Accounting, Finance, Sustainability, Governance & Fraud: Theory and Application

Graham Gal
Orhan Akişik
William Wooldridge *Editors*

Sustainability and Social Responsibility: Regulation and Reporting

Accounting, Finance, Sustainability, Governance & Fraud: Theory and Application

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Introduction

This book has as its goal to present works that look at the issues related to social responsibility and sustainability from the perspective of the trade-off between reporting versus regulation. This trade-off can be viewed as a continuum with one endpoint anchored on a complete regulatory approach to ensuring corporations and government organizations adhere to established principles of social responsibility and sustainability. At the other end of the spectrum would be a complete laissez-faire approach to meeting these principles with stakeholders making decisions about whether or not to support firms based on their public disclosures. We see nations spread out along this continuum without examples operating at either endpoint. However, it does seem important at least to frame the debate. This debate can be seen as arguing the point at which governments should operate, either establishing both social responsibility and sustainability targets along with enforcing regulations to achieve these targets or allowing markets to create incentives to achieve these targets. Readers of the book should consider not only the information provided directly, but also how it may inform the debate over the role of regulation versus reporting in meeting the goals of social responsibility and sustainability. For it is these goals that are important at no more critical time than now.

At the core of the social responsibility and sustainability movement is a desire to change the direction of national economies, and with that the global direction toward more sustainable outcomes. There is a belief that the current path of progress will result in a world that will not sufficiently accommodate the global population. The related question concerns how to efficiently and to effectively make this change in direction; are governments the answer or should markets lead the charge? The chapters in this book should be interesting to readers as they consider this question.

In Chap. 1, Sanjay Bhāle and Sudeep Bhāle present vital aspects of Corporate Social Responsibility (CSR) to establish its relationship with pragmatic business ethos in the pursuit of sustainable growth and economic development. They present evidence, which suggests that only a few organizations have recognized the importance of CSR as an integral part of corporate culture with consistently increasing contribution to the GDP of the nation. This paper includes a conceptual

method to validate the issue with the help of a live case substantiating that CSR is the decisive determinant of sustainable socioeconomic development. This paper also endeavors to support a structural model of business growth based on data gathered during the research.

In Chap. 2, Daniela M. Salvioni, Simona Franzoni, and Francesca Gennari look at the way in which corporate governance decisions are connected to disclosure activities. Sometimes, there are significant differences related to the characteristics of the stock markets and the composition of the corporate ownership. They argue that the emergence of the concepts of Corporate Social Responsibility (CSR) and Stakeholder Relations Management involves modifications in the corporate governance approach in accordance with the philosophy of sustainable development as critical element for long-term success in global markets. Their aim is to make some considerations when the CSR adoption and the disclosure represent a factor of convergence between insider and outsider corporate governance systems.

In Chap. 3, Henk Kloppers looks at CSR in the context of companies in South Africa. In the last decade or so, there have been significant leaps in incorporating CSR information in disclosures of South African companies. This is mainly due to the release of the authoritative reports of the King Commission on Corporate Governance and specifically the King II and King III Reports. This chapter examines the CSR content in these reports in order to provide guidance to businesses on the issue of CSR.

In Chap. 4, Charika Channuntapipat looks at the critical issue of providing assurance to sustainability disclosures. The assurance of CSR disclosures has been criticized as a part of greenwashing activities of some organizations. Unlike financial audit practice, sustainability assurance is largely unregulated. Thus, the roles of sustainability assurance providers are not clear whether they serve as a watchdog for stakeholders or business consultants of reporting organizations. This chapter employs a qualitative research approach—actor–network theory, using textual sources as the main data collection method. The chapter focuses on how sustainability assurance providers negotiate their roles and identities through their problematization of the assurance practice.

In Chap. 5, Guangyou Liu and Kaisong Gong examine another critical issue that must be addressed if governments are to regulate firm's socially responsible and sustainable practices; how to avoid corruption that could thwart the government's efforts. The authors investigate the role of state auditing in the anticorruption campaign throughout the Chinese Central Government Succession substantiated in 2012. The chapter reveals that the anticorruption campaign launched by the new Central Government of China concentrates on the political path for the country's healthy and steady socioeconomic development instead of the political purge stereotypes imposed upon it. Furthermore, the chapter shows that CNAO, which performs the state audit, follows the political directions of the renewed anticorruption campaign.

In Chap. 6, Jeffrey Gauthier and Bill Wooldridge develop a theory concerning how ratings of firms' business practices are likely to affect firm behavior. More specifically, the chapter draws from established theory on cognitive choice models

to posit that sustainability ratings systems may be more likely to promote improved social and environmental performance in non-core practices than in core practices. This improved performance constitutes a form of compensating tactics, as ratings agencies' analysts may raise their ratings of firms in which poor sustainability performance in core practices remains.

In Chap. 7, Farzaneh Jalali and Graham Gal examine an issue that can be particularly relevant when governments take a role in a country's sustainable development—how can they direct their actions toward a sustainable future? The chapter examines the role of sustainability and its requirements as well as the consequences in macroplanning and budgeting in Iran. The chapter examines the documents related to budgeting which contain information about sustainability and the way in which sustainability has grown in Iran's budget preparation. Budget circulars for the 10 years from 2007 to 2016 are reviewed with particular attention to the level of sustainability considered. Finally, a picture from budgeting and macroplanning in Iran with the advent of sustainability issue is presented. Sustainability issues as well as sustainable development and environmental issues have gradually evolved to consider economic, social, and environmental impacts.

In Chap. 8, Chen-Wen Chen presents a model of the process by which managers provide signals of the corporate actions to investors. As noted in previous chapters, social responsible and sustainability disclosures are voluntary. This chapter models the reaction of a manager to voluntary disclosures and the strategic decisions within social contexts concerning financial disclosure. Extensions of the base model examine the interaction of financial disclosure, investor relations, and managerial incentive to disclose, such as demonstrating a signaling game between a manager and investors for financial disclosure. With the reaction of investors to voluntary disclosure after information, this chapter analyzes why the disclosure of information has regulated the results as noise for investment decisions.

In Chap. 9, Ertan Kucukyalcin discusses the problem of different stakeholder groups having greater supremacy over the objectives of the corporation. A competition exists between shareholders and other stakeholders for the firm's direction. Proponents of both theories also have agreements on many areas. For example, they agree that corporations should create wealth and consider their stakeholders' concerns in making decisions. However, disagreements remain with important implications; what should be the corporate objective function? This chapter considers both the shareholder and stakeholder theories to construct an explicit corporate objective function with the aim at identifying the conditions under which the two theories converge. This also sheds light on how each theory advises management to act differently in similar business conditions.

In Chap. 10, Panagiotis Reklitis, Panagiotis Trivellas, Mantzaris Ioannis, Elisavet Mantzari, and Dimitrios Reklitis examine the effect of employees' perceptions of CSR activities of their organization on work-related attitudes. Building on the argument that employees' perceptions of CSR activities may be significantly related to workplace attitudes, behaviors, and performance, this chapter examines two CSR aspects (social and environmental) and several work-related attitudes (job performance, employee satisfaction, organizational commitment, OCBO, OCBI).

Their findings highlight that different CSR aspects exert selective direct effects on specific employees' attitudes.

In Chap. 11, Alexandros G. Sahinidis, Dimitra Daskalaki, Elisavet Mantzari, and Ioannis Mantzaris's objective is to investigate the effect of the economic crisis in Greece on companies' CSR budgets. One of the major concerns of firms is that the costs of CSR and sustainability actions make them hard to continue when their financial success is in question. The companies examined, reprioritized their CSR interests, doubling their society-related activities and reducing nearly by half those addressing the company personnel. The focus of the chapter is on a period of recession and shows how companies adapt to pressures during a period of adverse economic conditions and the way they learn to redeploy their resources allocated to social causes.

In Chap. 12 Ewan Mackie, Imon Palit, Madhu Veeraraghavan, and John R. Watson examine the riskiness of investing in socially responsible firms. The chapter identifies a lack of research that includes certain measures of risk when evaluating the return of socially responsible firms. The chapter investigates whether daily returns of Australian socially responsible equity funds have different tail risk exposure in the return distribution compared to matched conventional equity funds. The Australian funds management industry provides a natural setting within which to study the risk exposure of socially responsible investment funds. This is because Australia is the first country to introduce regulations that requires issuers of financial products and financial advisors to disclose and advise on ethical, social, and governance (ESG) considerations.

In Chap. 13, Ismail Adelopo, Musa Obalola, and Ramiro Cea Moure look at the CSR disclosures of Western European Banks. The chapter examines the impact of legal origin and culture on CSR disclosures. The examination is based on the CSR disclosure and other firm-specific information in the sustainability and annual reports for 2005 and 2008. The authors conclude that banks in Civil Law origin countries make more employee and shareholder social disclosures than banks in both Common Law and Scandinavian countries.

In Chap. 14, Stefano Marasca, Lucia Montanini, Alberto Manelli, Alessia D'Andrea, Martina Vallesi, Vania Carignani, and Paolo Galassi investigate the Italian Health System. As the Italian Health System is publically financed, the individual health units present difficulties in defining and measuring healthcare output and, at the same time, in the communication process to stakeholders about the clinical and ethical impacts of the use of economic resources. The chapter presents a reporting model based on a triple bottom-line approach (social, environmental, and economic) that could offer a system of multi-dimensional analysis, reducing information asymmetries between the health unit and its stakeholders by increasing external communication.

In Chap. 15, Amin Naseri, Rahmatollah Gholipour, and Bita Mashayekhi investigate the issue that governments need to address when they privatize industries which were previously state-owned. Article 44 of Iran's constitution sets out policies, which are the most important legal reference for the economic activities of the public sector's enterprises in Iran. The chapter examines the strengths and

weaknesses of the law in terms of good corporate governance rules. The chapter concludes that the most important weaknesses of Iran's privatization policies are as follows: (a) lack of a clear ownership policy for the state-owned enterprises; (b) insufficient consideration of the private and cooperative sectors and minority shareholders' concerns when privatizing large state-owned enterprises; (c) lack of an appropriate mechanism for a balanced relationship with all stakeholders.

In Chap. 16, Tomeika Williams examines issues related to fraud in the precious metals industry. The "tone of the top" sets an example of ethical behavior within an organization and is a responsibility of the board and executive management. The chapter reviews board composition characteristics of publicly traded corporations in the precious metals industry in 11 fraud cases from the year 2012. Several theories are presented to find a possible linkage between internal and independent corporate board members that may be in violation due to lack of strong corporate culture.

In Chap. 17, Marisa Agostini and Ericka Costa discuss the importance and relevancy of integrated reporting as investors have been requiring more information about how sustainability issues and initiatives are expected to contribute to the long-term growth. Both financial and non-financial reporting together provide stakeholders with a comprehensive view of the position and the performance of companies. This integrated reporting has also been encouraged by some European regulatory bodies. Despite this interest, social and environmental information is still disclosed differently in consolidated annual reports and in social-environmental reports.

In Chap. 18, Emrah Keleş and Ayten Çetin show that CSR increases volatility since it creates noise in financial markets. The chapter uses ESG research data from a large number of US firms and places them into high, medium, and low groups along with their social and environmental scores. The chapter then predicts the returns of these groups using investor's sentiment, which has the tendency to act based on cognitive biases rather than all the information at hand.

In Chap. 19, Julian Lustig Gonzalez and Laura Harcourt report on differences and similarities between various managers in creating socially responsible portfolios. This chapter examines criteria used by investment firms as a basis for standardized selection of socially responsible firms.

In Chap. 20, Obby Phiri and Elisavet Mantzari examine the mining industry in Zambia and their CSR practices. Using CSR disclosures and interviews of mining managers the authors explore motives for these disclosures and the prospects for future reporting.

Part I
Background of Corporate Social Responsibility (CSR)

Chapter 1
CSR—In Pursuit of Sustainable Growth and Economic Development

Sanjay Bhāle and Sudeep Bhāle

Abstract Objective: This paper explores vital aspects of corporate social responsibility (CSR) in contemporary business scenario in order to establish its relationship with pragmatic business ethos in the pursuit of sustainable growth and economic development. **Prior Work**: Over the years, ample awareness and debate have been there about the need for promoting a responsible corporate culture for substantial sustainable development. Incidentally, it has verified some effectual practices. However, evidence suggests that only a few organizations have recognized the importance of CSR as an integral part of corporate culture with consistently increasing contribution to the GDP of the nation. **Approach**: This paper includes conceptual method to validate the issue of whether CSR is the decisive determinant in sustainable socioeconomic development. This paper also endeavors to support a structural model of business growth based on facts and figures gathered during the research. **Implications**: This paper highlights two main implications. The first, realizing the duty to protect environment can develop an inclusive understanding of factors, such as responsiveness, responding to environmental needs with frugal ideas that lead to some tangible deliverables and that are responsible for the major proportion of balanced growth. The second implication is the notion that the sense of accountability within firms can fortify the quality of lives of its various stakeholders, resulting in a comprehensive model for sustainable development. **Value**: The definition of business does not encompass the myriad of elements of creating an offering and selling it at a mutually profitable proportion, but also the elements that surround and sustain life, including preserving the essential resources that permit the maintenance and continued evolution of business community and human life.

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1.1 Introduction

When we talk about business environment today it is inferred more as having a sustainable growth with ethical business practices than just earning considerable profits. Increasing business affairs domestic as well as international, call for moral absolute is more apparent and imperative in today's business scenario.

As far as the use of the notion "ethics" in business is concerned, the development of the field of business ethics began in the 1970s. Theologians and religious thinkers had developed the area of ethics in business and continued to develop it. It was this era when business-and-society concept began taking shape. But, it was actually in the mid-1980s when significant social uproars against indiscriminate business practices began. This is how element of ethics in business began taking center stage as the code of conduct of business practices with respect to the common humanitarian values (De George 1985).

This evolving movement is considered as ethical universalism and proactive corporate approach that would provide a platform for acceptable business practices that can also be sustainable. Such an approach is crucial for organizations to achieve commercial success in a way that honors ethical value and a humanitarian perspective as a part of social responsibility. While the subject of social responsibility has received some attention prior to the 1960s, it was a concern of the society with social issues in those years that made the concept of social responsibility of major importance to business organizations (De George 1985). After the 1960s, there were significant changes that affected business and management. The long-term effect of the social change has been a steering change in the "rules of the games" by which business is expected to operate (Buchholz and Rosenthal 1999).

Emergence of the corporate governance concept came under a natural occurrence of phenomenon called civil regulation, i.e., a new form of democratic governance for the global economy. The human race has so far been able to conquer the once most devastating illnesses such as smallpox and polio, has been able to increase life-expectancy in less industrialized countries by over a third, and witnessed their infant mortality fall by more than half. Meanwhile, the new technologies are helping people to communicate across great distances instantaneously, minimizing national and international barriers, keeping people in touch, and creating new opportunities for people with vision and energy (Bendell 2002).

Thus, business has become more of a socioeconomic phenomenon rather than just a commercial activity. Any socioeconomic ventures based on basic principles of CSR could lead to sustainability, and we all are aware that sustainability has become one of the most critical aspects of business environment becoming more and more unpredictable day by day. In recent times, business strategy has been connected persistently to the aspect of business sustainability and sustainability is

directly linked to one of the clauses of corporate social responsibility. An increasing number of regulations are emerging inside and across countries, mandating the disclosure of environmental, social, and governance data. Stakeholders and the capital markets are increasingly demanding for better and more transparent communication of sustainability data in sustainability reports. GRI, one of the measures used by OECD for global reporting initiatives (Sustainability Reporting Guidelines—OECD), promotes the use of sustainability reporting as a way for an organization to become more sustainable and contributes to sustainable development. Sustainability reports are also called CSR (corporate social responsibility), TBL ESG (environmental social governance) reports that convey information about organization's economic, environmental, and social impact. Triple-bottom-line approach (TBL; John Elkington 1994) revolves around three Ps: people, profit, and planet, capturing the essence of sustainability by measuring the impact of an organization's activities on the ecosystem leading to a balanced growth.

The concept of corporate social responsibility has been making rounds since the early 1960s, generating a broad range of scholarly contributions (Cheit 1964; Heald 1970; Ackermann and Baur 1976; Carroll 1979) and a concerned faction of social auditors and consultants. However, it remained a theory rather than being implemented and nothing significant happened in the field of CSR during the 1970s and 1980s and reemerged only in recent years, when it resurfaced in response to growing public concern about some alarming unsought consequences of globalization.

The paper is conceptual in nature and explores vital aspects of CSR in contemporary business scenario in order to establish its relationship with pragmatic business ethos in pursuit of sustainable growth and economic development. The paper highlights pragmatic approach and major implications of a good CSR measures undertaken by Tata Steel Company. It highlights two main implications in particular. The first implication deals with factors such as responsiveness—the way a company responds to stakeholders' needs with ideas that lead to some tangible deliverables, ideas which are responsible for the major proportion of balanced growth. The second implication is the sense of accountability within the firms that aims to fortify the quality of lives of its various stakeholders, resulting in a comprehensive model for sustainable development.

1.2 Stakeholders and CSR—The Notion of Strategic Approach

In the past few years, there has been an unrelenting call for business to be more socially responsible. That is, there have been growing expectations that business not only be profitable and obey the law, but that it be ethical and a good corporate citizen as well. To be sure these responsibilities contain ethical content, it is important to single out the ethical component as one part what organization does

beyond minimum (Carroll 1999). Though society expects business organizations to be profitable, as this is a precondition to their survival and prosperity, profitability may be perceived as "what business does for itself," and obeying the law, being ethical, and being a good corporate citizen may be perceived as "what the firm is doing for others," society or stakeholders.

In general, CSR is based on the idea that a company has responsibilities toward society that goes beyond profit making and that there is an increasing concern for companies to seek social legitimacy within societies (Schultz and Wehmeier 2010). The literature on CSR draws a number of theoretical aspects. Davis (1973) described the "law of responsibility", as the fact that firms exercising power will eventually be held accountable by society as one of the major stakeholders. Thus, firms are under the obligation not to abuse the power invested on them by society; otherwise, they risk losing society's implicit endorsement and stakeholder's congenial support. More recently, this viewpoint has resurfaced as a firm's need to retain its license to operate (Post et al. 2002). Stakeholder theory, as it has evolved in recent years has begun to focus attention on the importance of the relationships that companies have with stakeholders, a relationship that goes well beyond those that companies usually have with shareholders. In general, perspectives on stakeholder theory have moved away from an entirely corporate-centric focus, in which stakeholders are viewed as subjects to be managed toward more of a network based, relational, and process—oriented view of company—stakeholder management, where there is consideration of mutuality, interdependence, and power (Andriof et al. 2002).

Stakeholder's expectations are constantly in change, and a company's CSR strategy must be evaluated on a continuous basis (Morsing and Schultz 2006). As a result, the focal point within CSR functionalism has moved from focusing on companies managing stakeholders to the interactions—creating an engaging dialogue. Despite the fact that international issues such as global warming, climate change, and widening gap in societies are placed on high-priority agenda, corporations are faced with the need to identify and understand the views, opinions, and behaviors of different stakeholders thus making them an integral part of strategy development.

In spite of all this, evidence suggests that only few organizations have recognized the importance of CSR as an integral part of corporate culture which consistently contributes to the GDP of the nation. Though CSR has an old precedence, the nomenclature was more mundane, philanthropy. If we talk in the context of developing and developed nations (in terms of concept evolution), with India in this part of the world and the USA on the other side of the globe, both these nations had seen personal philanthropy for centuries. What changed here is the emergence of a new term, called corporate philanthropy. In the 1970s, just as the stakeholder theory was getting more attention, many American firms with farsightedness noticed the potential competitive advantage that could be derived from corporate philanthropy. However, the main advantage was the positioning of the firm as a *responsive corporate citizen* which cultivates a broad view of citizen—a broad view of their own self-interest with a larger good, seeking a reconciliation of their company's profit-making strategies with the *welfare of the society*.

Corporations participate in governing by sharing in the administration of individual citizen's rights, both within companies and more broadly within the boundaries of company's external economic relations. For example, Matten et al. (2003) argue that corporations increasingly administer the citizenship rights of their employees and families, like in the case of pay and working conditions, health, and education, that is, why GRI's guidelines have these categories. This is especially likely to be the case where regulation is weak, or where the welfare state is fragile or is withdrawing, and corporations might be expected to assume some of the burdens of ensuring that basic rights are met. Similarly, they argue that consumers, investors, and others might rely on the actions of corporations to ensure that their fundamental rights to property and basic services are protected. In extreme cases in developing countries, multinational corporations are increasingly expected to participate in governing where there has previously been a vacuum, thereby undertaking some governance initiatives to institute and enforce entirely new rules and norms to safeguard individual rights. Thus, organizations are able to participate in ways that are also assumed of citizens in civic republicanism. This extends from their propensity to operate like pressure groups in raising issues and pressing claims to participate in decision making and to sharing responsibility for governing (Crane et al. 2008a, b).

1.3 CSR—The Pragmatic Aspects

The fundamental idea embedded in "corporate social responsibility" is that business corporations have an obligation to work for social betterment. This obligation is incurred and acts as a constant function throughout all phases—mainstream and peripheral—of the company's operations. The obligation may be recognized and discharged voluntarily by preemptive actions of the company, or it may be imposed by the government. In fact, the obligation to work for social betterment is the essence of the notion of "corporate social responsibility" regardless of its origin or its or the segment it affects (Frederick et al. 1912). Over the years, this obligation is said to have arisen from a wide variety of sources, including the economic, social, and political power of the corporation (Berle 1954; Keith and Blomstrom 1975); a fear of government encroachment on private decision making; the exercise of an enlightened self-interest by corporate executives (Abrams 1951; Research and Policy Committee, CED 1971); the desire of corporations to be good corporate citizens of their respective communities; the need for some powerful and influential institutions to reconcile the competing claims of pluralistic interest groups (Eells 1960); the sometime gap between the profit goals of private companies and an array of changing social values (Chamberlain 1977; Madden 1972); the simple need of the company to comply with social legislation in order to be a law-abiding citizen (Sethi 1975); the pressure of prevailing humanistic, religious, and democratic values and attitudes (Reich 1970; Slater 1970); the desire to retain broad public acceptance (Buehler and Shetty 1975); and the social contract implications of the

corporate charter (Research and Policy Committee, CED 1971; Steiner 1975). That such an obligation exists or not, if so, that can be made to work has been a subject of intense debate. Some complain about the very idea as being fundamentally subversive of the capitalist system; some have scoffed at the volunteerism of the notion as being public relations puffery (Friedman 1971). Some have been dubious about the efficacy and detachment of government imposed social regulations (Cox et al. 1969; Green and smith 1972). Many believe the obligation is severely limited by economic, financial, and profit considerations (Chamberlain 1973; Galbraith 2007). In spite of these attacks, the idea persists among business executives, scholars, and the public that corporation has an obligation to be socially responsible (Davis and Blomstrom 1975; Eells and Walton 1961, 1969; Harris 1974, 1976, 1977; Research and Policy Committee CED 1971; Steiner 1975).

However, a new strain of thought crept into the deliberations about business's role in society. Ever more frequently, one began to hear the phrase "corporate social responsiveness" that refers to the capacity of a corporation to respond to social pressure. In fact, the literal act of responding, or of achieving a generally responsive posture, to society, is the focus of "corporate social responsiveness." The key question is, can the company respond? If the answer is affirmative, then the question is, how and to what extent? One explores in the organization for mechanisms, procedures, and behavioral patterns that, taken collectively, would mark the organization as more or less capable of responding to social needs. It then becomes evident that organizational design and managerial competence play important roles in how extensively and how well a company responds to social needs. Hence, the idea of "corporate social responsiveness" is an action-oriented managerial concept that is emphasized upon the management of company's relation with society. This approach also called as CSR-2 (Fredrick 1978) puts a strong emphasis on the need for tools, techniques, organization structures, and behavioral systems most appropriate for a truly responsive company toward more dynamic theories of values and social change.

It is not just creating a sense of responsiveness among MNEs but small entrepreneurs as well. This can help build an attitude at the initial stages of business as it has co-evolved with the transformation of the entrepreneurs and the spread of democracy to reach its current form (Gomez and Korine 2008). Considering that the legitimacy of corporations is an economic one (corporate exists to create wealth), Gomez and Korine identified three different stages in the evolution of corporate governance: the familiar model, from the late eighteenth century to the early twentieth century; the managerial model, from the late nineteenth century to the 1970s; and finally what they call the public model, from the economic crisis of the 1970s until today. The public model of corporate governance is characterized by the enormous growth of global capital markets, mass shareholding, and the increasing impact of public opinion through public debate. This is, indeed, a strategic issue related to environmental management that can greatly affect business success for today's corporate managers. They must understand the significance of environmental issues and shift their mind-set from one focused on environmental management to the competitive environmental strategy. CSR cannot be segregated from

company's public policy but has to be made as an intrinsic issue of strategy formulation (Hoffman 2000). King (2007) emphasized the activities that focus on environmental stakeholder groups because public and private costs of protecting the natural environment often diverge, thereby creating "problem of social cost" (Coase 1992). The imperative of "social legitimacy" comes from the theoretical assumption that all organizations are embedded in a wider environment that affects both performance and expectations of the firm. This symbiotic interface determines the firm's success and also its very survival (Werther and Chandler 2010).

1.4 Relationship to Engagement—A Paradigm Shift

In the last three decades, many corporations and environmental stakeholder groups have moved from a relationship of antagonism to one of "constructive engagement" (Rondinelli and London 2003). Prominent examples of such engagement include the joint effort by McDonald's and environmental defense to evaluate and redesign packaging materials and food processing methods, and pioneering efforts of Greenpeace and German home appliance company Foron to create and popularize hydrocarbon refrigeration technology. These are vital examples of smart alliance (Taylor and Scharlin 2004) that include corporate innovations and technological approaches to address environmental problems. This can simultaneously accommodate or capitalize on divergent societal stakeholder needs and meet corporate economic objectives (Stafford and Hartman 1998; Menon and Menon 1997).

McDonald's project with environmental defense began with the consideration of packaging for hamburgers and the size of napkins used in McDonald's restaurants. Over time, these joint projects progressed to more central issues, such as the sourcing and production of food ingredients. According to participants on the projects, if either party had observed unfair transfer of technology or other forms of reneging on agreements, the relationship would have been terminated. Both parties hoped to gain from future projects, which provided an incentive for good behavior on early projects. Taking the reference of early moral philosophy, King (2007) suggests here that positive social change occurs when parties reduce impediments to mutually beneficial exchange. This can also be considered as an extension of organizations' philanthropic approach. The new corporate philanthropy (Smith 1994) is considered as a shift to making long-term commitments to specific social issues and initiatives; providing more than cash contributions; sourcing funds from business units as well as philanthropic budgets; forming strategic alliances; and doing all of this in a way that also advances business goals. Business has such enormous potential to doing *good* in the world due to its value; besides, it is ethical because it is based on voluntary exchanges, elevates our existence, and creates prosperity (Strong and Mackey 2009). Many have regarded capitalism as an economic concept without a soul; it is all about business and markets. However, it can

be seen that the edifice of capitalism is undergoing its farthest-reaching transformation since Adam Smith narrated it in "The Wealth of Nation" in 1776. The nature of the transformation can be summed up in one short statement: Companies are increasingly motivated by and being held accountable for humanistic as well as economic performance (Sisodia et al. 2009).

The world of multinational enterprises (MNE) is changing dramatically. Their complex and dynamic international context presents them with special challenges, threatening their survival on one hand, and presenting with unprecedented opportunity on the other. Governance, which affects the way business is conducted, is undergoing significant transformation (Vachani 2006). In recent years, Western MNEs particularly American MNEs realized that this kind of good corporate citizenship could be an effective and competitive tool, especially in developing countries, where the concept was relatively less practiced. It does solve the purpose of building corporate philanthropy program through social alliances that can bring substantial benefits to needy people. Besides, it also helps in building brand value in the long run (Taylor and Scharlin 2004).

What is the meaning of good practices in business? A quick browse of the Web sites for the Fortune 500 reveals that good goes by many names, including corporate social responsibility, corporate citizenship, corporate philanthropy, corporate community involvement, community relations, and corporate societal marketing. Corporate social responsibility is a commitment to improve community well-being through discretionary business practices (Kotler and Lee 2005). The key element of this definition is the word discretionary. Business activities are not referred here as mandated by law or that are moral or ethical in nature. Rather, it is referred to a voluntary commitment a business makes in choosing and implementing these practices and making the contributions. Such a commitment must be demonstrated in order to describe whether a company is socially responsible and that can be fulfilled through the adoption of new business practices or contribution either monetarily or non-monetarily. The term community well-being in this definition includes human conditions as well as environmental issues (Kotler and Lee 2005).

During the 1970s, the debate regarding the responsibilities of corporations changed to some extent. The focus shifted from corporate responsibility to corporate responsiveness, thus emphasizing what companies could do better for the world rather than what companies could do to ensure their very survival (Makower 1994). This move was partly in response to the threats of US government taxation on "windfall" profits of industries. The result according to some observers was a new emphasis on political action, public affairs, lobbying, and public relations directed toward "strategic philanthropy" and "cause-oriented marketing." This proactive gesture quickly spread across the industries and other nations. In some cases, the concept became a strategy by which companies attempted to turn public relations problems into public relations assets (May et al. 2007).

1.5 A Comparative Approach

CSR in USA: The USA has had a strong tradition of corporate philanthropy. Some popular corporate social programs that are in practice include employee volunteering, matched giving, and involvement of organizations with a strong community focus. In USA corporate social responsibility in financial service sector is regulated by Community Reinvestment Act (CRA), which sets minimum requirements, monitors compliance, extend incentives through tax credits, and impacts on mergers and acquisitions. The recent trends include a stronger global focus especially for MNCs, with increased emphasis on sustainability, and a growing awareness about core business advantages of CSR.

CSR in Europe: In Europe, different countries have different cultural traditions and different styles of government (e.g., centralized vs decentralized), but there is a definite focus on social partnerships. In the UK, there are long established CSR practices—charity, business in the community, government funding support for networks such as employees in the community. A minister is appointed for CSR in the Department of Trade and Industry. The EU–India Network for Corporate Social Responsibility acts as a forum for exchange of information and best practices between European and Indian companies on corporate responsibility.

CSR in Asia: In Asia too, the concept of CSR is taking a firm hold. Building networks and alliances in the South Asian region, Partners in Change (PiC) is a founding member of South Asian Alliance for Responsible Business (SARB), in partnership with the CII (Confederation of Indian Industries). PiC has developed a CSR Self-Appraisal Toolkit to guide the corporate sector. The Asia Pacific CSR Group engages in active learning exchanges and practices, networking, and sharing of information. The main idea behind this is to support each other to achieve the vision of the members of the group, which includes the recognition of standards and benchmarks that may commonly apply in governance, and business practices in the field of environment protection, equitable human resource management. Besides, it also helps to maintain a CSR Index from the region to raise the level of CSR across the region, enhancing consumer and supplier confidence through acceptable benchmarks.

CSR in India: India has shown a keen inclination over the concept of wealth distribution. Mahatma Gandhi had a strong belief in the concept of "trusteeship." His view of ownership of capital was one of trusteeship, motivated by the belief that society was essentially providing capitalists with an opportunity to manage resources that should really be seen as a form of trusteeship on behalf of the society in general. A much less publicized but larger aspect of corporate social responsibility in India comes to light when one considers CSR as a concept that covers a range of issues under the purview of sustainable development (Modak 2005). This is a crucial term in business in the true sense today in developing nations. Protection of the environment and a country's natural resources are key elements of this concept. Moreover, this is an equally important issue to ensure that society does not suffer from disparities of income and provision of basic services such as health care,

education, and literacy. To illustrate, the United Nation's Millennium Development Goals (MDGs) and the Water, Energy, Health, Agriculture, and Biodiversity (WEHAB) agenda of UN Secretary General are deemed as essentials for bringing about a solution to the basic problems facing a society in a developing nation like India. There are several bodies now emerging in India that focus on issues of CSR. For instance, the Corporate Roundtable that focuses on Development of Strategies for The Environment and Sustainable Development—Business Council for Sustainable Development (CoRE—BCSD, TERI; The Energy and Resource Institute 2002) of India is a grouping of Indian corporate trying collectively and individually to build in sustainable development concepts into their operations. The CoRE–BCSD India includes some of the most innovative and forward-looking organizations that identify and further conceptualize the relevant projects to work upon.

The concept of CSR in India is gaining momentum as government directives mandate companies to allocate 2% of their net profits toward social welfare. Moreover, the industrial projects are increasingly facing headwinds of social unrest in recent developments. Besides, the effective CSR practices offer companies a chance to build goodwill in local communities and among other stakeholders. There has been an inquisitive awareness prevailing about sustainability, and in fact, there are some companies that have been generating sustainability reports. Though, the concept of Sustainability Reporting is still a jargon to some Indian companies, CSR is generally misunderstood as mere writing of cheques for social welfare programmes and non-governmental organizations. It is not considered unusual for a company to seek and discuss a policy or regulatory issue with a local figure, which usually is a political person in the region. He/she is asked for a favor, a financial grant for CSR project first, and then, discussing the core issue would be a secondary concern. Apparently, all this ends up with passing the funds to an NGO.

However, it is observed that most of the Indian corporate initiatives promoting the sustainability of a business are usually limited to pollution control and CSR. But this model falls short when it comes to preparing a company for the future. There are, indeed, some exemplary cases where companies have demonstrated CSR as an inclusive part of their business strategy, e.g., Bharti Foundation (the Airtel Group, India); The Britannia Nutrition Foundation (BNF) P&G's (Proctor & Gamble, India) Shiksha Educational Programme; Venkateshwara Hatcheries Small Farmer's Cooperative Programme; and Tata Steel's Community Development Programme.

At global level, AT & T is among a number of blue-chip companies, including Coca-Cola, Microsoft, and P&G that rely on prestige value of their products and have taken on larger philanthropic expenditure than their lean and lower priced competitors establishing the fact that competing on corporate citizenship is a smarter strategy than merely competing on price alone. This tactic has emerged essentially to accommodate the rising expectations of society from business and the equal anxiety of the business to secure and retain the faith among the community, and the larger stakeholders of the company. Large firms that require large proportions of land to set up greenfield projects understand that no amount of legitimate or explicit governmental support can push forward the projects, except by the

implicit support of the community. The amount of transparency, the ethics, and morality of what is being proposed to be done to those who eventually lose out or gain will ultimately determine the fate of the project. Moreover, this is not just a local issue anymore but a global phenomenon as more and more MNCs are expanding/merging their business boundaries across different nations.

These are more or less standard arguments to show that doing good in a transparent way do affect the long-term sustainability of a firm in a positive way. But the more critically important issue in the context of governance is how CSR can be factored while designing the business strategy of a firm. For example, in case of natural resources that are scarce (e.g., air spectrum, aluminum, iron ore), a careful planning and execution of a responsive and sustainable strategy is required. If the firm, among several bidders, possesses a considerable goodwill within stakeholders supported by credible legal regime, the prospects of business would be certainly higher.

As companies enter international markets, new issues relating to corporate governance emerge. As national governments realize the significance of CSR, there is a tendency to move from a voluntary CSR approach toward a state-mandated CSR. Global industry is working on its own assumption that is consistent with its scale and extensive footprints; it must lay down certain normative conditions of behavior that may satisfy the current and emergent expectations of stakeholders' community. If properly designed and implemented, such compliance can earn social legitimacy.

There have been six major initiatives by the industry to develop moral codes of conduct (Bhattacharyya 2013):

- The Caux Round Table Principles for responsible business;
- The Clarkson Principles of Stakeholder Management;
- Global Sullivan Principles to support economic, social and political justice;
- The CERES (coalition for environmentally responsible economics) Principles;
- OECD (Organization for Economic Cooperation and Development) Guidelines for Multinational Corporations; and
- UN Global Compact (UNGC) principles for human rights, labor, and environment.

Caux Round Table Principles set with a plea to moral capitalism were published for the first time in 1994, in order to improve the world business culture, aiming at the companies' responsibility toward employees, owners/investors, suppliers, and competitors carrying a strategic vision of "to live and work together for common good."

Clarkson (1999) views the corporation as a collaboration of multiple and diverse constituencies and interests, referred to as "stakeholders"—integrating stakeholders relationships within the firm's resource base, industry setting, and sociopolitical arena into a single analytical framework. It emphasizes that managing relationships with stakeholders for mutual benefit is a critical requirement for corporate success.

Global Sullivan Principles provide a theoretical framework of Global Business Citizenship (Logsdon; GBC; US 2004) extending the concept of corporate social responsibility as an alternative to the prevailing frameworks in finance and economics in that it accepts the validity of stakeholders' claims on the firm.

Ceres (2010) has created building blocks for weaving environmental and social challenges into core business practices to achieve sustainability. Along with initiating the concept of "climate risk" it also launched Global Reporting Initiatives, an international standard for sustainability reporting, used by over thousand companies worldwide. In the "21st Century Corporation Report," Ceres mentioned "enormous opportunities arise during transformative times" as we are in transformative times with planet facing extraordinary and unprecedented challenges. It states that "License to Operate" can no longer be taken for granted by business as challenges such as climate change, global warming, water scarcity, HIV/AIDS, and poverty have reached a point where society is demanding a response from business.

OECD Guidelines (2011 edition) provide non-binding principles and standards for responsible business conduct in a global context consistent with applicable laws and internationally recognized standards. Besides, the guidelines are supported by a unique implementation mechanism of National Contact Points (NCPs), agencies established by adhering governments to promote and implement the guidelines. The NCPs assist enterprises and their stakeholders to take appropriate measures to further the implementation of the guidelines. They also provide a mediation and conciliation platform for resolving practical issues that may arise.

UNGC principles (2005) extending with OECD Guideline provide most comprehensive, voluntary corporate responsibility initiatives. In articulating principles of responsible business conduct, they draw on international standards enjoying widespread consensus. The global compact is an open and voluntary corporate citizenship initiative engaging in a wide spectrum of multistakeholder participants across the globe.

All six initiatives to establish certain guidelines for responsible business have been applauded for their broad objectives of moral and ethical behavior in business conduct. UNGC has emerged as a force even if it was the last to be launched with effective participation from forward-looking private enterprises. The core idea of a common morality (Veatech 2003) is that all morally serious humans have a pretheoretical awareness of certain moral norms. The claim that it is a normal humans intuit or in some other way almost everyone knows that there is something wrong with things like lying or breaking promises. Taking this discussion further the concept of "hyper-norms" (Lacznaik and Kennedy 2011) says that these are broader established standards that would be postulated across the globe and across cultures. According to this discussion, it is suggested that the common elements in these six global codes may conceivably be thought of as hyper-norms. The analysis has identified the key common elements—human labor and consumer rights; environmental stewardship anti-bribery and corruption prohibitions; obligations to contribute to local development; compliance with law; respect for host countries; ethical advocacy.

1.6 CSR in Practice—at Tata Steel

Tata group is a diversified corporation indulged in companies ranging from automobiles, chemicals, steel, and software to consumer goods and telecommunications and operates in more than 80 countries. It has gone through substantial organizational phases—rationalization, globalization, and now slew of innovative attempts to reach $500 billion revenue by 2020–2021. Approximately two-third of the equity is held by philanthropic trust endowed by Sir Dorabji Tata and Sir Ratan Tata, sons of Jamshedji Tata, the founding father of Tata empire way back in 1860. According to Jamshedji, “in a free enterprise, the community is not just another stakeholder in business, but is in fact the very purpose of its existence.” The company has always been concerned about its corporate social responsibility; Tata sons contribute on an average 8–14% of the net profit every year for various causes. Tata Steel spends 5–7% of its profit after tax on several CSR initiatives. It has adopted the Corporate Citizen Index, Tata Business Excellence Model (TBEM), and the Tata Index for Sustainable Development. TBEM criteria devised by TQMS (Tata Quality Management Services) provides an integrated approach with a wide outline to attain higher level efficiency and productivity, improve business performance, contribute to organizational sustainability, and deliver better values to customers and stakeholders. Tata companies maintain sustainability reporting the guidelines of global reporting initiatives (GRI). In collaboration with United Nations Development Program (UNDP, India), Tata Council for Community Initiatives (TCCI) has crafted the Tata Index for Sustainable Human Development, aiming at directing, measuring, and enhancing the community work for the upliftment and welfare of the people.

It is quite evident that steel is the key driver of the Indian and global economy not only as material provider but also because of its capability to convert a natural resource into wealth, moving the wheels of the economy through end-use applications, while generating employment opportunity for the local people.

However, it is a well-known fact that the sustainability of the industry largely depends on key elements of economic, environmental, and social performance as organizations operate in a multistakeholder environment generating plurality that needs multiplying values for all. Tata Steel runs its CSR programs with professional zeal of a business unit to keep its eyes and ears focused to the ground on the communities it works. It has shown consistent evidence that it is listening to local communities around its factories and mines in the region where it is situated. It is also hearing out its thousands of workers and miners and that is the culture of social responsibility a hardwired DNA of Tatas right from the founder (Sir Jamshedji Tata) to remain committed to facelift the inclusive growth and empowerment of communities. Tata Steel has innovatively devised a HDI (Human Development Index) that covered 230 villages in 2012–2013 to access the effectiveness of its social initiatives. In fact, the TQM (Total Quality Management) approach that is

stakeholder-centric, dynamic management philosophy that involves a feedback loop of all the efforts, made it win Deming Grand Prize in 2012, demonstrating organization's commitment to quality and business excellence in all aspect of sustainable systems and processes of corporate governance. It also includes a project of "zero effluent discharge" to reduce discharges from operations of water sustainability program.

In 2012–2013, the HDI assessment for the villages served by Tata Steel Rural Development Society have had some accomplishments—company added 4192 acres under improving agriculture practices, supported 750 self-help groups (SHG) as well as trained 2225 youths most of whom were gainfully employed. Tata Steel primary healthcare interventions touched 370,000 lives, while a targeted maternal and newborn survival initiative reduced the percentage of infant deaths from 6.15 to 1.58 and percentage of neonatal deaths from 5.9 to 1.15. The company supports 200 schools and colleges in the Indian state of Jharkhand and 183 in Odisha state, where the operations are conducted. Besides, scholarship is granted to rural students and Adult Literacy Program made 13,000 adults functionally literate. The efforts to protect ethnicity of the tribes indigenous to these states were furthered with 8000 tribal youth being reintroduced to their traditional languages.

This has elaborated a bottom-up approach to reduce, minimize, mitigate, and offset some environmental impacts as most of the initiatives are designed and delivered through grassroots engagements with villagers, making CSR interventions participative in nature.

1.7 Stakeholder's Handholding—the Notion of Constructive Engagement

Tatas have established a corporate policy called "Tata Corporate Sustainability Policy" which is a central part of the strategic planning across all Tata group companies. The policy exhibit postulates related to responsible behavior toward all stakeholders:

- Comply with rules and regulations relating to the environment;
- Demonstrate responsibility and sensitivity to biodiversity and the environment;
- Constantly upgrade technology and apply state-of-the-art processes and practices with institutional arrangements that will combat larger issues such as climate change and global warming;
- Create sustainable livelihoods and engage community through social programs pertaining to health, education, empowerment of women and youth, employee volunteering; and
- Find ways to enhance economic, human, social, and natural capital for bringing and maintaining balance among society and environment.

1.8 Sustainability Issues—Performance and Measurement

Tata Steel has been showing commitment to protect environment and making constant efforts for sustainability with a collaborative and responsible approach. It supports the UN Global Compact and is committed to reporting its sustainability performance in accordance with GRI (Global Reporting Initiatives) guidelines, which also supports the principle of 'avoid, reduce, and reuse', optimal use of resources, finding alternative resources of fuel and raw materials, and maximizing reuse and recycling.

Sustainability issues which are related to environment and society are prioritized based on a systematic materiality process. The materiality of risk and opportunities, and further priorities are assessed on the basis of type of risk/opportunity, potential losses and profits, business impact, and corporate reputational value. Frequent reviews are done by Environment and Energy Departments in collaboration with Corporate Planning and related departments that include Technology Groups to prioritize and pursue implementation of identified actions according to climate change. The initiatives also include inputs from stakeholders obtained through a questionnaire-based survey which results in mapping the environmental issues identified by communities against issues articulated by internal stakeholders to identify the high-priority issues (Fig. 1.1).

Fig. 1.1 World steel sustainability factors. *Source* Tata Steel 13th CSR report 2012–2013

Tata Steel has identified key performance measures, which are globally accepted standards in areas of priority against which it measures the performance. It adheres to the World Steel Sustainability charter and monitors performance based on global sustainability indicators. It also continues to get independent assurance for its Corporate Sustainability Report.

The Steel Industry is an integral part of global economy as steel products helps to meet society's needs. Besides, steel producers realize their responsibility to meet the demand of steel in sustainable way. The World Steel Association (worldsteel) promotes the adoption of industry best practices and knowledge sharing across the globe to tackle critical issues facing society. Worldsteel member companies are committed to a vision where steel is valued as a major foundation for a sustainable world.

1.9 Management of Business Ethics—the Ethical Governance

The organization has laid down a code of conduct (The Tata Code of Conduct) that serves ethical guidelines for Tata companies including Tata Steel as it is committed to the core value of corporate governance by maintaining transparency at all levels of business. It has devised a process termed as MBE (management of business ethics) which revolves around a mechanism institutionalizing the business ethos into the processes (Fig. 1.2).

The effectiveness of MBE process is measured through stakeholders' perception, based on MBE assurance survey, measurement of training effectiveness, and analysis of concerns received (Fig. 1.3).

This mechanism reveled that total number of concerns raised in year 2012–2013 was 212 as compared to 209 and 105 in year of 2012 and 2011, respectively. And this was possible due to workshops conducted to make employees aware of interpretations with respect to ethical and unethical conduct.

