technology

Environmental Cost Report of Toxic Plc.
For the Year Ended 31 March 2010

	£	£
Prevention Costs		
Selecting suppliers	150,000	
Environmental risk study	40,000	
Staff training	50,000	240,000
Detection Costs		
Environmental monitoring	120,000	
Development of measures	10,000	130,000
Internal Failure Costs		
Operating pollution control	200,000	
Recycling waste product	140,000	340,000
External Failure Costs		
Restoring production site	400,000	
Environmental damage legal claim	500,000	900,000
Total		1,610,000

Fig. 13.2 Environmental cost report. (Source: Brabazon and Idowu (2001) Adapted)

(AMT) in product costing. The traditional overhead absorption method used before the advent of ABC during a time when the overheads incurred by businesses were volume related and therefore driven by variables such as labour hours, machine hours, production units and the prime cost. The proportion of the overhead costs incurred during this time was insignificant when compared with the total production cost; therefore any error made either in over or under absorption would not have led to serious consequences. The introduction of AMT has resulted in a significant increase in overhead costs in relation to total cost, which therefore means that errors in charging overhead costs to products or services could now lead to serious consequences in terms of products now being either over cost or under cost. To over cost a product or service means that its selling price would be higher than the competitors, customers are price sensitive, they are unlikely to return to buy more next time. To under cost the product or service is equally bad as the true cost of the item would not have been established, this could affect the long term survival of the entity.

The principles encompassed in ABC are capable of being used in environmental costing since it is important that those organisations incurring environmental costs which they need to pass on to customers must survive. In order to survive and prosper all costs must be absorbed to cost units or cost objects and consequently passed on to consumers. It is therefore important that activity based costing would have to be used as the costs identified in the Environmental Cost Report in Fig. 13.1 cannot be absorbed to products using the traditional overhead absorption methods. We are

going to demonstrate how this could be done using an example from the case of a fictitious company we shall call *Toxic Plc*.

Case

You are the management accountant of Toxic PLC. The current interest in Environmental Accounting has meant that for sustainability purposes, Environmental costs must be absorbed to cost units. Toxic Plc absorbs overheads to cost units using Activity Based Costing (ABC). The following budgeted information for the year ending 31 March 2011 was extracted from the Environmental Report produced for the year to 31 March 2010. Toxic Plc manufactures three products – A, B and C. Details of Products in Table 13.2.

You have ascertained that Toxic Plc overheads could be analysed into cost pools as follows see Table 13.3:

Table 13.2 Product information

Products	A	B	C
Production units	12,000	10,000	8,000
Cost per unit	£	£	£
Direct materials	25	20	15
Direct labour	16	22	25

Table 13.3 Activity based costing information

Coat pool	£000	Cost driver	Driver quantity	Cost driver rate (£)
Prevention costs				
– Selecting suppliers	150	No. of suppliers evaluated	100	1,500
– Environmental risk study	40	Environmental risk study hours	20,000	2
– Staff training	50	Staff training hours	5,000	10
Detection costs				
– Environmental monitoring	120	Monitoring hours	40,000	3
– Development of measures	10	Development hours	5,000	2
Internal failure costs				
– Operating pollution control	200	No. of production runs	1,500	133.33
– Recycling waste product	140	No. of production runs	1,500	93.33
External failure costs				
– Restoring product site	400	No. of toxic spills	100	4,000
– Legal costs	500	No. of legal claims	20	25,000

Additional details

You were told that the three products are similar and are usually produced in production runs of 20 units.

You have also been provided with the following details for the year ending 31 March 2011 as in Table 13.4.

Your task is to prepare the unit cost of products A, B and C for the accounting period having absorbed the Environmental Costs given on the basis of the information provided above.

Table 13.4 Additional details

Products	A	B	C
Inquiries to suppliers	20	50	30
Environmental risk study hours	9,000	5,000	6,000
Staff training hours	1,500	1,000	2,500
Monitoring hours	12,000	10,000	18,000
Development hours	1,000	2,500	1,500
Production runs	600	500	400
Toxic spills cleaned	40	40	20
Legal claims	–	10	10

Table 13.5 Solution

	A	B	C
	£	£	£
Prime cost	41.00	42.00	40.00
Prevention costs	5.25	9.50	10.25
Detection costs	3.17	3.50	7.125
Internal failure costs	11.34	11.34	11.34
External failure costs	13.33	41.00	41.25
	———	———	———
Unit cost	74.09	107.34	109.97
	====	====	====
Total costs	× 12,000	× 10,000	× 8,000
	= £889,080	= £1,073,400	= £879,760

Sources: Brabazon and Idowu (2001) adapted

Our solution to this question Table 13.5 demonstrates that each of the three products would respectively cost Toxic Plc £74.09, £107.34 and £109.97 to make. A series of planning, control and decision making activities could be derived from this piece of information. For instance, product C would have the highest selling price if Toxic's policy were to mark up each of its products by a given percentage.

13.10 Conclusion

The objective of this chapter was to take the debate of corporate social responsibility, sustainability and sustainable development to the accountancy profession in order to establish how the profession and those who provide information to external and internal users attempt to inculcate the philosophical beliefs of sustainability into what they do.

Accountants like their other colleagues in organisations are actively involved in ensuring that their organisations do not only remain competitive but are simultaneously socially responsible in all respects. The field of Social and Environmental Accounting (SEA) has brought about several initiatives for example Environmental Management Accounting (EMA), Product take Back, Cost of Quality Model and other relevant initiatives not discussed in this chapter.

The chapter looked at a relatively simple and straightforward practical example on product costing using Activity based costing which enabled us to work out the unit cost of three products. The idea was to ensure that non-accounting specialist readers would easily follow the example in order to understand the principle involved in working out the cost of a product.

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Chapter 14
Financial Reporting and Fraud

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Abstract Businesses around the world need funds from investors for growth and expansion. However, potential investors will only consider investing in a business that is financially sound and has the potential for growth and continuity. The published annual report and accounts of the business and other publicly available information about the business gives investors some insight into how its affairs are being managed. Given that these reports are produced under strict legal requirements and prescribed standards of reporting, and are subject to external audit, investors look up to these reports for reassurance about the financial viability of businesses. Unfortunately, recent scandals and corporate failures have shaken the confidence of investors as accounts which were purported to reflect a "true and fair view" of businesses have been misleading. In most of the reported cases, including those reported in this chapter, management have defrauded the company and covered it up by manipulating the financial statements of the company to reflect what management wanted the public to see. This has been possible because the very nature of financial reporting means that judgments and estimates have to be made during the compilation of the financial statements. In some of these cases also, the auditors, who were expected to act independently and lend credibility to the information disclosed in the accounts have been indicted. Recent corporate governance reforms, including the reform of company law and new auditing standards have attempted to close some of the loopholes identified in these cases of fraud. Whilst there have been so much emphasis for corporate managers to maximize shareholder value, it is now recognized (even in UK Companies Act 2006) that corporate management need to be aware of the impact of their activities on the wider society.

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14.1 Introduction

Jensen and Meckling (1976, p. 71) state that

> The publicly held business corporation is an awesome social invention. Millions of individuals voluntarily entrust billions of dollars, francs, pesos, etc. of personal wealth to the care of managers on the basis of a complex set of contracting relationships which delineate the rights of the parties involved. The growth in the use of the corporate form as well as the growth in market value of established corporations suggests that at least, up to the present, creditors and investors have by and large not been disappointed with the results.

Whilst there would appear to be some truism in this assertion by Jensen and Meckling in that the capital markets still remain one of the major sources for raising additional funds for growth and expansion in the corporate world, nevertheless recent corporate scandals, which saw millions of shareholders' funds wiped out from the capital markets has been attributed to fraudulent reporting by those entrusted with public funds. Mismanagement and fraudulent reporting by some corporate management are the reasons behind the recent financial crisis that engulfed many of the world's leading economies and led to the demise of some household names within and outside of the banking sector. These events draw attention to the basic tenets of the modern business organization, which is characterized by the separation of ownership and control and the need for some form of accountability.

Over the last 150 years or more, business organizations have changed from being owner-managed or family businesses, with a small number of employees, to vast multinational companies employing thousands of people. Such growth has been made possible through funds raised through the capital markets and have resulted in management passing from shareholder-owners to small groups of professional managers. This has given rise to the need for company managers to report on their financial performance to the entity's owners, and other providers of funds such as banks and other lenders. However, the reporting of business transactions can generate a range of accounting numbers to describe profits, cash flow and financial position (Lee, 2006) through the use of *creative* or *aggressive* accounting. Management can take undue advantage of *creative* or *aggressive* accounting to make the financial performance and position of the company seem better than they really are, and to have the effect of hiding information from shareholders in the short term (Coyle, 2009, p. 146). Whilst the financial performance of a company for the current financial year might be flattering because of the use of creative accounting, before long the "bad news" will eventually emerge. Enron, WorldCom, Adelphia, Ahold and Parmalat, amongst others, are all recent scandals where this would appear to be the case. Senior executives in these companies intentionally presented inaccurate financial information and made incorrect statements to the capital markets, with grave consequences, including loss of investments, jobs, and the erosion of trust in the capital markets.

14.2 Literature Review

14.2.1 Fraudulent Financial Reporting

In 1999 a research study (Fraudulent Financial Reporting: 1987–1997) sponsored by the Committee of Sponsoring Organisations (COSO) of the Treadway Commission provided a comprehensive analysis of fraudulent financial reporting occurrences which had been investigated by the SEC since the Treadway Commission issued its 1987 *Report of the National Commission on Fraudulent Financial Reporting (NCFFR).* The COSO Report provided insights into who, why, where and how of financial reporting fraud. The most commonly cited reasons for committing fraud identified in the Report (p. 21) include: (1) avoid reporting a pre-tax loss and to bolster other financial results; (2) increase the stock price to increase the benefits of insider trading and to obtain higher cash proceeds when issuing new securities; (3) cover up assets misappropriated for personal gain; and (4) obtain national stock exchange listing status or maintain minimum exchange listing requirements to avoid delisting.

Since the publication of the Treadway Commission Report in 1987 and the COSO Report in 1999, there have been significant changes affecting various parties in the financial reporting process, more so, following the collapse of Enron, WorldCom and others in 2001. The suggestion in the COSO Report (1999) that most frauds occurred in relatively small companies have since been over-taken by the events that enfolded with the collapse of corporate giants such as Enron, WorldCom, Xerox and others (examined later) due to fraudulent financial reporting.