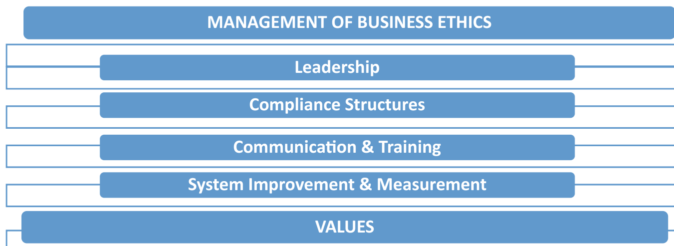

Fig. 1.2 MBE framework. *Source* Tata Steel 13th CSR report 2012–2013

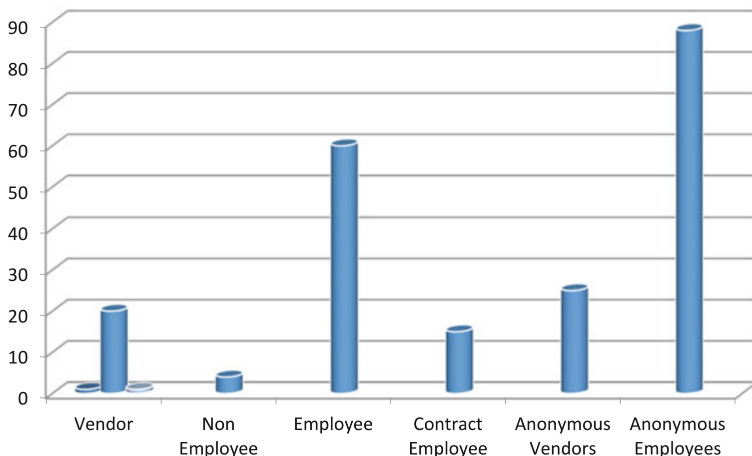

Fig. 1.3 Stakeholderwise concerns received. *Source* Tata Steel 13th CSR report 2012–2013)

Stakeholder Group - Community			
Approaches for Engagement	**Frequency**	**Key Concerns raised**	**Responses**
Resettlement and Rehabilitation teams	Day to day	Resettlement and Rehabilitation to make affected families partners in development	Tata Steel Parivar programme for Resettlement and Rehabilitation of displaced communities
Public Hearings			
Grievance			

Fig. 1.4 Community engagement. *Source* Tata Steel 13th CSR report 2012–2013

1.10 Inclusive Development—Community and Society

The social strategy at Tata Steel is revised annually in order to respond to the aspirations of the community. The plan is devised considering all norms of pre-budgetary exercise, and the progress of the plan is jointly monitored and reviewed. The company involves workers of grassroots level for effective implementation of programs by regularly organizing training-cum-orientation exercises. The main focus here is inclusive development; improving public welfare, environmental safety, and a systematic engagement of all community members, e.g., opinion leaders, women, youth. The company also undertakes strategic alliances with government and non-governmental organizations (NGO) to fulfill the aspirations of the community. Such consultative approach ensures an enduring and amicable relationship with communities at indigenous levels without any dispute (Fig. 1.4).

Stakeholder Group			
Approaches for Engagement	**Frequency**	**Key Concerns raised**	**Responses**
Resettlement and rehabilitation team	Day to day	Resettlemnt and rehabilitation to make affected families partner in development	Tata Steel Parivar (Family) programme for resettlement and rehabilitaion of afftected families
Public hearings			
Grievance redressal group			

Fig. 1.5 Stakeholder engagement—Displaced families. *Source* Tata Steel 13th CSR report 2012–2013

This supports the notion of collaboration among corporations, NGOs, and civic bodies. Collaboration can enhance a company's reputation and open doors to new markets while accelerating eradication of poverty. But to make this convergence phenomenon consistently productive, managers from both sides must understand the threats in working together and address them proactively. When managers address such challenges by applying potent principles, they create a far greater value for all players than their individual efforts could produce (Bruggman and Pralhad 2007).

Tata Steel's "Project Mansi" is implemented in more than hundred peripheral villages, focusing on maternal and newborn survival. It has brought down the infant mortality rate by 26.5% and neonatal mortality rate by 32.7% and still scaling up. The company has also developed a Human Development Index, which is used to assess the effectiveness of its interventions tangibly.

There is an issue of displaced families in this development process. It is but obvious that some of the communities are to be relocated when a new plant is sanctioned (Fig. 1.5).

The relocation of displaced family is done with proper diligence. The critical issues are addressed by the responsible team on a day-to-day basis. Besides, a third-party social audit is done to measure rehabilitation program and address the grievances of the people.

1.11 Improving Vendor Value Chain

Since supplier is a critical element of stakeholder group, their spirit is safeguarded efficaciously. Regular monitoring and relationship meetings to find joint improvement initiatives through a structured process improve the vendor value chain in terms of capacity building, business resource development, and adoption of ethical practices, and this gives the supplier an opportunity to become a strategic partner of company in a way (Fig. 1.6).

Stakeholder Group- Suppliers/Vendors				
Group	**Approaches for Engagement**	**Frequency**	**Key Concerns Raised**	**Responses**
Suppliers	Supplier Relationship Management	Day-to-day	Transparent and Ethical Practices Transactional issue	Whistle Blower Policy and Helpline
	Dedicated Micro Site	Online	Safety	m-junction
	Suppliers Meet			ProCare
Vendors and Transporters	Vendor Meets/ Transporters Meets			Six-Step Contractors Safety Managemet
	Dedicated Micro Site			

Fig. 1.6 Creating value chain. *Source* Tata Steel 13th CSR report 2012–2013

Stakeholder Group-Customers				
Group	**Approaches for Engagement**	**Frequency**	**Key Concerns Raised**	**Responses**
Institutional and Retail	Plant Visits	Regular/As per the plan	Cost	Customer Value Management
	Customers Meet/ Influencers Meet		Quality	Retail Value Management
	Customer Service Team		Delivery	Emerging Customer Value Management
	Customer Visit Report		Stability in supplies	Value Analysis and Value Engineering
	Senior Management Contact		Return on investment	Cost Down Weight Down programme
	Events for Focus Groups, End Users		Growth	New Product Development
	Reviews		Training programme for dealers	Reengineering of Supply Chain Processes
	Call Centre			
	Surveys and Studies			
	Customer Service Division			

Fig. 1.7 Customer engagement. *Source* Tata Steel 13th CSR report 2012–2013

1.12 Customers

In today's business scenario, customer is not considered an entity that purchases the product but an inherent element of the value creation. The process of customer engagement and value creation at Tata Steel is based on five key aspects:

- Customer need identification through a number of active listening and learning mechanisms—a reciprocative approach;
- Analysis and prioritization of inputs—an agile approach (Fig. 1.7);

- Evaluation of potential value of customers—a result-oriented approach;
- Implementation of pilot projects through cross-functional teams—a scientific approach; and
- Monitoring of projects—an analytical approach.

Other stakeholders include media, industry associates, academia, and scientific community who are connected through conferences, seminars, or collaborative projects. Top management participates in media to state their opinion in the interest of the sector in particular and the nation in general. This, in turn, also ensures information access on the sector and compliance with the disclosure obligations of listed companies status.

1.13 Generating Economic Value

It is evident that the commodity market has become volatile and complex more than ever before. Despite challenging market conditions and weak steel prices, the company sold an additional 850,000 tonnes during year 2012–2013. It recorded a significant increase EBITDA/tonne as a result of its TQM Programme which is a multiunit, multilocation, and cross-functional improvement program that aims at improved earnings and all operational parameters in the production process through a refined and structured framework. Its ability to achieve sequential volume growth in a difficult market reaffirmed the strength of distribution channels and customer orientation strategy, ultimately generating greater economic value for the customers and distributors (Fig. 1.8).

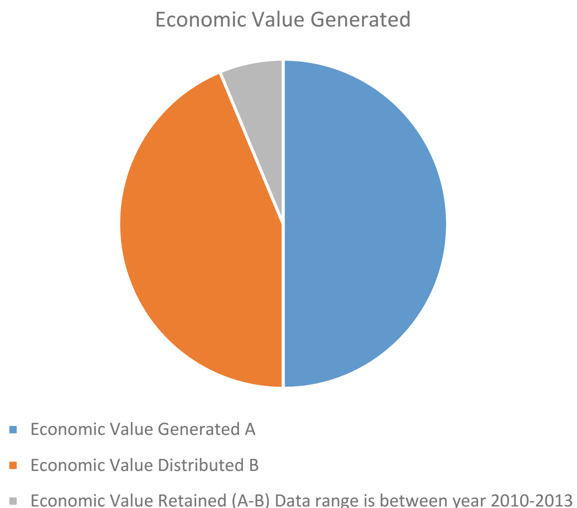

Fig. 1.8 Generating economic value. *Source* Tata Steel 13th CSR report 2012–2013

Table 1.1 Social organization of Tata Steel. *Source* Tata Steel 13th CSR report 2012–2013

Social organizations	Target groups
Tata Steel Rural Development Society	Various units serve rural communities—each located where Tata Steel has operations, focusing on sustainable livelihoods, health, education
Tata Steel Family Initiatives Foundation	Serves the communities in urban and semi-urban areas to provide family planning services
Tata Steel Skill Development Society	Youth at all operational locations get vocational training, benefiting them from inclusive growth
Urban Services	Serves underprivileged communities to affect socioeconomic change and empowerment
Speciality and Superspeciality Healthcare	Speciality hospitals located at every mining location equipped with state-of-the-art facility
Sports Department, Tata Steel Adventure Foundation	Three academies, 14 training centers, and 4 feeder centers mainstream sporting talent from rural and urban area, offering leadership program for youth
Tata Relief Committee	Undertakes disaster management across Eastern India

1.14 The Social Compassion

Apart from fulfilling mandatory clauses of CSR, a formal Corporate Social Responsibility and Accountability Policy was articulated in the year 2009 (with further modification in 2013) to reaffirm the company's commitment to voluntarily investing resources toward positively impacting the quality of life of the communities it serves. As Tata Steel mines and collieries operate in areas where communities are based for over a century, it has an intimate and long-standing association creating a mutual social harmony. This vision is based on the corporate citizenship approach that continues to remain in the ethos of the company, the mechanism through extended-organizations that Tata Steel furthers its social agenda, objectives, and strategies in order to sustain the trust of the stakeholders and the local community.

The organizations include the (Table 1.1):

The company supports 183 schools and 13 colleges in the state. Some pioneering institutes of professional education are being run in collaboration with state government's development partners and community-based organizations.

1.15 Conclusion and Discussion—CSR, an Enduring Imperative

The notion of CSR starts with the basic approach linked to the decision on how to spend money for social causes. It is linked to not only writing cheques for donation but to channelize resources to ensure the tangible impact. There is delusion that the CSR is all about charity rather than long-term investment for sustainable future,

translate into plausible commitment toward certain causes. If the exercise is taken as something to fulfill legal binding or an element of public relation program, it tends to get marginalized within the system.

There has been much evidences and debate over effective application of CSR concept. Whatever the outcome of the debate might have been had it been allowed to continue unabated, both proponents and opponents of corporate social responsibility seem to have agreed that certain key issues loom larger than others. First, the substance, the operational meaning of CSR, is vague (Sethi 1975). Does social responsibility refer to company action taken only in conformity with prevailing regulations, or only to those voluntary acts that go beyond law? Does it refer to those that conform to current public expectations, whether encoded as law or not, or those that anticipate possible future social needs? Are main stream company operations to be included among socially responsible acts or only those that are peripheral to the firm's major mission? How far must a company go in cleaning up pollution, eliminating discrimination, making the work place safer, or providing consumer protection to be considered socially responsible? Or what if a firm excels in one of these areas of social concern but fails rather badly in other? Is it then considered socially responsible or irresponsible? The difficulties in finding precise answers to these questions concerning the actual meaning of the *corporate social responsibility* have unending debates from the beginning.

The second question that has been difficult to answer concerns—the institutional mechanism through which the idea of *corporate social responsibility* could be made to work, assuming that its essential meaning could be clarified. The possible mechanisms include business response to traditional market forces; voluntary business response that goes beyond immediate economic considerations; government-assisted business response through subsidies, contracts, tax relief, etc.; government imposed social standards of corporate performance; and a much larger role for government planning, nationalized corporations, or federal charting of corporations. Just which one or which combination of these might produce the desired degree of corporate social responsibility still remains an elusive matter.

The third unresolved issue in the CSR debate is that the trade-offs between economic goals and costs, on the one hand, and social goals and costs, on the other hand, cannot be stated with any acceptable degree of precision. While it may be true that one persons or one company's economic betterment is another group's social deprivation. The air may be cleaned, and the workplace made safer and freer from discrimination, but at the probable price of job losses, de-capitalization of the industry, closing of plants, and the other types of economic costs.

Moreover, the most difficult issue concerning CSR is that the moral underpinnings of the idea are neither clear nor agreed upon. One searches in vain for any clear and generally accepted moral principles that would impose on business an obligation to work for social betterment. But one finds only a clutter of imponderable generalities concerning public purpose, enlightened self-interest, the social equality, human dignity, good citizenship, similar moralistic catchwords, and the responsible use of resources. The intractability of these central issues has, until recent times, posed dreadful possibilities that the debate over CSR would either

continue indefinitely with little prospects of final resolution or that it would simply exhaust itself and collapse as a viable, legitimate question.

It is clear that CSR is no more a merely corporate agenda, but an inclusive one; the more the concept of CSR is integrated into its business processes and operations, the better it will be to benefit from alternative thinking. Cost saving can also be incurred due to better relationship with the community, less attack by civil society and media, lower pollution fees, attraction of more and higher qualified workers, and lower worker turnover. CSR cannot be lived to its real meaning by confiding in mere legal bindings as it may a lack comprehensive approach that should include voluntary guidelines on a triple-bottom-line approach for companies. Business should support inclusive growth and equitable development. The companies should be encouraged to assess and disclose their substantive environmental, social, and governance (ESG) impacts on voluntary basis. They should also look outside the standard operating model for sustainable competitive advantage and that ought to come more from intangibles, e.g., firm's goodwill, brand equity that equally represents the corporate identity and not merely the market value of the firm.

However, there are some limitations while applying this concept; the varied and unduly publicized philanthropic activities of companies and promoters facing push-back from local communities are an example of how CSR can digress from the main cause. The phenomenon can be innovatively related to two issues (as per the contexts): first, the philanthropic cause that should be aligned to company's values and philosophies; second, the strategic issue if it should be related to the company's core competency. However, to acknowledge that CSR is all about value creation, there is no set clear universal metric to measure the success of CSR projects, as mere numbers and target cannot convey the success ratio. Setting rigid key performance indicators in the meager world of community can be difficult. The challenges lie in assessing whether the expenditures made in CSR activities are really making a difference to human development indicators.

Nevertheless, it seems that if the global business community makes the observance through moral compass, an integral component of their business models, firms can fortify the economy of their business, quality of lives of its various stakeholders resulting in a comprehensive model of sustainable growth.

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Chapter 2
Social Responsibility as a Factor of Convergence in Corporate Governance

Daniela M. Salvioni, Simona Franzoni and Francesca Gennari

Abstract For a long time, the corporate governance decisions and the connected disclosure activities were often direct to the satisfaction of shareholders' expectations, sometimes with significant differences related to the characteristics of the stock markets and the composition of the corporate ownership. In the listed companies, this management orientation tended to generate divergences between insider and outsider corporate governance systems. The emergence of the concepts of corporate social responsibility (CSR) and Stakeholder Relations Management involves modifications in the corporate governance approach, according with the philosophy of sustainable development as critical element for long-term success in global markets. This chapter aims to make some considerations when the CSR adoption and disclosure as element characterizing corporate culture represent a factor of convergence between insider and outsider corporate governance systems.

Keywords Sustainability · Convergence · Corporate governance · Insider and outsider systems · Corporate social responsibility · CSR disclosure

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Although this chapter is the result of a team effort, Daniela Salvioni can be considered the author of Sects. 2.1, 2.2 and 2.6; Simona Franzoni, the author of Sects. 2.3 and 2.4; and Francesca Gennari, the author of Sect. 2.5.

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2.1 Introduction

The globalization of markets and information has prompted the search for convergence between corporate governance systems, with particular regard to listed companies. In fact, the growing integration of financial markets seems to be a key factor of convergence of corporate governance systems.

In the last quarter century, the convergence has been promoted by regulatory and self-regulatory actions, centred on the sharing of best practices of corporate governance in international value. A host of regulation, standards, recommendations, programmes, and much more has emerged: from OECD Principles of Corporate Governance to the UN Guidance on Good Practices in Corporate Governance Disclosure. These initiatives are undoubtedly necessary and useful, but they seem to promote the so-called *de jure* convergence rather than the so-called de facto convergence (Khanna et al. 2006).

One of the most striking differences between corporate governance systems is about the firms' ownership and control across countries (OECD 1999). According to the degree of ownership and control, corporate governance systems can be distinguished in outsider systems (characterized by wide dispersed ownership) and insider systems (characterized by concentrated ownership).

Furthermore, governance practices vary not only across countries, but also across firms and their spirit of governance. Governance strongly oriented to economic responsibility towards shareholders tends to emphasize the differences existing in the firms' ownership and control. Specifically, in the presence of dispersed ownership, the orientation towards economic performance with a focus on the short term tends to prevail, to get positive feedback from the market. By contrast, in the presence of concentrated ownership, governance is often influenced by the majority shareholders, whose lasting involvement in the property tends to be reflected in the objectives of maximizing economic performance over time. As a result, the dominance of the shareholder view and the economic responsibility have often contributed to de facto divergence in corporate governance.

The acceptance of corporate social responsibility (CSR) and sustainability as business drivers have led managers to shift their attention from profit to the triple bottom line (Salvioni 2003; King 2008; McDonnell and King 2013; Salvioni and Astori 2013; Salvioni et al. 2014), which encompasses profit, people and planet. It is an approach based on a broad vision of responsibility, on a modern interpretation of the links between the long-term success of enterprises and equitable balance of interests of all stakeholders. We deduce that this approach helps to reduce effectively the differences between outsider and insider corporate governance systems.

CSR and sustainability require good corporate governance, grounded on stakeholder engagement, fairness, transparency and accountability. All these principles are related with boards more externally focused, and they determine a governance approach directed to the growth of sustainable value over time. This boards' focus has increasingly shifted to excellence every corporate governance systems worldwide.

The main finding of this chapter is that sustainability and the broader concept of social responsibility imply a change in spirit of governance, which promotes the de facto convergence between the different corporate governance systems existing all over the word. This spirit is inextricably linked to the culture and performance of an organization, and it implies a stronger focus on the principles and values that dominate internal and external relations, the innovation of the internal processes of behavioural orientation and the enhancement of transparency requirements and multidimensionality of responsibilities, objectives and results.

In form or de jure corporate governance convergence relates to the increasing of similarity in terms of legal frameworks and institutions, and it emphasizes the role of compliance. In function or de facto corporate governance convergence suggests that different countries may have different rules and institutions but the corporate boards may still be able to perform the same function, with attention to the same key performance indicators, such as ensuring fair disclosure or accountability.

In the light of the above, the chapter aims to make some considerations when the adoption of CSR (and connected disclosure) as element characterizing corporate culture represents a factor of in function convergence between insider and outsider systems. The treatment is structured as follows.

The second section briefly depicts the traditional divergences between insider and outsider systems, with particular reference to the characteristics of the stock markets and the composition of the corporate ownership. Furthermore, it underlines the possible passing of these divergences by means of the diffusion of sustainability and the broader concept of social responsibility, where good corporate governance is focused on achieving sustainable value. In particular, the modern interpretation of the links between the long-term enterprise's success and the equitable balance of all stakeholders' interests could lead to the overcoming of certain differences in key performance indicators that traditionally characterize the insider and the outsider systems of corporate governance.

The third and fourth sections underline how social responsibility, on the one hand, increases the interest of shareholders and other stakeholders to create sustainable value, on the other, it supports the convergence of cognitive expectations on a broad concept of economic and socio-environmental performances. The stakeholder engagement necessitates achieving better corporate transparency and accountability so it is useful to change the reporting system according to the logic designed to satisfy evaluation and knowledge expectation of the stakeholders across the triple bottom line. Social responsibility, promoting increasing convergence behaviour between insider and outsider systems dictated by orientation towards sustainable value creation, finds a significant success element in the adoption of common reporting documents.

The fifth section analyses the operational factor of convergence between insider and outsider systems promoted by sustainable corporations. Although a substantial convergence in the values declared by sustainable companies and the numerous proposal attempts regards global disclosure models, not always the disclosure declarations and behaviours coincide.

The sixth section makes same final considerations about the modification of corporate policies by sustainable companies, independently by the financial markets' characteristics and companies' ownership. This situation weakens the divergence between insider and outsider systems.

2.2 Corporate Governance and Capital Markets

Globally recognized systems of corporate governance are based on the relationship between ownership and governance bodies (administration/management and control). In this respect, different systems consider the following:

- the relationships between corporate boards, aimed at distinguishing monistic systems from dualistic ones;
- the delegation in nomination processes characterizing corporate governance systems, aimed at distinguishing horizontal dualistic models (in which both the management board and the supervisory board are appointed by the general shareholders meeting) from vertical ones (in which the general shareholder meeting, sometimes in conjunction with employees, appoints the supervisory board, who subsequently appoints the management board) (G20/OECD 2015).

When considering listed companies in different countries, financial market features and the level of concentration of ownership become important. In this respect, they distinguish outsider systems from insider systems (Salvioni 2008).

Outsider systems, typical of Anglo-Saxon countries, are characterized by the dominance of large listed companies with very fragmented and diffused ownership (public companies) and by the separation between ownership and management. In the presence of truthful, fair and transparent communications, the efficient functioning of capital markets determines the consent/control of administrative activity. The approval/disapproval of the work of the governance bodies is therefore reflected in the following: a change in share values, resulting from the dynamics of demand and supply of shares owned; the turnover at corporate governance mandate level and the mandate of shareholders.

The dominant model in outsider systems is the monistic one, with governing bodies with a typically short mandate (annual) and characterized by a high level of independence. In such situation, the market has the direct control over corporate governance, according to information received on the company's behaviour and current/future results. Reporting takes on an important role, and it highlights the role of external controls directed at the certification of information.

Outsider systems require well-developed stock markets, and they have high potential to attract resources, with the possibility of shift in investment from one share to another, depending on the information available on corporate governance and the related performance (Fama 1980; OECD 1996; Shleifer and Vishny 1997).

Generally, in such contexts, the institutional investors act as market facilitators (OECD 1997, 1999).

On the other hand, insider systems are typical of countries generally characterized by less developed financial markets. They have a concentrated and frequently stable ownership, with the majority shareholders involved in the management and able to influence corporate governance. In such contexts, there are monistic and dualistic systems, although the lack of ability to control the market highlights the importance of the adoption of systems that provide a specific supervisory board of corporate governance (dualistic systems) (OECD 1999; Salvioni 2008).

In insider systems (notably Continental Europe and Japan), the mandate of corporate governance is generally multiyear (Salvioni 2008; Yermack 2010). There is a high level of participation in management by majority shareholders, with a reduced incidence of independent members in the administrative body and a limited turnover at a corporate governance mandate level. In these situations, the competitive approach to the stock market is essentially defined by the desire to maintain a high value of stock and, not infrequently, it can be affected by shareholder resolutions intended to authorize the purchase of their own shares.

The presence of one or more controlling shareholders and the possible existence of shareholder agreements tend to affect governance in insider systems, and reporting is often constrained by rules and recommendations aimed at protecting the proper functioning of markets.

Beyond the different characteristics of the stock markets and the corporate shareholding structure, shareholders have always had a significant role in the attribution of the mandate of corporate governance. In fact, the general shareholders meeting is often the only responsible for appointing the members of governance board, and even with worker participation (as in Austria, Denmark, Germany, Luxembourg and Sweden, where employees of companies of a certain size have the right to elect some members of the supervisory body), it generally tends to intervene significantly in the conferment of the mandate of governance. This has contributed to the affirmation of the shareholder view, which has long dominated the orientation of corporate governance, emphasizing economic performance and financial reports.

In the past, the choices of corporate governance have therefore favoured profit maximization (Berle and Means 1932; Friedman 1962, 1970; Jensen and Meckling 1976), with a clear focus on obtaining the consent of shareholders. Such behaviour was particularly evident in outsider systems, but it dominated the majority of companies in industrialized countries. In fact, for listed companies, a governance approach oriented to shareholders implied important differences about management activities in outsider and insider systems. This situation was connected to the diverse degree of separation between ownership and management and to the consequent implications in terms of market and control value.

In the outsider systems, the high dispersion of share capital tied the corporate success with the maximization of the short-term profit. The aim was to guarantee positive judgments by the market with regard to the actions of managers characterized by a high level of independence. In this context, shareholders appreciated

the governance effectiveness referring to their expectations of short-term remuneration and their approval conditioned the board members' appointment and the shares' market value.

Vice versa, in insider systems the high capital's concentration and the frequent engagement in management by majority shareholders, who was often executives, caused governance activity oriented to the maximization of the value creation over time. In fact, the majority shareholders' behaviour deeply influenced corporate governance, because their lasting participation in ownership determined the preponderance of goals oriented to the maximization of economic performance in the long-term (OECD 1999; Salvioni and Gennari 2014).

The latest arise of new concepts referring to sustainability, social responsibility and stakeholder relation management (Steurer et al. 2005) is inducing a new approach about the role of companies in society, with clear consequences in terms of performance and reporting.

Corporate sustainability does not mean that the creation of value and the adequate shareholders' remuneration are less important; vice versa, the interdependence among stakeholder relation management, economic and socio-environmental responsibility, results (economic and not economic ones) and capability to obtain consents and resources is opportunely emphasized.

A governance approach directed to the enhancement of value creation for shareholders over time, by means of opportunities' exploitation and economic, social and environmental risk management, is gaining ground (Esty and Winston 2008; Brochet et al. 2012; Salvioni and Astori 2013). A sustainable company is clearly aware of its own responsibilities towards different stakeholders, and it adopts governance methods and tools with the aim to improve its economic, social and ecological performances. This is an approach based on a wide concept of responsibility and on a modern interpretation of the link between the long-lasting company's success and fair settlement of all stakeholders' interests (Salvioni 2003; Salvioni and Bosetti 2006).

In global markets, the need of corporate governance improvement is spreading, according to these objectives:

- to favour the convergence in governance systems for dealing with the fall of time and space barriers in the information and capital circulation;
- to appreciate the links among economic, competitive and socio-environmental management variables;
- to develop strategies and accountability tools with the aim to favour stakeholder engagement and to improve the transparency about global performances.

These are phenomena strictly connected, implying a greater attention towards principles and values that lead internal and external relations and innovation in processes for a systematic, coordinated, effective and efficient sustainable development.

In this sense, many international recommendations and numerous national regulating actions proliferate, promoting a growing attention for the quality of governance and reporting.

In particular, the statement and diffusion of responsible governance principles favour a global convergence in the governance tendencies towards value creation and growth in the long term. This condition removes a substantial divergence factor between insider and outsider corporate governance systems, and it represents a prerequisite for a better capitals circulation and for the crossing of speculative investment logics that are often characterized by a high shareholders' turnover.

In this regard, see the text of letter sent in March 2014 by Larry Fink, BlackRock's Chairman and CEO, to Chairman or CEO clients. He writes: «To meet our clients' needs, we believe the companies we invest in should similarly be focused on achieving sustainable returns over the longer term. Good corporate governance is critical to that goal. That is why, two years ago, I wrote to the CEOs of the companies in which BlackRock held significant investments on behalf of our clients urging them to engage with us on issues of corporate governance. While important work remains to be done, good progress has been made on company-shareholder engagement. I write today re-iterating our call for engagement with a particular focus on companies' strategies to drive longer term growth». This assertion is confirmed in the Annual Letter to BlackRock's Shareholders of 16/04/2015: «This annual report highlights how the platform we've created over time translates into long-term value for clients and shareholders even in the face of global market upheaval. But it also gives us a chance to look towards the future. BlackRock has stayed ahead of the competition over time by thinking long term: building the technology, talent and investment solutions that our clients and shareholders can build on, and that will pay dividends for decades, not just quarters».

The debate on sustainability and social responsibility is connected to new accountability needs. Changes in the governance orientation imply changes in the internal and external communication, promoting contents and circulation choices better complying with the stakeholders' cognitive and evaluating expectations. This situation induced a gradual change in reporting, also with the aim to develop transparent models with international value (Salvioni and Bosetti 2014).

The timely and accurate mandatory or voluntary disclosure on financial and non-financial information about all important matters regarding companies should contribute to the convergence of interests between shareholders and other stakeholders, emphasizing their important role in contributing the long-term success and performance of the company.

2.3 The Link Between Stakeholder Relation Management and Shareholder Satisfaction

The CSR requires the involvement and the appreciation of stakeholders' expectations, the transfer of top management orientations into behaviours, the verification of the consistency among aims, management objectives and actual results, in order to optimize performances and intercompanies relations.

The transition from a situation of overriding attention to shareholders and related economic responsibility to a clear appreciation of all stakeholders and the set of company's responsibilities (economic, social and environmental ones) are associated with the following:

- the expansion of relevant external stakeholders (Marlin and Marlin 2003), which is correlated to increased attention to fairness in the conduct of governance;
- the refinement of the forms of internal control systems designed to make effective the relationship between the corporate governance bodies and the organization;
- the change of reporting system, according to the logic designed to satisfy evaluation and knowledge of stakeholders' expectations across the triple bottom line.

The triple bottom-line logic broadens the traditional reference framework for the effectiveness of governance. Company success is no longer based only on criteria of economic performance, but it is linked to the optimization of environmental and social performance. Thus, sustainable enterprises determine their strategy considering the three aforementioned dimensions of performance, according to the logic of global responsibility, and consequently, they draw up long-, medium- and short-term objectives and processes aimed at ensuring their effective and efficient implementation.

Economic performance, on the other hand, is strongly influenced by the ability to maintain positive relationships with all relevant stakeholders (shareholders, employees, customers, suppliers, etc.), so that the shareholders' expectations have more potential of satisfaction compared to CSR-oriented managerial approaches (Carroll and Buchholtz 2006; Friedman and Miles 2006; Carroll 1979, 1999).

Therefore, the assumption of the stakeholder view (Freeman 1984; Jacoby 1973; Longstreth and Kesenblum 1973; Donaldsond and Preston 1995) leads to a profound change in the valuation of company's performance in relation to the enhancement of the reconciliation factors of competitive, economic and socio-environmental variables.

The ability to give effective answers to ownership's expectations is still a significant dimension, the achievement of which is durable but facilitated by meeting the expectations of other stakeholders and by respect for the environment (Salvioni 2003). The effectiveness of stakeholder relations is primarily correlated to the affirmation of a good governance approach, based on the respect of equity, fairness and transparency and on the activation of stakeholder engagement processes.

Therefore, the assertion of social responsibility increases shareholders' and other stakeholders' interests in the creation of sustainable value, widening their potential involvement in sustainable management. At the same time, it supports the convergence of cognitive expectations on a broad concept of performance, geared to enhancing the relationship between economic and socio-environmental variables (Gray et al. 1996; Guthrie and Parker 1990).

Increased exposure to and permeability of information by the various parties highlight the need to rationalize communications guaranteeing effectiveness, transparency and convergence compared with expectations. Likewise, the interdependence of economic, social and environmental responsibility (Deegan and Rankin 1997; Daub 2007) underlines the usefulness of final summary and programmatic documents aimed at supporting the employment of policies and emphasizing the principles of global responsibility, monitoring their implementation.

In particular, socially responsible companies are induced to change their reporting systems, enhancing the function of consensus management and behavioural orientation, both internally and externally. This change concerns internal reports, which are significant base for responsible decision-making and tools to orientate leaders' and organization's behaviours, and external reports, aimed at supporting effective interaction with shareholders and all other stakeholders.

The transformation of sustainability objectives into actual results gives specific importance to the internal communication system, aimed at spreading the culture of sustainability, to getting used to the assumption of socially responsible behaviour at all levels of the organization, to connect the behavioural effectiveness and the assessment to the multidimensionality of performances.

The actual ability to create sustainable value comes from the ability to orientate all management behaviours to optimize overall performances, necessarily based on the integration of performance across the triple bottom line.

Many information contained in internal reports are also a useful base for communications to external stakeholders as part of the economic synthesis reports (annual report) and/or of the sustainability reports (sustainability reporting, CSR reporting, integrated reporting, etc.). In fact, internal reports intend to improve the sustainability of behaviours assumed by stakeholders (leaders and employees) responsible for exercising corporate responsibility. However, the results of exercising this responsibility offer indications for the assessment of company's capability to equally satisfy stakeholders' expectations over time.

2.4 Stakeholder Relation Management and External Reporting

External social and environmental reporting has been subject of numerous interventions by major international players (as Global Reporting Initiative 2011; International Integrated Reporting Council 2013), as well as of substantial researches (Gray et al. 1987; Guthrie and Parker 1990; Roberts 1991; Kolk 1999; Cormier and Gordon 2001; Cerin 2002; Hibbit 2004; Mathews 1997). In this area, a number of documents that deal with the subject has been analysed, such as the social reporting, the environmental reporting, the social and environmental reporting, the sustainability report, the CSR reporting and the integrated reporting.

Therefore, the gradual affirmation of principles of social responsibility has led to the flanking of numerous financial reports with other reports aimed at showing specific results, often with significant differences in content and significant space–time divergences. In the first step of expansion of companies' responsibilities, the social and the environmental reporting have been widely used. Subsequently, additional documents have been proposed with functions of spreading integrated information, including sustainability reporting (Roca and Searcy 2012; MacLean and Rebernak 2007) and integrated reporting (Salvioni and Bosetti 2014).

At present, a common approach in terms of naming of reports for accountability does not always seem to exist. For example, the analysis of documents submitted in April 2015 by 20 companies present in the Global 100 index (Table 2.1), for five

Table 2.1 The companies analysed: countries, sectors and corporate governance systems

No.	Companies	Countries	Sectors	Systems
1.	Adidas	Germany	Textiles, apparel and luxury goods	Insider
2.	Agilent Technologies	USA	Life sciences tools and services	Outsider
3.	BG group	UK	Oil, gas and consumable fuels	Outsider
4.	Centrica	UK	Multiutilities	Outsider
5.	City developments	Singapore	Real estate	Insider
6.	Enbridge	Canada	Oil, gas and consumable fuels	Outsider
7.	H&M Hennes & Mauritz	Sweden	Retailing	Insider
8.	Kesko	Finland	Food and staples retailing	Insider
9.	Koninklijke Philips electronics	The Netherlands	Industrial conglomerates	Insider
10.	Natura cosmeticos	Brazil	Personal products	Insider
11	Neste oil	Finland	Oil, gas and consumable fuels	Insider
12.	Novo Nordisk	Denmark	Pharmaceuticals	Insider
13.	Prologis	USA	Real estate investment trusts	Outsider
14.	Statoil	Norway	Oil, gas and consumable fuels	Insider
15.	Storebrand	Norway	Insurance	Insider
16.	Sun life financial	Canada	Insurance	Outsider
17.	Suncor energy	Canada	Oil, gas and consumable fuels	Outsider
18.	Unilever	UK	Food products	Outsider
19.	Vivendi	France	Diversified telecommunication	Insider
20.	Westpac banking	Australia	Banks	Outsider

Table 2.2 Type of social reporting

No.	Companies	Type of reporting
1.	Adidas	Sustainability Progress Report 2014 Performance Counts
2.	Agilent Technologies	Social Responsibility Beyond Measurement—2013 Corporate Citizenship Report
3.	BG group	Sustainability Report 2014
4.	Centrica	Corporate Responsibility Performance Review 2014
5.	City developments	Sustainability Report 2014
6.	Enbridge	Corporate Social Responsibility 2014
7.	H&M Hennes & Mauritz	Conscious Actions Sustainability Report 2014
8.	Kesko	Integrated Annual Report: Business Review 2014
9.	Koninklijke Philips electronics	Sustainability Selection-Annual Report (Integrated Annual Report 2014)
10.	Natura cosmeticos	Natura Annual Report 2013 (full version GRI)
11.	Neste oil	Neste Oil's Annual Report 2014
12.	Novo Nordisk	Novo Nordisk Annual Report 2014
13.	Prologis	2013 Corporate Responsibility
14.	Statoil	2014 Sustainability Report
15.	Storebrand	2013 Sustainability Report
16.	Sun life financial	2013 sustainability report
17.	Suncor energy	Report on sustainability 2014 (summary report)
18.	Unilever	Sustainable Living Report 2014
19.	Vivendi	Non-financial indicators handbook 2013; annual report 2013
20.	Westpac banking	Annual Review & Sustainability Report 2014

consecutive years (2010–2015), highlights a very complex situation (Table 2.2). In this respect, Gray (2002) argues that the various designations employed, far from being substantially different, simply represent tags to identify a phenomenon characterized by common specifics.

The companies taken into consideration belong to both countries characterized by insider corporate governance systems (eleven companies) as well as to outsider systems (nine companies). However, all these companies have a strong focus on sustainable disclosure, as this is the first criterion for selection[1] adopted for inclusion in the Global 100 index.[2]

[1]In the context of global companies with a market capitalization of at least $ 2 billion as of October 1st of each year.

[2]The Global 100 index is the indicator that expresses the most sustainable companies, and it is managed by Corporate Knights Capital.

In fact, Corporate Knights Capital highlights: «The first screen eliminates companies that are not keeping pace with the sustainability reporting trends in their specific industry. Companies that fail to disclose at least 75% of the "priority indicators" for their respective "Global Industry Classification Standards (GICS) Industry Group are eliminated at this point in the project. Companies classified in Industry Groups where all 12 KPIs are priority indicators will need to disclose at least 9 ($12 \times 75\% = 9$) KPIs in order to pass this screen. The list of priority indicators may change in the future as disclosure practices evolves».

In addition, companies that pass this first selection criterion undergo further stages of selection: the financial dimension of the company (analysis of indicators such as net profit, operating cash flow, gross margin, etc.); the type of production (e.g. companies with a GICS Sub-Industry classification equal to Tobacco are eliminated); the amount in dollars paid by the company for penalties resulting from fines or penalties for environmental and social damage. The companies that have passed the mentioned above four selection criteria are further assessed, in order to identify the 100 companies who can belong to the Global Index. The ranking is defined by weighing and assigning scores based on the following 12 KPIs: energy productivity; carbon productivity; water productivity; waste productivity; innovation capacity; percentage tax paid; CEO to average worker pay; pension fund status; safety performance and number of lost time incidents; employee turnover; leadership diversity; clean capitalism pay link.

In order to verify the correlation between responsibility, stakeholder relationships and accountability, the reports indicated in Table 2.3 were analysed for investigating the real motivations that led to companies preparing such reports. The analysis of the sustainable report shows that a responsible company oriented towards sustainable development, regardless of operating in insider or outsider system, considers reporting economic and socio-environmental responsibility fundamental pursued through the transparent communication of performance reached, to meet the cognitive and evaluative expectations of shareholders and other stakeholders. In addition, the companies surveyed sustain the importance of participation, through consultation mechanisms, to achieve constructive and functional feedback for the construction of reports, as well as the continual improvement of corporate accountability.

Social responsibility, promoting increasing convergence behaviours between insider and outsider systems dictated by orientation towards sustainable value creation, finds a significant success factor in the adoption of common reporting documents. This is thanks to the efforts in this direction made by GRI, IIRC and many other transnational institutions.

Table 2.3 The motivation for adopting sustainability reporting

	Companies	Declarations indicated in reporting
Insider systems	Adidas	It was in a spirit of transparency and responsiveness towards its stakeholders that the company published its first sustainability report Still today, the Adidas Group is the only company in the sporting goods industry that has published an annual sustainability report since 2000
	City developments	City Developments voluntarily discloses the information as the company believes in upholding the principles of corporate transparency, disclosure and communication with our stakeholders
	H&M	We are committed to transparent reporting on the progress we make towards meeting our seven commit-ments Everything we do needs to be economically, socially and environmentally sustainable. All highly interconnected. All equally important for our future growth
	Kesko	The development of integrated reporting commenced with a project examining the factors that affect value creation and the views of the management and stakeholders on value creation
	Koninklijke Philips electronics	To ensure that success is repeatable, i.e., that we create value for our stakeholders time and time again and deliver on our mission and vision. We derive significant value from our diverse stakeholders across all our activities and engage with, listen to and learn from them
	Natura cosmesticos	Committed to providing our relationship network with comprehensive information about company management and performance and striving to continually improve the way in which this is communicated
	Neste oil	We actively engage in dialogue with our various stakeholders and strive to take into account their expectations in our operations. We are engaged with our stakeholders on a daily basis through a variety of communication and interaction channels
	Novo Nordisk	As Novo Nordisk's business continues to develop, the company remains committed to reporting its performance through its integrated reporting. In line with the Novo Nordisk Triple Bottom Line principle, the consolidated financial, social and environmental statements are presented separately along with the related notes
	Statoil	We believe that responsible and ethical behavior is a prerequisite for sustainable business. Transparency allows businesses to prosper in a predictable environment, contributes to a level playing field and enables citizens to hold government accountable
	Storebrand	Our sustainability work relies on a close dialogue with key players in society. The dialogue is partly, achieved through our annual discussions with players on sustainability matters

(continued)

Table 2.3 (continued)

	Companies	Declarations indicated in reporting
	Vivendi	Driven by the desire to better assess the contribution made by CSR to the results obtained by the Group in the performance of its various missions, Vivendi has introduced an integrated reporting approach. The Group maintains regular and constructive dialog with all its stakeholders
Outsider systems	Agilent technologies	This report demonstrates the commitment of our company, leaders and employees to the highest standards of social and environmental responsibility Agilent is committed to provide even more detailed and transparent data reporting on our corporate citizenship initiatives
	BG group	Our duty is to manage the risks from these hazards, keep our employees safe from harm and, as responsible stewards of the environment, minimise the impact of our operations. This requires a culture which emphasises individual accountability for safety, clear leadership, strong systems and a high level of competence
	Centrica	We prioritise our areas of focus by understanding which issues matter to our stakeholders, their relevance to Centrica and our ability to influence them
	Enbridge	Our Corporate Social Responsibilty (CSR) Report provides the accountability and transparency on our social and environmental performance that are fundamental to our ability to achieve that vision
	Prologis	We strive to provide transparent and industry-leading reporting. We also endeavor to engage in candid dialogue with our stakeholders and incorporate actionable feedback into our business
	Sun life financial	At Sun Life, sustainability is defined as taking accountability for our environmental, social and governance practices in ways that deliver value to our customers, employees, shareholders, and communities. Its scope provides information on social, environmental, economic and corporate governance aspects of our businesses, captured under the broad definition of "sustainability"
	Suncor energy	Our 2014 report includes consolidated social, economic and environmental data. We pursue a triple bottom line vision of sustainability. We're striving to continuously improve our performance. It's through our annual Report on sustainability that we are able to share with you the progress we've made, the challenges we face and how we can work together to deliver on our goals

(continued)

Table 2.3 (continued)

	Companies	Declarations indicated in reporting
	Unilever	We are committed to communicating our performance regularly and transparently. Engaging with stakeholders informs our decision-making, strengthens our relationships, and helps us deliver our commitments and succeed as a business. Engaging with stakeholders is of vital importance as it helps us drive forward our ambitious Unilever Sustainable Living Plan
	Westpac banking	Report sets out the group's non-financial performance across more than 110 indicators covering the environmental, social and governance aspects of our business. The report is also firmly aligned with our financial reporting, providing all of our stakeholders with the 'full story' on our performance, both financial and non-financial

2.5 Sustainability and Social Responsibility as Operational Factor of Convergence

The integration of markets caused by globalization started a gradual convergence process involving different corporate governance systems. (Carati and Tourani 2000; Mallin 2001; Aguilera and Jackson 2003). This situation interests both financial and products' markets and has significant effect on corporate governance. In financial markets, the phenomenon of international diversification by investors is increasingly spreading because of the proposition that holding an international portfolio leads to higher return and minimizes risks. Companies too attempt to obtain more resources at lower costs trying to attract investors and shareholders on international capital markets. This situation implies the acceptance by companies of international corporate governance standards (e.g. about the composition of corporate governance bodies and reporting) that favour the adoption of common behaviours. Also, the globalization of products' markets impacts on corporate governance: when competition intensifies worldwide, the capability to design effective strategies by governance bodies represents a critical factor of company's success and tends to be a best practice for other companies.

The events of convergence between outsider and insider systems can be observed according to the following dimensions (La Porta et al. 2000; Gilson 2004; Khanna et al. 2006; Yoshikawa and Rasheed 2009; Lazarides and Drimpetas 2010). The convergence appearing among national systems, encouraged by the production of rules about high-quality corporate governance standards, is the so-called de jure or formal convergence. The convergence characterizing corporate behaviours, motivated by the search of competitive advantages through the adoption of missions and targets critical for the performance optimization in global markets, is the so-called substantial or de facto convergence.

The formal convergence is about the systems and the corporate governance rules characterizing different countries. Many studies confirmed the diffusion of mandatory and voluntary rules at international level with the aim to favour the integration of financial markets and the effective finding of resources (Stiles and Taylor 1993; Coffee 1999; Aguilera and Cuervo-Cazurra 2004; Collier and Zaman 2005; Markarian et al. 2007).

An intense debate about the strengths and weaknesses of different corporate governance systems has characterized the last decades. The corporate governance systems are the results of cumulative processes, which create regulatory and cultural substratum, influencing contingent attempts of adaptation to different models (path dependence) (North 1990, 2005; Bebchuk and Roe 1999). Hence, it is not possible that the better rules of corporate governance can be implemented in each environment with the predicted results (Puchniak 2007). Indeed, countries seem to be characterized by situation of multiple optima in which the corporate governance best practices are accepted and executed respecting the existing bounds (Khanna et al. 2006).

The existence of mandatory (e.g. international financial reporting standards) or voluntary (e.g. recommendations by European Parliament and Council) international norms can represent a stimulus for formal compliance without qualifying, however, a guarantee of substantial convergence in the long term, this last based on a real culture of compliance existing in the company. In fact, the value of compliance should be embedded in the corporate culture, as a shared principle that guides the behaviour of the entire organization and constitutes the basis for managing any type of risks connected to global corporate responsibility in the long run.[3]

Vice versa, the adoption of a corporate philosophy inspired by sustainability—that is to say characterized by the emphasis on global responsibility and by the will to equally satisfy stakeholders' expectations—seems to be a significant factor of substantial convergence towards the reduction of the gap between insider and outsider systems (Salvioni and Gennari 2016; Salvioni et al. 2016a, b, c).

The inclusion of CSR in the corporate culture identifies the sustainable companies. In spite of different ways to realize corporate strategies, according to regulatory and organizational ties, this view leads to the definition of targets oriented to the minimization of economic, social, and environmental risks and to the maximization of corporate global value in the medium to long term for the benefit of wide stakeholders' groups.

[3]Maruti Suzuki, an Indian car manufacturing company controlled by Japanese motorcycle producer Suzuki, can be reported as an example of compliance with laws in the absence of a shared corporate culture. Maruti went beyond the Indian legislation adopting specific mechanisms to take care of the employees and to strength their protection in the workplace. Despite this fact, largely promoted by the company towards its public, Maruti has been repeatedly accused of violating fundamental labour and human rights guaranteed by the conventions of the International Labour Organization (ICLR 2013; ICLR 2014).

In fact, the tendency of governance towards sustainability principles represents a critical factor for company's success not only in insider systems, traditionally characterized by objects of performance maximization in the long term, but also in outsider systems (Eccles et al. 2011) historically oriented to the satisfaction of diffused ownership (Sect. (3.2).

So, considerations about CSR disclosure are strictly related to the convergence of corporate governance behaviours because of the association between these two complimentary mechanisms used by companies to enhance relations with stakeholders (Eng and Mak 2003; Van der Laan Smith et al. 2005; Haniffa and Cooke 2005; Chan et al. 2014). The sustainability reports, presenting the organization's value and governance model, should express the link between the company's strategies and commitment towards a sustainable corporate performance and sustainable global economy.

The analysis of the selected 20 companies (Sect. (3.4) confirms the emphasis on the link between sustainability and stakeholders' satisfaction by means of value creation in the long run independently from the company's activity in insider or outsider systems (Table 2.4).

The creation of privileged relationships with wide stakeholders' group expresses the crossing of the logic of the short-term value creation for the exclusive interest of shareholders. The latter are intended to belong to a greater category of company's public, and they deduce large benefits too by the exploitation of value creation opportunities and by the effective economic, social and environmental risk management.

Successful companies put effort into the adoption and strengthening of governance processes that are coherent with the international best practices standards. With this way, they can manage the business complexity and the relevant conditions for a sustainable development in the long term.

The effectiveness of responsible governance is related to strategies that emphasize the integration among economic, social and environmental performances and to the coherent definition of structures and processes (e.g. CSR committee and internal reports) that guarantee the realization of the strategies themselves. The external reports are the tools the companies use to inform their stakeholders about the corporate structure, the mission, the strategies, the results obtained according to a global corporate responsibility approach.

Although a substantial convergence in the values declared by sustainable companies selected in our study and the numerous proposal attempts regards global disclosure models (UN Global Compact Principles, OECD Guidelines, Integrated Reporting, GRI, etc.), not always the disclosure behaviours coincide. The enlargement of stakeholders' categories determines, even now, the production of different number of information in sustainable and annual reports, probably according with the belief that the amount of CSR disclosure provided by a company signifies the importance the company attaches to such matters (Gray et al. 1995; Deegan and Ranking 1996; Neu et al. 1998). For example, the 20 companies analysed privilege GRI guidelines because of their quantitative value and objectivity (Tschopp and Nastanski 2014), but they sometime simultaneously refer to

Table 2.4 Declared values (mission/vision/strategy overview)

	Companies	Declared values
Insider systems	Adidas	We are competitive. You have to be if you want to be successful in the long run. We want to create as much value for all our stakeholders as possible
	City developments	Sustainability is more than just an opportunity to make a positive impact on society and the environment; we believe it is imperative to our long-term viability
	H&M	We take a long-term view on our business and investing in our sustainability means investing in our future
	Kesko	For Kesko, responsible operation is a strategic choice and bearing our corporate responsibility is one of Kesko's values
	Koninklijke Philips electronics	With our understanding of many of the longer-term challenges our world faces, we see major opportunities to apply our innovative competencies and create value for our stakeholders by delivering technology solutions that improve people's lives more effectively
	Natura Cosmesticos	We will generate positive social, environmental and economic impacts, delivering value for our entire relationship network
	Neste oil	We create long-term business success and value to our external stakeholders by operating ethically and profitably
	Novo Nordisk	Novo Nordisk has chosen three long-term social targets to support long-term financial performance, balancing responsibility with profitability, with the aim of creating sustainable value for shareholders and other stakeholders
	Statoil	We aim to meet the world's energy by creating long-term value for both our shareholders and the societies and economies in which we operate
	Storebrand	Sustainability is a matter of our own long-term outlook and security for our customers. It is essential that we are able to take a long-term perspective
	Vivendi	Vivendi has fully integrated its CSR policy into its strategy and its governance The Group's societal, social and environmental information allows its relevant stakeholders to better evaluate the Group's overall performance over the medium and long term
Outsider systems	Agilent technologies	[…] commitment of our company, leaders, and employees to the highest standards of social and environmental responsibility. We are proud to recognize corporate citizenship as a fundamental value throughout Agilent's long, almost 75-year heritage as an industry leader
	BG group	Sustainability is a prerequisite for long-term performance and value protection for our shareholders

(continued)

Table 2.4 (continued)

	Companies	Declared values
	Centrica	How we work is important for ensuring the continuing success of Centrica and the delivery of long-term sustainable value creation for all stakeholders
	Enbridge	We cannot forget about strengthening our company's longer term future
	Prologis	Trust and business integrity are critical to the long-term health of any company. At Prologis, we recognize this fundamental principle
	Sun Life financial	Our focus on sustainability reflects the long-term nature of commitments we make to our customers, strengthens the company, and positions future generations to meet their needs
	Suncor energy	We are going to keep engaging with all of our stakeholders and listening to their concerns as we continue to develop and pursue long-term goals
	Unilever	We're also committed to continuously improving the way we manage our environmental impacts and are working towards our longer-term goal of developing a sustainable business
	Westpac banking	We are focused on three priority areas designed to support more sustainable long-term outcomes across our operating environment Beyond our balance sheet, the policies, practices and culture that define the Group also help us to remain strong and sustainable for the long term

other standards and their sustainability reports do not present uniform subjects' index (Table 2.5).

This situation cannot favour the immediate comparison about companies' sustainability performances by a non-expert stakeholder, who has to look for desired information in hundreds of pages. Moreover, industry guidelines and national rules about CSR disclosure can increase the data communicated in reports.

A way to simplify the comparison among companies belonging to different countries and businesses could be the compulsory inclusion of limited, but significant, CSR data in the mandatory financial reports, delegating the in-depth disclosure of different CSR aspects and performances to voluntary CSR reports.

The Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups seems to move in this direction, with the aim to provide investors and other stakeholders with mandatory and more comprehensive picture of a company's financial, social and environmental performances. This directive imposes on some large companies to disclose their management report, information on policies, risks and outcomes (as regards environmental matters, social and employee aspects, respect for human rights, anticorruption and bribery issues, and diversity in their board of directors). Now,

Table 2.5 CSR disclosure standards

	Companies	CSR disclosure standards
Insider systems	Adidas	UN Global Compact; Industry guidelines for best practice as provided by the GRI sector supplement for footwear
	City Developments	UN Global Compact; Communication on Progress (COP); ISO 26000:2010 Guidance on social responsibility; internationally adopted standards and regulations in the fields of occupational standards, environmental protection and the fight against corruption; GRI G3; Construction & Real Estate Sector Supplement (CRESS)
	H&M	UN Global Compact; Communication on Progress (COP); GRI G4; Apparel and Footwear Sector Supplement
	Kesko	UN Universal Declaration of Human Rights; UN Convention of the Rights of the Child; ILO convention on the Fundamental Rights and Principles at Work; OECD Guidelines for Multinational Corporations; ICC Business Charter for Sustainable Development and principles against corruption and bribery; UN Global Compact; purchasing principles of the Business Social Compliance Initiative (BSCI); ISO 26000 standard; GRI G4
	Koninklijke Philips electronics	IIRC Integrated Reporting <IR> framework; GRI G4; UN Global Compact; Communication on Progress (COP)
	Natura cosmesticos	UN Global Compact; United Nations Organization (UNO); GRI G4
	Neste oil	AA1000APS (2008) standard; GRI G3
	Novo Nordisk	UN Global Compact; Communication on Progress (COP); AA1000APS (2008)
	Statoil	GRI G4; Communication on Progress (COP)
	Storebrand	UN Global Compact; GRI G4
	Vivendi	French Grenelle II law; OECD Guidelines for Multinational Enterprises; Communication on Progress (COP); GRI G3; Media Sector Supplement (MSS); Telecom Sector Supplement (TSS)
Outsider systems	Agilent technologies	GRI G4; ISO 26000
	BG group	UN Global Compact; GRI G3; Oil and gas sector supplement
	Centrica	UN Global Compact; GRI
	Enbridge	UN Global Compact; GRI G4
	Prologis	GRI G4; AccountAbility 1000 Assurance Standard
	Sun life financial	GRI G3
	Suncor energy	UN Global Compact; GRI G3; Oil and Gas Sector Supplement
	Unilever	UN Global Compact; GRI
	Westpac banking	UN Global Compact; GRI G4; AA1000; National Greenhouse and Energy Reporting Act (2007); National Carbon Off set Standard (2012)

the EU does not impose disclosure standards, referring to the voluntary existing ones, but the Commission is to develop non-binding performance guidelines to facilitate the disclosure (the consultation with stakeholders is underway until the end of 2016). These guidelines could constitute best practices standards, first for European corporations and for those belonging to the supply and subcontracting chains, with a large impact at global level.

Hence, the convergence between insider and outsider systems is evolving. The formal and substantial convergence phenomena mutually influence each other, outlining a continuous path towards global governance best practices and disclosure, with the main aim to create long-term value, thanks to the relations between companies and their stakeholders.

2.6 Emerging Issues

Over the last few years, the issues of sustainable development and global corporate responsibility have emerged as relevant factors for the effectiveness of corporate governance. In this regard, numerous international institutions have intervened and companies, at least officially, have increased their focus on the interdependence between stakeholder relationship management and economic, social and environmental responsibility.

The increasing emphasis on sustainability in the governance leads to a greater focus on the dominant principles and values in internal and external relations, the innovation of internal processes of behavioural orientation and external communication.

The diffusion of the principles of sustainability and a broader concept of responsibility have, undoubtedly, promoted a review of the relevant performances of companies, creating significant preconditions of operational convergence between insider and outsider corporate governance systems.

In fact, in successful companies, the corporate governance is characterized by a widening scope of the goals, having to take an interest in the entire network of internal and external relations, according to an approach based on the exchange of information and the optimization of behaviour in relation to the stakeholders' expectations.

Regardless of the nature of stock markets and the concentration of ownership, socially responsible companies have therefore amended their corporate policy, giving importance to the creation of sustainable value as a condition for growth and development in the medium to long term. Hence, a major factor of divergence between insider and outsider corporate governance systems attenuates, because of the different time orientation in the results statement. However, we should consider that globalization—together with the gradual reduction of differences between spatial differences, cultures, information systems, traditions and institutions—tends to require greater uniformity in the corporate governance approaches worldwide. In addition, the lowering of barriers among markets and the capitals flow have

increased the alternatives for investors and the belief that the orientation to value creation in the long run may be a significant factor in reducing investment risk.

The change in the governance approach has also stressed the importance of corporate communication, promoting the spread of information content and diffusion choices that are increasingly responsive to the expectations and knowledge evaluation of stakeholders. In this regard, academics and practitioners have taken an interest in the contents, updating and dissemination of corporate communication since the last decade of the twentieth century, in order to overcome the partiality of information that was typical of documents focalised on specific aspects of responsibility. In this regard, some reports promoting a continuous and effective analysis of corporate structures, processes and results have become more and more important. The large number of proposed models highlights however difficult convergence towards a single model designed to allow all concerned to ascertain who managed the responsibility, how it was handled and what the achievements and future expected results are in terms of contribution to sustainability.

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Chapter 3
CSR, Corporate Governance, and the King Reports

Henk Kloppers

Abstract CSR has not been embedded in the South African corporate conscience to the extent that it has, for example, in developed countries. However, the last decade or so has seen significant leaps in this regard. This is mainly due to the release of the authoritative Reports of the King Commission on corporate governance and specifically the King II and King III Reports. This contribution examines the CSR content in these Reports in order to provide guidance to businesses on the issue of CSR.

Keywords Corporate governance · CSR · Governance Codes · King Commission · King Codes

3.1 Introduction

South Africa's history has played an important role in the development of the CSR (corporate social responsibility) movement—unfortunately for the wrong reasons. The country's history of apartheid and discrimination is well documented, and it is this history that caused many international brands to withdraw from the country in protest to the situation. In reaction to the official policies of the apartheid government, reverent Sullivan drafted the Sullivan Code, which laid down principles that should guide companies in their efforts to address social issues (Segerlund 2010). Compliance with the content of the Sullivan Code to some extent became a prerequisite for international companies that wanted to conduct business in South Africa. These principles were responsible for bringing socially responsible practices to the forefront and putting CSR on the international scene.

Decades later, South Africa took some important steps towards embedding corporate governance and CSR in the corporate conscience. This was done through

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the work done by the King Commission on corporate governance under the guidance of retired judge Mervin King. The commission released three King Reports which addressed various governance issues, including the issue of CSR. The aim of this contribution is to examine the role of King II and King III (as leading guidelines in the field of corporate governance) in establishing a CSR culture in the South African context.

Before discussing the King Reports, it should be noted that for purposes of this contribution, CSR can be defined in accordance with the definition provided by the ISO in its *Guidance on Social Responsibility*. CSR is thus defined as the

> responsibility of an organization for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that contributes to sustainable development, health and the welfare of society; takes into account the expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behaviour; and is integrated throughout the organization and practised in its relationships (ISO 2010: 3).

Included in this definition are concepts such as organisation, impacts, environment, ethical behaviour, sustainable development, stakeholders, and international norms of behaviour. Based on the inclusion of these concepts, this definition represents one of the most comprehensive currently available. It acknowledges the fact that an organisation's activities could change society, the economy, or the environment in both a positive or negative manner, and as a consequence, these possible impacts should be considered. In the context of this acknowledgement, businesses have a social responsibility to contribute to the well-being of their stakeholders. The definition supports the notion that social responsibility is found in compliance with applicable legislation and international standards. Note that this definition does not refer to CSR as actions that "voluntarily go beyond the law", as is the case with some of the definitions to be discussed in this section.

3.2 King Report on Corporate Governance for South Africa 2002[1] (King II)

Eight years after the release of the *King Report on Corporate Governance* (IoD 1994) (referred to as *King I*), *King II* was published, representing the second edition of the trilogy of King Reports promoting corporate governance.[2] *King II* reviewed and expanded the corporate governance measures contained in *King I* and succeeded in linking the concepts of CSR and good governance (Painter-Morland 2006). The Report was necessitated *inter alia* by legislative developments brought about as a

[1]See IoD (2002a). The main points of *King II* were summarised and released in an executive summary (IoD 2002b).

[2]In this context, *King II* represents the second step in the evolutionary process of corporate governance in South Africa.

result of *King I*,[3] as well as legislative interventions dealing with aspects of corporate governance.[4] In its promotion of good corporate governance, *King II* distinguishes between accountability and responsibility. According to *King II* (IoD 2002a: 7)

> [o]ne is liable to render account when one is accountable and one is liable to be called to account when one is responsible. In governance terms, one is accountable at common law and by statute to the company if a director, and one is responsible to the stakeholders identified as relevant to the business of the company.

This denotes that the board of directors of a company, acting within its fiduciary capacity and responsibility, is not merely accountable to the company shareholders, but also responsible to other stakeholders of the company (Rossouw 2005).[5] Following from this, in the language of *King II*, a good corporate citizen acting with its licence to operate is one which accepts that it has a responsibility towards various stakeholders resulting from its business operations. As a result of this responsibility, a business can be held accountable if it neglects to act responsibly. A responsible corporate citizen not only recognises that it coexists in “an environment where many of the country’s citizens disturbingly remain on the fringes of society’s economic benefits” (IoD 2002a: 18), but also takes meaningful steps towards addressing this societal issue.[6]

The notion that a company is responsible to its stakeholders (as opposed to shareholders) represents an important move away from the traditional shareholder supremacy approach[7] to a more inclusive stakeholder approach,[8] with stakeholders

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[3]Legislative developments in the area of labour law (such as the *Labour Relations Act* 66 of 1995 and the *Employment Equity Act* 75 of 1997), environmental law (such as the *National Environmental Management Act* 107 of 1998) and commercial law (statutory amendments to the *Companies Act* 61 of 1973).

[4]Legislative interventions such as the *Insider Trading Act* 135 of 1998, the *Public Finance Management Act* 1 of 1999 and amendments to the *Banks Act* 94 of 1994. For a discussion of these legislative advancements, see IoD (2002a).

[5]West (2006) is of the opinion that it appears as if the principle of accountability as identified in the Report is applicable to shareholders only, and not to other stakeholders.

[6]The reference to accountability and responsibility corresponds with the key principles of social responsibility as identified by the ISO (2010).

[7]The shareholder supremacy approach identifies shareholders as the only grouping with a legitimate interest in the business. *King II* stipulates that this approach is not in line with the international approach to corporate governance, where inclusivity is one of the foundations. According to *King II* (IoD 2002a), one of the reasons for the rejection of this approach is to be found in the fact that a company “becomes a separate persona in law and no person whether natural or juristic can be owned”.

[8]The inclusive approach advocated in *King II* received further endorsement in the *King Report on Governance for South Africa—2009* (Miles and Jones 2009; Gstraunthaler 2010; West 2006; Esser 2009). For a discussion of the inclusive approach, see Kloppers (2012).

such as local communities,[9] employees, and suppliers having moral claims on the company (IoD 2002a).

The Report further introduced a shift in the focus from the single bottom line (focussed exclusively on the financial aspects of a company's activities) to the now generally accepted triple bottom line, which encompasses the economic as well as environmental and social performance of a company's activities (IoD 2002a). This shift corresponds with the global focus on sustainability and the need for companies to contribute in a sustainable manner in their various spheres of influence. The move to triple bottom line management and Reporting encourages companies to embrace the "non-financial"[10] (i.e. environmental and social) aspects in integrated sustainability Reports.

The content of *King II* is divided into an introduction providing a background to the Report and a Code of corporate practices and conduct (the Code) containing recommendations addressing issues such as dealing with boards and directors (Sect. 3.1), risk management (Sect. 3.2), integrated sustainability Reporting (Sect. 3.4), and compliance and enforcement (Sect. 3.6). The Report does not provide a prescriptive list of disclosure requirements. It does, however, encourage companies to follow its guidelines to improve their overall governance.

The recommendations contained in *King II* are not prescribed by law, nor does the Report favour a legislative approach.[11] The recommendations are voluntary[12] and based on self-regulation, and as a result, no provision is made for enforcement through an enforcement agency.[13] Despite its voluntary nature, Rossouw (2005) notes that an adequate legal and regulatory framework is needed for the proper

[9]Who, according to Reed (2002: 239), "are the primary object of social and economic development and who not infrequently suffer negative development effects from irresponsible corporate practice".

[10]Although environmental and social aspects are referred to as non-financial matters, it should be stressed that these aspects have very real financial consequences. The reference to "non-financial" merely serves to distinguish these aspects from the traditional financial bottom line.

[11]According to Mervyn King, the chairperson of the King Committee, as quoted by Barrier (2003: 73) "[t]here's some suggestion that certain aspects of the recommendations in King II should be legislated—in other words, be compulsory for all companies. Business is a difficult matter, and those who run it can't have the prescience to envisage what is going to happen from day to day, so they need flexibility in the process associated with administering their companies. To have the rigidity of a statute doesn't make sense".

[12]The Johannesburg Securities Exchange Limited (JSE) does, however, require listed companies to disclose their compliance (or lack thereof) with the recommendations in *King II* through the use of a narrative statement which would enable shareholders and potential investors to evaluate the company's application of the principles of corporate governance (JSE *Listing Requirements* par 7. F.5; Esser and Coetzee 2004; Deloitte and Touche n/a).

[13]*King II* does, however, identify shareholder activism as an important enforcement mechanism which can be utilised by shareholders to ensure the implementation of the recommendations contained in *King II* (IoD 2002a). For a discussion on *King II*, corporate governance and shareholder activism, see Rademeyer and Holtzhausen (2003), where the authors refer to a variety of mechanisms available to shareholders in terms of the *Companies Act* 61 of 1973 through which concerns about corporate governance can be raised.

functioning of any voluntary governance Code stressing a link between the law and the Code.[14] The non-prescriptive nature of *King II* implies that enforcement of the Code should be regarded as an issue between company boards and their stakeholders. The focus is on corporate governance at a business level rather than on a regulatory level.

The discussion of the relevant content of *King II* will start with a short explanation of its focus and scope of application. Following these explanations, the discussion will then turn to the definitions which are relevant for a discussion of CSR, and finally, the section will provide an overview of recommendations with a CSR scope.

3.3 What Is the Focus of King II?

From a CSR perspective, the primary focus of *King II* is the move from concentrating purely on the single (financial) bottom line to a more inclusive approach where the environmental and social aspects of a company's activities are also included in business management and Reporting. Following this move from the single to the triple bottom line, the Report recommends that companies annually Report on sustainability issues in which disclosures on "non-financial" issues (i.e. social and environmental) are included.[15]

King II takes cognisance of the fact that the introduction of a Code of corporate practices and conduct across the entire business sector could be costly and give rise to burdensome administrative requirements. Consequently, its scope of application has been limited.

3.3.1 Scope of Application

The principles and recommendations contained in the Code (IoD 2002b) are applicable to companies listed on the JSE, banks, financial and insurance entities, and certain public sector enterprises.[16] Furthermore, all other companies are

[14]It should be noted that in many instances the reason for following the voluntary, self-regulatory approach is found in legal frameworks which do not make sufficient provision for the control of corporate activities. As a result of this inadequate legal framework, business sectors "almost have no other choice than starting the process of corporate governance reform in a voluntary self-regulatory manner" (Rossouw 2005: 98).

[15]For a discussion of the requirement of integrated sustainability Reporting, see par 2.5.2.

[16]*King II* follows the "comply or explain" approach, where those entities which fall within its scope of application are required to comply or provide justification for non-compliance (Aka 2007). A much more flexible approach of "apply or explain" is followed in *King III*. For a discussion of this approach, see par 3.5.

encouraged to give consideration to the application of the Code to the extent that the principles are relevant to the company (IoD 2002b; Loubser 2002).[17] The application of the Code is consequently limited to the company as a legal entity and is not applicable for instance to close corporations, trusts, or any other legal entity other than a company.[18] Despite the fact that *King II* is not applicable to the majority of business enterprises, it is important that the recommendations in the Report are "capable of being attained by all companies" (IoD 2002a).

3.3.2 Relevant Definitions

Although *King II* does not define CSR, it does identify social responsibility as one of the seven characteristics of good corporate governance (IoD 2002a, b).[19] A socially responsible company is viewed as a company which is aware of social issues and responds to these issues. *King II* links the notion of being socially responsible to being a good corporate citizen. According to *King II* (IoD 2002a: 11, b: 12), a good corporate citizen is seen as

> one that is non-discriminatory, non-exploitative, and responsible with regard to environmental and human rights issues.

Being a good corporate citizen and having good governance policies and practices in place has the potential to add value to the company, not only to the financial bottom line but also to the social and environmental balances. The following section will discuss the CSR content found in *King II*. It should be noted that much of the content which is relevant to CSR relates to the social and environmental aspects of business activities.

3.3.3 CSR Content in King II

From a CSR perspective, the most important topics addressed in *King II* are compliance and enforcement, and the requirement that companies should follow the inclusive approach to corporate governance and Report annually on sustainability issues.

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[17]*King II* became applicable to identified business enterprises with financial years commencing on or after 1 March 2002.

[18]Although the focus of *King II* is on companies, other legal entities used to conduct business should take note of the content and adapt and apply the recommendations to the extent that the recommendations could guide their business management.

[19]The other characteristics of good governance according to *King II* are discipline, transparency, independence, accountability, responsibility, and fairness (IoD 2002b).

3.3.3.1 Compliance and Enforcement

Compliance with the recommendations of *King II* remains voluntary for the majority of companies[20], and no enforcement authority has been established.[21] However, the Report stresses the fact that

> [t]he board should ensure that the company complies with all relevant laws, regulations and Codes of business practice, and that it communicates with its shareowners and relevant stakeholders (internal and external) openly and promptly and with substance prevailing over form (IoD 2002b: 21).

This statement underscores the fact that a director has a legal obligation to comply with legislation and relevant business Codes and practices, as well as a responsibility towards all relevant stakeholders (including shareholders). A responsible citizen, according to this statement, communicates (in company Reports too) in such a manner to its stakeholders that they would be able to form an informed opinion of the business based on its disclosures. This is a further endorsement of the inclusive approach advocated by the Report.

From a CSR point of view, the Report's stance on disclosure is to be welcomed. According to the Report (IoD 2002a), the adoption of a more open disclosure regime would benefit the company by highlighting misconduct or non-performance, resulting from which remedial action could be taken. The move towards a more open disclosure regime is important for the establishment of a culture of compliance, which is to be furthered by the requirement that companies should provide sustainability Reports.

3.3.3.2 Integrated Sustainability Reporting

One of the most important developments brought about by *King II* was the requirement that companies should provide sustainability Reports.[22] According to the Report (IoD 2002a: 91)

> [s]ustainability can be seen therefore to focus on those non-financial aspects of corporate practice that, in turn, influence the enterprise's ability to survive and prosper in the communities within which it operates, and to ensure future value creation. This, in turn, represents the essence of corporate social responsibility …

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[20]Except for listed companies for which compliance with *King II* is a listing requirement.

[21]Despite the fact that no enforcement authority is established, various legal mechanisms exist to enforce the principles of corporate governance which overlap with existing legal principles. Such principles include the director's fiduciary duties and the duty to act with care and skill as well as other statutorily imposed duties. Contravention of these duties would subject the director to criminal as well as civil prosecution.

[22]The term "sustainability" in this context is derived from "sustainable development" which is defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (IoD 2002a: 91).

This statement supports the argument that a good corporate citizen[23] acting with social responsibility is one which is concerned about more than just economic performance. A socially responsible business realises that its business practices have an influence on society at large and more specifically on the communities where it operates. It understands that a balance needs to be struck between economic performance and social and environmental performance. *King II* requires companies to Report on what is now generally referred to as the "triple bottom line"—Reporting which includes economic, social, and environmental issues, providing a clear signal to companies that social and environmental issues should become part of everyday business management in order to secure the company's longevity (Painter-Morland 2006).

The Report stipulates that a company should on an annual basis Report on the nature and extent of its policies and practices regarding stakeholder relations, social issues, transformation, health and safety, and environmental management (IoD b). Certain matters must be specifically included in the sustainability Report. These matters include a description of health and safety practices, Reporting on environmental corporate governance, policies defining the prioritisation and spending on social investment, and a disclosure of human capital development (IoD 2002b).

The integrated sustainability Report requires a company to Report on its compliance with safety, health, and environmental (SHE) legislation and regulations, and how any of these issues may impact on the financial bottom line (IoD 2002a).[24] Regarding the description of health and safety practices, a company must demonstrate its commitment to improving health and safety practices through a demonstrated effort to, for example, reduce workplace accidents. Reporting on health and safety issues should also include a description of the company's policies and practices with regard to HIV/AIDS and its potential impact on the company.[25]

Specific attention should further be given to the extent of initiatives supporting social transformation such as employment equity, BEE, and social investment. A company must show how it has contributed to social transformation and, in particular, how its procurement practices have benefitted those in need of upliftment.[26] Stakeholders should be informed about the company's performance on employment equity issues. How have previously disadvantaged individuals, and in particular women, been provided with equal opportunities to reach executive levels

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[23]*King II* refers to various defining characteristics of good corporate citizenship, which includes corporate governance (managing businesses in a responsible and accountable fashion), respect for human rights, environmental responsibility, and community engagement through the promotion of collaborative partnerships (IoD 2002a).

[24]This issue is also one of the issues which a company's social and ethics committee is now required to monitor. See Kloppers (2013).

[25]Compliance with this requirement would also be in line with the board's responsibility to have proper risk management systems in place (as required by paragraph 3 of the Code). HIV/AIDS represents a potential risk to any business. It requires dedicated attention from management.

[26]This requirement reflects the indicator on the BEE scorecard referring to preferential procurement. For a discussion of the BEE scorecard, see Kloppers (2012).

in the company (IoD 2002a)?[27] Stakeholders should further be provided with information regarding the company's contribution to BEE.[28] Detail of measures which the company has taken to enable historically disadvantaged South Africans to become economically active and enter the economy should be provided.

In the context of CSR, the most important Reporting requirement in *King II* is the requirement dealing with social investment disclosures. Unfortunately, *King II* does not provide many insights as to what is required from companies when Reporting on this subject. According to *King II* (IoD 2002a: 118)

> [b]oards should become familiar *with the criteria in regard to socially responsible investment* used by investment managers responsible for investment of corporate and pension funds on its behalf. (emphasis added)

King II does not provide any further guidance regarding the criteria to be used when Reporting on and accessing socially responsible investment. It does, however, refer to community investment as one of the three categories of socially responsible investment (IoD 2002a).[29] Community investment refers to investing in the development of communities in order to contribute to the growth and upliftment of the communities. Unlike other jurisdictions, South Africa does not, for example, require pension funds to indicate to what extent socially responsibility is used as a criterion for placing investments.[30]

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[27]The issue of equal representation in the workplace is addressed in the *Employment Equity Act*, which specifically requires an employer to draft an employment equity plan which provides an outline of how it intends to achieve proper racial representation in all levels of employment.

[28]A company's contribution to BEE will be evident from the points which it has achieved on the BEE scorecard.

[29]The other two categories of socially responsible investment referred to are positive and negative screening, and shareowner advocacy and corporate engagement. In terms of the first of these, positive screening is used to identify companies with a good CSR record, while negative screening refers to criteria used to exclude companies with unacceptable CSR track records. "Shareowner advocacy and corporate engagement" refers to "the process of using shareowner influence to help bring about corporate social and environmental change" (IoD 2002a: 118). Community investment is not only one of the seven legal principles of CSR, but also features very prominently in the ISO *Guidance*.

[30]In July 2011, the Institute of Directors of Southern Africa released the *Code for Responsible Investing in South Africa 2011* (CRISA), which is intended to provide guidance to institutional investors on responsible investing. This Code builds on the recommendation of King II to integrate environmental, social, and governance considerations into investment decision making (IoD *CRISA* 4) and is aimed at institutional investors as asset owners (such as pension funds or insurance companies). The Code is based on the following five principles: Principle 1: An institutional investor should incorporate sustainability (which is defined as "the ability of a company to conduct its operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs. Sustainability includes managing the impact that the business has on the life of the community…" (IoD n/a: 9), considerations into its investment analysis and investment; Principle 2: An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities; Principle 3: Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other Codes and standards

The matters referred to above which require specific consideration can be labelled as the disclosure of non-financial information.[31] Such disclosure should be based on the principles set out in the GRI Sustainability Reporting Guidelines on matters such as social performance.[32] It should be noted that when Reporting on financial matters, such Reporting is addressed to those who are financially literate. When Reporting on non-financial matters such as stakeholder relationships, however, it should be kept in mind that the style of disclosure should be appropriate to the targeted audience.

Reporting on the environmental and social dimensions of a business can be truly integrated only if it is approached in an inclusive manner. This approach is based on the notion that all stakeholders[33] (including shareholders)[34] should be considered and that the directors owe responsibility to the company as an entity, and not only to its shareholders. According to West (2006), *King II* justifies the inclusive approach by appealing to the possibility that companies might experience improved economic effectiveness[35] or by appealing to the prevalent socio-economic conditions in the country.[36]

The words of Miles and Jones (2009: 66) aptly summarise the approach as follows:

> [T]riple bottom line Reporting informs stakeholders about the intentions of the company to enhance its social performance, emphasises its positive actions, signifies its respect for Corporate Social Responsibility (CSR) and demonstrates the legitimacy of the company in the eyes of stakeholders.

Despite the fact that *King II* was a refreshingly welcome move towards establishing a culture of corporate governance where CSR plays an important role, the Report is not without its limitations.

(Footnote 30 continued)

applicable to institutional investors; Principle 4: An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should proactively manage these when they occur; and Principle 5: Institutional investors should be transparent about the content of their policies, how the policies are implemented, and how CRISA is applied to enable stakeholders to make informed assessments (IoD n/a).

[31]Although these are labelled as non-financial issues, they have potentially significant financial implications for the company.

[32]For a discussion of the GRI guidelines, see Kloppers (2012). These principles include reliability, relevance, and clarity.

[33]According to *King II* (IoD 2002a: 6) "[T]he inclusive approach recognises that stakeholders such as the community in which the company operates, its customers, its employees and its suppliers need to be considered when developing the strategy of a company".

[34]"The modern approach is for a board to identify the company's stakeholders, including its shareowners" (IoD 2002a: 7).

[35]"A company is likely to experience indirect economic benefits such as improved productivity, and corporate reputation by taking those factors into consideration" (IoD 2002a: 12).

[36]"… companies in South Africa must recognise that they co-exist in an environment where many of the country's citizens disturbingly remain on the fringes of society's economic benefits" (IoD 2002a: 18).

3.3.4 Limitations

Although *King II* represented an important step in the direction of instilling in companies the concept of being a good corporate citizen through the use, for example, of sustainability Reporting, the biggest stumbling block in the success of this initiative lies within its scope of application. Since the recommendations of *King II* are aimed at a very secluded section of the business sector, the majority of South African business enterprises fall outside of its scope of application. Such businesses are merely encouraged to consider the application of *King II* to the extent that the principles are applicable. Application remains totally voluntary for them. According to Loubser (2002, 138) “there is no general consensus that all companies will voluntarily comply if they are not compelled to do so”. In this regard, *King II* finds itself between a rock and a hard place. On the one hand, *King II* must remain voluntary in order not to become overly burdensome and in order to provide businesses with some scope of flexibility in applying the recommendations (Andreasson 2011). On the other hand, the question might rightfully be asked whether or not companies will comply if they are not legally required to. Should there be a move beyond the selective scope of application? Andreasson (2011) is of the opinion that such a move would in all likelihood materialise only in the event of an increase in big corporate scandals similar to the Enron scandal, which gave rise to the American *Sarbanes-Oxley Act*. He further notes that due to the fact that from a government point of view it is impossible for governmental departments to enforce voluntary disclosure,[37] “they often try to mitigate this difficulty with mandatory legislation” (Andreasson 2011: 17).

Although one of the purposes of requiring companies to Report on sustainability issues is to enable stakeholders to form an informed opinion of the company, Sonnenberg and Hamann (2006: 313) in an evaluation of the sustainability Reports of listed companies come to the conclusion that

> beyond the prescribed description of the structures and internal Reporting processes, very little information about their actual operation or the results of their interventions is divulged in a manner that would make it possible to assess their effectiveness.

Regarding social Reporting and stakeholder engagement, the authors find that fewer than 5% of companies included in their case study provided any information that would enable an assessment of their stakeholder engagement procedure. They concluded that Reporting on social issues was at best anecdotal and unsystematic.[38]

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[37]The voluntary nature of initiatives gives rise to the inability of government to enforce them.

[38]Regarding Reporting on social issues, the authors found that companies did Report on issues of occupational health and safety, employment equity, and BEE. The reason for Reporting in these areas is to be found in the fact that these disclosures are required by law and that companies are merely complying with their legal obligations (Sonnenberg and Hamann 2006). This problem is not unique to South Africa, however. On the international front, Gray (2001: 13) writes “the quality of attestation to social and environmental Reports is woefully poor”, while with reference to the UK, Sittle (2002: 349) notes that “there are significant distortions and omissions of

Unfortunately, it would seem that despite its good intentions, *King II* would be successful only once companies are convinced of the benefits associated with good corporate governance.

Due to its limited scope of application and the limitations identified above, the revision of *King II* became inevitable. Seven years after the release of *King II*, the King Committee released the third part in the ongoing corporate governance trilogy. The following sections will dissect this third King Report in order to determine whether or not it represents an improvement on *King II*, specifically in the CSR context.

3.4 The King Report on Governance for South Africa[39] and the King Code of Governance Principles (Collectively Referred to as King III)[40]

King III can be described as the map providing management with direction on how to manage a business within the changing world of corporate governance. It provides a list of best practice principles aimed at guiding businesses to "do the right thing" (Anon 2009a: 46). It is aimed at those managers who are forward-looking and who strive towards a business operating with a licence to operate endorsed by society.

King III was necessitated by the recommendations contained in *King II* together with the recent reform of corporate law, most significantly the new *Companies Act*,[41] which unlike its predecessor did not deal with corporate governance.[42] International trends and developments in corporate governance created the need for *King II* to further evolve. Although *King III* represents a voluntary approach (with no statutory obligation to comply) to corporate governance, Sect. 7(b)(iii) of the new *Companies Act* identifies one of the purposes of the Act as

> encouraging transparency and *high standards of corporate governance* as appropriate, given the *significant role of enterprises within the social and economic life* of the nation. (emphasis added)

(Footnote 38 continued)

information concerning ethical issues in current U.K. Reporting systems". Laufer (2003: 254) concludes that "simply relying on the integrity of corporate representations should seem increasingly naïve to those inside and outside the SRI community".

[39]See IoD (2009a), hereinafter referred to as the *King III Report.*

[40]See IoD (2009b), hereinafter referred to as the *King III Code*.

[41]71 of 2008.

[42]For a discussion on the synergies and interaction between *King III* and the 2008 *Companies Act*, see King (2010). For an enlightened discussion of governance issues in terms of the new *Companies Act*, see Deakin (2010), Olson (2010), Katz (2010), and Du Plessis (2010).

This purpose is indicative of the linkage between the law (the *Companies Act*) and governance (*King III*) and stresses the interplay between the Act and *King III*.[43] It is further an acknowledgement of the role that businesses play not only as corporate citizens but also to a large extent as agents of change. *King III* stresses the importance of companies accepting the fact that they are part of a larger environment and that they have a duty to act in a sustainable manner (Gstraunthaler 2010).

Since the work done by the King Committee is internationally recognised as being at the forefront of corporate governance, it was decided that the Committee should also be responsible for drafting the third Report. A further reason for the drafting of *King III* is to be found in the recent international financial crisis and corporate scandals. Had proper good governance practices been followed, the crisis and scandals might have been averted. South Africa's strong governance approach brought about by the predecessors of *King III* might be one of the reasons why the country has to a large extent been spared from the worst effects of the international economic crisis. In world markets, a good governance climate is conducive to gaining access to the global capital of institutional investors.[44]

The international economic crisis has left many institutional investors wary of investing in countries with a weak corporate governance regime, and they have turned their attention to countries with a strong governance approach. *King III* implicitly accepts the premise that institutional investors are increasingly taking note of the governance practices and principles of a business before deciding to invest in it. In this regard, institutional investors as a stakeholder group have an important role to play in driving governance practices and sustainability. The issues of governance and sustainability are central themes of the Report, which will be discussed in more detail in the sections to follow.

King III heralds a new era for good corporate governance and places a critical emphasis on issues such as sustainability and corporate citizenship. It is currently the benchmark against which future governance requirements will be measured.

Currently, very little academic literature has been written on *King III,* and as a result of this, the following sections will largely be based on the text of the Report as well as the *King III Code*. The following sections will provide a brief outline of and reflection on those aspects contained in the Report which relate to CSR in general. The outline will initially identify the focus of the Report as well as the scope of its application. Following this, it will be demonstrated how concepts such as CSR and corporate citizenship are defined in *King III* and then continue to identify the principles relevant to CSR.

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[43]Regarding governance, it should be noted that since *King III* is based on a voluntary approach, compliance with it will result in compliance with the Act, but that compliance with the prescriptions of the Act does not necessarily imply compliance with *King III* (King 2010).

[44]Institutional investors' commitment to corporate governance is evident from the fact that institutional investors are willing to pay a substantial premium for companies with strong corporate governance policies (Picou and Rubach 2006; Newell and Wilson 2002).

3.4.1 What Is the Focus of King III?

As stated above, the main focus of *King II* is on sustainability Reporting. *King III* identifies the need for integrated Reporting where social, environmental, and economic issues are combined in a single Report providing a more encompassing view of a business to its various stakeholder groups. *King III* strongly exhorts businesses to include integrated Reporting in their business management and strategies. The aim of integrated Reporting is to Report on the effect that a business has on the three environments in which it operates—the social (*people*), the natural (*the planet*), and the economic (*profit*)[45]—to highlight the positive effect that the business has in each of these environments and to indicate any existing negative impacts it may be having together with possible remedial activities to address these negative impacts. *King III* supports the notion that a responsible corporate citizen will embrace the concept of integrated Reporting and will use this Reporting to demonstrate its commitment to the society in which it operates in order to receive the community's approval and, in so doing, its licence to operate.[46] In this regard, it can be argued that businesses are accountable to the public from which a number of its stakeholders will emerge.[47]

King III recognises the fact that a business has various stakeholders and stresses the importance of the various stakeholders by proposing an inclusive stakeholder approach, where the interests and expectations of legitimate stakeholders are considered in decision making (IoD 2009a, b).

3.4.2 Scope of Application[48]

Unlike its predecessors, which focussed exclusively on companies (hence the specific reference to *corporate* governance), *King III* is applicable to all forms of legal entities "regardless of the manner and form of incorporation or establishment" (IoD 2009a: 17) and not specifically focused on specified types of companies. It is also applicable to all forms of business, whether a business is in the public, private, non-profit, or non-governmental sector (IoD 2009a; Coleman 2009; Good 2009). The broader, inclusive approach should be viewed as an attempt to create a culture of good governance throughout the entire South African economy. Since the scope

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[45]These three environments are commonly referred to as the 3Ps.

[46]In this regard, Gstraunthaler argues that corporate governance "might be used as a tool to enhance the legitimacy of companies" (Gstraunthaler 2010).

[47]One of the key features of accountability is that once it is established who is accountable to whom and what they are liable to account for, it should be established what the standards are against which accountable actions are to be measure. [For a general discussion of accountability under the new *Companies Act*, see Ncube (2010)]

[48]The recommendations contained in the King III Report became effective on 1 March 2010.

of application of *King III* is much wider than its predecessor, its goal of creating a culture of good governance throughout the economy has a better chance of being attained.

3.4.3 Relevant Definitions

In order to examine the principles and practices relevant to CSR recorded in *King III,* it is important to establish how relevant concepts such as CSR, corporate social investment, and corporate citizenship are defined. According to the *King III Report* (IoD 2009a) and the *King III Code* (IoD b: 50), responsible citizenship entails "an ethical relationship of responsibility between the company and the society in which it operates". Resulting from this relationship is the acceptance by a business that being a citizen implies having rights and responsibilities in the economic, social, and natural environments. A responsible citizen accepts responsibility for the economic, social, and environmental well-being of the society in which the citizen functions. According to Miles and Jones (2009: 60)

> King III asserts that a good corporate citizen is one which has comprehensive policies and practices in place which enable it to make decisions and conduct its operations ethically, meet legal requirements and show consideration for society, communities and the environment.

From this, it is evident that a responsible corporate citizen is *inter alia* a socially responsible citizen. Corporate social responsibility is defined as

> … the responsibility of the company for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that: contributes to sustainable development, including health and the welfare of society; takes into account the legitimate interests and expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behaviour; and is integrated throughout the company and practiced in its relationships (IoD 2009a: 118, b: 51).[49]

Corporate social investment is seen as one of the manifestations of a business' CSR, where the business invests (through financial or other contributions) in activities within the company's area of influence (IoD 2009a, b).

The core elements of this definition for CSR are the acceptance by a business that its decisions and activities have an impact on the society in which it operates—

[49]When the definition of CSR in *King III* is compared to the definition provided by the ISO *Guidance*, the similarities are evident. Both of these leading instruments regard CSR as the acceptance of responsibility (accountability) for the impacts that a business' decisions and actions have on society and the environment. Both of these instruments further establish the link between CSR and sustainable development and identify the important role of businesses in contributing to sustainable development. Further, both of the definitions place a strong emphasis on the role of stakeholders and the fact that the legitimate interests of stakeholders have to be taken into account in business decisions and actions.

a society consisting of more than mere clients or shareholders—and that a business has an important role to play in sustainable development.

The *King III* definition of CSR differs in a very important respect from the definition provided by the majority of international authors, with the exception of the ISO *Guidance*.[50] No reference is made to the notion that CSR consists of voluntary actions that go beyond the requirements of the law. This definition regards CSR as decisions or activities that are "in compliance with applicable law and consistent with international norms of behaviour" (IoD 2009a: 118, b: 51).[51] A business applying the recommendations of *King III* (as norms of behaviour) will be regarded as a socially responsible corporate citizen.

The basic approach of *King III* is that governance compliance (of which CSR is a facet) should be predominantly done on a voluntary, non-legislated basis. This approach does not, however, denounce the important role played by legislation in governance compliance as evidenced by the referral to corporate governance in Sect. 7 of the *Companies Act*. The international approach to corporate governance varies between the "comply or else" approach and the "apply or explain" approach.

3.4.4 "Comply or Else" Vs "Apply or Explain"

In terms of the "comply or else" approach, compliance with governance requirements is not optional (*comply*) and non-compliance will give rise to the business being sanctioned (*or else*).[52] This approach normally has a regulatory body which acts as a "watchdog". It is responsible for overseeing compliance and sanctioning non-compliance. Points of critique against this approach are that these compulsory governance requirements will result in additional costs to a business, will cause a further administrative burden on the business, and will be time-consuming—all of which will have a negative impact on a business' financial bottom line.

Regarding governance, South Africa currently follows a dual or hybrid system of governance consisting of compulsory legislative compliance (such as the *Companies Act*) and voluntary governance principles (such as *King III*). The approach followed in *King III* is one of "apply or explain" and is in line with the approach followed by

[50]For an overview of definitions provided for CSR, see par 3.2.

[51]Although the definition could not refer to itself, the impact of *King III* is such that reference should be made to decisions and activities that are in compliance with applicable law and consistent with *national* and international norms of behaviour. *King III* represents an important step towards establishing national norms of behaviour for businesses.

[52]The American *Sarbanes-Oxley Act* of 2002, which is aimed at preventing financial scandals such as the Enron or World Com scandals, follows the "comply or else" approach (IoD 2009a, b). This act follows the government regulation approach to governance instead of the voluntary self-regulation approach advocated by *King III* (Esser 2009; Good 2009).

the European Union.[53] *King III* promotes the voluntary and much more flexible approach to governance compliance. Since it is applicable to all types of businesses, regardless of its formation, a more cost-effective and less time-consuming approach had to be followed. Those responsible for the management of a business are required to *apply* the principles and practices proposed in *King III* or provide reasons for the fact that the principles and practices have not been implemented or followed (*explain*). If a business' management elects not to follow a particular recommended practice, the business will not face the threat of sanctions. Instead, management merely needs to indicate why it is not in the best interest of the business to apply the practice (Coleman 2009; Anon 2009b). In order to support the voluntary nature of *King III*, no explicit regulatory body exists which is charged with overseeing compliance with it.[54] This approach takes recognition of the fact that a one-size-fits-all approach is not desirable and that smaller business would, for instance, not be able to bear the burden of additional costs brought about by governance requirements. The requirement of *apply* as opposed to *comply* is to be preferred in an economy where entrepreneurial activities are encouraged.[55] However, where the *apply* approach fails, the more rigid *comply* approach must be followed.

The principles applicable to a business' social responsibility are based on the same premise of apply or explain. The following section will examine the principles contained in *King III* that are applicable to CSR and which should be integrated into the day-to-day management of a business.

3.4.5 CSR Content in King III

The following section will identify and examine the principles and practices contained in *King III* which are applicable to the social responsibility of a business in general.