Academic scholars have been concerned about the various ways in which fraud is perpetuated by management and its effect on financial reports. Studies by Beasley (1998), Beasley et al. (2000), Peasnell et al. (2000), Archambeault (2002), Abbott et al. (2004), Bédard et al. (2004), Uzun et al. (2004) and Persons (2006) amongst others have found that fraudulent financial reporting generally involves:

- Manipulation, falsification or alteration of accounting records or supporting documents from which financial Statements are prepared;
- Misrepresentation in, or intentional omission from, the financial statements of events, transactions, or other significant information
- Misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure (Grice Sr., 2001, p. 11).

14.2.2 Corporate Governance Attributes and Fraud

In addition to exploring fraudulent financial reporting directly, others (Beasley, 1996; Beasley et al., 2000; Bourke, 2006) have examined the effect of a number of corporate governance characteristics and attributes on fraudulent financial reporting. These studies reveal that:

- The inclusion of larger proportions of outside members on the board of directors significantly reduced the likelihood of financial statement fraud.
- The presence of an audit committee does not significantly affect the likelihood of financial statement fraud.
- Significant relationship existed between CEO and Chairman duality and the incidence of fraudulent financial reporting.
- As outside share ownership in a company increases so does the prospect of fraud.
- Independent and impartially led board of directors are negatively related to the incidence of fraudulent financial reporting
- There's a negative relationship between the retention of a Big 4 auditor and the incidence of fraudulent financial reporting.
- The effectiveness of the corporate governance structure is associated with fraudulent financial reporting
- By strengthening governance practices in public companies, fraudulent financial reporting might be minimized.
- Relationships exist between a number of corporate governance attributes and fraud.
- Industry traits do influence the propensity and type of fraud perpetuated in financial statements.

14.2.3 Fraud-Risk Factors

What other factors influence the incidence of fraudulent reporting? Using a sample of 77 fraud engagements and 305 non-fraud engagements, Bell and Carcello (2000) developed and tested a logistic regression model that estimates the likelihood of fraudulent financial reporting for an audit client, conditioned on the presence or absence of several fraud-risk factors. They found that fraudulent financial reporting is affected by the presence or absence of a number of fraud-risk factors including, a weak internal control environment, rapid company growth, inadequate or inconsistent relative profitability, management places undue emphasis on meeting earnings projections, management lied to the auditors or was overly evasive, the ownership status (public vs. private) of the entity, and an interaction term between a weak control environment and an aggressive management attitude toward financial reporting.

14.2.4 Creative Accounting

Although the practice of financial reporting, which involves the use of *creative accounting* is not often regarded as fraudulent, it is an area that has attracted much dialogue and debate amongst academic scholars, and it is the root cause of numerous accounting scandals (as will be examined later). What is creative accounting? It represents the transformation of accounting figures from what they are in accordance with the economic reality into what the managers desire them to be, using

the advantages of, and/or exploiting the loopholes in, existing regulations. The Oxford Dictionary of Business (2003, p. 140) defines creative accounting as *misleadingly optimistic, though not illegal, forms of accounting*. Some authors define creative accounting as an assembly of procedures having in view the change of the level of the result in order to increase or decrease, or present the financial statements, without these objectives being reciprocally excluded (Breton and Stolowy, 2000). For others, creative accounting is represented by the "assembly of techniques, operations and freedom spaces provided by the accounting texts which, without distancing from the accounting norm and strictness, allow the managers of an enterprise the change of the value of the result or the change of the aspect of the accounting documents" (Gillet (1997) quoted in Shabou Boulila Taktak, 2002).

Creative accounting is possible because of the unlimited nature of human creativity. This is the view expressed by Colasse (quoted in Balaciu et al., 2009) who defines creative accounting as a cumulus of accounting information practices, at the limit of legitimacy, practiced by some economic entities in order to beautify the image of the financial position and the economic-financial performances. Similarly, Trotman (1993) offers a definition of creative accounting in which the information in financial statements presented to investors and prospective investors has been filtered using techniques which portray a more favourable image and more attractive results than would normally be expected. Naser and Pendlebury (1993) presents an academic view and offers the following definition of creative accounting:

> (1) the process of manipulating accounting figures by taking advantage of the loopholes in accounting rules and the choices of measurement and disclosure practices in them to transform financial statements from what they should be, to what preparers would prefer to see reported, and (2) the process by which the transactions are structured so as to produce the required accounting results rather than reporting transactions in a neutral and consistent way (p. 59).

Merchant and Rockness (1994) perceive creative acting as a privilege of financial engineering which allows management to distort profits and which is not a consequence of economic reality. They point to the fact that these forced approaches can have a negative effect on the financial stability of the economic entities. Shah (1996) and also MacBarnet and Whelan (1999) suggest that financial engineering utilizes instruments of creative accounting to create the image of the entity desired by management. According to Shah, Management of companies use the breaches or ambiguities in legislation to create their own image of the enterprise emphasizing the idea that creative accounting does not break the law.

Griffiths (1986) writing from the perspective of a city editor, presents the pressures on companies to report flattering results. He claims that

> Every company in the country is fiddling its profits. Every set of published accounts is based on books which have been gently cooked or completely roasted. . . In fact this deception is all in perfectly good taste. It is totally legitimate. It is creative accounting.

In 1986, Griffiths published *Creative Accounting: How to make your profits what you want them to be*. It highlights the main forms of creative accounting used

at the time and provides some insight for shareholders and other users of financial information into hidden techniques. Griffiths (1986, p. 2) explains that creative accounting "comes from the flexibility and vagueness of the accounting rules and company law which governs how financial statements should be prepared and presented." As this book was published more than 20 years ago a number of loopholes in creative accounting techniques have subsequently been closed through the introduction of relevant accounting standards. However the main principles and key issues of creative accounting techniques generally still remain the same today.

Writing from the perspective of an investment analyst, Smith (1992) exposed the shenanigans of corporate reporting in the UK. His book *Accounting for Growth: Stripping the camouflage from Company Accounts* made the best seller list but quickly became known as "the one they tried to ban" because he provided concrete proofs of British companies that used creative accounting practices. Smith investigated the growth of companies in the 1980s (the period when creative accounting was very popular) and questioned whether it was "due to the improved efficiency of British industry or was it generated from the manipulation of profits by creative accounting?" He highlighted the case of three companies which had experienced financial collapse shortly after they had presented their financial statements which clearly reflected financial stability.

MacBarnet and Whelan (1999) investigated whether or not creative accounting can be controlled, as this has been a major concern for regulators as well as an ongoing problem. Baker and Hayes (2004) examined creative accounting practices connected to: (1) Off balance sheet financing; (2) Acknowledgement of profits and (3) Information regarding the financial statements. Based on these three parameters, they examined the generally accepted accounting principles (GAAP) requirements and the ways these were used by Enron to hide the economic substance representing the base of the transactions.

Also, using a scandal in the banking sector in Turkey, Omurgonulsen and Omurgonulsen (2009) suggest that the deficiencies in the legal frameworks for banking and accounting, the inadequacies in the autonomy of governmental regulation and supervision bodies, practical difficulties in enforcing legal and ethical rules due to the slow functioning of the judicial system are "significant reasons for creative accounting practices in addition to the personal greed of both owner and top management of Imarbank and its customers" (p. 651).

Whilst efforts have been made to minimize fraud in financial statements through plugging a number of loopholes in financial reporting, it is unlikely that creative accounting can be eliminated completely as long as accounting continues to make use of estimates and judgments in reporting economic transactions.

14.2.5 Creative Accounting and Auditors

The case of Enron and others to be examined later, implicate auditors in the use of creative accounting by these companies. It is presumed that in majority of the cases, the auditors compromised their integrity in approving accounts they knew

were materially misstated. As a matter of fact, the involvement of Arthur Andersen in the case of Enron was so pervasive that it led to the demise of the firm, which was one of the Big 6 accounting firms.

What is the frequency with which firms made use of creative accounting techniques? The literature on this has been sparse. Naser and Pendlebury (1992) examined the views of auditors about the frequency with which they met creative accounting techniques during the course of their audit and their perception as to why companies used creative accounting and how they can be eliminated.

The desire to make figures more or less appealing can be traced back to the days of Luca Pacioli in his renowned treatise, *Summa de Arithmetica, Geometria, Proportioni et Proportionalita*, which was the first accounting manual providing insights into creative accounting. It appeared in the Anglo-Saxon literature in the 1970s, in most articles on corporate bankruptcies as well as in the series of publications written by Watts and Zimmerman (1978, 1986, 1990), which represented the foundations of positive accounting theory. Creative accounting has developed geographically both in the complexity of its practices and in its nomenclature. Whilst in Europe the term "creative accounting" is used, on the other side of the Atlantic the most preferred term is "earnings management". Other terms used to describe creative accounting include income smoothing, earnings smoothing, cosmetic accounting, financial crafts, cooking the books, fabricated numbers, window dressing, manipulation of books, etc. This list is not exhaustive.

This review suggests that scholars have been concerned with the effect of fraud and creative accounting in financial statements and its impact on users. This chapter adds to the debate by examining the link between financial reporting and fraud. It reviews current legislation in financial reporting, recent corporate governance reforms that impact on financial reporting as well as the effect of the new standard of fraud and error detection (ISA (UK and Ireland) 240) on members of the auditing profession. How these new initiatives will reduce the incidence of fraud in financial reporting is yet to be seen.

14.3 Why Financial Reporting?

Financial reporting is the process by which financial information about a business entity is prepared in various formats and distributed to users of such information. The annual report and accounts of a company is the most common format of formal financial reporting. It has its roots in the problem created by the grant of Joint Stock Company status to business firms, and the separation of ownership and the management of such companies which resulted. This then makes it necessary for the managers to communicate to the owners the economic progress of the companies under their management. Although the shareholders are technically the owners of these corporations, they have no way of knowing how well their company is performing unless management provides them with this information. The reports include the financial statements, which in the UK have to be prepared in accordance

with the requirements of company law (currently the Companies Act 2006) and professional accounting standards. The financial statements present a report on the financial performance of the company over the previous financial year and the financial position of the company as at the end of that year. They include the balance sheet, and the income statement (also referred to as the profit and loss account), the cash flow statement and the notes to the accounts. The directors' report and other statements produced in the annual report and accounts provide supporting information, much of it in narrative than in numerical form. Shareholders and other investors use the information in the annual report and accounts to assess the stewardship of the directors and the financial health of the company. They are the means by which the directors of a company make themselves accountable to the various interests in the companies for which they are responsible.