[53] In the context of CSR, the "apply or explain" approach is also favoured by the Indian Government. In terms of s 135(5) of the Indian *Companies Bill*, *2011* certain companies are required annually to contribute at least 2% of the average net profits of the company made during the financial years preceding the current financial year to activities identified in its CSR policy. The section continues to state that if a company fails to spend the prescribed percentage, the board should provide reasons for not spending the amount. Companies should "apply" the section or "explain" the failure to do so without any further sanctions.

[54] The exception to this rule is the board of the JSE. Since compliance with *King III* is non-optional for listed companies, the board of the JSE will act as an overseeing regulatory body responsible for ensuring compliance.

[55] It should be noted that although *King III* relies on self-regulation, certain aspects contained therein might be included in legislation or industry-specific requirements, thus requiring compliance. In this regard, South Africa is one of the first countries requiring companies listed on the JSE to show their compliance with *King III* in order to maintain their listing. Listed companies are now required to Report in an integrated manner instead of Reporting on financial and sustainability issues in separate Reports (SAPA 2010).

3.4.5.1 Ethical Leadership and Corporate Citizenship

Chapter 1 of the *King III Report* deals with the issues of ethical leadership and corporate citizenship. Principle 1.1 requires a board[56] to provide effective, responsible leadership based on an ethical foundation (IoD 2009a). This principle acknowledges that a responsible board appreciates the fact that a business operates within a society and that the decisions and practices of the business have an impact on society in the social, economic, and environmental spheres. Through the acceptance of its corporate responsibility, a responsible board will be able to build a sustainable business and contribute to sustainable development—governance and sustainability have become inseparable (King 2010). The issue of ethical leadership and corporate citizenship has received legislative support through the enactment of Sect. 72 of the *Companies Act* that makes provision for the establishment of a social and ethics committee for certain categories of companies and that requires the committee *inter alia* to Report on issues addressing good corporate citizenship.[57]

In line with the definition for CSR[58], this principle further recognises that it is a responsibility of a board to give direct consideration to the legitimate interests and expectations of all relevant stakeholders—both internally and externally—referred to by the *King III Report* (IoD 2009a; King 2010) as inclusive stakeholder governance. In inclusive stakeholder, governance stakeholders should be considered in the business' decisions and activities—an inclusive approach to governance.[59] It is argued by the *King III Report* (IoD 2009a) that including and considering stakeholders in decision making and activities would create a greater level of trust between the business and its stakeholders that would provide the business with its licence to operate and that is required to operate sustainably. Without trust no business will be able to operate sustainably.

In line with the definition of corporate citizenship, Principle 1.2 deals with the requirement that a business should be seen as being a responsible corporate citizen that has the rights and responsibilities attached to its citizenship. Apart from having legal obligations, being a corporate citizen implies that the business also has social and moral obligations towards society, which are consistent with internationally

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[56]In this context, "board" refers to the "functional responsibility of those charged with governance" in a business and does not necessarily imply a board of directors (IoD 2009b: 19). Due to the fact that the agricultural enterprises referred to in this thesis are all companies, the reference to "board" will imply a board of directors.

[57]See Kloppers (2013) for a discussion of the requirements relating to social and ethics committees.

[58]See par 1 above.

[59]The *King III Code* recommends that the board should promote the stakeholder-inclusive approach of governance and that all decisions and actions taken by the board should be based on the values of good corporate governance as identified by the *King III Report* (IoD 2009a), i.e. responsibility, accountability, fairness, and transparency (IoD 2009b).

accepted norms of behaviour.[60] In terms of the *King III Code* (IoD 2009b), a business will be regarded as a good corporate citizen when the board not only considers the financial performance of the business but also the impact that the business has on the social and environmental spheres. A good corporate citizen also ensures that its business principles and activities are in compliance with the spirit and the letter of the law.[61] At a minimum, the board should comply with the requirements set out in the *Constitution* and especially the obligation to adhere to the rights afforded to individuals in the Bill of Rights. In terms of the *Constitution,* businesses (as corporate citizens) have a responsibility to act in accordance with the values on which the Republic is founded—values such as respect for human dignity, the achievement of equality, and the advancement of human rights.[62]

According to the *King III Report* (IoD 2009a), a responsible corporate citizen will "protect, enhance, and invest in the well-being of the economy, society, and the natural environment" and will respond positively to challenges facing the society in which it operates, whether such challenges are on the economic, social, or environmental fronts. In the final instance, Principle 1.2 stresses the need for what it refers to as a "collaborative response". A collaborative response requires businesses, especially those within the same sector, to start addressing sustainability challenges together. The recommended combined approach by businesses sharing the same business ethos will not only be beneficial to the societies in which the businesses operate but also to the businesses themselves.

Finally, this principle refers to the linkage between sustainability and black economic empowerment (IoD 2009a). Although the *King III Code* does not recommend a specific practice giving effect to the link between sustainability and BEE, businesses should be encouraged to become involved in social transformation efforts in order to be regarded as responsible corporate citizens.

Chapters 2, 3, 4, 5, and 7 of the *King III Report* deal with issues such as the composition of boards of directors, the duties of the company secretary, audit committees, the governance of risk, the governance of information technology, and the internal audit. These subjects do not expressly fall within the definition of CSR as provided by the Report and will not be discussed.

3.4.5.2 Compliance with Laws, Rules, Codes, and Standards

Chapter 6 of the *King III Report* addresses the issue of compliance with laws, rules, Codes, and standards. Principle 6.1 requires the board to ensure that the business

[60] The United Nations Global Compact (UNGC) is an excellent example of a voluntary initiative containing accepted principles aimed at guiding business behaviour.

[61] This notion of compliance with legislation and other governance instruments is repeated in Principle 6 of the *King III Code*, which will be discussed below.

[62] S 1(a) of the *Constitution* (South Africa 1996).

complies with applicable laws[63] and that it considers adherence to voluntary non-binding rules, Codes, and standards. The fact that a board should *consider adherence* to voluntary measures is in line with the "apply or explain" approach followed throughout *King III.* Boards are required to apply these voluntary measures to the extent that they are relevant to the particular business or provide an explanation for the non-application of those measures. The extent to which a business has applied relevant non-binding measures should be disclosed in the integrated Report in order to confirm the business' commitment to good governance. In line with the definition provided for CSR, this principle emphasises the fact that a socially responsible business is one which complies not only with the letter of the applicable legislation, but also with the spirit of such legislation. The *King III Report* (IoD 2009a) supports the notion that businesses should not try to find "loopholes" or shortcomings in legislation, but should rather act ethically within the spirit and context of the law.[64]

3.4.5.3 Stakeholder Management

The introduction to this section made reference to the fact that one of the main focuses of *King III* is the central role that stakeholder relationships play in governance. Managing these relationships is an essential requirement for being a good corporate citizen as well as for good governance.[65] It is imperative for a business to manage (maintain and enhance) its reputation and ensure that stakeholders regard the business as a responsible corporate citizen. The more the favourable stakeholders' assessments of the business are, the more likely the stakeholders are to form a positive image of the business.[66] Principle 8.1 is a reaffirmation of the requirement in Principle 1.1, which recognises that it is a responsibility of a board to give direct consideration to the legitimate interests and expectations of all relevant stakeholders (Esser 2009). A legitimate interest requires a reasonable and informed outsider to conclude that the interest is "valid and justifiable on a legal, moral, or ethical basis in the circumstances" (IoD 2009a: 100). The *King III Report*

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[63]The recommended practice for Principle 6.1 is that businesses *must* comply with all applicable legislation—the use of the word *must* makes this, a legal requirement. Practices which would result in good governance but which are not legally required are identified by the use of the word "should", while the use of the word "may" refers to a practice that could be considered (IoD 2009b).

[64]In this regard, the *King III Code* recommends that compliance should be an ethical imperative where the board understands the context of the law and how various pieces of legislation relate to one another (IoD 2009b).

[65]This statement reiterates two important theoretical underpinnings of CSR—the stakeholder approach and corporate citizenship.

[66]The recommended practice according to the *King III Code* is that a business should in the first instance identify its main stakeholder groups, establish what these stakeholder groups' perceptions of the business are, and based on these perceptions continue to manage the business' reputation (IoD 2009b).

identifies stakeholders as any group that has the ability to affect the business' activities or those groups which are affected by the business' operations including shareholders, investors, creditors, customers, and affected communities (IoD 2009a).[67] Stakeholder relationships should be dealt with proactively. Management should ensure that an appropriate balance is achieved between the various stakeholder groupings and that effective communication channels exist between the business and the stakeholders.[68]

3.4.5.4 Integrated Reporting

King III advocates integrated Reporting and focuses on the need for businesses to link the consequences of their business policies and practices to the impact they has on society and the business. Chapter 9, the final chapter of the *King III Report*, concentrates on the requirement that a business should annually[69] Report on matters beyond financial performance—sustainability issues such as social and environmental performance should also be included.[70] A business should thus Report in an integrated fashion across all areas of its performance and should be managed accordingly (Miles and Jones 2009). The *King III Report* (IoD 2009a) requires that substance be preferred to form, implying that businesses should ensure that their annual integrated Reports amount to more than just mere "tick box" Reporting or corporate greenwash, where Reporting is seen as a token effort made only to satisfy its stakeholders (Laufer 2003). An integrated sustainability Report should provide a true reflection of the state that the business finds itself in, in all three of the sustainability spheres, and should enable the various stakeholder groups to form an opinion about the business, to assess the business' economic value, and to establish the business' credibility. Principle 9.1 places an obligation on the board to ensure that the integrated Report is reliable and transparent and that the integrity of the Report is above reproach.[71]

The inclusion of sustainability disclosures in the integrated Report is highlighted by Principle 9.2. In terms of this principle, businesses are required to integrate sustainability Reporting and disclosures with legally required financial disclosures to form the integrated sustainability Report. The Report should therefore show how the business has made its money (IoD 2009a, b). The aim of the integrated Report is not to replace Reporting on financial performance. According to the *King III* Report

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[67]Also see Esser (2009).

[68]Principles 8.2, 8.3 and 8.5 respectively of the *King III Report* (IoD 2009a).

[69]As recommended by the *King III Code* 49.

[70]This approach is reflected in the regulations addressing the social and ethics committee. The committee is under an obligation to also monitor and Report on matters related to social development.

[71]The business should have measures in place to insure the integrity of the Report though the use of controls enabling the business to verify the content of its integrated Report (IoD 2009b).

(IoD 2009a), the integrated Report goes further than Reporting on financial performance only. The Report contextualises the financial performance by indicating the effect that the business has had on its stakeholders. The ultimate aim of the integrated Report is to identify the positives of the business and build on them and to indentify the negatives in order to try to address them in a proactive manner. Stakeholders are looking for Reports which justify the business' licence to operate and which provide proof of the business' good stewardship over societal resources.

According to King (2010: 452):

> By using an integrated Report incorporating its social, economic and environmental impacts, a company increases the trust and confidence of its stakeholders and the legitimacy of its operations.

The move towards sustainability Reporting is an international phenomenon with various international instruments such as the Global Reporting Initiative (GRI) and the UNGC advocating the need to place greater priority on Reporting on sustainability issues. Integrated Reporting represents one of the most important developments in the field of corporate governance, and although it might be seen as an administrative burden, the benefits of Reporting in an integrated manner outweigh the negatives.

3.5 Conclusion

Although still limited in its application, the contribution of *King III* with regard to CSR lies in the fact that issues related to CSR should now be Reported on and be integrated into the annual Report as opposed to the amalgamation of the sustainability Report and the financial statements recommended by *King II*. However, *King III* does not provide a clear framework for the integrated Report. In order to address this, the Integrated Reporting Committee (IRC) of South Africa released a discussion paper titled *Framework for integrated Reporting and the integrated Report* (IRC 2011), identifying the principles on which the Report should be based and suggesting the elements to be addressed in the Report. The paper identifies three categories of Reporting principles. The first category deals with the principles informing the scope and boundary of the Report, where the management identifies the entities represented in the Report. The second category addresses the principles relating to the selection of the content of the Report, where it must be established what content is relevant and material to the Report. The final category relates to the principles informing the quality of the Reported information and includes issues such as verifiability, comparability, and consistency.[72]

Besides identifying the Reporting principles, the *Framework* also identifies suggested elements to be addressed in the Report. These elements include the

[72]For a discussion of these principles, see paragraph 2 of the *Framework*.

Report profile, which identifies the scope and boundary of the Report; an organisational overview and governance structure; a description of the operating context; an account of the organisation's performance and future performance objectives; and an analytical commentary providing an overview of the views of the organisation's leadership about the organisation.[73] The inclusion of these elements in the integrated Report would provide stakeholders with the necessary information to form an informed opinion of the business.

The integrated Report will in future prove to be an important instrument used by a company to illustrate to its stakeholders and future stakeholders that amongst other things it is committed to socially responsible practices and that it views CSR as an important aspect of its day-to-day management. Companies can also include their BEE status in this Report, thus linking their sustainability practices with their BEE position, providing readers of the Report with an instant picture of the current position of their business. If the company can show to its stakeholders that it is involved in programmes which are of national importance and which could possibly in the future be beneficial to the company, such Reporting would further establish the company's commitment to socially responsible practices.

One of the characteristics of good governance as set out in *King II* is accountability. In order to be held accountable, it is necessary to establish criteria against which to be held accountable (Anon 2010). This requirement represents one of the biggest challenges to the implementation of *King III*. *King III* advocates integrated Reporting but does not provide the framework against which businesses' compliance will be measured. For example, if a good corporate citizen wishes to indicate to what extent it has accepted the imperative of CSR and excelled in its CSR practices, what are the accepted criteria against which this performance can be measured? Standards need to be set for integrated Reporting in order to indicate not only how a business has applied the recommendations but also to provide the business with an opportunity to explain its reasons for non-compliance. It has been Reported that major role players such as the Institute of Directors, Business Unity South Africa, and the South African Institute of Chartered Accountants formed an Integrated Reporting Committee (IRC) to determine the standards and a framework for the integrated Reports (SAPA 2010). Various international instruments such as the Global Reporting Initiative (GRI) and the UNGC have the specific goal of providing standards for Reporting. These and other instruments will be examined in the sections to follow in order to identify the criteria against which the performance of businesses on issues such as CSR can be measured. However, before these instruments are discussed, it is important to refer to the effect that *King II* and *King III* have had on the corporate world, especially companies listed on the Johannesburg Securities Exchange, as well as the attempt made by the JSE to establish a Socially Responsibility Index.

[73]For a discussion of these principles, see paragraph 3 of the *Framework*.

3.6 Summation

This contribution has paid specific attention to measures which are not included in a *legislative* framework, but which could be included in a *policy* framework for CSR. Since the legislative framework does not deal comprehensively with CSR, companies need to go beyond legal compliance, recognising that although legal compliance is a fundamental duty and an essential part of their social responsibility, other instruments and guidelines also form part of a possible CSR framework.

The national Reports on corporate governance (*King II* and *King III*) identify CSR as a characteristic of corporate governance, advocate the inclusive stakeholder approach, and require listed companies since 2011 to draft integrated Reports that focus on the need for businesses to link the consequences of their business policies and practices to the impact they have on society and the business. The value of these Reports is that companies should integrate sustainability Reporting and disclosures with legally required financial disclosures, thus enabling the drafters to contextualise the financial performance. Unfortunately, neither of the Reports on governance specifically prescribes how companies should Report on CSR, or how a company's CSR initiatives can be measured. As a result, South African companies still do not have a clear indication of how to Report on CSR and how to measure their initiatives.

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Chapter 4
Problematising Sustainability Assurance Practice: Roles of Sustainability Assurance Providers

Charika Channuntapipat

Abstract Sustainability assurance (hereafter 'SA') has been a significant area of development in corporate reporting during the last two decades. The practice has been criticised as a part of green washing activities of some organisations. Unlike financial audit practice, SA is largely unregulated. Thus, the roles of SA providers are not clear whether they serve as watchdogs for stakeholders or business consultancy of reporting organisations. This study employs a qualitative research approach, using textual sources as the main data collection method. Drawing on the perspective of actor–network theory (hereafter 'ANT'), the paper focuses how SA providers negotiate their roles and identities through their problematisation of the assurance practice. The findings show that assurance providers' understandings of their roles vary depending on the interests of other related parties. The study shows, in particular, that the providers' perceived roles vary between what can be termed an 'independent verifier', a 'sustainability consultant' and a 'sustainability promoter'. This paper provides further understanding of and thought-provoking messages about the SA providers' roles. This could benefit reporting organisations, stakeholders and regulators by enhancing their understanding and the awareness of the roles of SA providers that could reflect the purpose of the practice at large.

Keywords ANT · Problematisation · Sustainability assurance · Assurance practice · Sustainability reporting

4.1 Introduction

The increasing number of sustainability reports has driven the need for a mechanism to verify the integrity of such reports (Jones and Solomon 2010). Sustainability assurance (hereafter 'SA') has, therefore, emerged as a new service in the non-financial assurance market. Due to the unregulated nature of SA practice, it

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is not only professional accountants, but also other consultants, who play a role as SA providers. This brings diversity to the conduct of SA practice due to differences in these professions, in firms' ethos, and in practitioners' backgrounds and experience. As SA practice is relatively new compared to financial auditing, the roles and identities of the assurance providers, therefore, are not clearly defined and constructed. Previous literature highlights the roles and desired characteristics of financial auditors entering emerging areas, including SA practice (see Dogui et al. 2013; Huggins et al. 2011). However, only limited research has explored how the roles and identities of SA providers are constructed.

This paper focuses on what roles for SA are perceived by providers, and how such perceptions could affect practice. SA practice is an important area in which to explore identity construction because it is considered an additional service provided by both accounting assurance providers (hereafter 'AAPs') and non-accounting assurance providers (hereafter 'NAAPs') besides their more established services (i.e. financial audit, and certification or consultancy services). Thus, the assurance providers need to translate the discourses from this new practice in relation to those services. This is especially so for AAPs, who need to translate sustainability-related discourse into accounting terms,[1] when it has not previously been viewed in such terms. In this paper, SA providers are analysed collectively as the main translators of practice, trying to communicate and construct their roles and identities as SA providers. They introduce various benefits of SA practice to different actors, who have different goals and interests. This is called problematisation in actor–network theory (hereafter 'ANT') terms (Callon 1986). SA providers use different problematisation strategies to persuade other actors to support the SA service. These problematisation strategies reflect their constructed roles as assurance providers.

This study draws evidence mainly from textual sources including SA providers' websites and publications, related news and public SA statements. The messages communicated via those sources regarding the benefits and features of assurance services are the main sources of inscriptions[2] and important starting points to explore how SA providers portray their roles and identities. Qualitative content analysis of scripts is used as a main data analysis method. The results of this paper contribute to the understanding of how SA providers claim their practice space for SA services through role and identity reconfiguration. They translate their roles and identities in accordance with the interests of intended actors that they would like to enrol in their network.

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[1]The term 'accounting' in this paper is used as an umbrella term to cover 'auditing' as well. This is due to the use of the terms 'accounting' and 'non-accounting' by previous literature to make distinction between different types of SA providers. For example, 'SA providers with accounting background' refer to those with trainings, degrees or qualifications in accounting and/or auditing. Thus, the term 'accounting term' or 'accounting language' refers to discourses related to accounting and/or auditing.

[2]Gao (2005) refers to inscriptions as a form of anticipated characteristics that actors try to build into an artefact. These include texts and scripts. In the case of SA, inscriptions include, but not limited to, texts and scripts in reports, assurance statements and websites.

This chapter is divided into a further four sections. Section 4.2 presents how identity construction is important for SA providers to claim and develop the new practice area. Section 4.3 discusses the problematisation strategies used by sustainability assurance providers. Then, Sect. 4.4 provides reflection of the findings and introduces the roles of assurance providers. Section 4.5 concludes and summarises the chapter.

4.2 Translation as Identity Construction

According to previous literature, interview evidence from SA practitioners reveals that different assurance practitioners can perceive their role differently, based on their personal commitments, experience or education backgrounds (O'Dwyer 2011; Owen et al. 2000). This could explain how different assurance providers use different discourses to persuade reporting organisations to commission the assurance service (see Ballou et al. 2012; Branco et al. 2014; Simnett et al. 2009). It also explains how assurance providers conduct assurance engagements and exercise their professional judgments differently. To illustrate, some practitioners perceive that they represent stakeholders of reporting organisations; therefore, they act and exercise their professional judgments based on the perception that they are a 'voice' for the stakeholder (Edgley et al. 2010). In contrast, others may perceive that they work for reporting organisations' management, so they might be reluctant to provide negative feedback in the assurance statements (Ball et al. 2000).

These different perceived roles and identities constructed by SA providers show that, in this practice field, the identities of the assurance providers are evolving. Since the practice is relatively new compared to financial audit practice, the identities of SA providers are being developed through a construction and negotiation process with other actors. This identity negotiation is considered one form of translation process (Cooper and Robson 2006; Skærbæk 2009), in which the main translator (i.e. SA providers) tries to persuade other actors to accept the identities that they portray for themselves and assign to other actors. Those actors can accept or reject the assigned identities. Thus, the identities might be retranslated and reconfigured. The study by Gendron and Barrett (2004) shows that different attempts at problem formulation by accountants to enrol other actors in their Web Trust Seal network (i.e. one form of web assurance) yield different enrolment results. The attempts could fail if the problems introduced do not match with the interests of the target audience. These interests are an important starting point for translation and identity negotiation (Chua 1995).

Translation is a process in which identities of actors are negotiated. The main translator problematises the introduced practice to define a series of negotiable hypotheses on identity, relationship and goals of different actors (Callon 1986). All actors, including the main translators and other actors, receive their identities through their relationships to others because the identities of actors are not assigned automatically to them (Justesen and Mouritsen 2011). For example, in the case of

SA, the relationship between assurance providers and reporting organisations could indicate their identities. SA providers can relate themselves to reporting organisations as independent assurers, or they can relate themselves to reporting organisations as expert consultants. These relationships could affect how they construct their identities in relation to their relationships with other actors. The process of inscription is one way to create these relationships and supply the identities to the allocated actors. Identities are relational because actors define their role, work and expertise in relation to one another (Cooper and Robson 2006) by circulating inscriptions. Identity construction can be more or less powerful depending on the negotiations with other actors in the network or in other networks (Skærbæk 2009).

The question here is how, in order to claim their expertise in the evolving SA practice space, assurance providers translate the sustainability-related areas of information, which were not previously viewed in accountants' terms, into 'accounting language'. This translation reflects the providers' attempts to establish their presence and legitimacy as SA providers and involves different problematisation strategies as a way to persuade different actors to enrol in the networks of support they create (Gendron and Barrett 2004). For the case of AAPs, SA practice could promote assurance providers' identities to be closer to the identities of consultants so that they can renegotiate the terms of their professional status and widen their jurisdictional claims over other areas of expertise.

Identity construction can be the outcome of the process of inscription (Robson 1991). The identities of actors are not assigned automatically; however, their relations to other actors determine their identities (Justesen and Mouritsen 2011), and the process of inscription is one way to create these relationships and supply the identity to the allocated actors. Especially in SA practice, which is a hybrid service between independent assurance and consultancy, accounting or other practitioners working in such an environment might have different senses of responsibility, value and how they see their role as an assurance provider (Cooper and Robson 2006). However, a hybrid identity of an assurance provider could destabilise their occupational identity (Skærbæk 2009). For example, SA providers from the accounting profession have financial audit as their core service. They need to possess a strong independent identity due to the accounting profession. However, as SA practice is evolving and unregulated, the SA providers might highlight other aspects of identities, such as the consultant identity or sustainability expert identity, to promote the SA service. Without various identities, the claim of a provider to operate in the SA space might not be successful because the users or stakeholders of this new assurance service have various interests. When reconfiguring new identities in relation to a previously constructed identity, the new identities might face threats to such reconfiguration, especially in terms of expertise and independence (Gendron et al. 2007). For example, the independence claim in the identity construction of accountant assurance providers could be considered as an asset or constraint in the construction of their identities as SA providers (Skærbæk 2009). This could lead to a conflict of identities that, in turn, could lead to unexpected actions or responses by target actors.

Nevertheless, without various identities the claim to operate in the SA space might not be successful. The accounting profession renegotiates the terms of their professional status and widens their jurisdictional claims over other areas of expertise (Robson et al. 2007). Identity construction of SA providers is relational to participating actors. They can be more or less powerful, depending on the negotiation with network partners or competing networks (Skærbæk 2009). Actors usually define their role, work and expertise in relation to one (Cooper and Robson 2006); therefore, SA providers construct their identities in relation to their previous identities and the identities of their competitors. This facilitates comparison between different types of assurance providers because they have different relational identities to base their identity construction on.

SA providers could use inscriptions to convince reporting organisations and related stakeholders about the importance of SA practice. Those actors (i.e. reporting organisations and stakeholders) can be their spokespersons to help solidify their inscriptions by further persuading other actors to agree with the importance of the practice, and pass tests posted by opponents (Chua 1995). From the beginning, and during the process of translation, SA providers produce inscriptions, including advertising materials, publications and assurance statements, that have persuasive power to establish their presence in the field and project their identity to intended actors. Those actors have a right to accept or reject such projection of identities by the assurance providers. Translation and inscription are thus key concepts to understand the alignment of interests to form an actor–network because, when translation occurs, the interests of all of the parties involved in the network are inscribed (Gao 2005). Inscriptions are important sources to study identity construction because they provide a concrete tracking of how each type of assurance provider portrays themselves, and because of their characteristic of mobility. The mobility of inscriptions promotes their power to control action at a distance. In this case, they carry persuasive power to direct perception at a distance. However, since the focus on this study is on SA providers, a limitation of studying the persuasive power of inscription is that the results reveal limited responses or reactions to such persuasion.

This chapter emphasises the identities of SA providers through the ways in which they communicate their roles, as inscribed in different media and materials. This includes texts or inscriptions from various sources, such as their websites, publications, sustainability reports and assurance statements. The concepts and world view of ANT are useful to understand identity construction because they allow the analysis of power relations without any a priori notions about fixed roles, identities and interests of actors (Callon 1986). Actors interact through a process of translation (Bergström and Diedrich 2011), in which their identities are constructed and negotiated. Translation implies definitions, which in turn are inscribed in intermediaries (Callon 1991). Texts or inscriptions are considered as one of the intermediaries that order and form the network. Texts or inscriptions carry words, ideas and concepts to link actors together and create a set of new populations for the network. The inscriptions are part of the translation process, in which the identities are inscribed, negotiated and constructed.

4.3 Problematising Sustainability Assurance Practice

SA providers make a case regarding the advantages of SA practices to convince reporting organisations to engage in SA with their sustainability reports. They raise the importance of such assurance practice by introducing problems that sustainability reporting organisations could face without having their reports assured. They then render their SA service as a solution to the problems introduced. The inscriptions are not only for reporting organisations, but also for other consumers of sustainability reports because those consumers, including reporting organisations themselves, could affect the adoption of SA practice and also the choice of assurance provider. In other words, those scripts help them establish their presence in the field of SA practice. SA providers, therefore, render themselves as an 'obligatory point of passage' that every actor needs to pass in order to solve or alleviate such introduced problems (Callon 1986).

In addition to this persuasion to engage in SA practice, the assurance providers convince their potential clients to choose their assurance service over others by highlighting their skills and competitive advantages. Thus, they use inscriptions also to persuade clients and to show their superiority over other assurance providers. Inscriptions from this collected texts show that SA providers translate SA practice in two different ways. SA providers use different problematisation strategies as ways to translate SA practice to match with the interests of various groups of actors. Problematisation as a part of the translation process can be divided into two categories. One is problematisation of demand for the service, and the other is problematisation of the appropriate expertise to provide the service. Those categories of problematisation facilitate the promotion of SA services to clients and other actors, who have influence on the adoption of the practice by reporting organisations.

The translation process helps create allies in the defined networks by aligning the interests of other actors to their assigned identities. As the SA service is not the main service of both AAPs and NAAPs, and it is a comparatively new practice to corporate reporting and assurance, SA providers need to introduce the practice to reporting organisations and make their presence known and legitimate as assurance providers. From the translation of SA practice, SA providers highlight the benefits of the assurance service and also the disadvantages of not engaging with the service. By emphasising the problems facing sustainability reporting organisations without assurance, the assurance providers render themselves as providers of solutions for problems. They render themselves as an obligatory point of passage that the reporting organisations need to pass to fulfil their interests (i.e. avoid or solve problems) (Callon 1986). As the managements of the reporting organisations have varied goals, SA providers need to introduce more than one set of problems. The assurance providers use their terms of problematisation as a part of a translation process to persuade other actors (Robson 1991) so that they can link the problematisation with their established identities. This means they have to present the benefits of SA or problems that could arise if those actors do not engage in the

Table 4.1 Problematisation of sustainability assurance practice

Translation: Problematisation	Problematising demand	(i)	Information credibility enhancement
		(ii)	Performance efficiency enhancement
		(iii)	Value-added for integrated reporting
		(iv)	Flexibility of the SA engagement
	Problematising expertise	(i)	Expertise in the field
		(ii)	Public demonstration of commitment to sustainability

assurance practice. Due to the variety of actors that SA providers might want to enrol in their network, they need to present different types of benefits or problems to attract and meet the diverse interests of those actors (Gendron and Barrett 2004). This section, therefore, discusses how SA providers problematise the importance of SA practice to make their presence known and legitimate as assurance providers. SA providers use different problematisation strategies as ways to translate SA practice to match with the interests of various groups of actors. Problematisation as a part of the translation process could be divided into two categories. Table 4.1 summarises the problematisation strategies used by SA providers in their inscriptions. These problematisation strategies help them promote the practice and make their presence known in the SA practice space.

4.3.1 Problematising Demand

This section presents evidence on how SA providers problematise demand for SA services. The discourses used for problematising demand for the services include information credibility enhancement, performance efficiency enhancement, value-added for integrated reporting and flexibility of the SA engagement. These strategies can be inscribed in SA providers' communication channels to their target actors.

4.3.2 Information Credibility Enhancement

Providers of SA emphasise how such an assurance service could enhance the credibility of information presented in clients' sustainability reports. Information credibility is the heart of the assurance engagement, which aims to facilitate the users of assured information in their decision-making process.

> Your sustainability data will need to be verified if the reliability of your reporting is to be increased (Deloitte's website, Appendix-D1)

> Through our assurance services, we help organisations ensure the quality and credibility of their sustainability reports and communications (Advertisement of DNV from Eco-business.com, Appendix-DNV2)

> [Reporting organisations] need independent assurance to add credibility to the published information in their sustainability or corporate responsibility report (PWC's website, Appendix-P3)

The statements above address the need of SA to enhance the credibility and quality of published sustainability reports. Stakeholders of reporting organisations are aware of the unregulated and voluntary nature of sustainability reporting practice, and that these organisations could selectively report only good information or could exaggerate how good they are in terms of sustainability management. SA providers can also spot this threat to reporting organisations' information credibility, so they use this problem to persuade reporting organisations to engage in SA practice, as shown by one excerpt from KPMG's video advertisement.

> Without assurance, fewer than one in ten consumers actually believe what business say about their sustainability achievements (KPMG's video from YouTube, Appendix-K7)

The statement highlights the fact, although reporting organisations are the commissioner of the assurance engagement, external stakeholders also influence their decision whether to commission the assurance. The following statements also show discourses relating to external stakeholders' influence on the reporting organisations' decision to commission SA.

> Users of sustainability information will come to expect that the information has been validated by a reliable third party (EY's publication, Appendix-E6)

> A greater demand for transparency [by report users] now means that Corporate Social Responsibility and Sustainable Development issues have gained a firm place on the agenda of Boards and senior management worldwide (Bureau Veritas's website, Appendix-B4)

From the presented problematisation strategy, assurance providers try to highlight the adverse effect of not having SA on clients' sustainability reports. The inscriptions also indicate the importance of SA as a credibility-enhancing mechanism for the reported information. Also, engaging SA not only ensures the credibility of reported information, but also enhances the commitments of reporting companies for sustainability-related agendas. This problematisation strategy of SA providers raises the issue of trust in sustainability-related information that could affect reporting organisations.

Although the number of companies engaging in sustainability reporting and the number of users of such reports have increased, SA is still a voluntary practice. The voluntary nature of such assurance, therefore, discourages some reporting organisations to commission SA service. The management of some organisations has perceived that SA is not necessary, even though they publish sustainability reports because other mechanisms, such as internal audit, are enough to promote credibility of the information (Jones and Solomon 2010). Thus, SA providers need to highlight other benefits of the assurance in their circulated inscriptions beyond information credibility enhancement or need to come up with other problematisation strategies

to stimulate the interest of reporting organisations and other actors in their identities. They therefore relate the benefits of their SA service and their identities as assurance providers to more managerial issues to attract the attention of management to use the service.

4.3.3 Performance Efficiency Enhancement

Some companies are less visible to the public than others regarding the nature of their business or their size. The pressure to present sustainability-related information with high credibility by engaging in SA practice is relatively low. They have therefore decided not to engage in such practice due to the perceived benefits, the potential costs and the voluntary nature of the practice.

SA providers then need to reconfigure their identities and introduce problems that could arise from not engaging in SA practice in other ways that expand beyond information verification. The providers, therefore, align the benefits of having SA with benefits for internal business operations, which are one of the management's main interests.

> We go beyond this to examine how well the report addresses the issues of greatest materiality to your business and your stakeholders. (TwoTomorrows' publication, Appendix-TT3)

> Benefits of assurance include feedback on efficiency and effectiveness of controls and processes and risks and exposures (PWC's website, Appendix-P1)

> [Sustainability report assurance] provides comfort to management that the sustainability information supplies a robust basis for decisions and an accurate presentation of performance against business objectives (KPMG's website, Appendix-K1)

SA providers expand their translation of assurance practice from the information credibility issue presented in previous section to business performance enhancement. This mean of problematisation could enrol more sustainability reporting organisations who perceive little or no value in SA as information credibility enhancement. The function of the assurance service communicated by providers in this sense is to serve as a recommendation for internal change for the next reporting cycle and to enhance operating management relating to sustainability issues.

For the less visible or smaller companies that report sustainability information, they might perceive that the credibility of such information is more vital to their management team and internal stakeholders than to their external stakeholders. Unlike large companies that use SA mainly to gain trust from external stakeholders, these organisations would seek credible information mainly to increase the confidence of the board in the decision-making process (LRQA's website, Appendix-L2). Instead of emphasising only external verification of information credibility, assurance providers also highlight such points so that the management may perceive the importance of the assurance service and decide to engage in its practice.

4.3.4 Value-Added for Integrated Reporting

With the trend for integrated reporting[3] currently emerging, some assurance providers also translate the use of SA in relation to the issues of integrated reporting to persuade potential clients to join the network of sustainability reporting and assurance. It is apparent that AAPs use this problematisation strategy with their potential clients, since the integrated reporting framework includes the financial reporting aspect which is their expertise and their main service. With an understanding of their clients' financial information through the financial audit side, assurance providers can underline the synergy of overall risk assessments when integrating the audit to maximise value for reporting organisations (Deloitte's website, Appendix-D1). Such assurance providers from accounting firms, unlike ones from non-accounting firms, could help define the scope of integrated reports and render integrated assurance for both financial and non-financial information (KPMG's website, Appendix-K3). The evidence to support this problematisation strategy is not prominent compared to others because the integrated reporting practice is still in evolving. However, it is expected that this problematisation strategy will be increasingly used by AAPs because it is their competitive advantage over NAAPs. In this case, the assurance providers utilise their relevant expertise and skills, and their previously well-developed identities as financial reporting and auditing experts to enrol potential supporters to their networks of SA.

4.3.5 Flexibility in Sustainability Engagement

A number of reporting organisations hesitate to commission SA because it requires extensive resources in terms of both money and time (Jones and Solomon 2010). SA providers, therefore, try to persuade reporting organisations to commission the service by introducing flexible models of SA engagement to overcome such concerns.

> We carry out the full spectrum of assurance assignments from internal readiness assessments to external public assurance – for voluntary or regulatory purposes. (PWC's website, Appendix-P1)
>
> The cost of assurance needn't be excessive. We tailor the scope of our assurance work to meet your requirements and budget (TwoTomorrows' publication, Appendix-TT3)

SA providers translate assurance practice, which is perceived as a resource-intensive activity, into something less rigid in terms of resources consumed both financial and human. The flexibility leads to customisation is both scope and level of SA engagements.

> The scope of the work can be sized to your needs and the level of assurance designed accordingly. (PWC's website, Appendix-P1)

[3]See more details about integrated reporting at http://integratedreporting.org.

> We customise our verification to meet your criteria and required level of assurance. We will make flexible arrangements to make sure your corporate report is verified in accordance with agreed deadlines (LRQA's website, Appendix-L2)

Instead of trying to introduce a full report and high level of assurance over sustainability-related information, they highlight that they can provide customised assurance services to meet the scope and level of assurance that their clients require. The assurance providers express their understanding of the nature of sustainability-related information and assurance levels so that they can tailor the scope of the assurance engagement to match the requirements.

This form of negotiation regarding the scope and assurance level of SA engagements provides flexibility to sustainability reporters and allows them to feel more comfortable that they do not need to dedicate their resources to acquire a level of assurance beyond their needs and their resources. However, this also leads to managerial capture, which is a concern with unregulated assurance practice, and in such cases the reporting organisations could control the scope of the disclosures, as well as the scope of the assurance engagement (Ball et al. 2000).

4.4 Problematising Expertise

Besides translating SA practice to persuade reporting organisations to engage in such assurance practice, SA providers highlight their expertise in the field to convince reporters to use their service or to choose theirs over others. The communicated messages here are related to the providers' expertise in the field and introduce the skills of their personnel and cases of their clients. Also, rankings from independent parties are used to demonstrate their expertise in comparison to their competitors. Furthermore, SA providers make themselves visible by promoting sustainability projects of other organisations to reflect their commitment to the sustainability agenda. Such activities can increase their visibility as assurance providers and sustainability experts to the potential actors they are trying to enrol to such a network. It is worth mentioning that independence is one of the qualities of SA providers that they could use to strengthen their claims of expertise and persuade reporting organisations to commission their services. The emphasis on the independence discourses in the firms' websites is less prominent, when compared to that in SA statements.

4.4.1 Expertise in the Field

SA providers infer the quality of their services through the ability of their staff. The inscriptions presented on their websites, other advertisements or publications show that the team members who work in SA engagements comprise specialists from a

number of areas. Since sustainability reports contain multidisciplinary issues, ranging from financial to environmental information, to assure such information requires personnel with a wide range of expertise. Thus, the providers state that they have a number of specialists required for SA engagements in hand and plan to recruit further specialists to respond to the emerging issues in future engagements (PWC's article, Appendix2-P5). Besides the ability of firms' practitioner, SA providers also highlight their expertise through their client portfolio or past experiences by introducing some successful cases from their services.

A number of research organisations or ratings agencies also produce valuable inscriptions, such as rankings and recommendations, which SA providers use to strengthen their expert identity. SA providers include such ranking results on their websites and in their publications to strengthen their position among other service providers. Their ranking positions are another way to legitimise their claims of expertise, since the ranked positions show how well they render sustainability reporting, consulting or SA services to their clients.

> Independent analyst firm names Deloitte a Global Market Leader in SA Services (Deloitte's website, Appendix-D6)

> Bureau Veritas has been recognized by a Verdantix survey as the most-recognized certification body among sustainability leaders with the 5th highest brand preference in the market place for SA providers, along with the Big Four accounting firms (Bureau Veritas's article, Appendix-B3)

As there are a number of ratings firms and a wide range of ranking criteria used, SA providers can use rankings from different agencies to demonstrate the level of their expertise and service quality. One consulting firm stated that, according to the information from CorporateRegister.com, it is among the world's leading SA providers for reports employing AA1000AS, which is one of the dominant SA standards by AccountAbility (DNV's website, Appendix-DNV4). Here, the assurance provider attaches its ranking to a specific assurance standard setting body to assure its expertise in utilising such a standard. The standard, AA1000AS, is one of the most commonly used SA standards; therefore, the network of users of this standard is highly developed. By attaching to this ranking criterion, the assurance provider makes an attempt to convince its potential clients to choose its service by reference to its expertise.

4.4.2 Public Demonstration of Commitment to Sustainability

SA providers build their networks of support to claim their expertise not only by using direct problematisation strategies, but also by participating in sustainability-related activities and projects. EY, for example, inscribes its commitment to sustainability by asserting that its corporate responsibility is 'not just for [their] clients and for [their] own business and profession, but for our communities, for the greater

good of society everywhere and for the sustainability of our planet' (EY's website, Appendix-E3). This message claims commitment to changing the world to be a better place and implies that actions in the community and the firm's services should be aligned to create such changes. PWC also shows their commitment towards sustainability agenda and also reported negative information that they missed a set target.

> We've been focusing on finding ways to minimise our carbon footprint and on finding ways to make a meaningful difference to our communities; and measure the social impact of these initiatives…There are things we still have to work at. We've missed our target for carbon emissions from client-facing air travel (PWC's annual report, Appendix-P2)

In addition to the messages showing their organisational commitments to sustainability agendas in their websites and annual reports, assurance providers also show their commitments through sponsorship of public events and philanthropic projects. For example, KPMG initiated a Ph.D. project that shows its long-term commitment and support for the education of people in need (KPMG's video, Appendix-K8). This Ph.D. project gives long-term support for education; therefore, it implies that the organisation has committed to long-term social support. This shows the alignment between their services relating to sustainability and their commitment to such issues, reflecting their understanding of broader issues relating to sustainability. Also, the initiation and sponsoring of such projects help increase the visibility of the assurance providers.

Moreover, SA providers also show their commitments and increase their public visibility through sponsorship of sustainability-related events such as the GRI conference. EY was one of the main sponsors of the GRI Global conference 2013, which introduced the latest sustainability reporting framework called GRI G4 (Global Reporting Initiative (GRI) 2013). The conference consisted of around 1600 registrants from all over the world, who were interested in or were then involved in sustainability reporting and assurance. Sponsoring such an event helps raise awareness of the brand and show their enthusiasm for sustainability.

By using problematisation strategies, SA providers develop supportive networks for their assurance services by creating a fit between the interests of their existing or potential clients and their claims of expertise (Akrich et al. 2002). Here, the assurance providers try not only to create demand for SA, but also to amplify the demand from stakeholders calling for such assurance through those inscriptions. They inscribe a link between the need for the assurance and its importance that has not been strongly linked previously. Thus, the different persuasive strategies could be effective for different actors based on their different sets of needs (Gendron and Barrett 2004). The need for this SA service could be motivated by reporting organisations' own needs, or from indirect pressure from their stakeholders. Thus, SA providers need to establish their presence not only to reporting organisations, but also to related stakeholders who have influence on those reporting organisations.

The inscriptions and problematisation strategies within the translation process discussed above might reflect identity construction by SA providers; however, such

inscriptions are made purposefully for advertisement and public communication. Those inscriptions are made to represent the identities of SA providers externally. This means, in relation to those identities, they might or might not represent the actual work performed.

4.5 Reflection on the Problematisation Strategies

The findings discussed above reflect how SA providers inscribe and project their roles and identities to other actors. The textual sources from websites and publications show how SA providers translate target actors' interests along with their own so that they can eventually persuade these actors to engage with the practice. In other words, they problematise the SA service to match those interests. The process of interest alignment, therefore, reflects the identities of themselves that SA providers want other actors to perceive.

The translation process helps to create allies for the defined practice by aligning the interests of other actors to providers' assigned identities. From the translation of SA practice, SA providers highlight the benefits of the assurance service and also the disadvantages of not engaging with the service. By emphasising the problems facing sustainability reporting organisations without assurance, the assurance providers render themselves as a solution provider for the problems. They render themselves as an obligatory point of passage that the reporting organisations need to pass to fulfil their interests (i.e. avoid or solve these problems). The assurance providers use their terms of problematisation to persuade other actors (Robson 1991) so that they can link the problematisation with their established identities. This means they have to present benefits of SA or problems that could arise if those actors do not engage in the assurance practice. Due to the variety of actors that SA providers might want to enrol in the network, they need to present different types of benefits or problems to attract and meet the diverse interests of those actors (Gendron and Barrett 2004).

SA providers produce different kinds of texts and scripts to engage with various groups of actors. Some SA providers try to maintain their well-established identities (i.e. as financial auditors or environmental experts) while reconfiguring their identities to align with this newly established service. Also, they translate sustainability-related discourses to their main service areas to facilitate their identity construction so that they are perceived as legitimate assurance providers in the sustainability field. Inscription is one of the ways that can help them achieve this communication of their roles and identities in that sense. Although the link between previous constructed identities and the new ones might benefit the process of identity construction for the new practice, it could also lead to conflicts of identities. This could destabilise a previously accepted identity or expose it to the threat of rejection. For example, if an AAP highlights its expertise in sustainability in terms of how they can provide

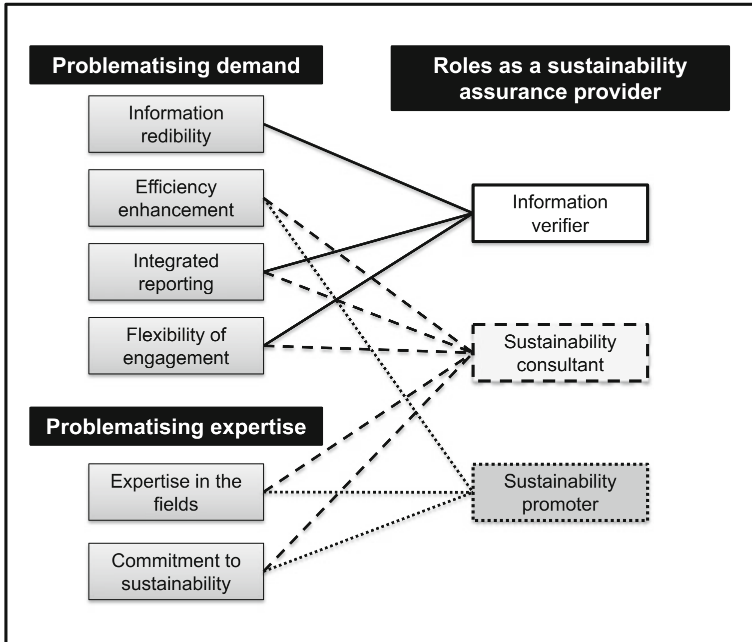

Fig. 4.1 Roles of sustainability assurance providers

valuable recommendations to enhance organisations' performance, such identity framing is closer to the identities of consultants than those of independent assurers. In this sense, these identities could create conflicts and destabilise the provider's independent accounting profession identity. Although there is no clear measurement of the independence of SA providers (Dogui et al. 2013), it is important that assurance providers do not cross the line beyond which their independence is certainly at risk. Thus, identity construction, especially independence, is relative and depends upon the relations with other actors of the main translators who construct those identities.

The problematisation strategies explained in previous section facilitate the categorisation of the providers' roles into three main categories—reporting consultant, information verifier and sustainability promoter. Figure 4.1 shows potential matches of problematisation strategies with roles as SA providers. The roles are not exclusive, meaning that for a particular SA engagement, the provider can have more than one role. However, the emphasis one each role might not be equal for a particular engagement.

One of the main problematisation strategies used by assurance providers relates to enhancing the credibility of reported information. In this case, they may act

merely as a verifier of sustainability-related information. The idea of SA practice here is considered as similar to the idea of its financial assurance counterpart. SA providers would hold their role as an assurer to provide a verification service on an arm's length basis. This means they would be involved in the sustainability reporting process merely as a verifier of the accuracy of the information presented and would not participate in any activity relating to sustainability report preparation.

SA providers can provide an assurance service that goes beyond performing verification of the accuracy of information. Another role of SA providers is to act as a consultant for the reporting organisations in the sustainability reporting process. The multiple problematisation strategies matched with this role also reflect the consulting nature of the practice. The providers not only provide information verification services to their clients, but also suggest how they can improve their sustainability-related performance and sustainability reporting. In this case, the assurance engagement, to some extent, serves the interests of the reporting organisations, which might or might not be the same as those of their stakeholders.

Besides, SA providers also project their role as promoters of sustainability. Some problematisation strategies show that SA providers advance themselves as promoters of sustainability because they (as an organisation) contribute to the sustainability of society and the planet. In turn, this could make other actors perceive that they have expertise and genuine commitment as SA providers.

Debate is ongoing regarding the degree of SA providers' involvement in the reporting process and the extent to which they can provide advice about and help with the preparation of sustainability reports. As discussed, the roles of SA providers and the concept of SA are still evolving. Thus, the roles of the providers and their levels of independence are not commonly understood and defined. This independence issue is amplified when assurance providers offer flexibility in the scope of the assurance engagement, in that reporting organisations can selectively choose what information in their sustainability report is to be assured, so that the cost of the assurance service is matched with the benefits from the assurance.

4.6 Summary and Conclusions

Identities of SA providers and the concept of SA are still evolving and being negotiated between SA providers and related actors. Thus, the identities of assurance providers are not stable and commonly agreed. Over time, the inscriptions and claims made by different SA providers converge to one another; however, different SA providers need to maintain their individual distinct identities that attract reporting organisations to choose their service over others. This means that, besides

constructing their identities through circulated inscriptions to claim their space to operate the practice, SA providers also need to use such inscriptions to show their superiority relative to other assurance providers.

Identity construction via inscriptions helps SA providers expand the boundaries of their existing service. This means SA providers negotiate and renegotiate the terms of their professional status and expand their jurisdictional claims over different areas of expertise (Robson et al. 2007) that are suitable for the assigned identities to other actors. They could promote their identities to be closer to the identities of consultants, instead of being merely assurers, so that they can provide a wider range of related services due to the widened jurisdictional claims over other areas of expertise (Robson et al. 2007). SA providers renegotiate the terms of their professional status and widen their jurisdictional claims over other areas of expertise (Robson et al. 2007). Their translations, therefore, focus on the process that creates mutual definitions and inscriptions and extend the traditional definitions of actions (Callon 1991).

The inscriptions explored in this paper are only one-way communication; therefore, the reactions of actors that receive such inscriptions produced by SA providers cannot be captured. Thus, it is not clear that their constructed roles and identities have been rejected or accepted. As the focus of this study is on SA providers, this acceptance or rejection is implicitly evidenced through the perspectives of SA providers. However, the inscriptions analysed in this chapter provide the interview guideline to further explore how SA providers build relationships with other actors.

From the three different roles of SA providers discussed in previous section, there is a spectrum of providers' independence with respect to the sustainability reporting process. The degree of independence of a SA provider, which varies from one engagement to another, is reflected through their communicated roles, because this reflects how far they will go to remain independent as an assurer. The discussion about the perceived roles and identities of SA providers from this study, therefore, provokes further investigation regarding issues around the interactions and negotiations between SA providers and other actors as a part of SA practice development process.

Acknowledgements This paper is a part of my doctoral work at Alliance Manchester Business School, The University of Manchester. I am grateful to my supervisors, Professor Stuart Turley and Dr. Anna Samsonova-Taddei, for suggestions and advice throughout my doctoral years.

Appendix

No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
1	D1	Deloitte	Firm's website	06-Apr-13	http://www.deloitte.com/view/en_NL/nl/services/accountancy/auditing-services/sustainability-reporting-and-assurance/index.htm	– Your sustainability data will need to be verified if the reliability of your reporting is to be increased – Because preparing your financial as well as your sustainability reporting requires comparable information, you may wish to have Deloitte perform both audits…ensuring efficiency and synergy when performing risk analyses and internal audit procedures during the audit process. This allows you to get the maximum benefit from long-term value for your corporation and all stakeholders
2	D2	Deloitte	Document published by the firm	06-Apr-13	http://www.deloitte.com/assets/Dcom-Netherlands/Local%20Assets/Documents/NL/Denktank/Sustainability/nl_en_assurance_sustainability_performance_2010_12_28.pdf	
3	D3	Deloitte	Document published by the firm—2012	06-Apr-13	http://www.deloitte.com/view/en_BE/be/industries/energy-and-resources/sustainability-climate-change/367d2dd9cc9b9310VgnVCM2000001b56f00aRCRD.htm	

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
4	D4	Deloitte	Firm's website	06-Apr-13	http://www.deloitte.co.uk/impact/commitment-to-sustainability/	
5	D5	www.big4.com	Article of 1 July 2011	06-Apr-13	http://www.big4.com/news/deloitte-sustainability-assurance-services-bright-spot-for-company/	
6	D6	Deloitte	Firm's website	06-Apr-13	http://www.deloitte.com/view/en_kz/kz/press/e4db4ea8ecb31310VgnVCM3000001c56f00aRCRD.htm	– Independent analyst firm names Deloitte a Global Market Leader in SA Services
7	E1	EY	Firm's website	06-Apr-13	http://www.ey.com/US/en/Services/Assurance	
8	E2	EY	Document published by the firm (marketing material)	06-Apr-13	http://www.ey.com/US/en/Services/Specialty-Services/Climate-Change-and-Sustainability-Services/Six-growing-trends-in-corporate-sustainability_overview	
9	E3	EY	Firm's website	06-Apr-13	http://www.ey.com/UK/en/About-us/Corporate-Responsibility	Responsibility and sustainability are integral to our business strategy, our values and day-to-day operations. At EY, we ask ourselves what we can do to make a difference, not just for our clients and for our own business and profession, but for our communities, for the greater good of society everywhere and for the sustainability of our planet

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
10	E4	EY	Firm's webcast	06-Apr-13	http://www.ey.com/US/en/Services/Specialty-Services/Climate-Change-and-Sustainability-Services/Video_Mar2012_Bottom-line-benefits-of-sustainable-business-practices	
11	E5	www.edie.net	News article of 14 Feb 2013	06-Apr-13	http://www.edie.net/news/6/Ernst–Young-tops-survey-of-global-sustainability-advisors/24055/	
12	E6	EY	News article of 16 March 2011	06-Apr-13	http://www.ey.com/CA/en/Newsroom/News-releases/2011-Sustainability-reporting	Research shows that more than 3000 companies worldwide, including over two-thirds of the Fortune Global 500, issue sustainability reports, says Cathy Cobey, EY's Canadian Sustainability Assurance and Advisory Services Leader. As this trend continues, users of sustainability information will come to expect that the information has been validated by a reliable third party
13	E7	EY	Document published by the firm	06-Apr-13	http://www.ey.com/Publication/vwLUAssets/Stock_exchanges_and_sustainability_reporting/$FILE/Stock_exchanges_and_sustainability_reporting.pdf	
14	E8	GRI	Conference page 2013	06-Apr-13	https://www.globalreporting.org/information/events/conference2013/Pages/default.aspx	

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
15	E9	Reckitt Benckiser	Sustainability report 2012	06-Apr-13	http://www.rb.com/documentdownload.axd?documentresourceid=48859	
16	K1	KPMG	Firm's website	30-Mar-13	http://www.kpmg.com/Global/en/topics/climate-change-sustainability-services/sustainability-assurance-services/Pages/corporate-responsibility-reporting.aspx	– Provide comfort to management that the sustainability information supplies a robust basis for decisions and an accurate presentation of performance against business objectives – Enhance existing processes—focusing on strategy, risk assessment, operational improvement, and benchmarking against Industry best practices
17	K2	KPMG	Firm's website	30-Mar-13	http://www.kpmg.com/global/en/topics/climate-change-sustainability-services/sustainability-assurance-services/pages/default.aspx	
18	K3	KPMG	Firm's website	30-Mar-13	http://www.kpmg.com/global/en/topics/climate-change-sustainability-services/sustainability-assurance-services/pages/integrated-reporting.aspx	KPMG member firms support the development of integrated reporting as the next step in improving the value of corporate reporting and can provide integrated assurance on your report
19	K4	KPMG	Document published by the firm	30-Mar-13	http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/iarcs-sustainability-reporting-what-you-should-know.pdf	

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
20	K5	YouTube	Video by KPMG of 11 Apr 2012	30-Mar-13	http://www.youtube.com/watch?v=x5bjVNOrIVM	
21	K6	YouTube	Video by KPMG of 5 Nov 2008	30-Mar-13	http://www.youtube.com/watch?v=MlZlrVDI8Zk	
22	K7	YouTube	Video by KPMG of 5 Nov 2008	30-Mar-13	http://www.youtube.com/watch?v=XnovZ50Xzg4	Companies are making public commitments, and these commitments are formalised in the annual sustainability reports, which are accepted companions to the annual reports Sustainability data is inherently prone to error. When it left unchecked, it leads to public information which can be inaccurate and unsubstantiated. It is not surprising that, without assurance, fewer than one in ten customers actually believe what business say about their sustainability achievements

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
23	K8	YouTube	Video by KPMG of 6 Mar 2013	30-Mar-13	https://www.youtube.com/watch?v=Jlw_2mIPpsw	We have now been funding this initiative for 19 years. Our visions are CR vision recognised as a shared value. What's good for the enterprise is good for the community
24	P1	PWC	Firm's website	05-Apr-13	http://www.pwc.co.uk/sustainability-climate-change/sustainability-assurance.jhtml	The benefits of assurance include: Greater credibility both internally and externally Feedback on efficiency and effectiveness of controls and processes and risks and exposures Guidance on quality of internal and external reporting Confidence in actions taken to reduce emissions – We carry out the full spectrum of assurance assignments from internal readiness assessments to external public assurance—for voluntary or regulatory purposes. The scope of the work can

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
						be sized to your needs and the level of assurance designed accordingly. We lead our profession by working closely with national and international standard setters and use the most widely recognised international standard, ISAE 3000
25	P2	PWC	Firm's annual report 2012	05-Apr-13	http://www.pwc.co.uk/en_UK/uk/assets/pdf/annual-report-2012.pdf	We've been focusing on finding ways to minimise our carbon footprint and on finding ways to make a meaningful difference to our communities; and measure the social impact of these initiatives There are things we still have to work at. We've missed our target for carbon emissions from client-facing air travel
26	P3	PWC	Firm's website	05-Apr-13	http://www.pwc.co.uk/audit-assurance/assurance-regulatory-reporting-sustainability.jhtml	You need independent assurance to add credibility to the published information in your sustainability or corporate responsibility report

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
27	P4	PWC	Firm's webcast	05-Apr-13	http://www.pwcplayer.co.uk/playpresentation.php?presid=653&ftheme=ent_pwc_3&framewidth=1020&frameheight=650	
28	P5	PWC	Firm's news article of 8 Sep 2010	05-Apr-13	http://pwc.blogs.com/press_room/2010/09/pwc-annual-results-2010-reflect-strong-growth-in-sustainability-practice.html	
29	P6	PWC	Document published by the firm—2012	05-Apr-13	http://www.pwc.co.uk/audit-assurance/publications/assurance-today-and-tomorrow-global-survey-of-investors-views-2012.jhtml	
30	P7	PWC	Firm's webcast	05-Apr-13	http://www.pwc.co.uk/corporate-sustainability/cs-videos-sustainability.jhtml	
31	P8	YouTube	Video by ESTV Sydney of 25 Sep 2009	05-Apr-13	https://www.youtube.com/watch?v=CNZpojy09is	
32	B1	Bureau Veritas	Firm's website	07-Apr-13	http://www.bureauveritastraining.co.uk/	
33	B2	PR Newswire	News article of 12 July 2011	07-Apr-13	http://www.prnewswire.com/news-releases/bureau-veritas-acknowledged-as-a-leading-provider-of-sustainability-assurance-services-by-independent-analyst-firm-verdantix-125426468.html	
34	B3	Bureau Veritas	Firm's article of 14 Feb 2013	07-Apr-13	http://www.bureauveritas.com/wps/wcm/connect/bv_com/group/home/news/business-news/bureau+veritas+receives+top+ranking+for+sustainability+assurance+services+from+major+firms	Bureau Veritas has been recognized by a Verdantix survey as the most-recognized certification

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
						body among sustainability leaders with the 5th highest brand preference in the market place for sustainability assurance providers, along with the Big Four accounting firms
35	B4	Bureau Veritas	Firm's website	07-Apr-13	http://www.bureauveritas.com/wps/wcm/connect/bv_com/group/services+sheet/sustainability-report-assurance_2866	A greater demand for transparency now means that Corporate Social Responsibility and Sustainable Development issues have gained a firm place on the agenda of Boards and senior management worldwide Openly communicating this accountability to stakeholders can build trust and support, but only if the stakeholders are confident the shared information is accurate in representing the company's social, environmental and ethical performance
36	B5	Bureau Veritas	Firm's website	07-Apr-13	http://www.bureauveritas.co.uk/wps/wcm/connect/bv_couk/local/services%20sheet/corporate%20responsibility%20and%20assurance	

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
37	B6	Bureau Veritas	Firm's website	07-Apr-13	http://www.bureauveritas.co.th/wps/wcm/connect/bv_coth/local/home/clients/case-studies/certification/cs_nestle?presentationtemplate=bv_master_v2/caseStudyItem_v2	Bureau Veritas provided Nestlé with an independent Assurance Statement for its CSV report rendering an opinion and adding credibility to the report. In addition to the independent assurance statement, Bureau Veritas delivered added value through a detailed management report that elaborated its insights and recommendations. This served as an action plan for internal change over the next reporting cycle. Bureau Veritas' contract was renewed to cover subsequent CSV reports and both companies see it as a long-term partnership aimed at building trust and credibility in the public domain
38	B7	Bureau Veritas	Firm's article on 22 Dec 2009	07-Apr-13	http://www.bureauveritas.com/wps/wcm/connect/bv_com/group/home/news/business-news/bureau+veritas+sponsors+scientific+trip+across+the+mediterranean	

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
39	B8	YouTube	Video of 20 Nov 2007	07-Apr-13	https://www.youtube.com/watch?v=0MTTDMhiERM	
40	B9	YouTube	Video by Bureau Veritas of 9 Apr 2012	07-Apr-13	https://www.youtube.com/watch?v=zQ1b4-VyKJg	
41	B10	Bureau Veritas	Video of 10 Jun 2008	07-Apr-13	https://www.youtube.com/watch?v=sXWi2shKACE	
42	B11	Bureau Veritas	Firm's website	07-Apr-13	http://www.bureauveritas.co.uk/wps/wcm/connect/bv_couk/local/home/about-us/our-business/certification/sustainability/sustainability-reporting	
43	CC1	Corporate Citizenship	Firm's website	17-May-13	http://www.corporate-citizenship.com/service/assurance/	
44	CC2	Corporate Citizenship	Firm's website	17-May-13	http://www.corporate-citizenship.com/service/reporting/	
45	CC3	Corporate Citizenship	Firm's website	17-May-13	http://www.corporate-citizenship.com/case-study/a-selection-of-our-clients/	
46	CC4	Corporate Citizenship	Firm's website	17-May-13	http://www.corporate-citizenship.com/case-study/assurance-anz/	
47	DNV1	DNV	Firm's article of 24 Dec 2011	17-May-13	http://www.dnv.com/press_area/press_releases/2011/dnvrecognisedasagloballeaderinsustainabilityassurance.asp	
48	DNV2	Eco-business.com	Adverts in the website	17-May-13	http://www.eco-business.com/directory/dnv-business-assurance-pte-ltd/	– Through our assurance services, we help organisations ensure the quality and credibility of

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
						their sustainability reports and communications – Through our stakeholder engagement services we add credibility to an organisation's stakeholder engagement efforts
49	DNV3	DNV	Firm's website	17-May-13	http://www.dnvba.com/uk/Pages/default.aspx	
50	DNV4	DNV	Firm's website	17-May-13	http://www.dnvba.com/global/assessment/reporting-communication/Pages/default.aspx	– We are amongst the world's leading assurors of reports using AA1000AS, according to figures from CorporateRegister.com
51	L1	LRQA	Firm's website	09-Apr-13	http://www.lrqa.com/about-us/why-choose-lrqa.aspx	
52	L2	LRQA	Firm's website	09-Apr-13	http://www.lrqa.com/services-we-offer/validation-and-verification/127172-corporate-reporting-verification.aspx	– It provides your board with increased confidence in the accuracy and completeness of data/information used to make their business and commercial decisions It helps identify opportunities for improvements generating cost benefits and commercial advantage

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
						– We customise our verification to meet your criteria and required level of assurance. We will make flexible arrangements to make sure your corporate report is verified in accordance with agreed deadlines
53	L3	Business Assurance	Article of 14 July 2009	09-Apr-13	http://businessassurance.com/episode-4-lrqa-business-assurance-trust-and-transparency-podcast-series/	
54	L4	Business Assurance	Article of 10 October 2012	09-Apr-13	http://businessassurance.com/downloads/2012/10/Sunday-Telegraph-Oct-2012-v72.pdf	
55	L5	LRQA	Firm's website	09-Apr-13	http://www.lrqa.co.uk/events/SLF2013.aspx	
56	L6	British Council	Article in the website	09-Apr-13	http://www.britishcouncil.org/partnerships/e-idea-lloyds-register-quality-assurance-lrqa	
57	L7	E-idea	Website	09-Apr-13	http://e-idea.org/	
58	L8	LRQA	Firm's website	09-Apr-13	http://www.lrqa.co.uk/standards-and-schemes/Corporate-Reporting/index.aspx	
59	L9	LRQA	Firm's website	09-Apr-13	http://www.lrqa.co.uk/help-and-support/case-studies/UK-Case-Studies/BT-CSR-1012.aspx	
60	S1	SGS	Firm's website	10-Apr-13	http://www.sgs.com/en/Our-Company/About-SGS/SGS-in-Brief.aspx?wt.mc_id=yt020001	

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
61	S2	SGS	Firm's website	10-Apr-13	http://www.sgs.com/en/Sustainability/Sustainability-Reporting/Sustainability-Report-Assurance-SRA.aspx	– Following the increase in corporate responsibility reporting, there is now added pressure from investors, the media, governments and non-governmental organizations for independent verification of the content of these reports. Sustainability Report Assurance helps demonstrate the credibility of your commitment to sustainability and sets you apart from the competition – Our approach to sustainability assurance is a flexible model based on the AA1000AS with optional modules to address your needs. Its primary objectives are to evaluate your report against the AA1000 Accountability Principles of Inclusivity, Materiality and Responsiveness, and

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
						to ensure the accuracy of the chosen scope of reporting through independent review
62	S3	SGS	Document published by the firm (marketing material)	10-Apr-13	http://www.sgs.co.th/~/media/Global/Documents/Brochures/SGS_SSC_Sustaintability-Report-Assurance-Services_EN_10.pdf	
63	S4	SGS	Firm's website	10-Apr-13	http://www.sgs.com/en/Our-Company/About-SGS/Sponsorship.aspx	
64	S5	YouTube	Video by SGS	10-Apr-13	https://www.youtube.com/user/sgseditor	
65	TT1	TwoTomorrows	Firm's website	10-Apr-13	http://www.twotomorrows.com/about-us/	
66	TT2	TwoTomorrows	Firm's website	10-Apr-13	http://www.twotomorrows.com/services/assurance/	
67	TT3	TwoTomorrows	Document published by the firm (marketing material)	10-Apr-13	http://www.twotomorrows.com/media/uploads/Two_Tomorrows_assurance_2011.pdf	– But without independent assurance of these reports, they are simply not credible. Assurance provides stakeholders with confidence that the information disclosed is complete, balanced and accurate – We go beyond this to examine how well the

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
						report addresses the issues of greatest materiality to your business and your stakeholders. It also provides constructive support by encouraging companies to identify key areas of risk and opportunity and by raising awareness among board executives and senior managers – The cost of assurance needn't be excessive. We tailor the scope of our assurance work to meet your requirements and budget
68	TT4	TwoTomorrows	Firm's website	10-Apr-13	http://www.twotomorrows.com/services/assurance/assurance-code-of-conduct/	
69	TT5	TwoTomorrows	Firm's website	10-Apr-13	http://www.twotomorrows.com/news/london-2012-greenest-ever-olympics/	
70	TT6	TwoTomorrows	Document published by the firm	10-Apr-13	http://www.twotomorrows.com/news/tomorrows-value-research/	
71	TT7	TwoTomorrows	Firm's blog (DNV GL Blog)	10-Apr-13	http://www.towardssustainablebiz.com/	

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No.	Code	Website owner	Type	Date access	Web address	Excerpts from original sources (Referred in-text)
72	TT8	TwoTomorrows	Firm's article of 13 Oct 2010	10-Apr-13	http://www.twotomorrows.com/news/agreement-brings-leading-edge-assurance-services-s/	
73	TT9	Integrated Reporting	Event page	10-Apr-13	http://www.theiirc.org/event/integrated-reporting-roundtable/	
74	TT10	AccountAbility	Certified Training for CSAP	10-Apr-13	http://www.accountability.org/standards/qualifications/training.html	
75	MISC1	Verdantix	News article of 10 Feb 2011	07-Apr-13	http://www.verdantix.com/index.cfm/papers/Press.Details/press_id/62/verdantix-benchmark-of-sustainability-consulting-reveals-the-seven-secrets-of-success/	
76	MISC2	www.edie.net	News article of 14 Jan 2013	05-Apr-13	http://www.edie.net/news/6/Decision-makers-pick-big-brands-for-sustainability-services/23833/	
77	MISC3	Verdantix	News article of 14 Jan 2013	07-Apr-13	http://www.businesswire.com/news/home/20130114005740/en/Verdantix-Survey-Names-Global-Brand-Leaders-Sustainability	
78	MISC4	Environmental Leader	News article of 22 Jun 2011	05-Apr-13	http://www.environmentalleader.com/2011/06/22/big-four-audit-firms-lead-sustainability-assurance-services/?graph=full&id=1	
79	MISC5	isosgroup.com	Article by FA Green, Sep 2011 issues	06-Apr-13	http://isosgroup.com/seeking-assurance/	

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Chapter 5
State Auditing and Anticorruption Campaign: Evidence from China

Guangyou Liu and Kaisong Gong

Abstract This study was performed to investigate the role of state auditing in the anticorruption campaign throughout the Chinese Central Government Succession substantiated in 2012. A data set of 269 state audit reports disclosed by China's National Audit Office (CNAO) has been manually collected from the CNAO's open access and coded into the research sample. This study reveals that the anticorruption campaign launched by the new Central Government of China is concentrating on the political path for the country's healthy and steady socioeconomic development instead of the political purge stereotypes imposed upon it. This study shows that CNAO, which performs the state audit, follows the political directions of the renewed anticorruption campaign. These conclusions contribute to the existing audit and corruption research literature by clarifying the true motivation of the anticorruption campaign in China and the strategic role played by CNAO in governmental governance and the national anticorruption campaign during the Central Government succession.

Keywords State audit · Anticorruption campaign · Central Government succession · China

5.1 Introduction

Corruption in public organizations involves the behavior of people in charge or control of allocating public resources who misuse their position and/or public resources for private gains (Kayrak 2008). In some instances, its disruptive nature can make corruption persuasive and is thus unwelcome in nearly all economies and governments. From the perspective of corruption auditors who play a key role in

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national socioeconomic governance, corruption refers to the breaking of rules by government officials for the purpose of private gain (Banerjee et al. 2012).

The specific Chinese institutional context is an interesting case for corruption studies. Most of the academic attention has been attracted by China's role as the largest transitional and developing economy in the world and by the rampant corruption in China over the past three and a half decades (Dong and Torgler 2012). Since the far-reaching reform policies of the 1980s, China has had a negative image with political critics because of its failure to cope with the corruption that occurs hand in hand with its rapid economic growth. Some international communities have given China low marks on indices of national governance and transparency. For example, China scored only 36 and 37 in 2014 and 2015, respectively, on the Transparency International's Corruption Perceptions Index scale from 100 (very clean) to 0 (highly corrupt) (Transparency International 2015).

China has a long history of programs to end corruption. Drawing reference from past Central Governments, the far-reaching anticorruption campaign under Xi Jinping began shortly after the conclusion of the Chinese Communist Party (CCP)'s 18th National Congress in November 2012. Since then, the Chinese government has increased the intensity of anticorruption efforts at a level unprecedented in China (Guo and Li 2015). Among the administrative infrastructure of the national anticorruption campaign, China's National Audit Office (CNAO) is playing a key role in China's governmental governance (Liu and Liu 2017). Liu (2012, 2015) noted that state audits have become an indispensable and powerful tool in Chinese governmental governance and the national anticorruption campaign.

However, the negative stereotypes about China's efforts in fighting corruption have mostly remained unchanged in the recent corruption literature reference. Some claim that the anticorruption campaign in China is in fact a process of political purge in the sociopolitical lives of different generations of the Central Government (Barme 2014; Quah 2015; Zhu 2015). Others argue that corruption is still a pervasive and disruptive problem in China's contemporary economic growth (Guo and Li 2015; He 2016).

This study, based on a sample of 269 state corruption audit reports issued by China's National Audit Office, investigated whether the current anticorruption campaign launched by China's Central Government is actually a political purge, as claimed in some prior studies. We also examine the strategic role played by CNAO in the increasingly stringent anticorruption campaign launched and reinforced by the new Central Government of China. This campaign is becoming even more important as there is an increase in corruption as a result of China's remarkable economic growth for the past three and a half decades. In this study, the theoretical views of political will and social interactions regarding corruption and national anticorruption efforts are interwoven into empirical analyses.

This study finds that the anticorruption campaign launched by the new Central Government of China is concentrating on the political will to clear a path for the country's healthy and steady socioeconomic development, instead of following the political purge stereotypes that some have imposed upon it. This study also concludes that while performing state corruption audits, CNAO strategically and

tactfully follows the political directions of the renewed anticorruption campaign. These conclusions contribute to the existing audit and corruption research literature by clarifying the true motivation of the anticorruption campaign in China and the strategic role played by CNAO in governmental governance and the national anticorruption campaign during the Central Government succession.

The remainder of this paper is organized as follows. The next section presents the institutional background for studies of Chinese corruption issues. This is followed by sections on literature review and research hypotheses, research design, and empirical results and analyses. The last section provides the summary and conclusions.

5.2 Institutional Background

The evolving institutional environment in China provides a rare opportunity to investigate the corruption problems in emerging and transitioning economies. Research questions can be raised regarding whether and how social and political developments lead to different economic and legislative attributes in the national anticorruption campaign. Over the past three and a half decades, China has experienced remarkable economic growth as it has moved into a transitory process of economic marketization (Chen et al. 2011). Like many other rapidly growing economies, China faces the challenges of corruption that often accompanies growth. With its tradition of fighting corruption, nearly all Chinese Central Governments have come to realize that failure to control widespread corruption can lead to serious threats to China's economic, social, and political stability (Lu 2000: p. 190). Nowadays, the Chinese Central Government has built up a solid infrastructure of varied anticorruption agencies from the ruling party's top authorities (e.g., the CCDI and its commissions at different political levels), the supervisory departments at different government levels, and different levels of state auditors.

Over the most recent decade, the state corruption audit has become one of the China's key anticorruption forces, especially in national economic governance. This anticorruption agency supplements the supervisory and disciplinary functions of the Central Commission of Discipline Inspection (CCDI). The CCDI focuses on maintaining the integrity of the CCP members and supervising the functions of various levels of local governments that focus on economic monitoring and governance. China has seen an increasingly powerful influence of state audits on the Central Government's anticorruption efforts. The state audit in China is a fundamental, legal, and institutional arrangement bestowed with the power of supervision, detection, and prevention to promote the healthy development of the national economy and of society (Liu 2012). Since President Xi's succession of Chinese administration in 2013, CNAO has enhanced its far-reaching efforts in the national anticorruption campaign launched by the new Central Government in China. Liu (2015) predicted that as a result of state corruption audits, China will experience

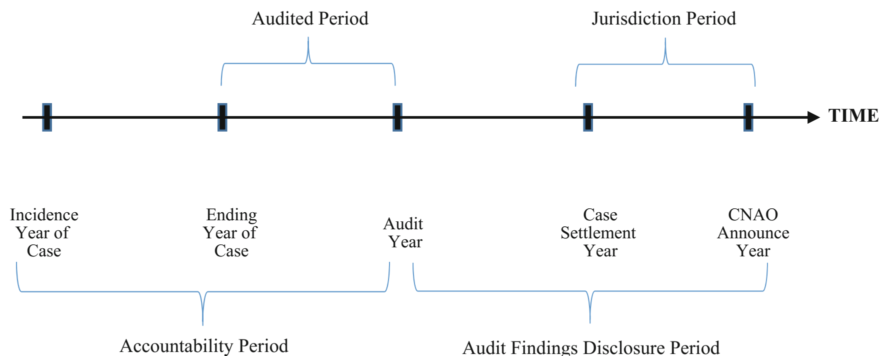

Fig. 5.1 Chronological description of state corruption audits and prosecutions

deepening reforms with enhanced rules and laws about national economic supervision and enhanced anticorruption mechanisms.

The state corruption audit is a special judicial review service provided by CNAO, apart from the financial report audits of the financial reports of governments and the value-for-money audits of the efficiency and effectiveness of public fund usage. Figure 5.1 presents the complete process of the state corruption audits and the following prosecution steps.

The corruption audit is performed by different levels of dispatched audit groups from CNAO normally focuses on a certain audited period ranging from the incidence year of the selected corruption case to its ending year. However, the accountability period may extend the audited period by the auditor's search for the facts before the incidence year and after the ending year of the corruption case. The jurisdiction period is the time frame for the prosecutor to try the corruption case delivered from the CNAO auditors. After the verdict is judged, the jurisdiction consequences are fed back to CNAO, which makes its anticorruption efforts transparent to the public as a strong deterrent to potential corruption commitments.

5.3 Literature Review and Development of Research Hypotheses

Very few studies have touched upon the relationship between government auditing and corruption (Olken 2007; Blume and Voigt 2011; Liu and Lin 2012). On the one hand, theories adopted to investigate the attributes, determinants, and deterrents of corruption are rare in the government audit literature. On the other hand, more constitutional studies and sociopolitical economic research than audit researchers have shown interest in corruption problems in economic development (Wedeman 2005; Barme 2014; Zhu 2015). Some theoretical foundations have been laid in the existing corruption literature. Two major theories applied in constitutional studies

examine the determinants and the deterrence of corruption: One is based on the political will of governments, and the other is the social interaction view of corruption. The following literature review on corruption and corruption deterrence and, accordingly, our research hypotheses are centered around these two theoretical views.

5.3.1 Corruption and the Political Will of Fighting Corruption

Many existing constitutional studies argue that the political will of a government to fight corruption acts as a crucial incentive to curb corruption (Wedeman 2005; Quah 2013, 2015, 2016; Barme 2014; Zhu 2015; Liu 2017). The political will view explains the motivation of governments, especially a newly established administration, in fighting corruption. Governments advocate proactive campaigns against corruption as an indispensable part of their political strategy to rebuild political trust and legitimacy. The successful experience of anticorruption in Singapore after its social and political reforms led to general elections shows that the government's proactive political acts were critical determinants in the success of curbing corruption (Qua 2013). A comparison of the anticorruption campaigns in six Asian countries provides further consistent evidence for the assumption that political will plays an important role in governments' fighting corruption and gaining good social and political reputations (Quah 2016). The political will assumption can provide reasonable constitutional explanations for the motivation and consequences of government anticorruption efforts based on the widely observed fact that the strong political will of government results in more stringent anticorruption legislation and enforcement of laws to prevent corruption.

However, when the existing corruption literature addresses the Chinese institutional context from the political will perspective, China's anticorruption efforts tend to be labeled as a political war and a weapon against rivals in business, in the government, and in the party (Quah 2015). Some critics regarding the prevailing anticorruption campaign in China even argue that those prominent anticorruption cases do not represent the political will of the government fighting corruption, but rather illustrate outgrown struggles for political power (Barme 2014). Quah (2015) criticized China's Central Commission for Discipline Inspection as ineffective because corrupt party members are not disciplined or punished. Zhu (2015) and Quah (2016) argued that China's Central Government is only fighting a selective anticorruption campaign to secure its social credibility and reputation, which means that the government is unable or unwilling to investigate and punish high-ranking corrupt officials.

Overall, the main body of the corruption literature that applies the theoretical view of political will to successful experiences in countries such as Singapore or South Korea has concluded that political will is a crucial determinant in deterring

corruption (Quah 2013, 2015, 2016). The political will analyses of the Chinese anticorruption campaigns lead to the conclusion that political purges or political struggles for power are dominating the anticorruption process (Barme 2014; Zhu 2015; Quah 2015, 2016).

Whether conclusions from prior studies of the Chinese anticorruption campaign are true or false deserves further convincing evidence and proofs, and the specific Chinese institutional background should be integrated into the analyses. Some Chinese domestic scholars suggest that China has long adopted a national governance structure of multi-tiered administrative units. Within this structure, local governments play crucial roles in the national social and economic growth by controlling a large portion of public resources (Liu and Lin 2012). Chinese institutional features often lead to some biases in the existing corruption studies due to misunderstandings. One common misunderstanding in many studies of China's anticorruption efforts stems from the long-standing criticism concerning the economic reforms launched in the past century. These reforms have drastically activated and pumped energy into the economic growth in China for three and a half decades. Another extensively quoted institutional bias derives from the nature of the Chinese social and political systems that differ from those in the developed Western countries.

Fortunately, the open access to CNAO's state corruption audit reports provides scholars with a rare chance to test research hypotheses developed on the basis of the current constitutional theories and also provides the domestic and international public with a transparent lens through which to view the anticorruption campaign in China. In light of the political will view of corruption indicated in the literature, some sociopolitical attributes of corruption should become the focus of the anticorruption campaign launched by the new Central Government of China. We conjecture that the corruption and anticorruption attributes illustrate the political will of the government to fight corruption in China. This is evidenced by the corruption dollar amounts, the perpetrator's political ranking, the number of audited cases delivered to the CCDI, the political ranking of the prosecutor, the length of the audited period, the length of the accountability period, and the length of the jurisdiction period. Accordingly, we propose seven hypotheses as follows.

H1a: The dollar amount of the audited case is significantly different before and after the anticorruption campaign launched by the new Central Government of China

H1b: The corrupt government official's political ranking is significantly different before and after the anticorruption campaign launched by the new Central Government.

H1c: The number of corruption auditing cases delivered to the CCDI is significantly different before and after the anticorruption campaign launched by the new Central Government.

H1d: The prosecutor's political ranking is significantly different before and after the anticorruption campaign launched by the new Central Government.

H1e: The length of the audited period is significantly different before and after the anticorruption campaign launched by the new Central Government.
H1f: The length of the accountability period is significantly different before and after the anticorruption campaign launched by the new Central Government.
H1g: The length of the jurisdiction period is significantly different before and after the anticorruption campaign launched by the new Central Government.

5.3.2 The Social Interaction View of Corruption and Corruption Deterrence

Social interaction advocates view corruption as the involvement of complex and continuous interactions among business, government, and society (Cheung 2015). Agatiello (2010) adopted the social interaction view to explain that governmental corruption results from the interaction of the private sector with government officials exercising their duties. In fact, the social interaction theory helps depict the collusion of interests in many Asian countries, which encompasses politicians, government officials, and the private sector (Agatiello 2010). Dzhumashev (2014) concluded from economic modeling that corruption creates distortions in private–public interactions. Lehman and Thorne (2015) suggested that social interactions between the public and private sectors are symbiotic and destructive. However, Neu et al. (2013) argued that social interactions can reduce the possibilities of collaboration within organizations and between the private and public sectors and thus are complementary in fighting organized and collusive corruption.

Some scholars argue economically that corruption in China is generated by the Chinese political system, which grants and protects privileges (Yao 2002). After a historical review of the corruption problems since the economic reforms in 1980s, Gul and Lu (2011) argued that China's pervasive and institutional corruption threatened the socioeconomic fabric of Chinese society. Ramirez (2014) specifically emphasized that China had trouble wrestling with the complex interactions introduced by the marketization process and the reforms of social and political systems. Gong (1997) studied the change of forms and characteristics of China's corruption and concluded that corruption, as a kind of socioeconomic behavior, responds to the social climates shaped by the continuous political and economic reforms in China. Dong and Torgler (2012) studied the influence of social interaction on the incidence of corruption, and from their observation of Chinese, within-country panel data concluded that the incidence of corruption is significantly related to social interaction. Dong and Torgler (2013) further explored the causes of corruption problems in China and suggested that bureaucratic discretionary power over the allocation of resources has significant and direct effects on the incidence of corruption. However, economic and social heterogeneity acts as indirect determinants of corruption. A typical misconduct resulting from social interactions of corrupt government officials is political rent-seeking behavior (perhaps an example of what this is).

Chen (2004) finds that many current corruption activities in China involve strictly economic benefits through rent-seeking with political power and that corrupt government officials can easily use many institutional loopholes for arbitrage to profiteer and to harvest personal gains.

The social interaction view has also been adopted to depict the relationship between government audits and anticorruption campaign in China (Yang et al. 2008). This theoretical view sheds light on China's process of democratic evolution via the interaction between the development of democratic politics and government auditing, and the interaction between the legislature and the government audit system.

Overall, current conclusions based on the economic modeling of social interactions have shown certain key social interaction attributes of corruption. Nevertheless, there is a lack of empirical research that probes comprehensively the social underpinnings of corruption in China. The corruption-related social interactions have important practical expressions in China, such as organized corruption involving multiple officials in one organization and corruption involving collusion between government officials and business people within governmental procurement. Other social interactions include government officials profiteering from the political and administrative power vested in them. These social interactions also can be examined through the relationship between the severity of financial and/or criminal punishment and corruption activity. After translating corruption-related social interactions into these expressions in the Chinese socioeconomic and sociopolitical contexts, we propose the following hypotheses.

H2a: More organized corruption cases are detected after the anticorruption campaign launched by the new Central Government of China than before.
H2b: More official-business collusion cases are detected after the anticorruption campaign launched by the new Central Government of China than before.
H2c: More rent-seeking occupational corruption cases are detected after the anticorruption campaign launched by the new Central Government of China than before.
H2d: The punishment for the reported corruption case after the anticorruption campaign launched by the new Central Government of China is harsher than before.

5.4 Research Design

5.4.1 Data Collection

The research hypotheses proposed in the prior section will be tested on a sample of 269 state corruption audit reports disclosed by CNAO. These reports were collected from the CNAO Web site (CNAO 2015), which contains an open-access column as

Table 5.1 Description of CNAO corruption audits in this study

Classification criteria	Year	Frequency	Percent	Cumulative percent
Audit year	2006	1	0.4	0.4
	2007	1	0.4	0.7
	2008	13	4.8	5.6
	2009	49	18.2	23.8
	2010	81	30.1	53.9
	2011	45	16.7	70.6
	2012	55	20.4	91.1
	2013	19	7.1	98.1
	2014	5	1.9	100.0
	Total	269	100.0	
Trial year	2008	1	0.4	0.4
	2009	11	4.1	4.5
	2010	16	5.9	10.4
	2011	89	33.1	43.5
	2012	79	29.4	72.9
	2013	48	17.8	90.7
	2014	25	9.3	100.0
	Total	269	100.0	

a repository of transparent state corruption audit reports. All of the acquired corruption audits and relevant reports were manually coded into the data set used in this study.

The first CNAO's state corruption audit report available online was dated June 2011, and the last report was updated for data collection of this study in June 2015. Our final sample thus consists of CNAO reports published between 2011 and 2015. The sample compositions in terms of the audit year and trial year are described in Table 5.1.

5.4.2 Variables

This paper identifies four groups of variables for the designated tests according to the regular process of CNAO's state corruption audits. Table 5.2 summarizes all of the studied variables with descriptions and measurements.

The first group of variables relates to the corruption features, consisting of CORRUPT$, CORRUPT_RANK, ORGANIZED, OCCUPATION, and COLLUSION. These variables are included to identify the characteristics of the corruption cases audited and delivered to prosecutors. The second group includes the variables that depict the characteristics of corruption prosecutors, consisting of

Table 5.2 Summary of studied variables

Variable	Description	Measurement
CORRUPT$	Embezzlement/bribery amount	Logarithm of corruption dollar amount
CORRUPT_RANK	Official ranking of corruption perpetrators	5 = Ministry/province level (*shengbuji*); 4 = Department/bureau level (*tingjuji*); 3 = Section level (*chuji*); 2 = Subsection/branch level (*keji*); 1 = No rank
ORGANIZED	Dummy for type of organizational crime	0 = Individual perpetrator 1 = Organizational perpetrator
OCCUPATION	Dummy for occupational crime	0 = Non-occupational crime 1 = Occupational crime
COLLUSION	Dummy for official-business collusion	0 = No collusion exists 1 = Collusion exists
AGEN_TYPE	Nature of anticorruption agency	3 = Discipline inspection and supervision 2 = Public security 1 = Government and administration
AGEN_RANK	Political ranking of prosecutor	4 = Cabinet level 3 = Province level 2 = Municipal level 1 = District level
PERIOD_AUD	Length of audited periods	No. of years covered by corruption audit
PERIOD_ACC	Length of accountability period	No. of years perpetrator accountable for
PERIOD_JUR	Length of jurisdiction period	No. of years for trial process
PUNISH_CR	Criminal punishment	Number of imprisonment years[a]
PUNISH_FN	Financial punishment	Logarithm of fine penalty

Note [a]Sentences of "life imprisonment" and "death penalty with a reprieve" are assumed to be 30 years, based on numerical maximum of 20-year imprisonment sentences in China

AGEN_TYPE and AGEN_RANK. The next group is related to the chronological features of the state corruption audits in this study, following the description in Fig. 5.1.

Notably, in the last group of variables regarding the results of jurisdiction against corruption, two kinds of punishment are applicable to the measurement of legal consequences to which the state corruption audits eventually lead: criminal sentences (denoted by PUNISH_CR) and financial penalties (denoted by PUNISH_FN).

Table 5.3 Descriptive statistics

Variable	N	Min	Max	Mean	Std. variance
CORRUPT$	269	−0.27	15.32	6.7658	3.06800
CORRUPT_RANK	269	1	5	2.44	1.185
ORGANIZED	269	0	1	0.43	0.497
OCCUPATION	269	0	1	0.39	0.490
COLLUSION	269	0	1	0.30	0.460
AGEN_TYPE	269	1	3	2.29	0.822
AGEN_RANK	269	1	4	3.03	0.948
PERIOD_AUD	269	1	12	2.74	2.049
PERIOD_ACC	269	1	16	4.01	2.449
PERIOD_JUR	269	1	7	2.22	0.989
PUNISH_CR	269	0.00	30.00	5.9198	8.36966
PUNISH_FN	269	−0.69	11.70	1.3870	2.32754
Valid N (*listwise*)	269				

5.4.3 *Descriptive Presentations of State Corruption Audits in China*

Table 5.3 contains the descriptive statistics of the state corruption audit sample. This table shows that the logarithmic mean for the corruption amount is 6.7658 (equivalent to USD51.52 million) and that the maximum is 15.32 (equivalent to USD6.849 billion). The mean value for the official rank of the perpetrators is 2.44, which means that most of them were middle-level officials or managers in government or business organizations. Organized corruption was slightly less than individual corruption (mean value, 0.43). Rent-seeking occupational corruption and official-business colluding corruption were even less (mean values, 0.39 and 0.30, respectively).

Table 5.3 also indicates that most of the corruption audit cases were delivered to the public security agencies for trials (mean value, 2.29) and that most of the corruption perpetrators were sent to the prosecutors at the provincial level (mean value, 3.03).

The descriptive statistics on chronological measures indicate that on average a state corruption audit case covered more than two and a half years (mean value, 2.74 years), its accountability period is as long as 4 years (mean value, 4.01 years), and its jurisdiction period is shorter than two and a half years (mean value, 2.22 years).

Finally, we find that the average punishment for corruption is close to 6 years of imprisonment and that the average financial penalty is equivalent to USD3560.

5.4.4 Defining the Recent Central Government Succession in China

On November 15, 2012, Xi Jinping was elected to the post of General Secretary of the Communist Party and Chairman of the CPC Central Military Commission by the 18th Central Committee of the Communist Party of China, making him the de facto paramount national leader. On March 14, 2013, Xi Jinping was elected President of the People's Republic of China in a confirmation vote by the 12th National People's Congress in Beijing.

This study adopts two methods to define political succession to investigate the relationship between the state corruption audit and the anticorruption campaign launched by China's new Central Government. One method is to define the succession as a two-phase process, that is, before and since the accession year of 2012, and the other method is a three-phase process including before (before 2012), during (year 2012), and after succession (after 2012).

This study further defines the succession year in terms of the audit year, which refers to the timing of the state corruption audit, and the trial year, which refers to the timing of prosecution and punishment of the corruption perpetrator.

5.4.4.1 Testing Methods

This study adopts *t* tests and Mann–Whitney U tests to test the research hypotheses with the assumption that the Central Government succession is defined as before and since President Xi's administration. In the additional tests in which the Central Government succession is defined as a three-phase process, Kruskal–Wallis tests are applied to three sample groups.