Adequate communication of stewardship would therefore require that the financial statements be clear and understandable to the users as well as reliable and "believable" (Coyle, 2009). However, the reliability of the information contained in the annual reports and accounts of a company depend on a number of factors, including (Coyle, 2009, p. 146):

- the honesty of the company in preparing them
- the care used by directors to satisfy themselves that the financial statements do give a "true and fair view" and that everything of relevance has been properly reported
- the opinion of the external auditors, which the shareholders should be able to rely on as an objective and profession opinion.

14.4 Financial Reporting and Applicable Accounting Framework

Financial reporting in the UK (as well as in other countries) is a legislative requirement. The current legislation governing the activities of businesses is the Companies Act 2006. Sec. 396(1) of the Act requires the directors of every company to prepare individual accounts comprising of a balance sheet as at the last day of the financial year, and a profit and loss account. The balance sheet (Sec. 396 (2)) must "give a true and fair view of the state of affairs of the company as at the end of the financial year", and the profit and loss account must "give a true and fair view of the profit or loss of the company for the financial year". The Act also specifies the form and content of the balance sheet and profit and loss account, which must be accompanied by notes to the accounts. An important requirement of the Act, like previous ones, is that directors must provide additional information, if necessary, or depart from any provisions of the Act if that is necessary to give a true and fair view of the state of affairs of the company. Further, Sec. 393 of the Act states that "the directors of a company must not approve accounts... unless they are satisfied that they give

a true and fair view of the assets, liabilities, financial position and profit or loss" of the company.

In spite of the overriding legal requirement in the UK for directors to prepare accounts which give a true and fair view of the state of affairs of their companies, the Companies Act 2006 (like the previous Acts) does not provide a definition of what is a "true and fair view". Hence, the meaning, effect and significance of the phrase has been the subject of much academic debate for over a century (see Chastney, 1975; Flint, 1982; Rutherford, 1985; Harris, 1987; Lyas, 1992; Alexander, 1993; Walton, 1993; Alexander and Jermakowicz, 2006, amongst others).

The legal requirement for annual accounts to give a TFV uses different signifiers, implies different signifieds and has different effects from time to time and from place to place (Nobes, 1993). Nobes suggests that the True and Fair wording appeared first in British law in the Companies Act 1947 and was consolidated into the 1948 Act. Prior to this, the British legal requirement (Companies Act 1900, Sec. 23) was that "a true and correct view" should be given but this was changed after advice from the accountancy profession that "correct" was too precise a word to reflect the practice of accounting and auditing (Rutherford, 1985). Other combinations of "full", "fair", "true" and "correct" had been used in nineteenth Century laws, according to Nobes (1993). The reason the signified changes over time, and presumably from place to place, is because the TFV is connected to practice, although intended to be an independent concept (Hoffman and Arden, 1983; Nobes, 1993). Hopwood (1990) suggests that the TFV became particularly important to Britain only when seen as a means of countering legalism in the 1971 draft of the European Fourth Directive (Nobes, 1993). Parker and Nobes (1991) make the related point that the TFV seems to have been increasingly useful to the British profession as accounting rules became more codified in standards (from 1970) and in law (from 1981). In the US, a different signifier is used, but here the indirect effect is also clearly different from that in the UK. US financial statements are required to "present fairly" in conformity with generally accepted accounting principles. Also, for listed companies, EU regulations require their financial statements to be "fairly presented". In terms of indirect effects, the TFV may be used by standard setters, directors or auditors in the UK as well as in other countries. However, only in the UK can it also be used to override the law or standards. The overriding legal requirement in the UK for financial reporting of giving "a true and fair view" was exported to Continental Europe via the European Community's (EC) Fourth Directive on Company Law. Nobes (1993) presents an analysis of the accounting rules before this process, and traces the gradual acceptance of the predominance of TFV in the drafting of the Directive after UK accession to the EC. He concludes that in some countries, the TFV legal requirement has moved from non-existence to existence without effects; in others from non-existence to existence with small direct effects on rules and marginal indirect effects. In terms of the usefulness of the TFV legal provision to directors, auditors and non-governmental rule-makers, Nobes (1993) observes that the greatest change in effects from 1970 has been in the UK.

Like the UK and the US, other countries have their own regulatory framework governing the conduct of businesses, including an appropriate accounting framework. However, this framework does not rest entirely on the provisions of government legislation. In most Western countries like the UK, legislators prefer to leave matters relating to accounting practices to the members of the accounting profession. Whilst the Companies Acts contain detailed provisions relating to the type of accounting information to be disclosed in the financial statements, they do not usually prescribe all the specific accounting practices to be adopted in preparing such information. As a result, the accounting profession and its institutions have gradually developed a system of accounting standards that prescribe standards required to be met in the preparation of information disclosed in financial statements. Most financial statements issued are based on Generally Accepted Accounting Principles (GAAP). However, in order to ensure the uniformity and comparability of reported accounting information across countries, there has been a recent move towards standardizing accounting rules by the International Accounting Standards Board (IASB). IASB develops International Financial Reporting Standards that have been adopted by Australia, Canada and the European Union (for listed companies only). Other countries are considering the adoption of IFRS. In the US, the Financial Accounting Standards Board is committed to converging the US GAAP and the IFRS over time.

14.5 Financial Reporting and Corporate Governance

Corporate governance plays an important role in ensuring the quality of the financial reporting process (Cohen et al., 2004). In a speech to directors, Levitt (1999, p. 2) noted that, "the link between a company's directors and its financial reporting system has never been more crucial". Many of the recent corporate failures (Enron, WorldCom, Xerox, BCCI, Parmalat, amongst others), have been attributed to poor governance, which manifested in fraudulent financial reporting and earnings mismanagement (Loomis, 1999; Wu, 2002; Palmrose and Scholz, 2002; Krugman, 2002; Larcker et al., 2004). These failures and lapses have been responsible in putting corporate governance in the limelight and generated enormous interest amongst practitioners (in the UK, Cadbury Report, 1992; Higgs Report, 2003; Smith Report, 2003 and in the US, Blue Ribbon Committee Report, 1999; Sarbanes and Oxley, 2002) and the academia. Academic research (Beasley, 1996; Dechow et al., 1996; McMullen, 1996; Beasley et al., 1999, 2000; Carcello and Neal, 2000; Peasnell et al., 2000; Klein, 2002; Krishnamoorthy et al., 2002, amongst others) provide evidence about the link between weaknesses in corporate governance and poor financial reporting quality, earnings manipulation, financial statement fraud and weaker internal controls. These findings have led to corporate governance reforms across the globe to bring about improvements in the financial reporting process and to make directors and management more accountable for ensuring the integrity of financial reports (Cohen et al., 2004).

What is corporate governance? There are as many definitions of the term, as there are text books on the subject. Solomon (2007) suggests that "existing definitions of corporate governance fall along a spectrum, with 'narrow' views at one end and more inclusive, 'broad' views placed at the other". The narrow view restricts corporate governance to the relationship between a company and its shareholders (the agency theory perspective), whereas the broad and more inclusive approach views corporate governance "as a web of relationships, not only between a company and its owners (the shareholders) but between a company and a broad range of other 'stakeholders': employees, customers, suppliers, bondholders. . ." (Solomon, 2010, p. 12). This is the stakeholder theory perspective. Other definitions of corporate governance are:

Tricker (1984)

> . . . the governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries.

The Cadbury Report (1992)

> . . . the system by which companies are directed and controlled.

Keasey and Wright (1993)

> . . . the structures, process, cultures and systems that engender the successful operation of the organization.

US Public Oversight Board (1993)

> . . . those oversight activities undertaken by the board of directors and audit committee to ensure the integrity of the financial reporting process.

Cannon (1994)

> . . . the governance of an enterprise is the sum of those activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership and control. It incorporates the trusteeship of assets, their management and their deployment.

Parkinson (1994)

> . . . the process of supervision and control intended to ensure that the company's management acts in accordance with the interests of shareholders.

The Corporate Governance Handbook (1996)

> . . . the relationship between shareholders and their companies and the way in which shareholders act to encourage best practice (e.g., by voting at AGMs and by regular meetings with companies' senior management). Increasingly, this includes shareholder 'activism' which involves a campaign by a shareholder or a group of shareholders to achieve change in companies.

Shleifer and Vishny (1997)

> . . . deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.

OECD (1999)

> . . . a set of relationships between a company's board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives, and monitoring performance, are determined.

Cohen et al. (2004) suggest a model, "a corporate governance mosaic" Fig. 14.1, which shows the interactions among the actors and institutions that affect corporate governance. They state that this model encompasses a broader view of governance not previously considered in prior accounting research. According to them, a narrow view of corporate governance restricting it to only monitoring activities may potentially undervalue the role that corporate governance can play.

The model depicts the actors in the governance process, highlights their potential interactions, and suggests that the governance process impacts the quality of financial reporting and, in the extreme, earnings manipulation and outright fraud (Cohen et al., 2004).