5.5 Empirical Results and Analyses

5.5.1 Testing Results and Analyses Based on Two-Phase Succession Process

Table 5.4 reports the results of *t* tests and Mann–Whitney U tests on the research hypotheses with the two-phase succession definition per audit year. Of the variables related to the political will of government in fighting corruption, CORRUPT$, AGEN_RANK, and PERIOD_JUR differed significantly from before to after the Central Government succession year of 2012. Research hypotheses H1a, H1d, and H1g are thus statistically supported ($\alpha = \leq 0.05$), whereas there is no significant evidence for hypotheses H1b, H1c, H1e, and H1f. Among those four social interaction hypotheses, only H2d is significantly supported by the test results on the variables PUNISH_CR and PUNISH_FN. However, there is no evidence for the

Table 5.4 Results of tests on two-phase succession per audit year

Variable	Audit year	N	Mean	Standard variance	*t* test	Mann–Whitney U test significance
CORRUPT$	Before succession	190	5.5251	4.02489		
	After succession	79	4.4399	3.57257	2.184*	0.033
CORRUPT_RANK	Before succession	190	2.49	1.225		
	After succession	79	2.33	1.083	1.064	0.337
ORGANIZED	Before succession	190	0.42	0.494		
	After succession	79	0.48	0.503	−0.974	0.327
OCCUPATION	Before succession	190	0.42	0.495		
	After succession	79	0.33	0.473	1.432	0.161
COLLUSION	Before succession	190	0.33	0.472		
	After succession	79	0.23	0.422	1.772	0.092
AGEN_TYPE	Before succession	190	2.31	0.791		
	After succession	79	2.24	0.895	0.559	0.762
AGEN_RANK	Before succession	190	3.13	0.953		
	After succession	79	2.80	0.897	2.731**	0.002
PERIOD_AUD	Before succession	190	2.68	1.989		
	After succession	79	2.90	2.193	−0.769	0.722
PERIOD_ACC	Before succession	190	3.83	2.347		
	After succession	79	4.44	2.645	−1.799	0.064
PERIOD_JUR	Before succession	190	2.489	0.9799		
	After succession	79	1.570	0.6541	8.990**	0

(continued)

Table 5.4 (continued)

Variable	Audit year	N	Mean	Standard variance	*t* test	Mann–Whitney U test significance
PUNISH_CR	Before succession	190	6.4065	8.64149		
	After succession	79	4.7494	7.60133	1.563*	0.029
PUNISH_FN	Before succession	190	1.1411	2.12186		
	After succession	79	1.9785	2.68379	−2.471*	0.004

Note **Significant at 0.01 level (2-tailed); *Significant at 0.05 level (2-tailed)

hypotheses on organized corruption, official-business colluding corruption, and rent-seeking occupational corruption.

These test results show significant declining trends in the audited corruption amounts, the political ranks of corruption prosecutors, and the length of the jurisdiction period for prosecution and punishment of corruption. Meanwhile, both criminal and financial penalties for the audited corruption perpetrators have increased as the anticorruption campaign has continued.

Table 5.5 reports the results of *t* tests and Mann–Whitney U tests on the research hypotheses with the two-phase succession conceptualization per trial year. Of the variables related to the political will of government in fighting corruption, CORRUPT$, PERIOD_AUD, and PERIOD_ACC differed significantly from before to after the Central Government succession year of 2012. These test results significantly support research hypotheses H1a, H1e, and H1f, but there is no statistical support for hypotheses H1b, H1c, H1d, and H1 g. Of the four social interaction research hypotheses, H2d is significantly supported by the test results on the variables PUNISH_CR and PUNISH_FN ($\alpha = 0.01$). However, there is no evidence for the other three social interaction hypotheses.

These test results show that the state corruption audit cases prosecuted in courts were very different before and after the Central Government succession with respect to the corruption amount, the length of the state corruption audit, the length of the accountability period, and the legal consequences of corruption. It can be observed that, in terms of both audit year and trial year, the audit corruption dollar amounts are significantly declining, whereas criminal and financial penalties for corruption perpetrators are significantly increasing. Furthermore, these results lead to the conclusion that the courts are giving more weight to corruption cases that are more complex and persuasive and that require longer periods of audit work and accountability.

Table 5.5 Results of tests on two-phase succession per trial year

Variable	Audit year	N	Mean	Standard variance	t test	Mann–Whitney U test significance
CORRUPT$	Before succession	117	5.8650	3.55609		
	After succession	152	4.6995	4.12253	2.485**	0.012
CORRUPT_RANK	Before succession	117	2.33	1.182		
	After succession	152	2.53	1.185	−1.326	0.178
ORGANIZED	Before succession	117	0.38	0.486		
	After succession	152	0.48	0.501	−1.719*	0.088
OCCUPATION	Before succession	117	0.39	0.491		
	After succession	152	0.39	0.490	−0.026	0.979
COLLUSION	Before succession	117	0.28	0.452		
	After succession	152	0.32	0.466	−0.599	0.551
AGEN_TYPE	Before succession	117	2.37	0.783		
	After succession	152	2.22	0.847	1.441	0.181
AGEN_RANK	Before succession	117	2.95	.990		
	After succession	152	3.10	0.912	−1.274	0.236
PERIOD_AUD	Before succession	117	2.24	1.436		
	After succession	152	3.13	2.349	−3.842***	0.005
PERIOD_ACC	Before succession	117	3.26	1.792		
	After succession	152	4.59	2.722	−4.815***	0.000
PERIOD_JUR	Before succession	117	2.145	.7686		
	After succession	152	2.276	1.1288	−1.130	0.744

(continued)

Table 5.5 (continued)

Variable	Audit year	N	Mean	Standard variance	*t* test	Mann–Whitney U test significance
PUNISH_CR	Before succession	117	4.0184	6.72627		
	After succession	152	7.3834	9.19867	−3.465***	0.002
PUNISH_FN	Before succession	117	0.6640	1.51020		
	After succession	152	1.9436	2.67322	−4.962***	0.000

Note ***Significant at 0.01 level; **Significant at 0.05 level; *Significant at 0.10 level

5.5.1.1 Additional Tests and Analyses Based on Three-Phase Succession Process

One further investigation is based on the three-phase succession process per audit year. Table 5.6 reports the results of Kruskal–Wallis tests on the data set classified by three phases: the presuccession phase (before 2012), the succession phase (2012), and the post-succession phase (after 2012). The variables COLLUSION, AGEN_TYPE, AGEN_RANK, PERIOD_JUR, and PUNISH_FN were significantly different throughout the three phases under investigation. By these test results, hypotheses H1c, H1e, H1g, and H2b are significantly supported ($\alpha = 0.05$ or less), whereas H2b is supported partially in terms of financial punishment.

The Kruskal–Wallis test results prove that both the number of official-business colluding corruption cases and the political ranking of prosecutors declined from the presuccession phase to the succession phase and then increased in the post-succession phase. They also prove that more corruption audit cases were delivered to disciplinary and public security agencies in the presuccession and succession phases, and more to governments and administrative agencies. In addition, they prove that the jurisdiction period has been shortened, whereas financial penalties for corruption have increased throughout the three-phase succession process.

Another further investigation is based on the three-phase succession process per trial year. The Kruskal–Wallis test results are included in Table 5.7. The statistically significant cross-phase differences are observed in the variables such as CORRUPT$, ORGANIZED, PERIOD_AUD, PERIOD_ACC, PUNISH_CR, and PUNISH_FN. Hypotheses H1a, H1e, H1f, H2a, and H2d are significantly supported ($\alpha = 0.05$ or less).

The Kruskal–Wallis test results show that both the corruption dollar amount and the number of organized corruption cases declined from the presuccession phase to the succession phase and then increased in the post-succession phase. They also show that the length of audited period increased from the presuccession phase to the succession phase and then decreased in the post-succession phase and that the

Table 5.6 Results of tests on three-phase succession per audit year

Variable	Audit year	N	Mean	Standard variance	Kruskal–Wallis test significance
CORRUPT$	Before succession	190	5.5251	4.02489	0.059*
	Succession	55	4.1046	3.56032	
	After succession	24	5.2082	3.55508	
CORRUPT_RANK	Before succession	190	2.49	1.225	0.111
	Succession	55	2.16	1.032	
	After succession	24	2.71	1.122	
ORGANIZED	Before succession	190	0.42	0.494	0.145
	Succession	55	0.42	0.498	
	After succession	24	0.63	0.495	
OCCUPATION	Before succession	190	0.42	0.495	0.338
	Succession	55	0.35	0.480	
	After succession	24	0.29	0.464	
COLLUSION	Before succession	190	0.33	0.472	0.041**
	Succession	55	0.16	0.373	
	After succession	24	0.38	0.495	
AGEN_TYPE	Before succession	190	2.31	0.791	0.043**
	Succession	55	2.40	0.830	
	After succession	24	1.88	0.947	
AGEN_RANK	Before succession	190	3.13	0.953	0.006***
	Succession	55	2.71	0.975	
	After succession	24	3.00	0.659	
PERIOD_AUD	Before succession	190	2.68	1.989	0.636
	Succession	55	2.82	2.262	
	After succession	24	3.08	2.062	

(continued)

Table 5.6 (continued)

Variable	Audit year	N	Mean	Standard variance	Kruskal–Wallis test significance
PERIOD_ACC	Before succession	190	3.83	2.347	0.066*
	Succession	55	4.18	2.420	
	After succession	24	5.04	3.071	
PERIOD_JUR	Before succession	190	2.489	0.9799	0.000***
	Succession	55	1.636	0.7035	
	After succession	24	1.417	0.5036	
PUNISH_CR	Before succession	190	6.4065	8.64149	0.060*
	Succession	55	5.0764	7.82682	
	After succession	24	4.0000	7.16119	
PUNISH_FN	Before succession	190	1.1411	2.12186	0.000***
	Succession	55	1.2793	1.94451	
	After succession	24	3.5807	3.42073	

Note ***Significant at 0.01 level; **Significant at 0.05 level; *Significant at 0.10 level

accountability period and both criminal and financial punishment have increased throughout the three phases.

A review of the forgoing empirical tests leads to the following results: Research hypotheses H1a, H1e, and H2d are significantly supported in three tests; H1 g and H1f are significantly supported in two tests; H1c, H1d, H2a, and H2b are supported only once; and H1b and H2c are not supported at all. These results show that significant differences exist in the corruption dollar amount, the length of the audited period, and the legal consequences of corruption audit cases throughout China's Central Government succession. They also show that some significant differences exist in terms of the prosecutor types; the lengths of the audit, accountability, and jurisdiction periods; and the numbers of organized and official-business colluding corruption cases. Finally, no significant differences are observed in the corrupt officials' political ranking or the number of audited rent-seeking occupational corruption cases.

Comparing the results of the tests based on two-phase and the three-phase Central Government succession, we find that more social interaction hypotheses have been supported by the latter. In addition to the commonly proven hypothesis on criminal and financial penalties for corruption, the hypotheses on the organized and official-business colluding corruption gained significant support from the tests

Table 5.7 Results of tests on three-phase succession per trial year

Variable	Phase	N	Mean	Standard variance	Kruskal–Wallis test significance
CORRUPT$	Before succession	117	5.8650	3.55609	0.009***
	Succession	79	4.1713	3.98645	
	After succession	73	5.2711	4.21773	
CORRUPT_RANK	Before succession	117	2.33	1.182	0.370
	Succession	79	2.56	1.152	
	After succession	73	2.49	1.226	
ORGANIZED	Before succession	117	0.38	0.486	0.000***
	Succession	79	0.34	0.477	
	After succession	73	0.63	0.486	
OCCUPATION	Before succession	117	0.39	0.491	0.279
	Succession	79	0.46	0.501	
	After succession	73	0.33	0.473	
COLLUSION	Before succession	117	0.28	0.452	0.791
	Succession	79	0.30	0.463	
	After succession	73	0.33	0.473	
AGEN_TYPE	Before succession	117	2.37	0.783	0.165
	Succession	79	2.32	0.809	
	After succession	73	2.12	0.881	
AGEN_RANK	Before succession	117	2.95	0.990	0.306
	Succession	79	2.97	1.074	
	After succession	73	3.23	0.677	
PERIOD_AUD	Before succession	117	2.24	1.436	0.017**
	Succession	79	3.38	2.700	
	After succession	73	2.86	1.881	

(continued)

Table 5.7 (continued)

Variable	Phase	N	Mean	Standard variance	Kruskal–Wallis test significance
PERIOD_ACC	Before succession	117	3.26	1.792	0.000***
	Succession	79	4.53	2.846	
	After succession	73	4.64	2.600	
PERIOD_JUR	Before succession	117	2.145	0.7686	0.242
	Succession	79	2.152	1.1445	
	After succession	73	2.411	1.1035	
PUNISH_CR	Before succession	117	4.0184	6.72627	0.007***
	Succession	79	7.6101	9.76305	
	After succession	73	7.1381	8.60698	
PUNISH_FN	Before succession	117	0.6640	1.51020	0.000***
	Succession	79	1.2218	2.00135	
	After succession	73	2.7246	3.07534	

Note ***Significant at 0.01 level; **Significant at 0.05 level; *Significant at 0.10 level

based on the three-phase succession. These results show that, from the perspective of social interactions, CNAO has been tactfully playing a strategic role in the national economic governance and anticorruption campaigns throughout the different phases of the Central Government succession in China.

5.6 Summary and Conclusions

Corruption is universally considered a disruptive tumor to all social, economic, and political systems. China has gained note among emerging and transitional countries for its widely held negative image of fighting corruption. The open-door reforming policies in 1980s have spurred rapid economic growth at the indispensable costs caused by corruption. Different generations of Central Governments in China have long sought to tackle corruption problems. Among those anticorruption agencies, CNAO plays an important role in the national anticorruption campaign launched by the new Central Government in China accessing to its power and leadership in 2012. The open-access disclosure of state corruption audits recently begun by CNAO offers a rare chance to investigate its state audit strategies and the role it plays in the national anticorruption campaign.

We find that the strong political will of the current China's Central Government has been illustrated in the socioeconomic effects of state corruption audit. The strategic role played by CNAO in the prevailing anticorruption campaign focuses on the socioeconomic aspects of Chinese society instead of sociopolitical ones. No political purge has been observed from the CNAO's state corruption audits and their legal consequences, because there is no evidence that the state corruption audits are specifically targeting higher political officials or sending the audited corruption cases to the CCP-sponsored disciplining inspection agencies. Accordingly, we conclude that the anticorruption campaign launched by the new Central Government of China is concentrating on the political will to clear a path for the country's healthy and steady socioeconomic development instead of political purge stereotypes imposed upon it.

We conclude that CNAO strategically and tactfully follows the political directions of the renewed anticorruption campaign when performing its state corruption audits. Further, the Chinese corruption prosecutors are giving more weight to corruption cases that are more complex and persuasive and require longer periods of audit work and accountability.

This study also shows that some social interaction factors such as official-business collusion and organized corruption have been seriously considered over the past 5 years, during which China's Central Government succession has been smoothly accomplished. However, rent-seeking occupational corruption has not been taken into the state corruption audits, although it is typically a misconduct that results from social interactions.

Our conclusions are implicative to future anticorruption research and practices in manifold aspects. On one the hand, future academic studies can integrate state auditing research with the search for the effective channels for fighting corruption; those sociopolitical theories such as political will and social interaction may be introduced into the state auditing-related anticorruption research, and the political succession factor can be an important factor in investigation of state auditing and anticorruption campaigns.

On the other hand, the supreme audit office should be a critical player in the national anticorruption campaigns, as state auditing can strategically serve the political will of the Central Government in enhancing the national economic governance. The findings of this study imply that there is an urgent demand for establishing an effective institutional structure integrating the anticorruption functions of state auditing and other governmental agencies in the national anticorruption campaign.

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Chapter 6
Sustainability Ratings and Organizational Legitimacy: The Role of Compensating Tactics

Jeffrey Gauthier and Bill Wooldridge

Abstract This chapter develops theory concerning how ratings of firms' business practices are likely to affect firm behavior. More specifically, we draw from established theory on cognitive choice models to posit that sustainability ratings systems may be more likely to promote improved social and environmental performance in non-core practices than in core practices. This improved performance constitutes a form of compensating tactics, as ratings agencies' analysts may raise their ratings of firms in which poor sustainability performance in core practices remains. The extent to which non-core improvements influence ratings increases, we further argue, is contingent on the visibility of those improvements: improvements marked by higher visibility are more likely to influence ratings increases than lower-visibility improvements. This chapter contributes to a growing body of literature that examines the impact of ratings systems on organizations' practices, and provides an understanding of the psychological foundations of sustainability through a discussion of cognitive choice models.

Keywords Sustainability · Ratings · Legitimacy

6.1 Introduction

Sustainability has become a subject of intense interest among both management scholars and the public at large. In the years following the World Commission on Environment and Development's articulation of sustainable development as

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"development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (1987, p. 43), management scholars have generated significant insights with respect to the environmental (Hart 1995; Porter and van der Linde 1995; Russo and Fouts 1997) and social (Hillman and Keim 2001; Waddock and Graves 1997; Wood 1991) foundations of sustainability. Public opinion polls indicate strong support for sustainability. Sixty-six percent of respondents in a recent global survey indicated a willingness to pay a premium for sustainable goods (Nielsen 2015). Further, sales of consumer goods from brands exhibiting commitment to sustainability rose 4% globally from 2014 to 2015, with an increase of less than 1% from brands without such commitment (Nielsen 2015). Interest in sustainability shows no sign of abating among either scholars or the broader public.

As interest in sustainability has increased, ratings systems have been developed to assess sustainable business practices. One of the most prominent of such systems has been Global Socrates, developed by KLD Research & Analytics (KLD) and subsequently re-launched as ESG Manager. KLD, now part of MSCI Inc., rates firms on the basis of the following categories: environment, community/society, customers, employees/supply chain, and governance/ethics. Annual assessments are conducted through analysis of 10-K filings, corporate sustainability reports, direct company communication, government and non-governmental organization data, media reports, and other documents. Each category is assessed separately, with the results aggregated into a letter grade reflecting the firm's overall performance. Other sustainability ratings systems include those of Oekom Research, which assigns a letter grade on the basis of a firm's social and environmental performance, and ASSET4 (owned by Thomson Reuters), which rates firms' environmental, social, and governance performance.

The intent of ratings systems such as KLD, Oekom, and ASSET4 is to provide greater transparency to stakeholders regarding the sustainable business practices of firms. Sustainability ratings are of particular interest to investor stakeholders, who may wish to assess the environmental, social, and governance risks associated with their investments. While ratings may ultimately redound to other stakeholders such as employees and consumers, an examination of the Web sites of leading ratings systems indicates that investor stakeholders are viewed as the primary customers of ratings agencies. To the extent that ratings provide transparency, they provide a valuable service to concerned stakeholders.

In the case of KLD, ratings have gained widespread credibility in scholarly research (Gerde and Logsdon 2001; Waddock 2003; Waddock and Graves 1997). Nonetheless, questions remain. For instance, evidence has been found to suggest that KLD's ratings do not optimally use public data (Chatterji et al. 2009). Additional concerns include the argument that KLD data were developed atheoretically (Sharfman 1996). This chapter is motivated by another potential criticism of ratings systems such as KLD, Oekom, and ASSET4: that sustainability ratings may ultimately encourage organizations to simply compensate for, rather than improve, poor sustainability performance in core business practices.

The literature on cognitive choice models helps to explain the genesis of this potentially negative outcome. Cognitive models (e.g., Fishbein 1967; Tversky 1969, 1972) shed light on the decision-making processes of individuals and, in so doing, suggest how organizations might respond to sustainability ratings. These behaviors can be conceptualized as follows. First, ratings agency analysts construct company-level ratings in a manner consistent with compensatory models of decision-making, in which negative attributes in one dimension can be compensated for by positive attributes in another dimension. Second, stakeholders such as investors concerned with sustainability risks employ these ratings as simplifying heuristics to help to decide whether to support firms, thus serving to promote a compensatory choice model. Third, firms conclude that they may preserve stakeholder support by managing their ratings through compensating tactics—improving sustainability performance in non-core, rather than core, business practices. In effect, the rating becomes the salient metric that encourages firms to compensate. Thus, ratings systems hold the potential to motivate firms to continue poor performance in core practices while pursuing compensating tactics to attain a sufficiently high overall rating.

Evidence indicates that firms do indeed alter their behaviors in response to third-party ratings (Chatterji and Toffel 2010). The question remains, however, whether such changes are substantive. To the extent that these changes involve compensating tactics, sustainability becomes a more elusive goal for stakeholders to promote; although improvements in non-core practices may be beneficial to society, these actions may also serve to forestall more significant improvements that would, if undertaken, prove more beneficial to society. This chapter argues that an investigation of cognitive choice models will contribute to a more comprehensive understanding of these issues. The goal of this research is, therefore, to investigate the psychological foundations of sustainability through an examination of ratings systems and cognitive models. In so doing, we develop theory regarding when and how ratings systems are more likely to influence improved sustainability performance in non-core practices than in core practices.

We proceed as follows. The next section reviews the purpose and motivation of sustainability ratings systems. Next, we examine cognitive choice models to generate insights into the decision-making processes of stakeholders. Propositions are developed concerning sustainability ratings and the sustainability performance of organizations. We close with a discussion of implications for research, practice, and policy.

6.2 Sustainability Ratings

The goal of ratings agencies that evaluate corporate sustainability is to make the social and environmental impact of firms more transparent (Chatterji et al. 2009). Similar to credit ratings agencies, sustainability ratings agencies seek to reduce information asymmetries between rated firms and interested stakeholders. While

credit ratings appeal to investors concerned with a firm's ability to repay debt, the appeal of sustainability ratings is broader: investors are able to utilize sustainability ratings to assess the environmental, social, and governance risks that may ultimately impact a firm's market valuation.

Despite the central appeal of sustainability ratings to investor stakeholders, it should be noted that the ratings themselves assess a company's impact on a broad range of stakeholder groups. Consider, for example, the methodology of KLD's ratings. This impact is illustrated through consideration of the five stakeholder categories upon which the company's overall rating is based: environment, community/society, customers, employees/supply chain, and governance/ethics.

The environment stakeholder category attempts to offer transparency to stakeholders that share resources such as water and land with rated firms or are impacted by emissions of rated firms. The community/society category is particularly relevant to local population stakeholders. The motivation of this category is to evaluate rated firms' effects on communities in which they operate. Primary concerns of the customer stakeholder category include the quality and safety record of rated firms' products. The employee/supply chain category measures management of employee, contractor, and supply chain stakeholders. The goal is to analyze such areas as labor–management relations and employee safety of workers throughout the supply chain. Finally, the governance/ethics category measures investor relations and management practices, including sustainability reporting (KLD 2009).

Thus, it is evident that KLD ratings assess a firm's impact on a vast array of stakeholder groups: the natural environment, local communities, customers, the firm's employees, employees throughout the supply chain, and investors. A similar set of stakeholders in considered in the ratings of another leading provider, Sustainalytics (Sustainalytics 2016), and Oekom Research defines relevant stakeholder groups broadly, including the natural environment and persons affected by a firm's activities (Oekom 2016). The common link between varied stakeholders is sustainability: Sustainability ratings agencies are concerned with providing transparency regarding the environmental, social, and economic foundations of sustainability affecting each stakeholder group.

But transparency itself is arguably not the end goal. Transparency, in turn, becomes a tool to empower impacted stakeholder groups. Investors, in particular, are empowered to reward those firms committed to sustainability and punish those firms lacking in commitment. Through such means, we might expect that rated firms will be incentivized to improve their performance with respect to sustainability, resulting in benefits to other stakeholders such as local communities and employees.

The purpose and motivations of sustainability ratings are undoubtedly laudable. However, the question remains as to what circumstances may create dissonance between goals and outcomes. To this end, the next section examines the role of cognitive models in the decision-making processes of stakeholders and explores the conditions in which these models may limit the potential impact of ratings systems by promoting compensating tactics.

6.3 Cognitive Models and Compensating Tactics

Individuals tend to utilize simplifying heuristics in their decision-making processes. Decision makers often adopt simplifying choice heuristics which reduce cognitive effort, while striving to maintain a sufficient level of decision accuracy (Beach and Mitchell 1978; Bettman 1979; Payne et al. 1988; Tversky and Kahneman 1974). Cognitive choice models illustrate the means by which individuals employ varying levels of cognitive efforts.

Cognitive choice models may be viewed as either compensatory or non-compensatory. Compensatory models involve an individual's use of a mental cost-benefit analysis, in which all relevant attributes of a brand or product are considered, and a negative evaluation of one attribute can be compensated for by a positive evaluation of another attribute. A multi-attribute model, for example, is a type of compensatory model in which the individual considers all relevant attributes and assigns different weights to attributes of different importance (Rosenberg 1956; Fishbein 1967). Due to the consideration of a full set of relevant attributes, compensatory models involve relatively high levels of effort.

Decision makers can reduce the cognitive effort involved in compensatory models through the utilization of non-compensatory models. In a non-compensatory model, a negative rating on one important attribute will lead the individual to reject the associated brand or product. For example, the elimination-by-aspects model is a type of non-compensatory model in which individuals compare options one attribute at a time, in order of importance, and any option below a set cutoff level for a considered attributed is eliminated (Tversky 1972). While other non-compensatory models have been developed, such as conjunctive, disjunctive, and lexicographic (Coombs 1964; Coombs and Kao 1955; Dawes 1964a, b), the common element of non-compensatory models is a lower level of cognitive effort, enabled by the ability to reject an option based on evaluation of a restricted set of attributes.

The distinction between compensatory and non-compensatory models lies at the heart of much subsequent research in cognitive psychology, such as dual-process theories (Evans 2008). Such theories distinguish between decision-making processes that can be characterized as rapid, low effort, and high capacity, and those that are comparatively slow, high effort, and deliberative (Evans 2008). Evans (2006), for example, labels the former processes heuristic and the latter processes analytic. While labels may vary, this basic distinction is the hallmark of research on dual-process theories (Lieberman 2003; Strack and Deutsch 2004; Wilson 2002). Non-compensatory models imply rapidity and lower effort, while compensatory models imply deliberative and higher effort decision-making, consistent with the distinction made by dual-process theories.

Sustainability ratings systems hold the potential to realize the advantages of each type of cognitive model. The consideration of a broad range of criteria, across multiple stakeholder groups, promises the comprehensiveness of a compensatory model. The assignment of a single company-level rating, however, offers a

simplifying heuristic for individuals. Therefore, stakeholders who use such ratings do not confront the daunting cognitive challenge of evaluating companies themselves along multiple dimensions. They are able to conduct their decision-making process through the consideration of a single rating which serves as a proxy for a company's performance with respect to sustainability.

Given the characteristics of ratings systems and cognitive models, the following sections examine implications for sustainability. Specifically, we examine when and how ratings may promote compensating tactics which lead to the continuation of poor sustainability performance in core business practices. Our arguments draw largely from cognitive psychology and institutional theory. It is necessary to draw from each of these two areas, as models of decision-making from cognitive psychology inform the actions of ratings agency analysts and stakeholders, and institutional theory informs questions of organizational legitimacy. Our allowance for agency, minimized in many early works of institutional theory, reflects subsequent conceptual development that accounts for strategic responses to institutional pressures (Oliver 1991; Scott 2008). Joining insights from cognitive psychology and institutional theory allows for an examination of how organizations may seek to preserve legitimacy by influencing the decision-making processes of ratings agency analysts and stakeholders. The propositions offered apply to circumstances in which negative ratings are driven by core business practices—that is, practices perceived by management to be integral to the firm's business model.

Practices may be considered core by nature of the company's processes or products. For example, significant negative environmental externalities are associated with firms operating in the mining industry. The process of mining itself results in the removal of most of the existing ecosystems at mining sites (Associated Press 2010). Similarly, the integrated oil and gas industry utilizes processes that are highly detrimental to the environment. The process of heavy oil extraction is particularly energy-intensive. The estimated carbon footprint of producing heavy oil at Chevron's Kern River facility in Bakersfield, California, for example, is 50 kilograms of carbon dioxide per barrel of oil (Pearce 2010). For businesses operating in such industries, the nature of the firm's processes may drive negative sustainability ratings.

Alternatively, the nature of the firm's products may drive negative sustainability ratings. Gasoline is, of course, one of the most prominent examples of a product with negative environmental externalities. Motor gasoline is responsible for an estimated 1.1 billion metric tons of carbon dioxide emissions per year in the USA alone (United States Department of Energy 2009). The aviation industry's impact on the biosphere has also been well-documented. A recent study forecast that worldwide aviation is expected to generate more than 1.2 billion tons of carbon dioxide emissions per year by the year 2025 (Demerjian 2008). Thus, firms may be subjected to negative ratings due to practices considered by management to be integral to either internal production processes or to the characteristics of final product offerings themselves.

The issue of poor sustainability performance in core practices is both prevalent and timely. Hart's (1997) Sustainable value framework sheds light on the timeliness of this issue. The sustainable value framework suggests that firms can simultaneously promote profit and improve sustainability by moving from strategies of pollution prevention and product stewardship, to strategies of clean technology and a sustainability vision (Hart 1997). There is arguably a structural barrier, however, that prevents many firms from moving beyond the first stage—pollution prevention—of this framework. Early stages of pollution prevention often yield large emission reductions relative to costs, but diminishing returns gradually set in (Hart 1995). As a result, companies in the pollution prevention stage may find that capital intensive investments or fundamental changes in product and process design are required to promote further sustainability (Hart 1995, 1997; Hart and Ahuja 1996). Many companies have reached the point of diminishing returns for pollution prevention and now face an impending choice: commit to fundamental changes in support of sustainability or pursue lower-cost compensating tactics.

Figure 6.1 depicts our theoretical model. First, we posit that, under conditions in which the practices that gave rise to a poor rating are perceived by the firm's management to be integral to the firm's business model, poor sustainability ratings based on compensatory models will be more likely to influence improved sustainability performance in non-core practices than in core practices. We define core practices as those perceived by the firm's management to be integral to the firm's business model. Improvements in non-core practices, we argue, are compensating tactics that serve a compensatory effect—influencing ratings agency analysts to increase their ratings, despite continued poor sustainability performance in core practices. Firms adopt these tactics to preserve their legitimacy, avoiding the negative economic impact associated with a potential loss of stakeholder support. Next, we introduce a contingency that would be expected to impact the likelihood of a compensatory effect and, by extension, the ultimate ability of the firm to preserve its legitimacy: we contend that firms adopting higher-visibility non-core improvements will be more likely to exhibit a compensatory effect than firms adopting lower-visibility non-core improvements. The following sections develop the logic underlying the propositions.

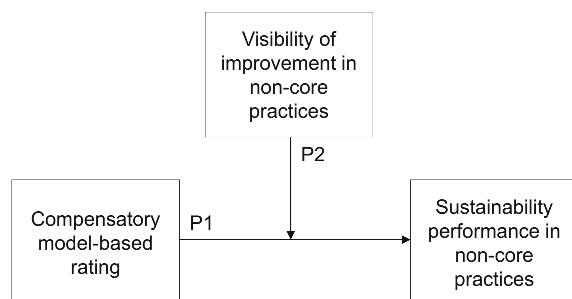

Fig. 6.1 Organizational response to negative ratings

6.3.1 Ratings and Sustainability Performance

Prior research has shown that firms alter their behaviors in response to negative ratings (Chatterji and Toffel 2010). However, these changes in behavior may not result in optimal outcomes for society. There are indications that investment in social issues management may decrease shareholder value (Hillman and Keim 2001) and suggestions that an optimal level of corporate social responsibility exists for firms, which can be calculated through cost-benefit analysis (McWilliams and Siegel 2001). Given this, we would expect firms to carefully consider investments in sustainability and to choose investments that maximize potential ratings impact and avoid fundamental business model changes.

For example, an analyst may assign a relatively low rating to a firm, based in part on that firm's negative environmental practices. A low rating becomes a threat to the company's legitimacy, which may, in turn, have adverse consequences through a decrease in stock price (Bansal and Clelland 2004). Faced with this situation, a low-rated firm will seek to protect its legitimacy—the "generalized perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman 1995, p. 574)—in the most cost-effective, least disruptive manner possible. Such an approach may be seen as akin to Oliver's (1991) strategic response of avoidance, in which organizations respond to institutional pressures through tactics such as concealment of nonconformity or buffering from institutional pressures. Elimination of negative environmental practices may not be seen as a viable option due to sunk costs or the need for fundamental changes to the company's business model. For instance, a certain level of environmental externalities may be an inherent aspect of the organization's business model, as in the case of the mining industry. Elimination of such externalities is simply not a plausible option for these organizations. Instead, we would anticipate that low-rated companies will seek ratings improvements through lower-cost compensating tactics. For example, Newmont Mining's rating was upgraded from B to BB in 2014, and reasons cited for the upgrade included an enhanced commitment to community development programs and greater attention by top management to addressing community concerns (MSCI 2014a). Newmont Mining's investments in community development may be viewed as an effort to compensate for negative environmental practices inherent in the mining industry. More broadly, suggestions that corporate philanthropy may serve as a legitimation tool (Chen et al. 2008), and indications that corporate charitable contributions help to secure stakeholder support (Adams and Hartwick 1998; Brammer and Millington 2004) suggest that philanthropy may be an appealing compensating action.

Ratings agencies' methodologies serve to promote such compensating tactics, insofar as they are consistent with a compensatory model of decision-making. An examination of KLD's stated methodology, for instance, reveals that ratings are determined by a compensatory model. Analysts may review approximately 2000 performance data points for any one company and score approximately 200

performance indicators. Scores from performance indicators are then aggregated in a four-step process, from performance ratings, to impact assessment ratings, to stakeholder category ratings, and to a single company-level rating. KLD notes that up to 20 impact assessment ratings may be assigned to a company, depending on the industry, and that different weights are assigned to different categories of impact (KLD 2009). Given that KLD's company-level ratings are constructed through a multistage aggregation process, with different weights assigned to different categories, it is evident that KLD's approach is consistent with compensatory models of decision-making. In other words, concerns in certain categories may be offset by strengths in other categories. Compensating tactics would, therefore, be expected to hold the potential to increase ratings.

The approach of other providers of sustainability ratings is also consistent with compensatory models of decision-making. ASSET4 aggregates results from over 250 performance indicators into category groupings within the environmental, social, and governance pillars. The environmental pillar consists of three categories (emission reduction, product innovation, and resource reduction), the social pillar consists of seven categories (community, diversity, employment quality, health and safety, human rights, product responsibility, and training and development), and the governance pillar consists of five categories (board functions, board structure, compensation policy, shareholders policy, and vision and strategy) (Reuters 2013). Oekom Research aggregates assessments of approximately 100 data indicators into social and environmental sustainability categories (Oekom 2016). As with KLD, stronger performance in a certain category may offset weaker performance in another category, consistent with compensatory models.

When agencies increase organizations' ratings as a result of compensating tactics, organizations face diminished incentive to improve sustainability performance in core practices. By increasing their ratings, institutional intermediaries such as ratings agencies confer a degree of legitimacy on these firms. This legitimacy is achieved as stakeholders such as investors employ the agency's rating as a simplifying heuristic. Thus, organizations employing compensating tactics remove the potential threat to legitimacy that a low rating represents, while avoiding disruptive business model changes.

The concept of decoupling (Meyer and Rowan 1977), within institutional theory, helps to inform the actions of firms utilizing compensating tactics. While firms often adopt programs to signal conformity to social norms, they may decouple those programs from ongoing practices to preserve flexibility while maintaining legitimacy (Meyer and Rowan 1977). Decoupling becomes, in effect, a means of buffering the organization from external pressures (Oliver 1991). Commitment to the ISO 14001 environmental management standard, for example, is often superficial, decoupled from day-to-day business practices (Boiral 2007; Boiral and Gendron 2011). Trade association initiatives formed with the declared goal of advancing environmental responsibility may similarly have little substantive impact and enable firms to decouple participation from practice. King and Lenox (2000), for example, found that firms participating in the Chemical Manufacturers Association's Responsible Care Program polluted more than comparable firms within the industry.

Evidence of decoupling has been found in multiple and varied contexts, including suppliers' adherence to retailers' codes of conduct (Egels-Zanden 2007), security analysts' investment ratings (Hayward and Boeker 1998), long-term incentive plans (Westphal and Zajac 1998), and stock repurchase plans (Westphal and Zajac 2001).

Decoupling and compensating tactics are driven by similar rationale: the desire to maintain flexibility while preserving legitimacy. Given this similarity, we would expect comparable organizational outcomes. Said differently, we would anticipate that both decoupling and compensating tactics will enable persistence of core organizational practices. In the case of compensating tactics, this persistence is driven by ratings increases: company-level ratings offer simplifying heuristics for stakeholders evaluating a firm's legitimacy, and a sufficiently high rating signals such legitimacy. This outcome assumes that most stakeholders will tend to use the agency's rating as a simplifying heuristic, allowing the compensating tactic to, in effect, mask continued poor sustainability performance in core practices. With legitimacy maintained through improved sustainability performance in non-core business practices, organizational motivation to improve sustainability performance in core business practices diminishes. Given this logic, we offer the following proposition:

Proposition 1 *Poor sustainability ratings based on compensatory models are more likely to influence improvement in sustainability performance in non-core practices than core practices.*

6.3.2 Visibility of Improvement in Non-core Practices

The outcome suggested in the previous section is made possible by a compensatory effect, as improvements in non-core practices influence ratings agency analysts to raise their ratings, while poor sustainability performance in core practices continues. The visibility of improvement in non-core practices adopted as compensating tactics represents a contingency that would be expected to influence the likelihood of a compensatory effect and ultimate ability of the firm to preserve its legitimacy. Visibility has been suggested to influence environmental responsiveness, as firms whose activities are more visible face greater institutional pressures to conform to accepted standards of environmental performance (Bowen 2000, 2002). Normative frames create shared expectations of proper and desirable actions (DiMaggio and Powell 1983), and improvements with higher visibility would be expected to more effectively signal conformity to shared expectations. Thus, the likelihood of a compensatory effect and maintained legitimacy would increase as the visibility of improved sustainability performance in non-core practices increases. Importantly, though, this outcome assumes that the improvements undertaken are viewed positively, rather than being perceived as a ploy.

Amazon.com's sustainability performance serves as a useful example of this expected influence. The company ranks in the bottom half of its industry overall,

with a large workforce whose wages are among the lowest in the retail industry and a lack of transparency in its environmental performance (MSCI 2014b). In 2013, the company introduced AmazonSmile, an initiative allowing customers to donate 0.5% of the price of many purchases to a charity of their choice (Brustein 2013). The highly visible nature of this initiative, in which customers take an active role in selecting a charity to support, serves to increase the likelihood of a compensatory effect, enhancing the ability of Amazon.com to preserve its legitimacy.

This outcome may occur in the following manner. Ratings agencies employing compensatory models may conclude that the AmazonSmile initiative represents an improvement in social performance that justifies an increased rating. As noted in the discussion of ratings methodology, analysts consider media reports when assessing the performance of rated companies, and media reports that raise the visibility of the initiative will factor into analysts' assessments of whether to increase the company's rating. Stakeholders who use sustainability ratings as a proxy for a firm's legitimacy may view the firm as more legitimate. In summary, the likelihood of a compensatory effect increases, strengthening the ability of the firm to maintain its legitimacy. Accordingly, we suggest the following proposition:

Proposition 2 *Firms with higher-visibility non-core improvements are more likely to exhibit a compensatory effect than firms with lower-visibility non-core improvements.*

6.4 Discussion and Implications

Recent scholarship suggests that firms alter their behaviors in response to third-party sustainability ratings (Chatterji and Toffel 2010). In this chapter, we argue that the characteristics of ratings systems and cognitive models may paradoxically encourage the continuation of poor sustainability performance in core business practices, rendering sustainability a more elusive goal. This outcome is not optimal for society, in that firms are not encouraged to view positive sustainability performance as requiring strong commitment in all pillars of sustainability. We suggested that poor ratings based on compensatory models will be more likely to influence improved sustainability performance in non-core practices than in core practices. Improved performance in such areas represents compensating tactics yielding a compensatory effect, as ratings agency analysts increase their ratings while poor sustainability performance in core practices continues. We further argued that firms conducting non-core improvements characterized by higher visibility would be more likely to exhibit a compensatory effect than firms conducting non-core improvements characterized by lower visibility. Our research responds to calls to develop new insights in behavioral strategy (Powell et al. 2011) and offers implications for future scholarship, practice, and policy.

Future empirical research that builds on this chapter's arguments will require careful assessment of firms' business models. Given that the framework applies to

conditions in which poor ratings are caused by practices seen by management as integral to the firm's business model, researchers will need to devise methodologies to assess the centrality of these practices. While survey data may assess perceptions of management, other sources might be used as a proxy. For example, in the case of KLD ratings, researchers might attempt to analyze KLD's environmental "concern" variables for a firm in the context of industry performance. Specifically, if KLD identifies a concern with respect to its "substantial emissions" variable for a given firm, researchers could ascertain whether the percentage of firms in the industry sharing that concern exceeds a particular threshold. This analysis could be used to form conclusions regarding whether certain practices are likely to be viewed by management as integral to the firm's business model.

The notion that compensating tactics may be used to preserve legitimacy will require credible mechanisms to judge whether a particular tactic is truly compensating. One approach might be to classify as compensating only KLD "strength" variables identified subsequent to the assignment of a poor rating. For instance, a newly assigned strength associated with the "recycling" variable may be indicative of compensating tactics, but only in cases where KLD did not alter previously identified concerns. The visibility contingency described in Proposition 2 may be measured through frequency of media reports on compensating tactics, using databases such as Lexis-Nexis.

The compensatory effect discussed in this chapter has been suggested to entail analysts' increases in ratings, which may be used as a proxy for legitimacy by stakeholders. Additionally, legitimacy may be preserved through changes in the perceptions of stakeholders using compensatory models of decision-making. The ability of firms to secure ratings agency increases may be examined through KLD's STATS database, which provides access to historical ratings. Firms' effectiveness in altering stakeholders' perceptions may be measured through surveys, or indirectly through measures such as revenue growth or change in market valuation.

Research that examines compensating tactics may also enable contributions to the substantial body of literature investigating the link between corporate social and financial performance (e.g., Godfrey et al. 2009; Hillman and Keim 2001; Hull and Rothenberg 2008; Martínez-Ferrero and Frías-Aceituno 2015). Many studies in this area have made extensive use of KLD data, and authors have recognized limitations in KLD's company-level ratings by constructing new aggregations of social performance. Hillman and Keim (2001), for example, employ KLD's "strength" and "concern" indicators to create separate aggregations of stakeholder management and social issue participation. An interesting avenue for future research might begin with the acknowledgment that such prior aggregations have not specifically examined implications of compensating tactics. For instance, scholars might build on Hillman and Keim's (2001) finding that social issue participation was negatively related to shareholder value by determining whether compensating tactics moderate this relationship. Such a research agenda addresses calls to identify moderating and mediating variables with respect to social and financial performance (Margolis and Walsh 2003; Orlitzky et al. 2003; Peloza 2009) and, in so doing, holds significant potential to contribute to the extant literature.

Future research might also examine how firms react to poor ratings based on non-compensatory models. We have suggested that the nature of ratings systems based on compensatory models may influence firms to adopt compensating tactics. Presumably, non-compensatory models would appear to offer less incentive to firms to engage in compensating tactics. Consumer guides from third-party organizations such as Environmental Working Group (EWG) provide a potential empirical context for such research. EWG rates products, including household cleaners and sunscreens, according to the degree of environmental and human health concerns. EWG employs a non-compensatory model, and future research might examine whether poor EWG ratings influence firms to modify the formulation of poorly rated products.

Turning to implications for practice, our research offers guidance to stakeholders seeking to support sustainable organizations. While the use of a single company-level sustainability rating may initially appear to be an attractive heuristic, stakeholders should be cognizant of the inherent limitations of this approach. As we have argued, leading sustainability ratings systems such as those of KLD, Sustainalytics, ASSET4, and Oekom Research are based upon a compensatory model of decision-making, in which compensating tactics in one area may offset continued poor sustainability performance in another area. With respect to the role of visibility, stakeholders may wish to encourage ratings agencies to find ways to raise the visibility of firms' core practices, beyond the assessment embedded within a single letter rating. Such increased visibility may influence firms to improve performance in core practices, rather than adopt compensating tactics.

For policy makers, this research suggests that while non-governmental ratings agencies may motivate firms to change their behaviors, these changes may, in many cases, fail to promote sustainability. Although the encouragement of information disclosure should be a continued goal for governments supportive of sustainability, a significant implication of this research is that information disclosure alone may be insufficient to effect change. Policy makers should consider how this information is aggregated and delivered to interested stakeholders. Given that there are limits to the utility of aggregations inherent in company-level ratings, policy makers should encourage both governmental and non-governmental organizations to develop information delivery platforms that provide sufficient detail for interested stakeholders, while adhering to user-centered design principles. Ultimately, improved information delivery redounds to the benefit of stakeholders, enabling them to make more informed choices regarding their support of a firm.

In summary, by exploring the role of cognitive models in the development and use of sustainability ratings, we argue that companies will, under certain conditions, attempt to preserve their legitimacy through improving sustainability performance in non-core practices rather than improving sustainability performance in core practices. We further suggest that the visibility of improvements in non-core practices will influence companies' ability to preserve their legitimacy. We hope that this work will encourage researchers to further examine the role of cognitive models in sustainability ratings, and to thereby generate a more comprehensive understanding of the psychological foundations of sustainability.

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Chapter 7
Can Sustainability Be Budget for? Evidence from Iran

Farzaneh Jalali and Graham Gal

Abstract Sustainability has been interpreted as the fulfillment of current generations' needs without jeopardizing the needs of future generations. Sustainable development has evolved into an important area of study and has recently entered into governments' planning and budgeting. This evolution has followed similar pattern in Iran, where the discourse around sustainability and sustainable development in different parts of government and society are increasing. In this chapter, we survey the role of sustainability and its requirements as well as the consequences in macroplanning and budgeting in Iran. For this study, the documents related to budgeting which contain information about sustainability and the way in which sustainability has grown in Iran's budget preparation are investigated. For this purpose, the Iran's budget circulars for the 10 years from 2007 to 2016 are reviewed with particular Iran's attention to the level of sustainability considered. Finally, a picture from budgeting and macroplanning in Iran with the advent of sustainability issues is presented. Sustainability issues like sustainable development and environmental issues have gradually evolved into considering economic, social, and environmental impacts. This chapter will include analysis of all of the three sections. This research will be carried out using content analysis of the documents. Using this method, we are going to investigate, classify, and report the relevant documents. Among the various techniques of content analysis, our study will examine frequency, clusters, and categories. Using these techniques, our aim is to discover sustainability status in Iran's budget.

Keywords Sustainability · Budgeting · Development · Government planning

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7.1 Introduction

Sustainability has been interpreted as the fulfillment of current generations' needs without jeopardizing the needs of future generations. Sustainability goals have grown to become as an important topic, as the pursuit of financial goals. The achievement of these goals has faced on serious shortcomings in the face of the needs of the quickly changing world. Therefore, supplementary considerations are critical. Given the background, sustainability appears to be rooted in wider concept of sustainable development. Sustainable development has evolved into an important area of study and has recently entered into governments' planning and budgeting. This evolution has followed similar pattern in Iran, where the discourse around sustainability and sustainable development in different parts of government and society are increasingly a focus of governmental decisions.

In this chapter, we survey the role of sustainability and its requirements as well as the consequences in macroplanning and budgeting in Iran. For this study, the documents related to budgeting which contain information about sustainability and the way in which sustainability has grown in Iran's budget preparation are investigated. These documents include the budget circulars for the 10 years from 2007 to 2016. budget circulars, are the main documents relating to future plans of a country, and are directly related to public financial decisions and therefore would be highly informative. Hence, in this chapter budget circulars will provide most of the focus for sustainable direction of the Iranian economic planning. budget circulars in Iran for 10 years are gathered and investigated, and concepts related to sustainability are extracted.

The results show that over time the Iranian government has changed their focus on different areas of sustainability as evidenced by the frequency of specific codes in the budget circulars. Our analysis also shows that the number of social sustainability codes has diminished over the period covered in our research. Further, the frequency of certain sustainability codes has varied over the periods covered by our project. For instance, the frequency of codes related to social behaviors has all but disappeared from the circulars. Our analysis can help us understand the direction and importance placed on different aspects of sustainability by Iranian government.

The remainder of this chapter is structured as follows. Section two considers the theoretical framework and literature review of sustainability. Section three describes the research methodology, including research method and procedures. Section four contains a detailed description of results and conclusions are offered in section five.

7.2 Theoretical Framework

7.2.1 Sustainability

The root for sustainability as a concept back to the 1960s, when environmental movements have been started and issues related to environment, was under attention by social groups. It can be declared that the Stockholm conference in 1972 was the beginning of international events in this regard (Hopwood et al. 2005). After that in 1987 the definition for sustainability, that was generally accepted, was issued by a commission including WCED, UN chaired by the then Norwegian Prime Minister Gro Harlem Brundtland (Miller et al. 2012). Although there are many definitions for sustainability, but the Brundtland Report is the famous one. According to Brundtland commission definition, economic growth should improve social matters and preserve the environment (Del Bello 2006). The Brundtland Report defines sustainable development, as:

> Development that meets the needs of the present without compromising the ability of future generation to meet their own needs (UNWCED 1987, p. 8) (Bebbington et al. 2014; IFAC 2011).

The definition of sustainable development presented by Brundtland Commission is left vague, and it is open for various ideas for stakeholders. Some researchers claim that the definition is normative (Newman 2006).

While this definition is perhaps the most quoted, it may be hard to operationalize so other definitions of sustainable development have been provided. Another definition found in IFAC report in 2011 states:

> Sustainable development is not a fixed state of harmony, but rather a procefss of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are made consistent with future as well as present needs (IFAC 2011).

As it has cited in Yanarella and Levine (1992), the most detailed definition of sustainable development is presented by Brown (1981). Brown (1981) defines the sustainable society in terms of population stabilization, the preservation of the earth's renewable natural resource base, the prudent use of land (urban, farm and wilderness), the protection of biological systems (including fisheries, grasslands and forests), the reforestation of the earth, the maintenance of the web of life from microorganisms to the gene pool to extant species and flora and fauna, and the conservation of energy resources through the shift to renewable sources of energy.

From other perspective, Birkin (2000) is looking for an ontology regarding sustainable development. In his article, it is discussed that the sustainability concept is some sort of critical topic and for its implementation there is a need to move from environmental economics to an economic ecology. Also, it is stated that sustainability is beyond an academic concern and it should be stated more practically (Atkinson 2000). It is because in today's world according to the increase in population and their related environmental problems, corporations and governments are

supposed to put this reality on their decisions and strategies. The sustainable development is a concept that raised in this situation and with these considerations (Bonini 2010; Hopwood et al. 2005). As it is stated by Hopwood et al. (2005), the sustainable development can be defined by the combination of environmental and socioeconomic issues that are used in Brundtland Report's definition.

Indeed, as it is stated in mentioned definition, sustainability considers not only environmental issues, but also economic and social ones (Dempsey et al. 2011). So, sustainable society is a society in which individuals consider the needs for live in future (Dempsey et al. 2011). It is stated by Norgaard (1988) that modern society is not sustainable as the use of limited fossil fuels is supported. As development is unsustainable, it is our duty to attain sustainability in this regard.

In this regard, Saha (2009) did a survey on factors that are important in success of sustainability. Political culture, institutional, intergovernmental, and economic variables have been surveyed in this research. Furthermore, Manderscheid (2012) states that sustainable development is a notion that dominates all sociopolitical processes. And as the sustainability should be organized as a global effort, it needs a model in this regard (Schwaninger 2014).

From the above definitions, it can be seen that the main factor in sustainability is consideration of the future. In other words, for sustainable development there needs to be more attention to future resources in government and organization plans. Therefore, it is necessary to become familiar with sustainability dimensions, for understanding their impact on budgets and planning.

As it is stated by Kenny and Meadowcroft (2002):

> 'sustainable' and the related term 'sustainability' can be combined with a vast array of terms other than 'development': thus we have 'sustainable growth', 'sustainable biosphere', 'sustainable living', 'sustainable resource management', 'sustainable cities', the 'sustainability of ecosystems', 'cultural sustainability', and so on (Kenny and Meadowcroft 2002).

Furthermore, about 25 years ago Yanarella and Levine (1992) stated that sustainable development alone does not lead to sustainability. They had predicted that this expression would attract a great deal of attention all around the world, but it is still unclear (Yanarella and Levine 1992). It is stated that sustainable development is not a scientific concept, but it is a challenging topic in political discourses regarding the behavior and activities of human beings (Bebbington and Larrinaga 2014). Also it is declared that sustainable development is not considered as a policy but it is an approach (Russell and Thomson 2009). Similarly, the concept of "Dynamic Sustainable Development" that is presented by Newman (2006) suggests that sustainable development is not an aim or goal but is a way or process. It is a continuous process of change.

Sustainable development and growth are getting closer to each other semantically. Growth refers to the increase in size by adding material, but development means to expand by recognizing the potentials. So, it can be proved that growth is quantitative and development is qualitative (Daly 1990). There is an important issue that is mentioned by Bebbington (2009) that sustainable development researches are faced with very important challenges. First of all, this subject is considered as a

public goal or policy, but it is yet "politically plastic." It means that it could be interpreted and done variously. Indeed, it is difficult to relate this unclear subject to accounting. Secondly, the framework for sustainable development definition is not stable and clear enough. And finally although there are numerous papers and conferences about this issue, there are rare operational experiences in this regard (Bebbington 2009).

Various researches have been done regarding sustainability and sustainable development concept. For instance, the role of agency and structure in sustainable development is discussed by Wangel (2011). In another research, the discourse of sustainability from governmentality in Foucault (1991) perspective is discussed by Murdoch (2004). The rationality and power concepts in this research are discussed along with planning for sustainability. Also, Kolk (2016) illustrate that in social responsibility literature, the investigations are started from ethics and environment to CSR and sustainable development.

7.2.1.1 Sustainability Dimensions and Models

As it was discussed, policy making for sustainable development needs developed processes. It needs not only economic issues, but also sociocultural and environmental aspects (Meppem 2000). Indeed, financial sustainability is introduced as one of the sustainability elements but not all of it and non-financial items are important in this regard, too (Dollery et al. 2006). According to A21,[1] the concept of accountability is categorized into three parts of economic, environment and social (Del Bello 2006). It could be stated that a sustainable society seeks to protect the environment, meet social needs, and promote economic success (Mercer and Jotkowitz 2000). The science of sustainability is described as the interaction between environment and society. Indeed, in order to know the interaction, there is a need to understand both (Bebbington and Larrinaga 2014). Similarly, Daly (1992) declares that environmental sustainability has four elements: poverty, population, technology, and life style (Daly 1992). Also, some researchers have focused on one dimension of sustainability for instance. Manderscheid (2012) has focused on social justice in sustainability only.

There are numerous models and frameworks about the dimensions of sustainability which are useful for understanding planned or budgeted sustainability. One of these models is World Business Council for Sustainable Development's three-pillar model that encompasses economic growth, ecological balance, and social progress (Fig. 7.1). This model reinforces the importance that maximizing long-term value for stakeholders is closely related with social, environment, and economic performance (IFAC 2011).

[1]Agenda 21 prepared by the Commune and the Province of Ferrara (Italy) in 2003 (Del Bello 2006).

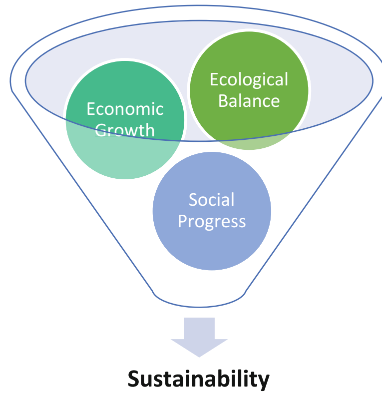

Fig. 7.1 World Business Council for Sustainable Development's three-pillar model

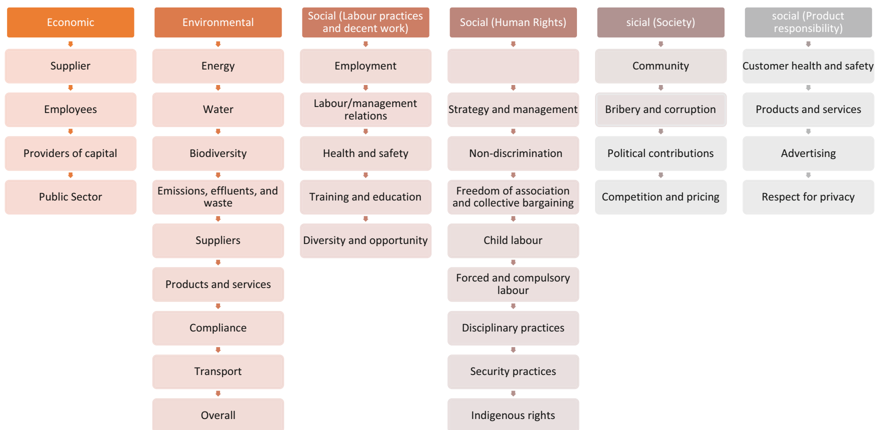

Fig. 7.2 GRI framework for performance indicators (Lamberton 2005)

Similar to World Business Council model for sustainable development, in other sustainability models, the environmental, social, and economic factors are inseparable. For instance, WCED model of sustainability has root in three-dimensional model of TBL which was published in 1987 in Our Common Future (WCED 1987) (Lamberton 2005). In the IFAC (2011) report, these dimensions called economic viability, social responsibility, and environmental responsibility. And in this regard, state that:

> As a global vision sustainability embodies hopes for a peaceful society with social equity and justice and economic prosperity in a clean, natural environment (Schaltegger and Burritt 2005).

Also, GRI framework, containing economic, environmental, and social aspects (Fig. 7.2).

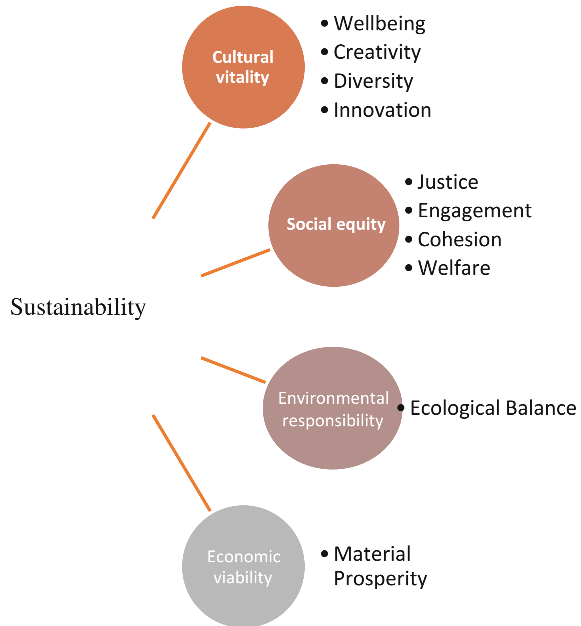

Fig. 7.3 Four-pillar sustainability model

However, Hawkes (2001) argues that there is a forth pillar for sustainability; cultural values. For Hawkes' (2001) cultural values contains well-being, creativity, diversity, and innovation as being critical for sustainable development (Fig. 7.3).

After considering all these frameworks and models of sustainability and sustainable development, this research will use them to analyze budgets in Iran and measure the level of sustainability in budget preparation process. For this purpose, we will follow one of these frameworks which is evolved into consideration of economic, social, and environmental impacts. Economic impacts on sustainability would encompass the need to not raise debt for future generations. Social sustainability concerns cultural subjects and the system of beliefs and thoughts, and so governments need to consider how their actions impact different cultures in their country. Environmental sustainability has proved to be the most attractive and easily understood as it embraces ecological issues. The following research will include analysis of all of the three sections.

7.2.1.2 Sustainability Consideration in Governmental and Local Decision

As it is stated by researchers, local governments are very important in sustainability because of their plan and control in this regard (Glass 2002). Actually, it is due to the need to legislate new or change values for performing sustainability (Glass 2002). Indeed, sustainability, especially environmental sustainability, can be stated

as one of the most important innovations in recent political discourse (Kenny and Meadowcroft 2002).

In the realm of government responsibilities regarding sustainability development, Estevez and Janowski (2013) have discussed Electronic Governance. Governance is a means which government acts to regulate social actors and policy making. Indeed, long-term inter-generational perspective in government policy making is an example for sustainable development government decision. The role of government is outlined and discussed by many researchers. For example, Sciulli (2011) has mentioned population growth, climate change, and the extension of the urban growth boundary as significant issues that are impacting the local government. Furthermore, Sciulli (2011) as well believes that local government leadership, communication with stakeholders, and community engagement are influencing sustainability reporting. Among researches about different governments experience in sustainable development strategies, Dalal-Clayton and Bass (2002) in their paper pay attention to recent efforts from OECD and UN regarding sustainable development in different countries. In this regard, Martinuzzi and Steurer (2003) discussed Austrians government strategies, and Enticott and Walker (2005) presented the result of environmental sustainability in 102 English local authorities along with its relationship with managerial reform. Steurer and Martinuzzi (2005) discussed models for strategies in public sector regarding sustainable development. Also, M'Gonigle (1989) believes that toward a common strategy for sustainability there is a need for change in consciousness and in institutional design and these changes need common strategy and vision.

Ahmad (1992) discussed sustainability development in Bangladesh. Concepts such as economic growth, population growth, mobilization of resources, the role of women, devolution and decentralization, equity, and protection of the environmental base are stated as the sustainable development dimension. Furthermore, Lueg and Radlach (2016) in their research gathered case studies regarding implementation of control systems for sustainable development enforce. They found out that the small parts of SD like environmental aspects are more frequent than social aspects. Also, Pires et al. (2014) with analyzing documents and semi-structured interviews found out that using guidelines and indicators has benefits in local sustainable development, but the main constrains in this regard are related to limited political support. Also sustainable development is considered as a characteristic of Scotland's government (Russell and Thomson 2009).

As a consequence, in today's world due to the increase in population and the related environmental problems, corporations and governments are supposed to incorporate these realities into their decisions and strategies. The sustainable development is, thus, the concept that is raised to answer these concerns (Hopwood et al. 2005). Public and private organization leaders acknowledge that among their very much responsibilities and obligations, the environmental issues should be considered too. In this regard, accounting and accountability realms help them to get to the point in sustainability development. Indeed, there is a need to work on various dimensions of sustainability theoretically and practically (Unerman and Chapman 2014). Thus, although moving toward sustainable society as a policy is

acceptable in every nation, it should not be overlooked that it needs operational strategies to achieve these ends too. So the first steps of sustainability should start from governmental organizations and their performance. The public goods created by the public sector on behalf of citizens need to conserve environment and to provide benefit not just for the present but also for future generation (Burritt et al. 2009).

7.2.1.3 Sustainability and Accounting

There are some researches in the field of accounting that discuses sustainability issue (e.g., Bebbington and Larrinaga 2014; Bebbington and Thomson 2013; Bebbington et al. 2014; Birkin 2000; Burritt et al. 2009; Lamberton 2000, 2005; Russell and Thomson 2009; Unerman and Chapman 2014). Actually as it is stated by Bebbington and Larrinaga (2014), since the 1970s with the articles published in Accounting Organizations and Society, the general perception of accounting's role in sustainable development started to form. In those mentioned studies, the main focus is on how to relate accounting to sustainability development in order to expand its principles to corporation and governments.

Although most of the researches about sustainable accounting and accountability contain reporting issues, in recent years accounting controls, have been under investigation for sustainable development and have entered it into decision processes (Unerman and Chapman 2014). It is because as the effects of human activities increase, the role of sustainability as a principle increases too. Indeed, knowledge is supposed to help this principle to expand (Bebbington and Larrinaga 2014). As an example of sustainability research in accounting, Lamberton (2000) presented a model for performance evaluation of sustainable development that is suitable for a combination of local, social, and economic purposes. In this accounting model, environmental indexes and life cycle analysis are used.

Moreover, Akisik and Gal (2011) investigated sustainable development from corporate social responsibility and accounting standards perspective. Their valuable results indicated that socially responsible firms and good accounting standards lead to better sustainable development in business. Also, from Atkinson's (2000) point of view, sustainability in corporations can be achieved by full cost accounting that imports pollution in corporate accounts.

Research on accounting and accountability in terms of sustainability has been performed for a long time. But there is a need to work on theoretical side of this realm of study. So we need more theoretical researches in this regard (Unerman and Chapman 2014).

7.2.1.4 Sustainability and Budgeting

As it has been mentioned in IFAC (2011), the budgeting and planning process should contain goals for expenditures, use of resources, and investments.

These plans should be in accordance with sustainable purposes using financial and non-financial resources. For instance, environmental factors, such as energy consumption, waste management, and environmental projects, should be mentioned in budgeting (IFAC 2011). Many governments try to focus on sustainability criteria, for example, the Western Australian government has established a sustainability evaluation process for development of projects, programs, and policies (Jenkins et al. 2003). Governments at all levels and in all regions are beginning to understand the importance of sustainability, and its discourse is spreading in public policy discussions (Bell 2002). Furthermore, Preuss (2007) states that local government in Britain have an effective role in sustainable development. Case studies of various government and business organizations show a vast range of activities related to sustainable development containing economic, social, and environmental aspects.

Regarding public sector cooperation in policy making, Bebbington (2001) states that sustainable development and sustainability in public sector exist when governments pay attention to political issues about environment and society (Burritt et al. 2009). Sustainable government policies create economic, social, and environmental values, while minimizing damage to the environment and the society. The main feature of these institutions is transparency and accountability. Situations in which government is the biggest organization and in some countries the greatest energy consumer then the greatest environmental effect is created from the government side (Bell 2002). Indeed, the sustainable development concept can be seen as a mainstream reform strategy that is the combination of economic, social, and environmental policies in all levels of government (Steurer and Martinuzzi 2007). So, as a strategy, sustainability should be presented at planning documents and budget circulars.

7.2.2 Budget Preparation in Iran

The Administration and Planning Organization is the central agency in the budget preparation process in Iran. This Administration and Planning Organization's process is initiated, developed, and published in budget circulars which are distributed among public organizations and governmental institutions. This circular contains necessary financial and non-financial information for budget preparation including micro policies like increasing percentage for wages for the next year, and macropolicies like unemployment rate and inflation. Using this circular, organizations and institutions fill in the required information on the website of the Administration and Planning Organization and the process for budget preparation continues until the approval by the legislature.

The budget circulars are documents that contain strategies and proceedings offered by the government to achieve macrogoals in a fiscal year using appropriate budget mechanisms. This document is prepared by the government cabinet and signed by president. Therefore, the budget circular is an important document to

survey the government's point of view regarding sustainability issues, and information can be extracted to understand how much attention is made by the government on these topics. It is expected that sustainability concept has evolved to become an important area of study and has recently entered into governments planning and budgeting in Iran. Indeed, the main question in this research is stated as "How is the status of sustainability in budget preparation in Iran?"

7.2.3 Research Method

This research will be carried out using content analysis of the budget circulars. Using this method, we investigate, classify, and report on the relevant topic areas in these documents. Moreover, semantic content analysis will be applied. In this method, the content will be classified without regard for the word used to address the topic. Among the various semantic content analysis methods, designation analysis will be the focus of our research. As such, our analysis will focus on the frequency and the subject trend. Among the various techniques of content analysis, our study will examine frequency, clusters, and categories. Using these techniques, our aim is to discover sustainability status and emphasis in the Iranian budgeting process (Krippendorff 2011).

We will use three-dimensional model for sustainability as sustainability issues as well as sustainable development and environmental issues have gradually evolved into three sections of economic, social, and environmental in most of the researches (Burritt et al. 2009; Hawkes 2001; IFAC 2011; Lamberton 2005).

7.2.3.1 Sample Selection

In this chapter, we survey the role of sustainability and its requirements as well as the consequences in macroplanning and budgeting in Iran. For this purpose, the documents related to budgeting which should contain information about sustainability and the way in which sustainability has grown in Iran budget preparation are investigated. Our focus will be on budget circulars for the 10 years from 2007 to 2016 as regards the level of sustainability consideration.

7.2.4 Research Results

For the purpose of survey on sustainability in budget preparation in Iran, 10 budget circular gets under precise and complete content analysis. The circulars were prepared 10 budget circulars and signed by two different governments, as presented in Table 7.1.

The descriptive statistics of budget circulars are presented in Table 7.2.

Table 7.1 Budget circulars investigated for research

Budget circular years	Government	President
2007–2013	9th and 10th government	President Ahmadinejad
2014–2016	11th government	President Rouhani

Table 7.2 Descriptive statistics for budget circulars

Budget year	Date of publish	Comprehensive plan period	Number of pages (excluding the appendixes)	Number of codes
2007	Act 2006	1st year of 4th plan	21	83
2008	Oct 2007	2nd year of 4th plan	4	38
2009	Oct 2008	3rd year of 4th plan	4	16
2010	Oct 2009	4th year of 4th plan	6	45
2011	Nov 2010	5th year of 4th plan	6	65
2012	Oct 2011	1st year of 5th plan	8	46
2013	Oct 2012	2nd year of 5th plan	7	37
2014	Oct 2013	3rd year of 5th plan	12	51
2015	Sep 2014	4th year of 5th plan	11	49
2016	Sep 2015	5th year of 5th plan	9	61

The number of pages for each budget circular varies according to the government policies and other issues in the year of publish. The number of pages in the 9th and 10th government [2008–2013] has been less than that of the 11th government [2014–2016] because it contained more description about the current economic and social situation.

There are similarities among investigated circulars as they contain instructions and strategies that are not very different in survey years. But the focus of budget and the budget's main purpose and plan of government can be diverse.

The frequency of sustainability codes in mentioned budget circular is presented in Table 7.3. From the table, it is obvious that social sustainability codes are more frequent than economic sustainability codes. Also it is very important to point out that the codes relate to environmental sustainability are very low during all 10 years. The sustainability codes and their frequency show changes in the attention made by the Iranian government to various aspects of sustainability. This is an important indicator of the government's changing priorities with respect to sustainability over time.

7.2.4.1 Social Sustainability

From Table 7.3, it can be interpreted that codes which are related to social sustainability are the most frequent in comparison with other measures of sustainability.

Table 7.3 Frequency of sustainability codes in budget circulars

Count of code	Column labels									
Row labels	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Grand Total
Social sustainability	17	14	5	16	19	12	2	4	4	5	98
Ethics	2	1		1	1	1			1	1	8
Social discipline				1	1	1					3
Unemployment decrease		2	1	1	1			1			6
Social insurance		1		1		2	1			1	6
Social welfare		2	1								3
Collective health	4								1	1	6
Justice	5	6	3	3	4	1		2			24
Cultural	6	1		2	5	2	1	1	2	2	22
Islamic identification				1	2	1					4
Social behaviors		1		5	4	4					14
Training quality				1	1						2
Economic sustainability	10	4	4	8	13	5	11	10	11	13	89
Budgeting reforms	2	1	1		1			1	1	2	9
Costing reforms	1							1	1	1	4
Financial discipline	1			1	1	1	1	1	3	1	10
Debt policies	1						4	1	2	1	9
Economic frugal	1	1	2	2	4	3	2	1		1	17
Non-oil and gas resources in budget	3	2		4	5	1	4	4	3	5	31
Economic growth	1		1	1	2			1	1	2	9
Environmental Sustainability	5				1			3	3	1	13
Environmental issues	5				1			3	3	1	13
Grand total	32	18	9	24	33	17	13	17	18	19	200

However, in different years and with changes in the ruling government, the attention to social issues in budget preparation has been different. As it is illustrated in Fig. 7.4, the average of social sustainability codes in the 9th and the 10th government in Iran is clearly greater than the codes for the 11th government. These differences can be interpreted as the amount of attention to social subjects and their importance to different governments.

Among the social sustainability issues, justice, cultural subjects, social behaviors, and ethics are the most important topics. Figure 7.5 present frequency of

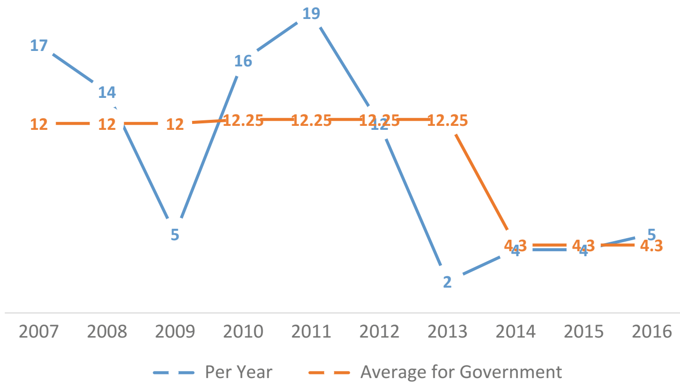

Fig. 7.4 Sustainability Codes

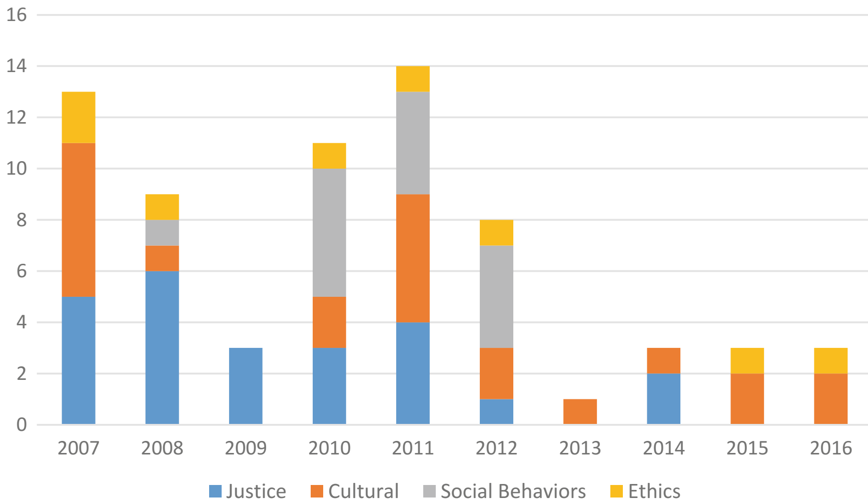

Fig. 7.5 Frequent social sustainability codes

mentioned codes in 10 years. It is obvious that justice and social behavior codes disappeared after 2014 and 2012, respectively.

However, ethics and cultural issues are important in all investigated years.

Justice

The most frequent code in the budget circulars reviewed was justice. Concepts that accounted for this category were priority for under-developed regions, social justice development, elimination of discrimination, and creating equal opportunity.

From Fig. 7.5, it is apparent that these important concepts are eliminated in recent budget circulars.

7.2.4.2 Cultural Issues

Recognizing cultural capacities, creating cultural atmosphere, deepening values, preserving cultural heritages, develop a culture of sacrifice, and strengthening national identity are concepts that are the focus of the cultural issues category. While the number of codes related to this category has diminished, cultural issues continue to be considered in the budgeting process.

7.2.4.3 Social Behaviors

Concepts which are categorized as social behavior contain honesty, self-esteem, conscience, and collectivity in work. Social behavior concepts received a great deal of attention in budget circulars from 2008 until 2012. However, in the budget circulars after 2012 codes related to social behaviors are not mentioned at all.

7.2.4.4 Ethics

Although ethical values are very important and can impact every subject, the percentages of ethical issues in budget circulars have not been large when compared to other aspects of social sustainability. Codes categorized as ethics include the growth of moral virtues, the creation and atmosphere for growth of moral virtues, and the promotion of the moral values of Islam.

7.2.4.5 Economic Sustainability

As discussed in previous sections, economic sustainability refers to the concepts related to future consideration in the process of making economic decisions. Investigated budget circulars contain information regarding financial and economic strategies that encompass the need not to raise debt for future generations. However, in budget circulars reviewed various strategies that consider the debt left for future generations become evident.

The topics related to economic sustainability in budget circular increased during the investigated period (2007–2016) as it is presented in Fig. 7.6. This shows that the 9th and the 10th government in Iran were more eager to address social sustainability issues in comparison with the 11th government which had a greater economic emphasis.

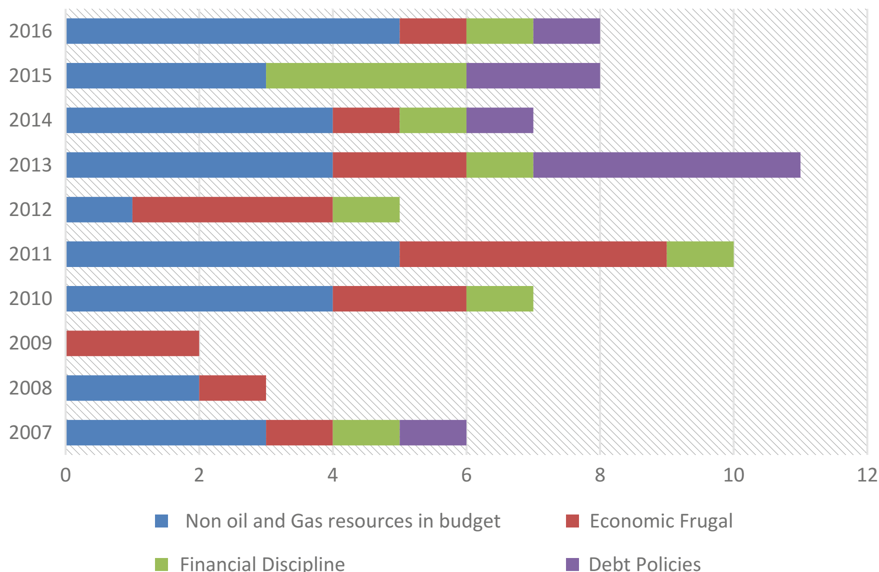

Fig. 7.6 Categories of sustainability codes 2007–2016

In Fig. 7.6, we categorized the economic sustainability codes in several categories and the category with the highest priority is "non-oil and gas resources in budget."

Non-Oil and Gas Resources in Budget

It is very vital to pay attention to natural resources that form the countries budget resources. While Iran has significant oil and gas resources, for economic sustainability it will be critical to decrease in amount of dependency on oil and gas revenue in budgeting.

In investigated budget circulars, there were concepts that could be related to moving toward new approaches regarding oil and gas resources. These circulars contained an increase in the portion of tax in government revenue from non-oil and gas export sources. However, using the oil and gas revenue to create long-term investments and to diversify the creation of revenue from other resources will allow for economic sustainability.

Economically Frugal Actions

One of approaches that lead to sustainability in economic affairs is economic frugal. It contains concepts such as avoiding the profuse use of resources, observing frugal

use of resources, and being content with current availability of resources. Governments should try to encourage their citizens and organizations to be more efficient and to save the limited resources for future generation. In budget circular, concepts related to this topic have been decreasing from 2007 to 2016.

Financial Discipline

Financial, monetary and budgeting discipline are the principles that can be found in budget circulars in most years we investigated. Financial discipline in budget preparation refers to the compliance with laws and regulations on the use of the treasury. During the investigated period, the concepts related to this topic remain constant.

Debt Policies

As we have pointed out budgeting policies can have significant effects on other generations. Among policies, those which are related to debt are directly linked to future generation resources and can be categorized as critical mechanisms in economic sustainability. Concepts in investigated budget circulars that can be placed in this category are emphasis on not generating new debt, using sustainable financial resources, managing debt, using Islamic financial instruments, and diversifying financial instruments like Sukuk. According to Fig. 7.6, codes related to debt policy are more frequent in recent 4 years.

7.3 Summary and Discussion

The budgeting process becomes a formal representation of priorities both for business organizations and governments. The budgets not only represent priorities, but also can provide some insights into processes within these organizations. Governmental budgets can be used to understand actions that affect many areas of the economy. One area that is becoming increasingly important is the effect of budgets on a country's sustainability efforts. The Brundtland Report considers sustainable development as development that does not compromise the needs of future generations. The needs of future generations have been viewed along three dimensions: social, economic, and environmental. Recently, cultural sustainability has also been viewed as a critical dimension that should not be compromised. For this study, we reviewed Iranian budget circulars for the period from 2007 to 2016 and looked for codes related to portions of the budget that dealt with these areas that are critical for sustainable development. This time period covers two presidencies, and therefore, the importance of various aspects of sustainable development cannot be attributed to a single government. Our analysis shows that while environmental

sustainability will have a significant impact on future generations, it does not appear as a major budgeting issue during the period of analysis. For the time period, social codes appeared to be the most significant component of the budget circulars. Within this dimension, codes related to justice were the most frequent with cultural codes second. However, the codes related to justice were most frequent in the early years of the budget circulars they are nonexistent in the most recent ones. Cultural codes appear consistently across the years of our analysis. For economic sustainability in the budgeting process, it is apparent that revenues from non-oil and gas resources have been seen as a consistent need across all the years of our analysis. It is important to note that budget circulars contain information about priorities and that our analysis is based on textual analysis and represents our interpretation of budget categories and language. Therefore, it is critical to acknowledge that there could be room for interpretation of whether specific language in the budget circulars should be classified as pertaining to a certain code. It is also important to understand that budgets are statements of policy that can assist in understanding what governments want to accomplish, but various governmental agencies must take actions to see that these policies are actually accomplished. There is always a possibility that budgeted actions do not match actual actions.

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Author Biographies

Farzaneh Jalali finished her high school in Karaj and continued studying accounting in the most famous and top-notch university in Iran, Tehran University. By hard working and dedicating to her studies, she could successfully be admitted for postgraduate studies in the same university in September 2009. Short after, she even started experiencing teaching of various subjects. In 2012, she was chosen by the accounting faculty board of Tehran University to further her studies in doctoral course. Her lecturer Mrs. Mashayekhi (Ph.D.) was a great help and guided her gracefully to publish many papers. Her achievements could not have certainly come true without Mrs. Mashayekhi support.

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Part II
Analytical Models

Chapter 8
A Signaling Game Between a Manager and Investors for Financial Disclosure

Chen-Wen Chen

Abstract This paper discusses the reaction of a manager to voluntary disclosure and the strategic decisions within social contexts concerning financial disclosure. Extensions of the base model examine the interaction of financial disclosure, investor relations, and managerial incentive to disclose, such as demonstrating a signaling game between a manager and investors for financial disclosure. This paper demonstrates how Rule 10b-5 of the 1934 Securities and Exchange Act fails to induce voluntary disclosure. While there is a link between the way in which companies raise external capital and the information that the companies disclose, the transformed reaction of disclosure is the signal for the company's financing policy. With the reaction of investors to voluntary disclosure after information is disclosed, this paper analyzes why the disclosure of information has regulated results as noise for investment. The extra requirement for information shifts the positions of investors toward managers concerning the policy of financial disclosure.

Keywords Signaling · Financial disclosure · Game

8.1 Introduction

Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions (Suchman 1995). Social responsibility exhibits some aspects of forbidding and fraudulent practices. To evaluate the reward (or punishment) of information disclosed for a certain behavior, we review the literature about voluntary disclosure.

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The theories most often used in prior research to explain voluntary disclosure practices are the agency theory, signaling theory, proprietary cost theory, political economy theory, stakeholder theory, and legitimacy theory (Cotter et al. 2011). Due to investors' volatile reactions to any news, we exemplify the impacts of investors' preferences, prior beliefs, and the combination of information and endowment (Hakansson 1977, p. 398) on their belief for financial disclosure. We target to derive specific conditions under a social context for the Rule of Disclosure to work best.

The concept of social responsibility is hard to be measured. Because it concerns the moral and awareness of desired actions, we first analyze it by a dichotomy of honest and dishonest types of companies. As for the effect of social responsibility, we examine whether the Rule of Disclosure may affect a manager's tendency to disclose truthful information through the following questions.

- What is the change in financial disclosure if the origins of capital for project financing change?
- What is the change in financial disclosure if the incentive of the manager changes?
- How can the quality of financial disclosure be improved?

The primary objective of this paper is to analyze factors that cause the positional shifts of investors toward managers concerning the policy of financial disclosure. The second objective is to investigate the social contexts in which investors affect a manager's decision to disclose and by which the Rule of Disclosure works best. To answer the third question above, we summarize the effects determined from the social contexts in which the Rule of Disclosure achieves its maximal function.

Through a simple framework, we first analyze the relationship between companies' financing policy and tendency to disclose information (Chen and Liu 2008). While a company is modeled as a principal-agent game between risk-neutral[1] owners (the principal) and the manager (the agent), a contract that minimizes the expected cost of compensating the manager can lessen the expected compensation cost, subject to guaranteeing the manager's reservation utility, inducing a good performance level of effort and having a truthful disclosure for each signal. Hence, disclosure becomes contractible in such a way as to make possible the elimination of misrepresentation.

As we relax the assumption of manager type, we cannot help but discuss the possibility of more than just a dichotomy or even trichotomy. Once the (situation of) laissez-faire has been affected by the enrollment of law, the reaction of investors to the investment decision made by managers has been discussed broadly. Moreover, the conjunction between the company and its manager will break and

[1]According to Kimball (1993) risk-averse principals who are willing to bear one risk are less willing to bear another risk, even when the two risks are independent. People are approximately risk-neutral when stakes are small (Rabin 2000). If the principal and the agent are both assumed to be risk-averse in this study, then the reaction of rational managers discussed in Sect. 8.3.2 would be congruent and we would not have to relax the assumption of manager type by discussing the possibility of there being more than just a dichotomy under the Rule of Disclosure.

result in investors' ambivalence to the same company. Without a contract established between the manager and the company owner, we extend the discretion to disclose information as a right that the manager ought to have. We argue that the Rule of Disclosure may affect a manager's tendency to disclose truthful information and reset our model without imposing any scrutiny and only with managerial support for the policy of disclosure. This paper contributes to the literature by demonstrating the social context in which investors affect a manager's decision to disclose.

Section 8.2 reviews the literature about Rule l0b-5 of the 1934 Securities Exchange Act (hereafter, Rule) in the USA to find the rationale for the interdependence between the manager, investors, and companies. Section 8.3 sets up a framework to analyze the relationship between the companies' financing policy and tendency to disclose information and then resets up our model by exemplifying factors about investor relations that owners of companies take into account. This helps explain behavior in the social contexts among investors, financial disclosure, and managerial incentive to disclose in Sect. 8.4. Section 8.5 concludes the findings of this study.

8.2 Literature Review

The literature has extensively discussed the interaction between managers and outside investors (La Porta et al. 1999, 2000; Tirole 2001; Fuerst and Kang 2004; Drymiotes 2008; Bebchuk and Neeman 2009). A manager plays the role of disclosing information about his company, in order to get a reasonable stock price evaluation from outside investors in the stock market. When the extent to disclose information encompasses the personal decisions of the manager, a company can be taken as an organized system, with its success judged by its external conditions and interactive elements, and by the planning and execution process of strategies. The possible impacts from the interaction between managers and investors on company stock prices may be determined by the information-disclosing efforts exerted by the manager. When outside investors notice the information released from the investment market to avoid a loss, managers, as directors of their companies, have incentives to prove the company performance by disclosing information. If the inefficiency of investment timing can be mitigated from hidden information and the actions of the manager, then the effort exerted for investors will strengthen the incentives.

Riedl and Srinivasan (2010) investigated whether managers' presentation of special items within the financial statements reflects informational versus opportunistic motivations. For informational motivations, they suggested managers use the income statement versus footnote presentation as a mechanism to assist users in better understanding the economic implications of the reported special items. For opportunistic motivations, they recommended managers use this presentation decision to bias perceptions of the companies' performance, implying that

managers may have incentives to change their support for information disclosure given situations of the macroenvironment under the Rule. For example, while disclosure eliminates a bank's information advantage over its competitors, disclosing information creates a new advantage for the bank in terms of a lower cost of external funds (Tassel 2011). Finally, any disclosure must be truthful, but the manager can strategically withhold information in the all-or-nothing model; or the manager's disclosure may not be truthful in the cheap-talk[2] model until there is a high penalty cost for misleading investors (Li and Sun 2012).

So many factors are taken for granted to affect the flow of capital in the stock market. Johnson and Schwartz (2005) used stock market data to provide evidence that investors are, on average, misled by pro forma earnings disclosures despite the widespread concern expressed in the financial press and by regulators. Why and how does the policy of financial disclosure assist investors in judging company performance? Hirshleifer and Teoh (2009) proposed the psychological attraction approach to accounting and disclosure policy in two very different ways. One is good rules for bad users: Rules and policies that provide information in a form, that is, helpful for users who are subject to bias and cognitive processing constraints. The other is bad rules: Superfluous or even pernicious rules and policies that result from psychological bias on the part of the "designers" (managers, users, auditors, officials, or voters). As for the former, a mistaken message may be generated by the misunderstanding of investors, which is a fault due to the purpose by which rules are made. The companies are still running regularly and normally, but it is not just managers, accountants, and regulators who design rules. Users are important indirect designers, because managers who need to raise capital are pressured to report or disclose in forms that are appealing to them.

Ronen and Yaari (2002) found that Rule l0b-5 for Disclosure does not deter misrepresentation and may in fact suppress voluntary disclosure, or it induces some companies to adopt a partial disclosure policy of disclosing only bad news or only good news. This inspires them to draw the discretion to disclose information and demonstrate factors in which the Rule of Disclosure affects investors' tendency to believe the information. Raffournier (1995) proposed that the extent of disclosure is positively related to ownership diffusion, which is difficult to be measured in the absence of the disclosure requirement about ownership structure. To understand and try to realize whether ownership structure has an effect on financial disclosure, we characterize the suppliers of capital by two groups: debt holders and equity holders. We find that the derivation and the discretion to offer disclosure are supported reasonably by the related literature (Chen and Liu 2008).

[2]Cheap talk is the situation in which information is shared through ordinary, informal talk. Joseph and Rabin (1996) presented this situation and argued that cheap talk can and often do matter, but it does not generally lead to efficiency. Chen et al. (2008) introduced that in the standard model of cheap-talk communication, an informed Sender sends a message to an uninformed Receiver. The Receiver responds to the message by making a decision, that is, payoff relevant to both players. Talk is cheap, because the payoffs of the players do not depend directly on the Sender's message.

There are still other factors that result in disclosure and reporting practices varying over time. Bagnoli and Watts (2007) assumed that the manager knows the variance of an item in the company's financial reports and selects a voluntary disclosure strategy to maximize the market price of the company. However, disclosing plans notifies the market that future transactions under the plan do not necessarily reflect the executive's view concerning the future of the company (McKinney 2007). Rational investors interpret any piece of withheld information that can be credibly disclosed as conveying bad news, inducing companies to fully disclose their private information, however, unfavorable it is, in order to distinguish themselves from companies possessing even worse information (Einhorn and Ziv 2008). Investors rationally anticipate the enhancing impact of the current disclosure on the company's current market price no matter whether the news is bad or good to them, because the Rule may provide managers the opportunity to manipulate the timing or content of disclosure related to material information obtained subsequent to a faithful plan's initiation.

Veliotis (2010) also criticized the extent to which 10b5-1 plans encourage a company's insiders to strategically time truthful disclosure and to misrepresent the content of disclosure. For example, Zechman (2010) tried to understand how managers use voluntary disclosure in the trade-off between cash flow and financial reporting incentives. The emphasis on mandatory requirements may further override managers' incentives to disclose voluntary information (Arshad et al. 2011). As there are so many factors to explain an investor's choice in the capital market, we turn to derive the social contexts under which the Rule of Disclosure achieves its maximal function. According to the action of investors, this context shows the relationship between disclosure and managerial discretion for corporate investment that incorporates the heterogeneous beliefs of investors and the regulations of disclosure in the market. Our model shows that a company's strategies to invest are associated with news, the managerial support for the Rule, and the proportions of investor types in the market.

8.3 The Model

8.3.1 The Company

Consider that there are two types of companies in the market. Type H (honest or the debt-issuing company) is the one whose owners' (shareholders') actions are motivated by the expectation of assets being liquidated. The other company type, D (dishonest or the equity (stock)-issuing company), is the one whose owners wish that the manager tries his best to enhance the company's stock price, no matter what and how the manager may select different kinds of signal to disclose. Since the owners' actions are motivated by the expectations of the stock price, in order to maximize the rent and insiders' private benefits, the managers of D companies may

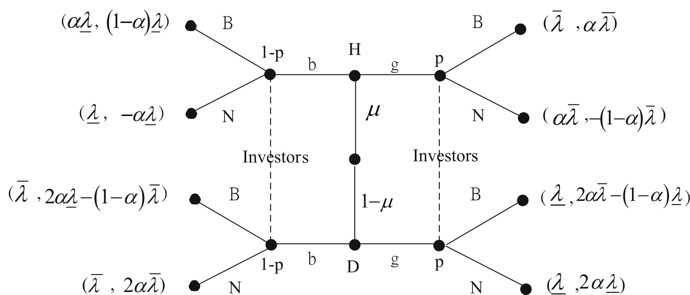

Fig. 8.1 Model setting

disclose news dependent of the shareholders' and their own self-interests in the following Fig. 8.1 (Chen and Liu 2008).

The timing

1. The companies operate and yield a market value, in which $\bar{\lambda}$ means a higher value of the company, while $\underline{\lambda}$ means a lower value of the company than that of the last quarter on date 1.
2. On date 2, the manager pre-observes the information on the outcome of operating performance and decides the timing to disclose it.
3. On date 3, the manager of D company decides to disclose false news to the public or not to do so. At the same time, the manager of H announces the news truthfully. Thus, the news signal, s, can be either good g or bad b, i.e., $s \in \{g, b\}$. Investors assume that the prior probability that the signal is good is p, i.e., $\Pr[s = g] = p$.
4. Finally, the investors can choose to believe (B), the signal disclosed by the company accordingly, or the investors do not believe (N) the news until the audited report is published, and they may suffer a loss in stock price (Table 8.1).

The manager here is assumed to operate the company and announces any informative signal truthfully. Highly leveraged companies are expected to disclose more information that helps monitor and restrain managerial opportunism, which favors equity holders at the expense of debt holders.

Let investors in the market be the signal receiver who can choose to believe (B) the signal transmitted by the company or to not believe (N). If they believe, then they could go forward by buying the company's stock according to the signal. In the interests of efficiency, it is to the company's advantage to reduce information asymmetry so as to reduce the information asymmetry component of the cost of capital. One way to achieve information asymmetry reduction is for the company to commit to the highest level of public disclosure at the time shares in the company are first offered. Hence, we assume that both types of the companies always disclose truthfully under symmetric information during the beginning of the time for raising their capital.