This corporate governance mosaic shows a more comprehensive framework, which considers all major stakeholders in the governance mosaic, including those within and outside the firm. It indicates the interrelationships between the various actors and mechanisms within the corporate governance mosaic. The model suggests that the role of the external auditor in the governance mosaic is significant and complex, as the auditor has to interact with other stakeholders (management and the audit committee). It considers the interactions among the audit committee, the external auditor, the internal auditor, the board, and the management to be crucial

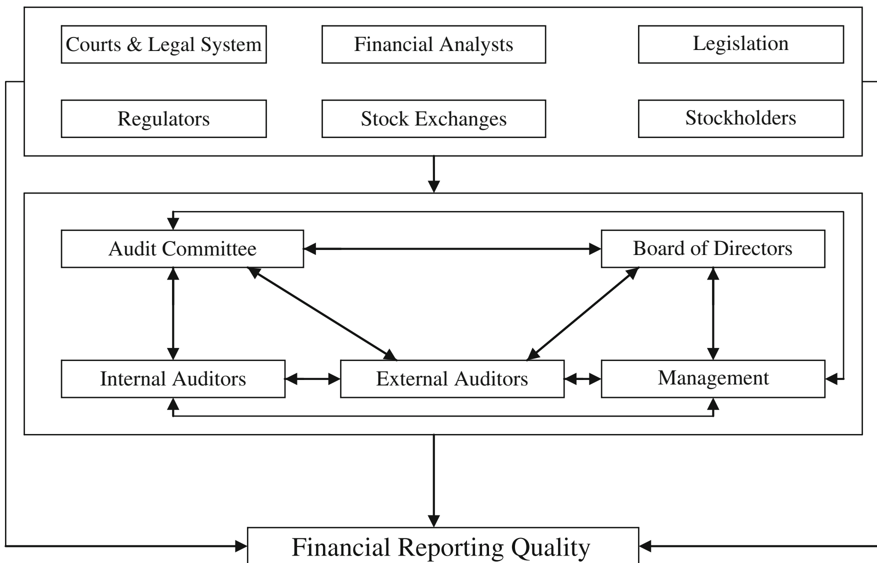

Fig. 14.1 Corporate governance mosaic and financial reporting quality. Source: Cohen et al. (2004)

to effective governance and to achieving high quality financial reporting (Sarbanes and Oxley Act 2002). Also, the interplay among the stakeholders is affected by outside forces such as regulators and stock exchanges as well as pressure to meet financial analysts. These external forces influence the governance of corporations in significant ways and are integral to safeguarding the interest of the company's stakeholders. The model draws attention to the need for research to focus not only on "documenting associations and not causal relationships", but also the substance of the interactions in the corporate governance mosaic. (Cohen et al., 2004).

With its diverse shareholder base,[1] the UK illustrates well the problems often associated with the separation of ownership and control of corporations, and hence has many agency problems (discussed later). According to Mallin (2007) "the agency problems, including misuse of corporate assets by directors, and a lack of effective control over, and accountability of, directors' actions, contributed to a number of financial scandals in the UK". Hence, the drive for better practices in corporate governance began in the late 1980s and early 1990s, following this spate of scandals. The Council of the London Stock Exchange, the Financial Reporting Council and the Accountancy Profession set up *The Committee on the Financial Aspects of Corporate Governance*, in 1991, headed by Sir Adrian Cadbury, to review financial reporting and accountability in the context of corporate governance. The Committee was formed following public concerns over the way in which companies were being run and fears concerning the type of abuse of power prevalent in the Maxwell case, inter alia" (Solomon, 2010, p. 52). The Committee issued its Report in 1992, which included a Code of Best Practice, with which all listed companies in the UK were required to comply. The Cadbury Report has since been the forerunner of numerous policy documents, principles, guidelines and codes, including those in other countries (Solomon, 2010). Figure 14.2 illustrates the development of corporate governance in the UK and the various internal and external influences on these developments. The main reports highlighted here are as follows[2]:

- *Myners Report 1995* – which looked at the relationship between companies and their institutional shareholders, recommending how the relationship between institutional investors and company management should be handled.
- *Greenbury Report 1995* – focused mainly on directors' remuneration and issued a Code of Best Practice on establishing remuneration committees and remuneration policies of listed companies.
- *Hampel Report 1998* – Combined both the financial aspects of corporate governance (the Cadbury Report, 1992) with the recommendations in the Greenbury Report 1995, culminating into the Combined Code (1998).
- *Turnbull Report 1999* – provided an overview of internal control systems in UK listed companies and made recommendations for improvement.

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[1]These include institutional investors, financial institutions and individual shareholders.

[2]For detailed discussions on the development of corporate governance codes in the UK, see (Solomon, 2010; Mallin, 2010)

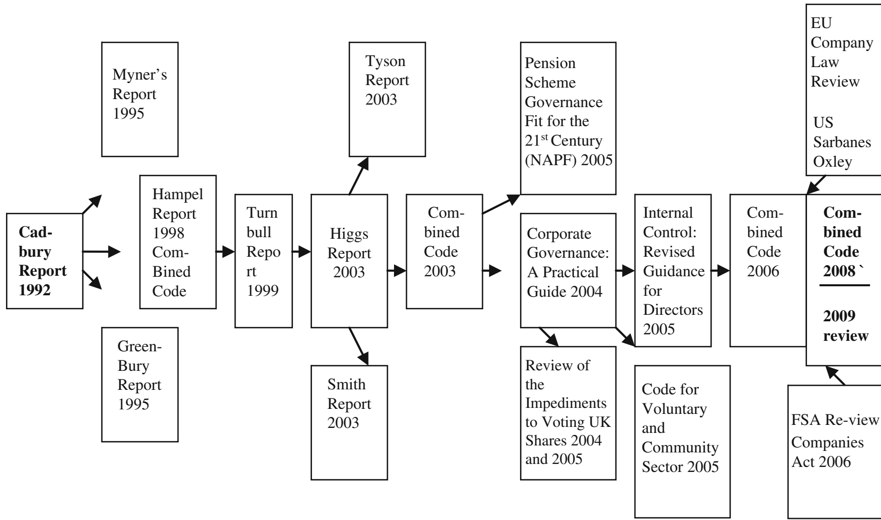

Fig. 14.2 Corporate governance reforms in the UK. Adapted from Solomon (2010, p. 53)

- *Higgs Report 2003* – considered the role and effectiveness of non-executive directors and made recommendations for changes in the Combined Code.
- *Tyson Report 2003* – was about the Recruitment and Development of Non-Executive Directors. The Report indicated that greater boardroom diversity improved relationships with corporate stakeholders (Solomon, 2010).
- *Smith Report 2003* – considered the role and effectiveness of audit committees and emphasized the essential role the audit committee should play in ensuring the independence and objectivity of the external auditor, as well as monitoring company management.
- *Combined Code 2003* – incorporated the substance of the Higgs Report and the Smith Report.
- *Combined Code 2006* – produced following FRC consultations on the effectiveness of the 2003 Combined Code
- *Combined Code 2008* – incorporates changes made following a review of the impact and effectiveness of the Code held during 2007. The changes include the removal of the restriction on an individual chairing more than one FTSE 100 company; and for listed companies outside the FTSE 350, allow the company chairman to sit on the audit committee where he or she was considered independent on appointment.

The Combined Code on Corporate Governance sets out standards of good practice in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. The first Code was issued in 1998 and has been updated at regular intervals since then. The 2007 review found

that companies and investors considered the Code to be having a broadly beneficial impact, and have contributed to higher overall standards of governance among UK listed companies. Consequently only two changes were made to the Code as a result of that review.

All companies incorporated in the UK and listed on the Main Market of the London Stock Exchange are required under the Listing Rules to report on how they have applied the Combined Code in their annual report and accounts. Overseas companies listed on the Main Market are required to disclose the significant ways in which their corporate governance practices differ from those set out in the Code. From April 2010, under the FSA's revised Listing Regime, all companies with a Premium Listing will be required to report on how they have applied the Code regardless of their country of incorporation (FRC).

The Combined Code contains broad principles and more specific provisions. Listed companies are required to report on how they have applied the main principles of the Code, and either to confirm that they have complied with the Code's provisions or – where they have not – to provide an explanation. Solomon (2010) explains that the adoption of a "comply or explain" approach to corporate governance has been in keeping with the preferential approach of company law in the UK. The US has taken a statutory (rules-based) rather than a voluntary principles-based approach to corporate governance. Following the financial scandals at corporations such as Enron and WorldCom, statutory rules on corporate governance were introduced by the Sarbanes-Oxley Act in 2002.

Some further aspects of corporate governance have been brought into law, with much of the initiative coming from the European Union. New regulations in 2002 were introduced for greater disclosures of directors' remuneration by listed companies, replacing similar regulations that were included in the Listing rules from 1995. The Companies Act 2006 sets out new statutory duties of directors, and contains a requirement for quoted companies to be more accountable to shareholders by publishing a business review in narrative form each year. Amendments to the 4th and 7th EU Company Law Directives approved in 2006 include a requirement for quoted companies to include a corporate governance statement in their annual reports, and amendments to the 8th Company Law Directive in 2008 is for "public interest entities", including listed companies, to have an audit committee consisting of independent NEDs and to publish an annual corporate governance statement (Coyle, 2009).

In March 2009 the FRC announced a review of the Combined Code, as a result of which it proposes to make a number of revisions to the Code. Consultation on these proposals ended on 5 March 2010. Subject to the outcome of consultation it is intended that the revised Code – which will be known as the UK Corporate Governance Code – will apply to financial years beginning on or after 29 June 2010.

The directors (and management) of a company are responsible for the preparation and content of the financial statements, and they have certain legal duties with regard to financial reporting. In relation to UK law, the directors have a duty to (Coyle, 2009):

- Prepare annual company accounts, and in the case of a parent company, consolidated accounts for the group (Companies Act 2006, Sec. 394 and 399). The accounts must be approved by the board and signed on behalf of the board by a director.
- Prepare a directors' report, which must also be approved by the board and signed on its behalf by a director or the company secretary (Sec. 415 and 419). Unless the company is subject to the small companies' regime, the directors' report must contain a business review (Sec. 417).
- Prepare a directors' remuneration report, which must be approved by the board and signed on its behalf by a director or the company secretary (Sec. 420–422).
- Lay the accounts and reports of a public company before the shareholders in a general meeting (Sec. 437) and the shareholders of a quoted company must be invited to approve the directors' remuneration report (Sec. 439).
- File with the Registrar of Companies at the end of each financial year, a copy of the annual accounts, the directors' report, the auditors' report and, in the case of quoted companies, the directors' remuneration report (Sec. 441).

The Combined Code places additional requirements and responsibilities on the directors with regard to financial reporting, and states that the financial reports should be balanced and understandable (Coyle, 2009).

- The board should present a balanced and understandable assessment of the company's position and prospects. This requirement applies not only to the statutory financial reports, but also to interim reports, other price-sensitive reports and reports to the regulators.
- The directors should explain in the annual report their responsibility for preparing the accounts.
- The auditors must provide a statement about their reporting responsibilities.
- The directors should also report that the business is a going concern (i.e. that it will continue in business for an indefinite period). This requirement is also included in the UK Listing Rules, which requires listed companies incorporated in the UK to include in their annual report and accounts a statement by the directors that the business is a going concern, "with supporting assumptions or qualifications as necessary". This statement should be viewed by auditors before publication.

Having made such a statement of responsibilities, the directors must also accept liabilities arising out of a failure to carry them out.

The Combined Code stresses that it is the responsibility of management, not the audit committee, to prepare complete and accurate financial statements. It is the responsibility of the audit committee to review the significant financial reporting issues and judgments that are made in connection with these statements:

- The audit committee should consider significant accounting policies used to prepare the statements, any changes to them, and any significant estimates or judgments on which the statements have been based.

- Management should inform the committee about the methods they have used to account for significant or unusual transactions, where the accounting treatment is open to different approaches.
- Taking the external auditors' views into consideration, the committee should consider whether the company has adopted appropriate accounting policies and made appropriate estimates and judgments.
- The committee should also consider the clarity and completeness of the disclosures in the financial statements.

The Guidance issued by the Financial Reporting Council[3] states that if the audit committee is not satisfied with any aspect of the proposed financial reporting by the company, it should report its views to the board. The Committee should also review related information presented with the financial statements, including the business review and the corporate governance statements relating to audit and risk management.

14.6 Financial Reporting to Whom?

To whom are directors of companies accountable? To whom are they responsible? The answer to these questions has been the subject of much debate amongst academics (see Cohen et al., 2004), and has been addressed from two main perspectives – a narrow perspective, the *shareholder value approach,* which is embedded in *agency theory* and a broad perspective, the *stakeholder value approach,* embedded in *stakeholder theory.*

14.6.1 Agency Theory

The development of agency theory is often traced back to Berle and Means (1932), although some authors suggest that it goes far beyond this date and can be attributed to Adam Smith in 1776, in his influential book, *The Wealth of Nations*. Letza et al. (2004) suggest that the agency problem was effectively identified by Adam Smith when he argued that company directors were not likely to be as careful with other people's money as with their own. Subsequently the firm was viewed as a nexus of a set of contracting relationships among individuals – between shareholders (as principals) and directors (as agents). The shareholders own the company and are not involved in running it. They appoint directors as agents to run the company on their behalf. The theory is based on the assumption that directors in seeking to maximize

[3]The Financial Reporting Council is the UK's independent regulator responsible for promoting confidence in corporate governance and reporting. The Council promotes high standards of corporate governance through the Combined Code, but do not monitor or enforce its implementation by individual boards.

their own personal benefit, take actions that are advantageous to themselves but detrimental to the shareholders.

Jensen and Meckling (1976) suggested that the governance of a company is based on the conflict of interests between the company's owners and managers. Whilst the shareholders may be seeking to maximize the value of their investments over the long term, the managers may not have long-term interest in the company, especially if they do not own any shares in it. The "agency contract" between owners and managers should ensure that managers always act in the best interest of the owners. However, finding the perfect contractual relationship is not always possible. Conflict of interest in the relationship arises through "moral hazard", level of effort, earnings retention and time horizon. Moral hazard presupposes that the managers will want to maximize their personal benefits from the company, through spending activities that may diminish shareholder returns. Level of effort would mean that the managers may not put as much energy or effort into running the company as they would do if they owned it. Given that the remuneration of directors is often linked to company size and not necessarily the size of profits, they may prefer to reinvest profits into the company than declare dividends to shareholders. Also, whilst owners may be looking to maximizing the value of their shares in the long-term, the managers may be interested in short-term returns, especially where this is linked to their performance.

Agency costs become inevitable to enable the agents make decisions that will be in the best interest of the principal. These costs are monitoring costs, bonding costs and residual loss. Monitoring costs are those costs that the principals are willing to pay to enable to monitor the actions of their agents. This would be the cost of annual reporting to the shareholders, including having the accounts audited on their behalf. Bonding costs would include the remuneration packages paid to directors so they would act in the best interests of the owners. Residual losses are those costs which principals have to bear due to poor management decisions, such as the loss in the sale of company assets.

Agency theory is therefore based on having effective corporate governance systems in place to help reduce agency costs. If boards are effective, for example, such costs can be reduced. Also proper accountability will ensure that principals receive feedback from their agents on their performance, which will enable the agents to be adequately rewarded. Greater accountability will also help reduce agency costs.

Agency theory is based on the maximization of shareholders value. Companies exist to maximize the wealth of the owners in the form of share price increases and dividend payments. Whilst this approach has enjoyed universal acceptance, the Organization for Economic Development (OECD) in its principles of governance offers a more inclusive approach, stating that corporate governance is about:

> Maximising value; subject to meeting the corporation's financial and other legal and contractual obligations. This inclusive definition stresses the need for boards of directors to balance the interests of shareholders with those of other stakeholders – employees, customers, suppliers, investors, communities – in order to achieve long-term sustained value.

Also, the International Corporate Governance Network (ICGN), an international body that promotes world-wide best practices in corporate governance has

acknowledged in its revised corporate governance principles (2005) that "the overriding objective of the corporation should be to optimize over time the returns to its shareholders. Corporate governance practices should focus attention on this objective".

The presumption of agency theory that the purpose of the firm is to maximize shareholder value, has been criticized as being too narrow. Such a view would be incompatible with the responsibilities of the enlightened modern corporation, which needs to take into account the effect of its actions on working conditions, relations with customers and suppliers, and the environment (Wearing, 2005, p. 11).

14.6.2 Stakeholder Theory

Agency theory has an underlying assumption that profit maximization is the main motivation for a company's strategy and tactics. Stakeholder theory stresses the importance of all parties who are affected, either directly or indirectly, by a firm's operations (Wearing, 2005). Stakeholders in a company are those who have an interest, or "stake" in it, and are affected by what the company does. They can expect the company to behave or act in a particular way with regard to their interest. Stakeholder groups in a company Fig. 14.3 include the shareholders, the directors, managers, employees, customers, suppliers, the government and other parties. The nature of their interests differs between stakeholder groups, and there is some debate as to which stakeholder group interest should predominate and to what extent the interests of different groups can be met or reconciled (Coyle, 2009).

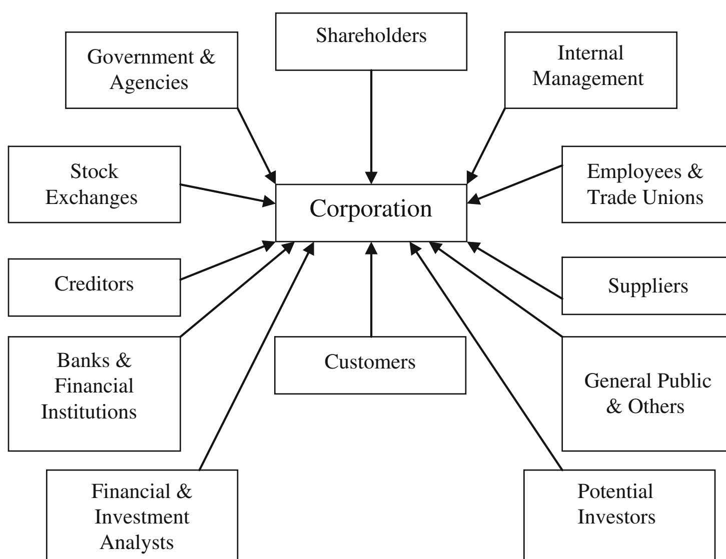

Fig. 14.3 Stakeholders in an organization

From a stakeholder perspective, corporate governance is concerned with achieving a balance between economic and social goals and between individual and communal goals. Sound corporate governance should recognize the economic imperatives companies face in competitive markets and should encourage the efficient use of resources through sound investment. It should also require accountability from the board of directors to the shareholders for the stewardship of those resources. Coyle (2009) argues that within this framework, the aim should be to recognize the interests of other individuals, companies and society at large in the decisions and activities of the company.

Stakeholder advocates argue that companies should recognize a responsibility to all those affected by companies' decisions. Some advocates go further and call for directors to be accountable and responsible to a wide range of stakeholders far beyond companies' current company responsibility to shareholders. Such responsible behaviour, the stakeholder advocates argue, should be the price society demands from companies for the privilege of incorporation, granting shareholders limited liability for the company's debts (Tricker, 2009). However, supporters of agency theory would argue that any corporate governance reforms should align managers' interests with shareholder interests, for instance by tying directors' bonuses closely to profitability.[4] The business itself would benefit, since re-invested profits will help to build up the firm's resources, thereby allowing for future economic growth (Wearing, 2005). Such activities will ultimately benefit other stakeholders such as employees, who can be assured of long-term job security.

Although stakeholder theory suggests that the purpose of corporate governance should be to satisfy, as far as possible, the objectives of all key stakeholders, a strong opponent to that school of thought is Milton Friedman, a free market economist (Solomon, 2010). Friedman (1962, 1970) believed strongly that a company existed to maximize returns to its shareholders, adopting a pure agency theory perspective. Others who shared his line of thought include Sternberg (1997, 1998). According to Sternberg (1997, p. 5)

> Stakeholder theory provides no effective standard against which corporate agents can be judged. Balancing stakeholder interests is an ill-defined notion, which cannot serve as an objective performance measure; managers responsible for interpreting as well as implementing it are effectively left free to pursue their own arbitrary ends.

Similarly, Jensen (2001, p. 305) suggests that the reason why managers and directors of corporations embrace stakeholder theory is motivated by self-interest:

> Because stakeholder theory provides no definition of 'better', it leaves managers and directors unaccountable for their stewardship of the firm's resources. With no criteria for performance, managers cannot be evaluated in any principal way... By expanding the

[4]However, such an action could create other ethical traps and could be seen (and has been seen) as a further reason for management to boost up annual results in order to justify higher bonuses. Similarly, the additional emphasis on self-interest and profitability could potentially jeopardize more costly but environmentally friendly or socially responsible investment.

> power of managers in this unproductive way, stakeholder theory therefore increases agency costs in the economic system. Viewed this way it is not surprising that many managers like it.

Also, Coyle (2009, p. 23) notes that the "problem with the stakeholder approach is that company law gives certain rights to shareholders, and there are some legal duties on the board of directors towards their company". Although Coyle suggests that the interests of other stakeholders are not reinforced by company law, this was the case with previous company legislations. The Companies Act 2006 has introduced new measures clarifying the duties of directors for the first time in statute law. These duties are to:

> act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole and, in doing so have regards (amongst other matters) to:
>
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment.
> (e) The desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) The need to act fairly as between members of the company (Part 10, Chap. 2, Sec. 172).

These provisions of the Act lend support for the recognition of wider interests in the affairs of companies. Directors are required to have regard to wider stakeholder interests as well as to the shareholders.

Recently, some features of the agency model and stakeholder theory have been combined in an attempt to make both approaches more appealing. Jensen (2001) argues for a modified approach to agency theory and stresses the importance of maximizing firm value. He argues that a firm cannot maximize its value if it ignores the interest of its stakeholders. Therefore he makes a case for enlightened shareholder value maximization, which he regards as identical to enlightened stakeholder theory (Wearing, 2005).

The enlightened shareholder approach to corporate governance is that the directors of a company should pursue the interests of their shareholders, but in an enlightened and inclusive way. It is a form of compromise between the agency view and the stake holder view (Coyle, 2009). The directors should look to the long term, not just the short term, and they should also have regard to the interests of other stakeholders in the company, not just the shareholders. Managers need to be aware of the need to create and maintain productive relationships with a range of stakeholders having an interest in their company.

A criticism of the enlightened shareholder view is that most shareholders do not fit the image of enlightened investors. Most shares in public companies are owned by institutional investors, who are themselves relatively unaccountable to their beneficiaries (Coyle, 2009). However, Coyle suggests that the role of institutional investors is likely to evolve with time and they would be more proactive in promoting the rights and interests of shareholders.

14.7 Financial Reporting and Auditing

One of the most important elements of modern corporate governance is the external audit function. From an agency theory perspective, it represents one of the most indispensable corporate governance checks and balances that help shareholders in their monitoring and control of company management (Solomon, 2010). The importance of auditing as a societal function has been suggested by various writers, including Beck (1973), Flint (1971, 1982, 1988), Shearer and Kent (1983), and Stamp and Moonitz (1978), amongst others. The Cadbury Committee reiterated the importance of the audit, stating in their Report that

> The annual audit is one of the cornerstones of corporate governance... The audit provides an external and objective check on the way in which the financial statements have been prepared and presented.

14.7.1 What Does an Audit Entail?

There is no single definition of auditing, although all the definitions offered do give some insight into the main features of a financial statement audit. In the Statement of Auditing Standards, the Auditing Practices Board (APB) defines auditing as

> An exercise whose objective is to enable auditors to express an opinion whether the financial statements give a true and fair view (or equivalent) of the entity's affairs at the period end and of its profit and loss (or income and expenditure) for the period then ended and have been properly prepared in accordance with the applicable reporting framework (for example relevant legislation and applicable accounting standards) or, where statutory or other specific requirements prescribe the term, whether the financial statements "present fairly".

According to Flint (1988, p. 45), auditing is

> A control function which monitors and reports on conduct, performance and achievement measured by reference to agreed criteria and compared with established norms of expectation, attesting the quality of information about an organization required by persons who have a vested interest in it.

Cosserat and Rodda (2009, p. 22) states that

> The financial statement audit involves obtaining and evaluating evidence about an entity's financial affairs in order to establish the degree of correspondence between the management's assertions and the established criteria, such as Financial Reporting Standards and legal requirements.

Also, Porter et al. (2008, p. 4–5) offer the following definition:

> A financial statement audit is an examination of an entity's financial statements, which have been prepared by the entity's management/directors for shareholders and other interested parties outside the entity, and of the evidence supporting the information contained in those financial statements.

These definitions reveal the two main stages of a financial statement audit: (1) an investigative stage, and (2) the communication or reporting stage. See Fig. 14.4.

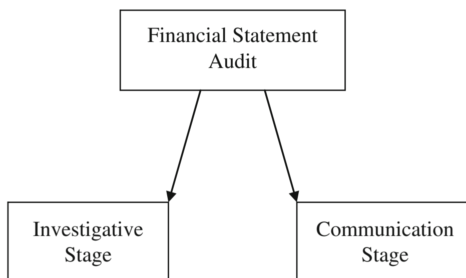

Fig. 14.4 The two stages of the audit process

In the investigative stage, the auditor seeks to establish the accuracy/reliability of management prepared information, through the systematic examination and evaluation of evidence which is undertaken to ascertain whether the statements by individuals or organisations fairly represent the underlying facts and comply with established criteria; and in the communication stage, the auditor reports (formally) to relevant parties, the outcome of his investigation by expressing his/her opinion on whether the information presented by management reasonably reflect reality.

Whilst Fig. 14.4 reveals the two main stages of the audit process, Fig. 14.5 provides detailed insights into the main features of a financial statement audit and the interactions between the parties in the process. This type of audit is carried out by qualified, experienced professionals, appointed by shareholders, and who are independent of the entity.

After completing their annual audit, the auditors are required to prepare a report to the shareholders of the company (Companies Act 2006, Sec. 495). The report

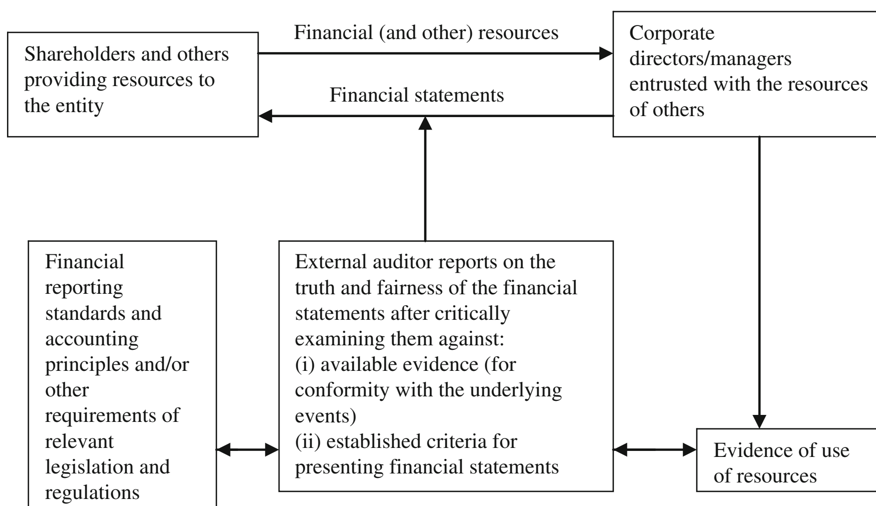

Fig. 14.5 Major features of a financial statement audit. Source: Porter et al. (2008, p. 5)

is included in the published annual report and accounts of public companies.[5] The audit report has two main purposes:

1. To give an expert and independent opinion about whether the financial statements give a true and fair view of the financial position of the company as at the end of the financial year covered by the report, and of its financial performance during the year;
2. To give an expert and independent opinion on whether the financial statements comply with relevant laws.

In addition,[6] auditors of listed companies in the UK are required to review the company's compliance with the Combined Code, and to obtain evidence to support the company's statement of its compliance with the Code.
Why do financial statements require to be audited?
ISA 200 (redrafted), *Objective and General Principles Governing an Audit of Financial Statements* states that

> The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material aspects, in accordance with an applicable financial reporting framework.

The external audit of financial statements is necessary because of the separation of ownership from control, and the potential conflict of interest that may arise. Shareholders who invest in companies (and are therefore, owners) are not involved in the day to day management and have to rely on directors (who control the affairs of the company) to manage their investments in the most objective manner. The directors have to make periodic reports on their performance to the shareholders and other stakeholders (Fig. 14.3), who rely on the information contained in these reports and accounts to assess the performance of management. The annual report and accounts, which is the formal medium of reporting, is audited each year by independent auditors. The purpose of an independent audit is to make sure, as much as is reasonably possible, that the financial statements are objective and can be relied on. The APB states that

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[5] Companies which qualify as small are generally exempt from a statutory audit (CA, s.477). These are companies with turnover of not more than £6.5 million and balance sheet total not more than £3.26 million.

[6] Listed companies are also required to issue additional reports by the Disclosure and Transparency Rules of the Financial Services Authority (FSA). The rules were amended from 2007 by the introduction of the requirements of the EU Transparency Directive. Listed companies are required to issue an interim financial statement for the first 6 months of the financial year. This statement is not subject to audit. Companies are also required to announce to the stock market relevant information affecting their business (for example, profit warning). This information must be issued to the stock market through a Regulated Information Service (Coyle, 2009). The Transparency Directive has introduced requirements for listed companies that do not publish quarterly results. Companies are now required to issue two interim management statements; one during the first half and the other during the second half of the financial year. These should include information on trading performance, financial position and any major transactions or events that have occurred during the relevant period.

> Auditors add to the reliability and quality of financial reporting [to external parties]; they [also] provide to directors and officers [of the auditee] constructive observations arising from the audit process; and thereby contribute to the effective operation of business capital markets and the public sector (Auditing Practices Board, 2003, Appendix 2).

The Committee on Basic Auditing Concepts (COBAC) of the American Accounting Association in *A Statement of Basic Auditing Concepts* (1972) provide four conditions which created the demand for an independent audit of financial statements. In the absence of a monitoring mechanism, these four conditions collectively contribute to information risk; the risk that the financial information may be incorrect, incomplete or biased. Thus an audit enhances the credibility of financial statements by reducing information risk. The four conditions suggested are:

1. *Conflict of Interest* – may exist between the user and the preparer of information. Directors prepare the statements and are reporting on their own performance. Users need assurance from an audit that the information reported by management is as accurate as possible and not biased in favour of management.
2. *Consequence* – of making decisions based on inaccurate financial information may be grave for users of the financial statements. Therefore they need assurance that the information contained in the statements are reliable before they can be used as a basis for making investment decisions.
3. *Complexity* – of the financial information contained in company financial statements could make them susceptible to unintentional errors. Besides this complexity makes it difficult, if not impossible for users to verify the information themselves. This is where the services of auditors become inevitable.
4. *Remoteness* – of users from the accounting records on which the statements are based. As a result of legal, physical and economic constraints, users may not readily gain access to the financial records of the company. Consequently, they are unable to assess the quality of the statements. Under such circumstances users have two alternatives (Cosserat and Rodda, 2009, p. 43): (1) to accept the quality of the financial data in good faith, or (2) to rely on the attestation of a third party. The second alternative is more likely to be preferred by users.

If financial statements are produced in a way that is intended deliberately to mislead shareholders, the persons responsible would be guilty of fraud, which is a crime. In most companies, this would require deception by a small group of executives, such as the CEO and finance director (Coyle, 2009).

The purpose of the audit report is to give users of a company's financial statements some reassurance that the information in the statements is believable. Users of accounts want reassurance that there has not been any fraud or error in the accounts.

Whilst the importance of the audit function is recognized, there is an "expectations gap" between the level of assurance auditors can reasonably give and that which users of accounts expect from auditors. Users of accounting information (Fig. 14.3) expect auditors to provide assurance concerning material fraud, irregularities and the viability of the business and its management. When companies fail

due to fraud or mismanagement of funds, users expect auditors to unearth such problems. What users of accounts do not want is for auditors to sign off the accounts of a company, as representing a "true and fair view" of its financial position and the next day the company goes burst. Until recently, the profession argued that the problem lay with users' failure to understand the role of the auditors and the limitations of financial reporting. The Cadbury report emphasizes that it is not the role of auditors to prepare financial statements, nor to provide absolute assurance that the figures in the financial statements are correct, nor provide a guarantee that the company will continue as a going concern, but the auditors have to state in the annual report that the financial statements show "a" true and fair view rather than "the" true and fair view (quoted in Solomon, 2010, p. 172). The auditing profession has since taken some steps to address users' concerns including the introduction of the expanded auditors' report (see ISA (UK and Ireland) 700 *The Auditor's Report on Financial Statements*), to ensure that users are better informed and do not hold unrealistic expectations of the assurance provided by audited financial statements. Also, steps have been taken to improve the quality of financial reporting[7] so as to address any aspect of the gap which relates to poor/inadequate performance by auditors.

Academic research into the role of auditors and the effectiveness of the audit function has produced mixed results. Authors (Healy and Palepu, 2001) have queried whether or not the audit adds value for investors and whether auditors' actions are independent of client interest. Kothari (2001) provides evidence that share prices react to earnings announcements. This suggests that shareholders consider audited accounting information to be credible and useful in investment decisions. Furthermore, Leftwich (1983) found that banks required companies to present audited financial information, suggesting that shareholders and other providers of capital acknowledge the usefulness and effectiveness of the audit function. Objectivity in the audit enhances the credibility and therefore the value of the audit (Lee, 2006).

Higson (2003) argues strongly that the external audit should be viewed in the context of the audit of management's motivations. According to him management is keenly interested in the picture that is portrayed in the financial statements. However, the very nature of financial reporting means that a whole multitude of judgments and estimates have to be made during the compilation of the financial statements – hence the potential for bias. But bias can arise from the transactions undertaken over which the auditor has no say, as well as from the way the figures in the financial statements are compiled and presented, which the auditor may not be able to influence if the matter is material (Higson, 2003, p. 131). Therefore, the

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[7] The Accounting Standards Board (ASB) is an operating body of the Financial Reporting Council (FRC), the UK's independent regulator responsible for promoting confidence in corporate reporting and governance. The prime role of the ASB is to maintain UK accounting standards. The ASB also collaborates with accounting standard-setters from other countries and the International Accounting Standards Board (IASB) both in order to influence the development of international standards and in order to ensure that its standards are developed with due regard to international developments.

first issue to be addressed is whether it is possible to eliminate bias from financial statements and what role the auditor is expected to play in eliminating such bias. The second issue is to establish whether there is a thin line between "permissible" bias in the financial statements and the potential for management to commit fraud. Higson (2003, p. 132) argues that whereas there has been a lot of clamouring about the role of auditors in the detection of fraud, it must be remembered that not all bias have material effects on financial statements and therefore may not influence the decisions of users of such statements. Secondly, he reiterates that "while it is easy to criticize auditors for failing to detect a fraud, it is impossible to quantify the deterrent effect of the external audit. It may be cold comfort that if things are bad now with the external audit, they would probably be much worse without it". Similarly, whilst exposing the weaknesses in the current system of auditing, Solomon (2010) confirms that "there is a lot of academic literature in accounting that exposes serious flaws in our current system but offers no alternative. Overthrowing the status quo requires a viable system to replace it and a lot of support to impose the alternative.

14.8 Fraud and Error in Financial Reporting

Fraud is a highly controversial area, and the extent of auditor responsibility for the prevention and detection of fraud has been the subject of discussion for many years (see Porter, 1997; Beattie et al., 2001). It is one of the areas of financial reporting that has been responsible for the 'expectations gap' between users of accounts and auditors (see Humphrey et al., 1992). The traditional view of auditor responsibility for fraud detection is well documented in the famous ruling of Lord Justice Lopes, in *Re Kingston Cotton Mill Company* in 1986, in which he stated that *An auditor is not bound to be a detective, or... to approach his work with suspicion, or with foregone conclusion that there is something wrong. He is a watchdog, not a bloodhound*. However, as the reporting environment has become more and more sophisticated; more so, following the spate of corporate scandals, there has been the need to ensure that auditors assumed more responsibility in their reporting role.

Fraudulent financial reporting significantly affects not only the companies and organizations in which such frauds are perpetuated, but also the confidence of the public in the capital markets. High profile cases of fraudulent financial reporting often draw attention to, and cause the public to question the credibility of structures put in place to protect the investing public. According to Vanasco (1998, p. 60)

> Fraudulent financial statements are of great concern not only to the corporate world, but also to the accounting profession. Every year the public has witnessed spectacular business failures reported by the media.... These catastrophic events have shocked the public, undermined auditors' credibility in their reporting function, and eroded public confidence in the accounting profession.... Events such as unreported revenues, manipulation of losses, inflated sales, fraudulent write-offs of uncollectable accounts, unusual related-party transactions, misappropriation of assets and many other irregularities have spearheaded several court rulings and shaped the auditing standards.

BCCI (1991)	☐ Difficulty of a major customer to repay loan meant the bank was in financial trouble; financial impropriety embarked upon to cover up the problem ☐ Audit initially shared by Ernst & Young and Price Waterhouse (PW) ☐ Ernst and Young left, Price Waterhouse retained as sole auditor ☐ PW discovers financial improprieties ☐ PW gave warning signs to bank regulators in the UK in 1990 ☐ BCCI shut down as insufficient funds prevented it from being restructured; massive fraud uncovered ☐ PW acting as auditor and consultant to BCCI– conflict of interest
TransTec Engineering (1999)	☐ Senior executives colluded to conceal from full board and the auditors information about debit notes issued to the company by Ford. ☐ Fraud not spotted by auditors, although had been misled ☐ Company collapsed due to fundamental failings of executive leadership exacerbated by poor corporate governance. ☐ JDS concludes the audit firm had “failed to carryout adequate audit procedures in relation to the debit notes including investigating conflicting explanations as to what the debit notes were… In 1998 audit they did not find fault with the management”. ☐ PwC fined £495.000 by the Accountant’s Joint Disciplinary Scheme (JDS)
Enron (2001)	☐ Profit as at 31 December 2000 was $979 million ☐ Used ‘Special Purpose Entities’ (SPEs) to conceal large losses October 2001 non-recurring loss of $1b declared/$1.2b write-off against shareholders’ funds ☐ More accounting problems revealed ☐ December 2001 filed for bankruptcy ☐ Largest bankruptcy in US history
Adelphia Communications (2002)	☐ 5 former executives arrested in July 2002 and charged with fraud. ☐ Company’s founder and two sons, part of the executives, looted the company on a massive scale using the family as their ‘piggy bank’. ☐ Charges included using loans from company to buy cars; self-dealing between the company and companies controlled by family members; misleading statements to investors about the financial position of the company; use of corporate funds for personal benefit by family
Parmalat (2003)	☐ Expansion through acquisitions ☐ Increase in debt ☐ Difficulty making a bond repayment despite supposedly large cash reserves ☐ Investigations revealed cash reserves were non-existent ☐ Company went into administration ☐ Founder, Calisto Tanzi, accused of providing false accounting information with the intention of deceiving other board members and the company’s audit committee

Fig. 14.6 Examples of corporate scandals which were as a result of fraudulent financial reporting

Figure 14.6 that follows provides some cases of fraud involving executive management. In some of these cases, the auditors have been found to compromise their independence.

In all of the recent corporate scandals, the senior executives intentionally presented inaccurate financial information not only to their shareholders, but also to the capital markets, and some to their auditors.

Common themes that tend to run through cases in which fraud has occurred are:

- Charismatic and powerful business leaders
- Companies experiencing rapid and unsustainable rates of growth
- Unreasonably optimistic market expectations of future growth

- Unnecessarily complicated organization
- Inadequate control environment, including weak internal accounting controls
- Ineffective oversight by executive management, the audit committee and the board of directors
- Lack of monitoring of controls and compliance with corporate policies and procedures

When the annual financial statements of a company prove to have been misleading, questions are inevitably raised about the effectiveness of the external auditors. There are two main issues relating to the external audit of a company: whether it should be the job of the auditors to discover financial fraud and material errors; and the problem of the relationship between a client company and its auditors and the extent to which the auditors are independent and free from the influence of the company's management. If auditors are subject to influence, they might be persuaded to agree with the controversial method of accounting for particular transactions, which shows the company's performance or financial position in a better light. The demise of Arthur Andersen in 2002 appears to have been as a result of their lack of independence from the management of Enron.

Coyle (2009) suggests three ways in which published financial statements could be misleading:

1. There could be a fraudulent misrepresentation of the affairs of the company, where the company's management deliberately presents a false picture of the financial position and performance.
2. The company might use accounting policies whereby it presents its reported position and profits more favourably than would be the case if more conservative accounting policies were used.
3. The financial statements could be complex and difficult for investors to understand.

14.8.1 The Distinction Between Fraud and Error

There is the need to differentiate between accounting fraud and accounting error; the key difference being that of the intent of the preparers of the accounting information. The term "fraud" is a broad legal concept. Huntington and Davies (1994) point out that any fraud would have two elements, namely, deception or concealment, and deprival or loss to the victim. This is in line with French's 1985 definition of "fraud" as "deception, either by stating what is false or by suppressing what is true, in order to induce a person to give up something of value" (p. 128). However, within the context of auditing, the auditor is only concerned with fraud that causes a material misstatement in the financial statements. *ISA 240 (UK and Ireland)*[8] defines fraud as: *An intentional act by one or more individuals among management, those*

[8] International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland) 240) *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements* issued in December 2004

charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage (para. 6)

The two types of fraud that are most relevant to the auditor according to ISA (UK and Ireland) 240 are misstatements arising from fraudulent financial reporting, and misstatements arising from misappropriation of assets.

"Error" on the other hand refers to *an unintentional misstatement in financial statements, including the omission of an amount or a disclosure*. ISA 240 (UK and Ireland) says *The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional* (para. 5).

14.8.2 Responsibilities for Fraud and Error Detection

Users of financial statements often have a misunderstanding about responsibilities for financial reporting, because it is assumed that the external auditors are responsible for the "true and fair view" in the financial statements. Should financial statements be found to be misleading or incorrect, users assume that auditors have been negligent and are to blame. ISA (UK and Ireland) 240 makes it clear who has the main responsibility for the prevention and detection of fraud: *The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management* (para. 13).

ISA (UK and Ireland) 240 goes on to state, however, that *An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error* (para. 21).

Accordingly, both the entity and the auditors have responsibilities for fraud and error. This standard, expects auditors to approach their audit with an attitude of skepticism stating (para. 23): *The auditor plans and performs an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.*

Due to the characteristics of fraud, the auditor's attitude of professional skepticism is particularly important when considering the risks of material misstatement due to fraud. ISA (UK and Ireland) 240 defines "professional scepticism" as *an attitude that includes a questioning mind and a critical assessment of audit evidence.* The standard states that professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist.

Nonetheless, ISA (UK and Ireland) 240 makes it clear that an auditor cannot obtain absolute assurance that material misstatements in the financial statements will be detected because of such factors as the use of judgment, the use of testing, the

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is the current standard that applies with regards to auditors' responsibility for fraud and error detection in the audit of financial statements in the UK and Ireland.

inherent limitations of internal control and the fact that much of the audit evidence available to the auditor is persuasive rather than conclusive in nature. This means that no matter how well an audit is planned and carried out, there will always be some risk that fraud or error has occurred but not been detected. By its very nature, time and resource constraint prevent auditors from 100% examination of clients books and records. Therefore, a process of sampling and testing of transactions is applied, which could mean that some errors in the accounts might escape unnoticed. Also, the accounting systems and internal control procedures are vulnerable to fraud and error, which can be perpetuated by employees or executive management.

14.9 Conclusion

This chapter has examined the link between financial reporting and fraud. Many of the corporate governance "scandals" that have resulted in the collapse or near-collapse of companies have involved fraudulent or aggressive financial reporting. A number of corporate governance reforms are now in place as a direct consequence of concerns about the quality of financial reporting in the UK (and elsewhere) and the ability of the auditing profession to provide sufficient assurances to the investment community about the reliability of company financial statements. Reliable financial reporting and auditing is probably the most significant issue for corporate governance. Good corporate governance should ensure that financial reporting is reliable and honest, and that the opinion of the external auditors is objective and unbiased. Whilst the responsibility for fraud and error detection rests with the management and those charged with governance, the new international standard on auditing (ISA (UK and Ireland) 240) now expects auditors to assume some secondary responsibility for fraud and error detection. Auditors are required to plan and carry out their audit with an attitude of professional skepticism, a questioning mind, recognizing that circumstances may exist that cause the financial statements to be materially misstated. Failure to detect fraudulent reporting during the course of an audit can expose the auditor to adverse legal and/or regulatory consequences. This could result in the auditor suffering both substantial litigation costs and irreparable damage to their reputation.

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Corporate Social Responsibility: Concluding Remarks

Samuel O. Idowu, and Céline Louche

Life can only be understood backwards; but it must be lived forwards

Soren Kierkegaard

Corporate Social Responsibility should be disconnected from short-term corporate or individual successes but needs to be understood and considered from a long term perspective combined with a forward looking approach. It cannot be achieved by some judgments based only on annual financial results, but rather from a sound understanding of the past which is an important source of constructing scholarly hypotheses, models and theories. The historical mirror should not be allowed to obstruct man's future developments but instead should be used as a vehicle which helps to generate innovative ideas that facilitate a better understanding of how the future would look like. It was argued in one of our earlier books – *Innovative CSR* that CSR requires continuous innovation and value creation which provide the opportunity for knowledge sharing.

There is still a long way to go in the arduous journey of corporate social responsibility but these authors believe that it is still not too late for the present generation to contribute positively to the process of averting serious social and environmental catastrophe unfolding on planet Earth and future generations of man and other life forms that come to live on it. There are several actions required of us all if we were to succeed in making a big difference by our little individual and corporate actions, some of these actions have already been discussed either directly or indirectly in the 14 chapters that make up this book.

Scholars around the globe have provided us with many reasons why we should all behave responsibly as good citizens of this planet regardless of whether we are individuals or corporate entities (Kotler and Lee, 2005; Porter and Kramer, 2006; Amaechi and Adi, 2007). But (Porter and Kramer, 2006) for example note that "many companies have done much to improve the social consequences of their

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activities, yet these efforts have not been nearly as productive as they could be". These two scholars argue that in order for these corporate and individual actions to yield productive results, the enormous benefits inherent in the interdependency between business and society should be tapped and made use of instead of propagating a "them" and "us" culture. They further argue that, each corporate entity regardless of whether they are small or large should be encouraged to think of CSR in the way most appropriate to their own strategy. The field of CSR has provided the impetus for organizations to take a wholesale view of social and environmental consequences of all their actions and ensure that preventive actions are put in place to reduce the adverse effects of these actions. In the past, taking cognizance of adverse consequences would ordinarily have been assumed to fall outside business economic responsibilities. Actions emanating from taking the wholesale view of matters relevant to social and environmental responsibilities continue to play some beneficial roles in the quest to embed sustainability and sustainable development in corporate strategy, but there is still a long way to go as we move further into the future.

Rake and Grayson (2009) in their paper on *Embedding corporate responsibility and sustainability – everybody's business* note that CSR, if run and managed responsibly is a genuine source of business opportunities and competitive advantage. These scholars ask a number of questions which they argue are required to be answered by any organization hoping genuinely to take advantage of these business opportunities and competitive advantage. For instance they suggest that the organization must ask itself the following questions. Does it operate ethically and fairly in its dealings with its key stakeholders – employees, suppliers, customers, governments, competitors? Does it seek to minimize negative environmental and social impacts and maximize positive ones? Is it a good neighbour? Finding answers to these questions are the necessary ingredients of success to the organization and society in both financial and non-financial terms. Modern businesses are aware that success in today's terms is not only measured in terms of the bottom line results but also in terms of some social and environmental achievements made by the organization. But Johnsen and Ennals (2011) as a matter of fact expect modern businesses to derive not competitive advantages from their CSR activities but instead collaborative advantages, in which they all thrive and succeed as a result of their CSR actions. The environment for this to flourish could be created by corporate CSR activities.

Rake and Grayson (2009) note also that past corporate and individual mistakes have brought about some economic, environmental and social problems on us all. Finding lasting solutions to these problems is everybody's business. These problems; which Rake and Grayson (2009) innovatively refer to as challenges of our era, are manifested in the form of climate change, resource depletion, water shortages, loss of bio-diversity, pollution and several others which are still to become obvious to us. Life would become very difficult and even impossible to live if the problems were allowed to persist in man's natural environment.

This book ~*Theory and Practice of CSR* is a four part book which has comprehensively pooled together experts' knowledge of how the theory of CSR mixes

with its practice to coherently form a whole unit of views expressed in each of the 14 chapters that make up the book. The intention of the book was to add to the existing knowledge of current practitioners and experts in the field whilst simultaneously inculcating these two aspects of CSR into tomorrow's CSR practitioners and experts. Hopefully, this would prepare future generation of practitioners and experts in the field of CSR to better cope when dealing with these environmental and social problems. It should be commended that corporate entities of today are having to survive and practice the field of CSR under a dire global economic conditions not witnessed anywhere in the world since the 1930s. Things can only get better as the current global economic conditions improve.

Rake and Grayson also cited the findings from studies by Globescan and Edelman which reveal that around the world, society expects more and more from business whilst simultaneously trusting business less. The issue of trust between business and society is vital for business and society to co-exit conveniently for each others' mutual benefits which was perhaps why Mostovicz and Kakabadse in their paper on *Between Trust and CSR*: *The role of leadership* explore the role which corporate leaders need to perform in restoring the badly needed trust between society and business. The lack of trust between the two, since society and business are interwoven (Wood, 1991) could lead to a series of social, economic and environmental problems which could make it impossible for business to achieve its objectives and for society to continue to function effectively.

Okike also on the issue of financial reporting and fraud argue that investors rely implicitly on the annual financial reports of companies for reassurance of companies' financial viability before handing over their hard earned funds for investment purposes. Unfortunately, some recent irresponsible and fraudulent acts committed by some senior corporate managers on their own companies have badly shaken this confidence. It became widely known some few years back that some managers acted irresponsibly by defrauding the companies they were responsible for and consequently investors and other stakeholders in these companies, surprisingly with the help of their external auditors, who were expected to carry out the duties diligently and independently of managers in their examination of the company's state of affairs. As a result of this, several measures have been taken by governments around the world to prevent a reoccurrence of this and similar problems. For example, the UK Companies Act 2006 expressly requests managers to take cognizance of the impacts of their activities on the wider society; the United States' government passed the Sarbanes-Oxley 2002 Act, also known as the Public Accounting Reform and Investor Protection Act to protect shareholders and the general public from fraudulent accounting errors and practices.

That managers must be held morally responsible for their own actions as well as the actions of their staff was the interest of Rozuel and Kakabadse. They argue strenuously that our world today expects a sustainable ethic from managers which

requires them to demonstrate consistency of character and a more sustainable, fulfilling and authentic ethical practice in all their endeavours, as a way forward to improving morality on the corporate scene.

There is no other option either for this generation or future generations of man other than to accept that the way we do things and conduct our activities have got to change from what they were. That this should happen, is not someone else's business or problem it is everybody's problem. Accepting this fact is the only way to finding lasting solutions to our economic, social and environmental problems.

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