Table 8.1 Notation for Fig. 8.1

Sign	Meaning	Explanation
H	Honest or the debt-issuing company	There are two types of companies in the market
D	Dishonest or the equity (stock)-issuing company	
B	Believe	Investors in the market are the signal receiver who can choose to believe (B) the signal transmitted by the company or to not believe (N) it
N	Not believe	
α	Probability to withhold false disclosure	
$\bar{\lambda}$	A higher value of the company	
$\underline{\lambda}$	A lower value of the company	
g	Good	The news signal
b	Bad	
p	Prior probability that the signal is good	
$1 - p$	Prior probability that the signal is bad	
μ	Probability that the company is H	
$1 - \mu$	Probability that the company is D	

To analyze company D's behavior, it is not difficult to find that since the ability of companies to capture the benefits is affected by their transparency, their incentive to invest that benefit for their sophisticated customers is affected by their capital structure.

We denote α as the probability to retard false disclosure. Companies are indifferent between sending the uninformative signal and disclosing their types in the full-disclosure equilibrium. In contrast to the above, if a single company discloses news according to the market's expectation, then the expected value of all non-disclosing companies will fall. Thus, we argue that investors must believe that it is always a type D company that sends uninformative signals under the assumption that full disclosure is indeed the game's only equilibrium in addition to that lying must be considered as a possible strategy out of equilibrium. This implies that investors cannot ignore the disclosure, because they know that H has designed a truth-telling contract while D sends the same signal, which may be noisy but informative.

Without the Rule, company D always discloses bad news while company H discloses any news truthfully under symmetric information. The investors may sometimes have difficulty in distinguishing the company type and thus discount the

bad news either from company D or company H. From the proof of the pooling and separating equilibrium, it is possible for company H to disclose bad news, because it is doing well.

8.3.2 The Manager

Suppose that rational managers gather information for investors, and further consider managers who invest. Some never invest while others may invest through financing. Consider that A managers are those who rarely change their preference in keeping some investment and always obey the Rule. They will not change their information-disclosing behavior easily unless there is a very rare and disastrous financial crisis to investors. Separately, B managers are those who are always affected by many factors, such as news and rumors. This type of manager always suffers from psychological pressure, and it is easy for B managers to become nervous by being eager for any information in their daily life.

For each type of owner, the equilibrium strategy is the best response. Since the manager of company H wants to keep the stock until the end of paying out liquidating dividends, he will disclose news truthfully. No matter what type of manager investors prefers, it is natural for a rational manager to internalize the cost of financing when financial disclosure conveys an advantage relative to the status quo. By creating opportunities for self-belief improvement, the disclosure induces investors to change preferences. At the same time, rules in principle should only make dishonesty less attractive in the execution of any law. We make several points about the transformation for the Rule of Disclosure to affect companies that disclose their information.

1. Depending on the nature of private information, managers could have different incentives to disclose.
2. Managers appropriately trade off the costs and benefits of information disclosed. To insist upon the rising costs of greater transparency, the image that a company projects to its stakeholders is important for its profitability, and these costs also play an important role in the determination of capital structures.
3. Throughout accounting, one often-stated rationale for a manager to be concerned with the company's current capitalization level, as opposed to the company's future value, is that contracts are incomplete. Due to adverse selection and reputation capital, there is no denying that the soundness of companies' corporate governance may be an issue affecting the managers' discretion to disclose.

Through derivation, we find that there is one pooling and separating equilibrium under symmetric information settings. Each company has its own type. The investors maximize the expected profit conditional on their beliefs of the company's type, which implies that they set the stock price according to the news disclosed.

The investors' beliefs are derived from the strategies of the companies' owners via Bayes' rule when they observe a disclosure that is an equilibrium for at least one type.

The link between the verifiability message and truth telling is only valid within an equilibrium in which the manager of type H companies may have incentives to disclose truthfully for reputational reasons. However, the situation exists only when we assume that the Rule of Disclosure may not affect a manager's tendency to disclose truthful information here. Otherwise, we may distinguish truth-telling effects from different social contexts in which investors influence a manager's decision to disclose in Sect. 8.4.

The investors thus believe good news is the truth from the H company, and then they form a probability distribution over the types upon disclosure of bad news. This leads us to Proposition 1 as follows:

Proposition 1 *Without the Rule, company D always discloses bad news while company H discloses any news truthfully under symmetric information. The investors may sometimes have difficulty in distinguishing the company type and thus discount the bad news either from company D or company H.*

Within the context of this model, there is asymmetry between the effects of favorable and unfavorable information about the company. To model the probability of truthful disclosure under the premise that managers do disclose favorite information about their company, we follow the process whereby Bayesian traders combine new information with their prior beliefs to revise their assessment of the company's expected value. The result may be biased without considering noise or some unavoidable reasons that exist in the trading process.

8.3.3 The Social Contexts

The condition for bad news to be disclosed, which comes from company H, is $\underline{\lambda} > \alpha\bar{\lambda}$. That helps to explain why company D (the equity (stock)-issuing company) is more unwilling to disclose truthful information than company H (the debt-issuing company). We argue that company D may avoid actions that generate information, such that its manager tends to disclose false news. In particular, we expect the tendency of companies H and D to disclose their information may be affected by the Rule.

Investors are interested in management's predictions as to the future of the company, but predictions by their very nature are not always accurate. Allowing legal actions against managers for inadequate or untimely disclosures can encourage companies to increase voluntary disclosure.

Investors, therefore, believe financial disclosure is the truth from the manager, but their preference does not form a probability distribution upon disclosure of news for the manager. We, therefore, impose the Rule of Disclosure hereafter and derive the results of the reset model in the following Fig. 8.2 (Table 8.2).

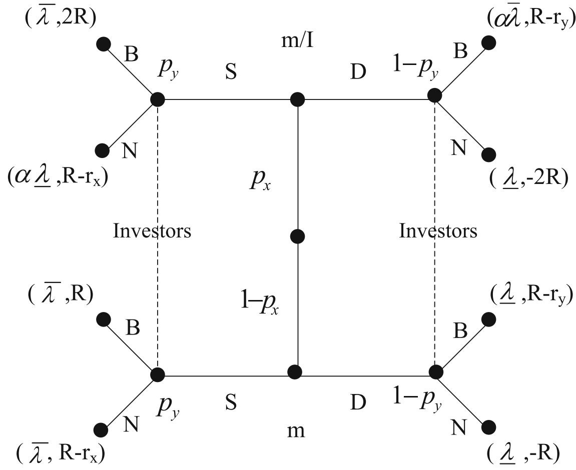

Fig. 8.2 Model resetting

Table 8.2 Notation for Fig. 8.2

Sign	Meaning	Explanation
p_x	Probability that nature decides the manager as type X	
$1-p_x$	Probability that a manager who is type X changes to type Y	
m	Manager who never invests	
m/I	Manager who invests	
p_y	Probability that nature decides the manager as type Y	
$1-p_y$	Probability that a manager who is type Y changes to type X	
B	Believe	Investors in the market are the signal receiver who can choose to believe (B) the signal transmitted by the company or to not believe (N) it
N	Not believe	
R	The profit of companies from financial disclosure to investors	
α	Probability to withhold false disclosure	
$\bar{\lambda}$	A higher value of the company	
$\underline{\lambda}$	A lower value of the company	
S	Managers support the policy	
D	Managers do not support the policy	
r_x	Cost to the (owners of) companies to face type-not-change managers	
r_y	Cost to the (owners of) companies to face type-changing managers	

Depending on the nature of private information, managers could have different incentives and considerations to disclose. By disclosing their intentions, managers will be reluctant to change their minds in the future, which may lead them to make inefficient project implementation decisions.

8.4 Extension of the Base Model

8.4.1 *The Message for Truth-Telling Construct Conveyed by the Managers*

If the manager supports the policy of financial disclosure, then the shareholders will know his willingness to be honest on behalf of his company. Basically, the innocent investor would have sold his share(s) regardless of whether an insider traded without disclosure or abstained from trading. Therefore, the investor theoretically will have suffered no loss unless there is inconsistency among the policy of financial disclosure, the manager, and shareholders (Table 8.3).

Investors seek assurances that a good policy of financial disclosure for investment opportunities is in place that can guard the truth-telling behavior of the manager, who tends to be incentivized to maximize company profits. Even though honesty is indeed the only equilibrium of the game, lying must be considered as a possible strategy outside of the equilibrium. This implies that investors cannot ignore the disclosure, because they know that shareholders have to induce managers into truth-telling, whereas managers must choose to send the correct signal, which may be noisy but informative. Therefore, we present the next proposition.

Proposition 2 *Without the Rule, no matter whether investors support the policy of financial disclosure or not, the manager will be honest in disclosing any news. The investors may only have difficulty in distinguishing the company type, but the type of managers in either company D or company H is clearly known.*

More specifically, after all factors (investor preference, prior belief, information, and endowment) discussed above (in Sect. 8.3.3) are taken into account, any financing action by investors is now rooted in a particular social context (Fig. 8.3).

The equilibrium strategy is the best response for investors. Since owners of a company want to maximize the profit until the end of paying out liquidating

Table 8.3 Notation for Fig. 8.3

Sign	Meaning	Explanation
Honest	Honest company	There are two types of companies in the market
Dishonest	Dishonest company	
B	Believe	Investors in the market are the signal receiver who can choose to believe (B) the signal transmitted by the company or to not believe (N) it
N	Not believe	
A	One of the binary manager types who rarely changes his preference in keeping some investment and always obeys the Rule	
B	The other of the binary manager types who is always affected by any factors, such as news and rumors	

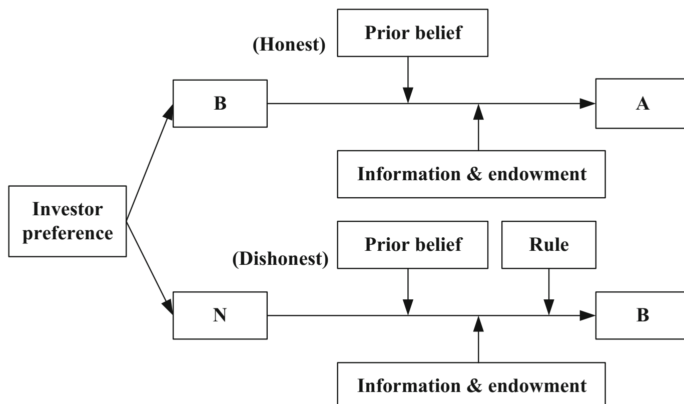

Fig. 8.3 Factors to recognize manager's type under the Rule

dividends, they tend to induce the manager to execute a policy of financial disclosure. At the same time, the owners want to maximize the profit minus managers' type-changing cost and thus may avoid any flaw in the disclosure policy, which results in their loss.

8.4.2 Rule Executed and Reaction of Companies to Screen Managers' Behavior

To fully understand a given disclosure of news, the reaction of investors to believing it must, therefore, be situated within the framework of the non-discrete relations that encompass it. Taking the costs as given and extending the analysis to consider the possibility that the company has an investment opportunity, then depending on its initial capital structure a company may be required to raise external capital. In some situations, the company will pass up positive NPV investments that need to be funded externally, because of the expected costs associated with the information that will be generated during the process of raising external capital. Debt holders in contrast seek assurance that good governance systems are in place that will guard against opportunistic behavior by the management, which tends to be incentivized to maximize the welfare of equity holders. In particular, debt holders expect the board of directors to rein in managerial opportunism, since debt holders themselves are more likely to be concerned with the overall value of the company.

Investors must believe that a type D company always sends uninformative signals. This implies that investors cannot ignore the disclosure, because they know

that type H company has induced truth-telling while type D company sends the same signal, which may be noisy but informative. The investors, therefore, believe good news is the truth from the type H company, and then they form a probability distribution over manager types. Therefore, we now present Proposition 3.

Proposition 3 *With the Rule, company D always discloses good news while company H truthfully discloses any news. The investors thus discount the good news and sometimes have difficulty in distinguishing the manager type in either company D or company H.*

Presenting legal actions against managers for inadequate or untimely disclosures can encourage companies to increase voluntary disclosure. Litigation potentially reduces the incentives to provide disclosure, particularly of forward-looking information, if managers believe that the legal system penalizes forecasts made in good faith. It is hard to effectively distinguish between unexpected forecast errors due to chance and deliberate management bias. Empirical evidence also suggests that litigation risk is not just relevant for companies with bad news, but also for those with good news. Healy and Palepu (2001) reviewed research on financial reporting and voluntary disclosure of information by management and argued that one factor enhancing the credibility of management disclosures is regulators. While the negative effect of unfavorable information exceeds the positive effect of positive information, companies find it costly to take any action, like issuing equity, which generates information about its type (Almazan et al. 2003). This helps to explain why company D is more unwilling to disclose truthful information than company H. We argue that company D may avoid actions that generate information, such that its manager will tend to disclose false news. In particular, we expect that the tendency of a type B manager to disclose information may be affected by the Rule. Therefore, the following Proposition 4 arises.

Proposition 4 *With the Rule, company D would rather not disclose bad news than to disclose it. To avoid being distinguished as a company D and not to have its financial leverage be investigated, company D and manager B may at the same time avoid disclosing any news.*

When the manager's information is such that there exists an affirmative duty to disclose under Rule l0b-5, the news disclosures are expected to be more precise than those that reflect unfavorable information. Hence, to ensure the news disclosed from a "rational" manager is due to its social context, it is necessary for the manager to persuade investors to invest.

We now consider those "making" a false or misleading statement with actual or constructive knowledge that his or her representation will reach potential investors. We characterize the different changing probability of managers and summarize the results of the derivation in the following cases.

Case 1 If $p_y < p_x$, then $(R_x - r_x) > (R_x - r_y)$. Under this situation, the companies operate regularly. Some investors suffer losses from managers changing their types. Mere possession of information about managers does not mandate disclosure, and equal access to owners is not the best (Sabbath 1983). We derive that $(R_x - r_x)[p_x p_x - p_y(1 - p_y)] > (R_x - r_y)[p_y p_y - p_x(1 - p_x)]$ and reset the presumption as the following. To recognize this type of managers, we just screen their support for the disclosure policy.

Case 2 If $p_y > p_x$, then $(R_x - r_x) < (R_x - r_y)$. If the probability of consistent preference is sufficiently high, then it is necessary in a l0b-5 case that there be a disclosure which can be linked to previous statements that the manager can allege were misleading or incomplete or both (Narayanan 1994). We derive that $(R_x - r_x)[p_x p_x - p_y(1 - p_y)] > (R_x - r_y)[p_y p_y - p_x(1 - p_x)]$ only when $(R_x - r_x) < 0$.

Case 3 If $p_y = p_x$, then $(R_x - r_x) = (R_x - r_y)$. The important point is that the investor was disadvantaged by his lack of information at the same time that the insider profited from his access to it. We are able to derive that $(R_x - r_x)[p_x p_x - p_y(1 - p_y)] = (R_x - r_y)[p_y p_y - p_x(1 - p_x)]$. Corporate information seems to be treated as a type of trust, and the persons to whom it is or should be communicated seem to be treated as the beneficiaries.

One possible view is that, by explicitly gaining a manager's formal recognition of his legal responsibilities, it will be easier to prosecute him in case of violation. Pushed even further, one might argue that the Rule is a signal that there is a clear intent to do as much as possible to catch a manager in a violation.

8.4.3 The Message Conveyed by the Managers

From the proof of separating equilibrium, it is possible for companies to recognize X managers through financial disclosure, because the companies will be better off doing so. If managers do support the policy of financial disclosure, then the owners would know whether the managers are induced to be honest in the company. The probability of the policy being supported, which comes from type X managers, is p_x. The conditional probability p_x is the same as the probability of the policy being unsupported by the same type X managers, no matter what signal is disclosed from their companies or the Rule. Moreover, the probability $(1 - p_x)$ is the support for financial disclosure from type Y managers and thus is informative. Hence, we only list two situations of pooling equilibrium in the following and ten interesting situations for the separating equilibrium. Each provides thinking clues for how to improve the effect of a policy with voluntary disclosure, no matter what may be adopted or accepted (Table 8.4).

Table 8.4 Temporary outcome of the game

	(3)	(4)	(5)	(6)[a]	(7)
Policy	Supporting	Supporting	Not supporting	Supporting	Supporting
News	Bad	Bad	Bad	Bad	Bad
Investors	B (believe)	N (not believe)	B (believe)	B (believe)	B (believe)
Companies	H (honest)	H (honest)	H (honest)	H (honest)	D (dishonest)
X managers	Y type	Y type	Y type	X type	Y type
Equilibrium	Exist	Not exist	Not exist	Exist	Exist
	(8)	(9)	(10)	(11)	(12)
Policy	Supporting	Supporting	Not supporting	Supporting	Supporting
News	Good	Good	Good	Good	Good
Investors	N (not believe)	B (believe)	N (not believe)	N (not believe)	N (not believe)
Companies	D (dishonest)	D (dishonest)	D (dishonest)	D (dishonest)	H (honest)
X managers	Y type	Y type	Y type	X type	Y type
Equilibrium	Not exist	Exist	Not exist	Not exist	Not exist

[a]The policy has the maxima effect

(1) Pooling at supporting the policy of financial disclosure with good news disclosed (does not exist).

If the investors choose N (not believe) and companies appear to be D (dishonest), then:

The condition for G to choose to disclose $\underline{\lambda}$ is $(\underline{\lambda} + \alpha\underline{\lambda}) > \left(\alpha\bar{\lambda} + \underline{\lambda}\right)$, and the condition for type X managers to choose to be type Y is $2\alpha\underline{\lambda} + R - r_x > -(1-\alpha)\bar{\lambda} - 2R$.

(Since $\bar{\lambda} > \underline{\lambda}$, this pooling equilibrium does not exist.)

Parameter	Direction	Effect
Policy	Supporting	The policy has not been enforced well, because either investors do not believe the news or companies are not honest. Although the policy is supported, good news only shows a lower level of company value
News	Good	
Investors	N (not believe)	
Companies	D (dishonest)	
Managers X	Y type	

(2) Pooling at not supporting the policy of financial disclosure with good news disclosed (does not exist).

If the investors choose B (believe) and companies appear to be H (honest), then:

The condition for G to choose to disclose $\bar{\lambda}$ is $\left(\alpha\bar{\lambda}+\bar{\lambda}\right) > \left(\underline{\lambda}+\bar{\lambda}\right)$, and the condition for type X managers to choose to remain type X is $\alpha\bar{\lambda}+R-r_{\mathrm{y}} > 2\alpha\bar{\lambda}-(1-\alpha)\underline{\lambda}+2R$.

(Since $\bar{\lambda} > \underline{\lambda}$, this pooling equilibrium does not exist.)

Policy	Not supporting	The policy has not been enforced well, although investors believe the news. Companies are honest and good news also shows a higher level of company value. However, even though the policy is not supported, it still exists and is enforced
News	Good	
Investors	B (believe)	
Companies	H (honest)	
X Managers	X type	

(3) Separating: Supporting the policy of financial disclosure with bad news disclosed, but X managers choose to be type Y (exist).

If the investors choose B (believe), but companies appear to be H (honest), then:

The condition for Y to choose to disclose $\bar{\lambda}$ is $\left(\bar{\lambda}+\bar{\lambda}\right) > (\alpha\underline{\lambda}+\underline{\lambda})$, and the condition for X managers to choose to be type Y is $(1-\alpha)\underline{\lambda}+R-r_{\mathrm{y}} > 2\alpha\underline{\lambda}-(1-\alpha)\bar{\lambda}+R$.

Policy	Supporting	The policy has not been enforced well, although it helps investors believing the news to distinguish honest companies. On the other hand, bad news shows a higher level of company value. Although the policy is supported, the manager type is not the equilibrium and may change
News	Bad	
Investors	B (believe)	
Companies	H (honest)	
X Managers	Y type	

(4) Separating: Supporting the policy of financial disclosure with bad news disclosed, but X managers choose to be type Y (does not exist).

If the investors choose N (not believe), but companies appear to be H (honest), then:

The condition for Y to choose to disclose $\bar{\lambda}$ is $\left(\bar{\lambda}+\bar{\lambda}\right) > (\underline{\lambda}+\underline{\lambda})$, and the condition for X managers to choose to be type Y is $-\alpha\underline{\lambda}-R > 2\alpha\bar{\lambda}+R-r_{\mathrm{x}}$.

(Since $\bar{\lambda} > \underline{\lambda}$, this separating equilibrium does not exist.)

Policy	Supporting	The policy has not been enforced well, because investors do not believe the news, even when companies are honest and bad news shows a higher level of company value. Although the policy is supported, it only impacts companies and managers. It does not contribute to the market
News	Bad	
Investors	N (not believe)	
Companies	H (honest)	
X Managers	Y type	

(5) Separating: Not supporting the policy of financial disclosure with bad news disclosed, but X managers choose to be type Y (does not exist).

If the investors choose B (believe), but companies appear to be H (honest), then:

The condition for Y to choose to disclose $\bar{\lambda}$ is $(\alpha\underline{\lambda}+\underline{\lambda}) > (\bar{\lambda}+\bar{\lambda})$, and the condition for X managers to choose to be type Y is $(1-\alpha)\underline{\lambda}+R-r_{\mathrm{y}} > 2\alpha\underline{\lambda}-(1-\alpha)\bar{\lambda}+R$.

(Since $\bar{\lambda} > \underline{\lambda}$, this separating equilibrium does not exist.)

<table>
<tr><td>Policy</td><td>Not supporting</td><td rowspan="5">The policy has not been enforced well, because it is not supported. Although investors believe the news and bad news shows a higher level of company value, the policy has no impacts on the market. Companies are not honest, and the manager type is not the equilibrium and may change</td></tr>
<tr><td>News</td><td>Bad</td></tr>
<tr><td>Investors</td><td>B (believe)</td></tr>
<tr><td>Companies</td><td>H (honest)</td></tr>
<tr><td>X Managers</td><td>Y type</td></tr>
</table>

(6) Separating: Supporting the policy of financial disclosure with bad news disclosed, while X managers choose to remain type X (exist).

If the investors choose B (believe) and companies appear to be H (honest), then:

The condition for Y to choose to disclose $\bar{\lambda}$ is $(\bar{\lambda}+\bar{\lambda}) > (\alpha\underline{\lambda}+\underline{\lambda})$, and the condition for X managers to choose to be type X is $2\alpha\underline{\lambda}-(1-\alpha)\bar{\lambda}+R > (1-\alpha)\underline{\lambda}+R-r_{\mathrm{y}}$.

<table>
<tr><td>Policy</td><td>Supporting</td><td rowspan="5">The policy has maxima effect in this situation when investors believe the news and support it. Companies are honest and bad news also shows a higher level of company value. The manager type is the equilibrium and may not change</td></tr>
<tr><td>News</td><td>Bad</td></tr>
<tr><td>Investors</td><td>B (believe)</td></tr>
<tr><td>Companies</td><td>H (honest)</td></tr>
<tr><td>X Managers</td><td>X type</td></tr>
</table>

(7) Separating: Supporting the policy of financial disclosure with bad news disclosed, but X managers choose to be type Y (exist).

If the investors choose B (believe), but companies appear to be D (dishonest), then:

The condition for Y to choose to disclose $\bar{\lambda}$ is $(\bar{\lambda}+\bar{\lambda}) > (\alpha\underline{\lambda}+\underline{\lambda})$, and the condition for X managers to choose to be type Y is $(1-\alpha)\underline{\lambda}+R-r_{\mathrm{y}} > 2\alpha\underline{\lambda}-(1-\alpha)\bar{\lambda}+R$.

<table>
<tr><td>Policy</td><td>Supporting</td><td rowspan="5">The policy has not been enforced well, although investors believe the news. The policy does not impact companies and managers even when bad news shows a higher level of company value. However, companies are not honest and the manager type is not the equilibrium and may change, though the policy is supported</td></tr>
<tr><td>News</td><td>Bad</td></tr>
<tr><td>Investors</td><td>B (believe)</td></tr>
<tr><td>Companies</td><td>D (dishonest)</td></tr>
<tr><td>X Managers</td><td>Y type</td></tr>
</table>

(8) Separating: Supporting the policy of financial disclosure with good news disclosed, but X managers choose to be type Y (does not exist).

If the investors choose N (not believe) and companies appear to be D (dishonest), then:

The condition for Y to choose to disclose $\underline{\lambda}$ is $(\underline{\lambda} + \alpha\underline{\lambda}) > (\alpha\bar{\lambda} + \underline{\lambda})$, and the condition for X managers to choose to be type Y is $-(1-\alpha)\bar{\lambda} - 2R > 2\alpha\underline{\lambda} + R - r_{\mathrm{x}}$.

(Since $\bar{\lambda} > \underline{\lambda}$, this separating equilibrium does not exist.)

Policy	Supporting	The policy has not been enforced well, because investors do not believe the news. Companies are not honest and good news also shows a lower level of company value. Although the policy is supported, the manager type is not the equilibrium and may change
News	Good	
Investors	N (not believe)	
Companies	D (dishonest)	
X Managers	Y type	

(9) Separating: Supporting the policy of financial disclosure with good news disclosed, but X managers choose to be type Y (exist).

If the investors choose B (believe) and companies appear to be D (dishonest), then:

The condition for Y to choose to disclose $\underline{\lambda}$ is $(\underline{\lambda} + \bar{\lambda}) > (\alpha\bar{\lambda} + \bar{\lambda})$, and the condition for X managers to choose to be type Y is $\alpha\bar{\lambda} + R - r_{\mathrm{y}} > 2\alpha\bar{\lambda} - (1-\alpha)\underline{\lambda} + 2R$.

Policy	Supporting	The policy has positive impacts, but good news shows a lower level of company value. Although investors believe the news, companies are not honest and the manager type is not the equilibrium and may change
News	Good	
Investors	B (believe)	
Companies	D (dishonest)	
X Managers	Y type	

(10) Separating: Not supporting the policy of financial disclosure with good news disclosed, but X managers choose to be type Y (does not exist).

If the investors choose N (not believe) and companies appear to be D (dishonest), then:

The condition for Y to choose to disclose $\underline{\lambda}$ is $(\alpha\bar{\lambda} + \underline{\lambda}) > (\underline{\lambda} + \alpha\underline{\lambda})$, and the condition for X managers to choose to be type Y is $-(1-\alpha)\bar{\lambda} - 2R > 2\alpha\underline{\lambda} + R - r_{\mathrm{x}}$.

(Since $\bar{\lambda} > \underline{\lambda}$, this separating equilibrium does not exist.)

Policy	Not supporting	The policy has not been enforced well, because investors do not believe the news. Companies are not honest and good news shows a lower level of company value. Because the policy is not supported, it only impacts companies and managers, who are not the equilibrium and may change
News	Good	
Investors	N (not believe)	
Companies	D (dishonest)	
X Managers	Y type	

(11) Separating: Supporting the policy of financial disclosure with good news disclosed, but X managers choose to remain type X (does not exist).

If the investors choose N (not believe) and companies appear to be D (dishonest), then:

The condition for Y to choose to disclose $\underline{\lambda}$ is $(\underline{\lambda} + \alpha\underline{\lambda}) > \left(\alpha\bar{\lambda} + \underline{\lambda}\right)$, and the condition for X managers to choose to be type Y is $-(1-\alpha)\bar{\lambda} - 2R > 2\alpha\underline{\lambda} + R - r_{\mathrm{X}}$.

(Since $\bar{\lambda} > \underline{\lambda}$, this separating equilibrium does not exist.)

Policy	Supporting	The policy has not been enforced well, because investors do not believe the news. Companies are not honest and good news shows a lower level of company value. Although the policy is supported, the manager type is not the equilibrium and may change
News	Good	
Investors	N (not believe)	
Companies	D (dishonest)	
X Managers	X type	

(12) Separating: Supporting the policy of financial disclosure with good news disclosed, but X managers choose to be type Y (does not exist).

If the investors choose N (not believe) and companies appear to be H (honest), then:

The condition for Y to choose to disclose $\underline{\lambda}$ is $(\underline{\lambda} + \alpha\underline{\lambda}) > \left(\alpha\bar{\lambda} + \underline{\lambda}\right)$, and the condition for X managers to choose to be type Y is $-(1-\alpha)\bar{\lambda} - 2R > 2\alpha\underline{\lambda} + R - r_{\mathrm{X}}$.

(Since $\bar{\lambda} > \underline{\lambda}$, this separating equilibrium does not exist.)

Policy	Supporting	The policy has not been enforced well, because investors do not believe the news. Companies are honest, but good news only shows a lower level of company value. Even though the policy is supported, the manager type is not the equilibrium and may change
News	Good	
Investors	N (not believe)	
Companies	H (honest)	
X Managers	Y type	

Neither managers modeling investors' behavior, nor the reliability of financial disclosure itself, is publicly observable. To analyze the truth-telling possibility of managers, it is not difficult to realize that, for companies to capture the capital of their investors, the profit is affected by financial disclosure. For corporate owners, the lessons are clear: Investors' incentive to invest in projects that benefit the managers is impacted by their incentive to support the policy of financial disclosure. Extending the analysis to consider the possibility that the manager has autonomy to be honest, depending on investors' information may be required in order to raise consistent external capital. As we derive herein, in some situations the company will ensure the honesty of its manager, because of the policy of financial disclosure.

8.5 Conclusion

The courts have created a similar fictional scenario in civil cases brought under rule 10b-5 (Sabbath 1983). Since honesty by the manager is regulated by the Rule, whether or not the owners want their company to be honest is unknown. Moreover, the penalty regulated by the Rule of Disclosure may retard the effect of social responsibility. The manager does not have the choice of abstention or disclosure when trading stock on the open market, and a dishonest one is absolutely forbidden to disclose information, for disclosure would be a breach of the trust owed to shareholders. Furthermore, the innocent investor would have sold his security regardless of whether the insider traded without disclosure or abstained from trading.

One can also demonstrate that the probability of a disclosure will increase with both the precision of the manager's information and the variability of his company's earnings (Trueman 1997). However, this leaves some room for legal means to discuss false disclosure. The investor who has sold his shares would not have received any more or less than he would have otherwise had the manager not breached his fiduciary duty by trading on information. Therefore, the investor theoretically suffers no loss unless there appears any inconsistency among the policy of financial disclosure, the manager, and the owner. Due to the cost of equity capital, how to improve what types of information companies are disclosed on a voluntary basis depends on the managerial strategy. The negative effect of unfavorable information may exceed the positive effect of positive information from a legitimate point of view. This makes discussing the dichotomous or even trichotomous situations even more interesting once the Rule allows investors to be ambivalent to the same company.

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Chapter 9
Converging the Shareholder and Stakeholder Theories

Writing an Explicit Corporate Objective Function

Ertan Kucukyalcin

Abstract European Commission (2011) defines Corporate Social Responsibility (CSR) as 'the responsibility of enterprises for their impacts on society.' By addressing the claims of the stakeholders, CSR aims at enhancing the economic, social, and environmental welfare of the society. In parallel, there goes a debate over the shareholder vs stakeholder supremacy; whether corporations should have the sole responsibility to their shareholders or to all stakeholder groups. The shareholder or stakeholder supremacy is a long standing debate, but no definitive consensus has been reached yet. The debate continues, but proponents of both theories also have agreements on many areas. For example, they agree that corporations should create wealth and consider their stakeholders' concerns in making decisions. However, disagreements remain with important implications. The main disagreement is about the purpose of the firm; 'What should be the corporate objective function?' By discussing the shareholder and stakeholder theories to construct an explicit **corporate objective function,** the article aims at identifying the conditions under which the two theories converge. This also sheds light on why each theory advises management to act different in similar business conditions. The structure of the paper is as follows. Following a brief overview of each theory and key criticisms they receive, the paper addresses three areas of particular concern: (i) treatment of stakeholders under the two theories, (ii) wealth creation and allocation from the perspectives of both theories, and (iii) the 'problem of justification.' In the final section, we will construct the corporate objective function in three stages.

Keywords Stakeholder · Shareholder · Corporate Objective Function

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9.1 Introduction

European Commission (2011) defines Corporate Social Responsibility (CSR) as 'the responsibility of enterprises for their impacts on society.' Respect for applicable legislation, and for collective agreements between social partners, is a prerequisite for meeting that responsibility. To fully meet their CSR, enterprises should have in place a process to integrate social, environmental, ethical, human rights, and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders, with the aim of:

- maximizing the creation of a shared value for owners/shareholders and other stakeholders including society, and
- identifying, preventing, and mitigating their possible adverse impacts.

OECD states that corporate responsibility involves the search for an effective 'fit' between businesses and societies in which they operate. OECD also states that this 'fit' between the two helps to foster an atmosphere of mutual trust and predictability that facilitates the conduct of business and enhances economic, social, and environmental welfare.

Similarly, ISO 26000 Social Responsibility (2014), points to the key role of stakeholders and sustainability; 'Organizations around the world, and their stakeholders, are becoming increasingly aware of the need for, and benefits of, socially responsible behaviour. The objective of social responsibility is to contribute to sustainable development. An organization's commitment to the welfare of society and the environment has become a central criterion in measuring its overall performance and its ability to continue operating effectively…'

Global Reporting Initiative (GRI) G4 Sustainability reporting helps organizations to set goals, measure performance, and manage change in order to make their operations more sustainable. A sustainability report conveys disclosures on an organization's impacts—be they positive or negative—on the environment, society, and the economy. Stakeholder inclusiveness principle states that the organization should identify its stakeholders and explain how it has responded to their reasonable expectations and interests.

As noted above, and in various other definitions in the literature, stakeholders are the key for CSR. From a CSR perspective, it is critical to define and classify stakeholders and understand and respond to their claims.[1] For that purpose, the triple bottom line taxonomy (economic, social, and environmental) will be used in this article to address *some* of the stakeholders. Other stakeholders', such as customers', employees', and suppliers' interests are addressed in the accounting profit (revenues & costs of the firm), while the shareholders' interest is addressed through the shareholder value creation (cost of capital of the firm). Building on these, the article will discuss the shareholder vs stakeholder supremacy debate. Following the

[1]Negotiation capacities (i.e. power, *legitimacy and urgency of stakeholder claims*) *will be discussed in Sect.* 3.2.

historical steps of the business understanding, the article will argue a three-phased progress in the perceptions on the purpose of the firm, accounting profit maximization, shareholder value maximization, and finally stakeholder value maximization.

Shareholder vs stakeholder supremacy debate is on whether corporations should have sole responsibility to their shareholders or this responsibility should be extended to all stakeholder groups. The shareholder *or* stakeholder supremacy is a long standing debate, but no definitive consensus is reached yet.

The origins of the controversy can be found at least since the infamous debate between Dodd and Berle in early 1930s (Williamson 1985: 322; Fisch 2006 and Ho 2010: 71). Some scholars, (Sundaram and Inkpen 2001: 6) date the debate to the mid-nineteenth century while some others even trace it to earlier periods. For example, according to Key (1999: 319), Adam Smith's identification of external interests to the firm may be viewed as an early recognition of stakeholders; consumers being external members who were affected by and had an interest in the firm. However, the current understanding of stakeholder is commonly credited to Freeman's landmark book *Strategic Management: A Stakeholder Approach* (1984). The use of the term stakeholder, however, grew out of the pioneering work at Stanford Research Institute in the 1960s, which was heavily influenced by concepts developed by the planning department of Lockheed (Freeman and McVea 2001: 4).[2]

The debate continues, but proponents of both theories also have agreements on many areas. For example, they agree that corporations should create wealth and consider their stakeholders' concerns in making decisions. However, disagreements remain with important implications. The main disagreement is about the purpose of the firm; what should be the purpose of the firm? Put it in another way; '*What should be the corporate objective function?*' (For an overview of the two perspectives; see Jensen 2001 and Freeman et al. 2004).

The main aim of this paper is to construct the **explicit corporate objective function.** This, in my view, should enable us to identify the differences between the two theories in an analytical way, i.e. under which conditions the two theories converge or why does each theory advise management to act different in similar business conditions?

In constructing the corporate objective function,[3] I will start with a proposition; the perception of the purpose of the firm has passed (and is still passing) through three phases, and each phase is a modified version of the previous one.

This Paper argues that in the first phase, the corporate objective function was ***accounting profit maximization*** (total revenue minus total costs). Then, in the second phase, with the introduction of opportunity cost, the objective function has

[2]For historical review of CSR and stakeholders, see Agle and Mitchell (2008: 155–158), Carroll (1999) and Kristoffersen et al. (2005).

[3]Note that the corporate objective function is 'maximization of' another function, such as profit function.

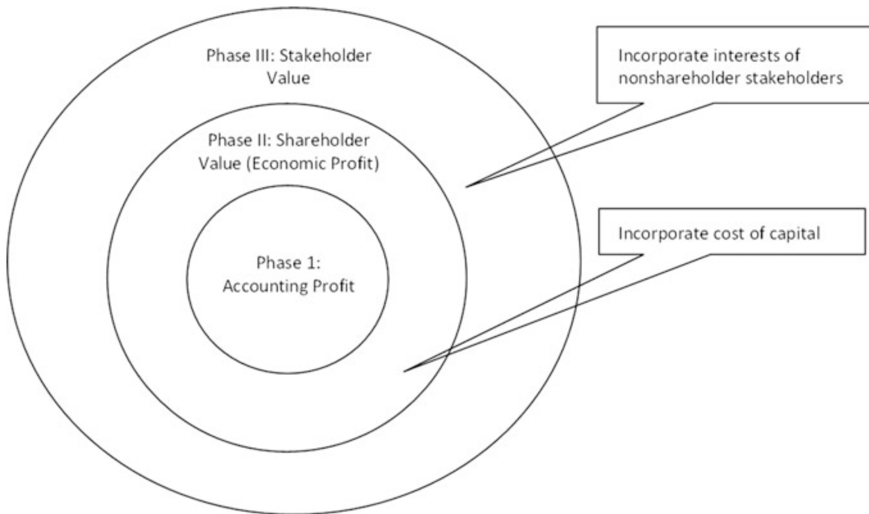

Fig. 9.1 The three phases of the perceptions on the purpose of the firm

been transformed to ***shareholder value maximization*** (economic profit). Finally in the third phase, with the introduction of stakeholder[4] interests, the paper will propose that the corporate objective function is ***stakeholder value maximization***. See Fig. 9.1.

In the next section, I will provide a brief overview of each theory and key criticisms they receive. I will then address three areas of particular concern: (i) treatment of stakeholder classes under the two theories, (ii) wealth creation and allocation from the perspectives of both theories, and (iii) the *'problem of justification*.[5] These areas form the foundation over which we can explicitly write the corporate objective function. In the final section, I will construct the function in three phases.

9.2 Definitions and Criticisms

> …the so-called debate is just a disagreement about how business actually works. There is no fundamental value disagreement here, just a disagreement about what it might mean to maximize profits… Freeman (2008: 165), in reference to the shareholder-stakeholder debate

[4]As we will discuss later in detail, classification of stakeholders and how their claims are viewed will fundamentally impact the analysis.

[5]'*Why should the stakeholder theory be accepted or preferred over alternative conceptions?*' (Donaldson and Preston 1995: 73).

Shareholder value theory says that the purpose of a corporation is to maximize shareholder wealth. As Phillips, Freeman, and Wicks (2003: 498) write, there are multiple means for measurement of shareholder wealth (e.g., accounting profits, firm value, dividends, long- and short-term market value for shares). Sternberg (2001) defines it as long-term owner value while Jensen (2001: 8) prefers to define it in terms of firm value, where the firm value is the sum of the values of all financial claims on the firm—debt, warrants, and preferred stock, as well as equity. Whichever way shareholder wealth is measured, the shareholder supremacy argument is best summarized in the now-classic quote from Friedman's 1970 essay in the New York Times where he says; *'There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.'*

On the other hand, s*takeholder theory begins with the assumption that values are necessarily and explicitly a part of doing business. It asks managers to articulate the shared sense of the value they create, and what brings its core stakeholders together* (Freeman et al. 2004: 364). According to Donaldson and Preston (1995: 87*), the ultimate justification for the stakeholder theory is to be found in its normative base. The plain truth is that the most prominent alternative to the stakeholder theory (i.e., the 'management serving the shareowners' theory) is morally untenable.*

Stakeholder value approach is criticized in several ways. It is argued that the sole responsibility of businesses is to make profits and obey the law—"the business of business is business!" Taking on greater social and environmental responsibilities than those legally mandated is only likely to increase costs and reduce efficiency (SIDA 2005: 16). Jensen (2001: 6) argues that it is logically impossible to maximize in more than one dimension; purposeful behavior requires a *single-valued objective function*. He further notes that the stakeholder theory makes managers unaccountable for their actions and can be attractive to the self-interest of managers and directors. According to Key (1999: 326), stakeholder theory, at its current form, lacks sufficient theoretical content and no specific theory logic has been identified which explains the relationships between stakeholders and the firm.

Shareholder value theory is not immune from criticisms as well. Some of the criticisms against the theory can be found in the work of Freeman et al. (2004: 366). According to them, proponents of this view distinguish the economic from the ethical consequences and values; therefore, the resulting theory is a narrow view. Secondly, maximizing shareholder value is not value-neutral and contains vast ideological content. At its worst, it involves using the prima facie rights claims of shareholders to excuse for violating the rights of others. A third criticism is that shareholder view is more susceptible to moral myopia, such that if managers' primary duty is to make money for shareholders, than it might be considerably easier for managers to rationalize questionable practices that place harm on non-shareholder stakeholders in the name of increased profitability.

The current debate is on whether to introduce stakeholder claims into the corporate objective function or not. The two theories provide opposing answers, but

why? The reason is related to how each theory views stakeholder claims. Are their claims *ends* in themselves (as in stakeholder value theory)[6] or are they *means* to satisfy other corporate objectives, such as shareholder wealth maximization. This *ends-or-means* distinction leads us to derivative questions: how should we classify stakeholders so that the differences between the two theories can be analyzed, how wealth creation is defined and allocation is decided under the two theories, and why should we chose shareholder or stakeholder view (the justification problem). I will address these questions in sequence.

9.3 Foundations for the Explicit Corporate Objective Function

9.3.1 Classifying Stakeholders

Freeman (1984: 46) defined the term as '*Stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the activities of an organization.*'

However, several differing definitions of the term evolved in the literature since then. A chronology of the definition of stakeholder by different authors can be found in the work of Mitchell et al. (1997: 858). As Post, Preston and Sachs (2002), rightfully suggest, the definition of Freeman has a problem since it would include, say, competitors whose interests are directly opposed to the focal corporation's interests, but can affect or be affected by it. Therefore, I am inclined to their definition of stakeholder;

> The stakeholders in a corporation are the individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth-creating capacity and activities, and that are therefore its potential beneficiaries and/or risk bearers Post, Preston and Sachs (2002:19).

I believe, the above definition, by making a distinction between *voluntary &involuntary* stakeholders, signals us that we need to identify and treat the two types of stakeholders in distinct ways. As Mitchell et al. (1997:853) suggest, different categorizations of stakeholders exist in the literature.[7]

I propose classifying stakeholders based on whether the costs (or benefits) are *internalized* in the pricing mechanism by the corporation. For example, wages, interest payments on loans, payments to suppliers, and taxes or revenue from

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[6]*each stakeholder group has a right to be treated as an end in itself, and not as means to some other end* (Donaldson and Preston 1995: 73).

[7]Such as; primary or secondary stakeholders; as owners and non-owners of the firm; as owners of capital or owners of less tangible assets; as actors or those acted upon; as those existing in a voluntary or an involuntary relationship with the firm; as rights-holders, contractors, or moral claimants; as resource providers to or dependents of the firm; as risk-takers or influencers; and as legal principals to whom agent-managers bear a fiduciary duty.

customers are all internalized in the income statement. Therefore, employees, creditors, suppliers, government, and customers can be classified under ***stakeholders of internalities***. As the residual profit is attributed to shareholders, we can also classify them under this category.[8] On the other hand, some stakeholders are ***stakeholders of externalities***, such as the local community or the environment, whose interests are not internalized.[9]

Under the shareholder theory, internality stakeholders are recognized and assumed to be fully compensated. This is done through the competitive markets assumptions that all participants who have transactions with a firm are willing participants in free and competitive markets and are fully compensated at fair market prices for their services/supplies or get fairly valued products/services for the prices they pay (Krishnan 2009:2). In this theory, external stakeholders do not exist. We will assume that stakeholder theory adheres to the competitive markets assumptions for internal stakeholders[10] and that the external stakeholders have legitimate claims.

Internality and externality stakeholder classification will determine how interests of each class of stakeholders will be represented in the corporate objective function. I will now turn to the questions of wealth creation and allocation.

9.3.2 Wealth Creation and Allocation

The two theories differ in defining *wealth creation* and criteria on wealth allocation. As Boatright (2006:116) notes, wealth must be created before it can be distributed. *Shareholder value theory* is straightforward. A corporation should make the decision based on whether an action is expected to create wealth (i.e. profit) to the corporation itself.[11] If the answer is 'yes', then the corporation will take the action and take all the wealth created.

Stakeholder value theory, on the other hand, concludes that, a corporation should initially assess whether an action is expected to create wealth to the corporation itself *and* then whether the action is expected to increase the wealth of all stakeholders combined. If the answers are 'yes', then the corporation will take the action.

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[8]Shareholders are a corporation's 'residual claimants' in the sense that they are entitled to appropriate all (and only) the net assets and earnings of the corporation after all contractual claimants—such as employees, suppliers, and customers—have been paid in full (Armour et al. 2009: 25).

[9]Externality is a phenomenon that arises when an individual or firm takes an action but does not bear all the costs (negative externalities) or receive all the benefits (positive externalities) (Kaul et al. 1999: 509).

[10]It is possible to release that assumption and analyze its impacts, but this would be beyond the scope of this paper. We could call it as strong form of stakeholder theory. For example, are the wages paid to workers 'fair'?

[11]In the case of subsidies, even when an action is not profitable in itself, outcome may change.

Table 9.1 Wealth creation and allocation under the two theories, ($\beta > 0$)

Change in wealth of stakeholders	Potential outcome if factory is built	Corporate decisions under shareholder view	Corporate decisions under stakeholder view
$\alpha \geq 0$[a]	The factory will create wealth to both the corporation and the stakeholders. Absolute social wealth has increased	Build factory, take β	Build factory, take β
$-\beta \leq \alpha < 0$	The factory will create wealth for the corporation but destroy wealth of the stakeholders. Absolute social wealth has increased, *but* wealth allocation distorted	Build factory, take β	Build factory, compensate stakeholders by at least α. Take (β - compensation)
$\alpha < -\beta$	The factory will create wealth for the corporation but destroy wealth of stakeholders. Absolute social wealth has decreased *and* wealth allocation distorted	Build factory, take β	Do not build factory

[a]When α and β are both greater than zero, then we are in a situation what Porter and Kramer (2011) call ‘shared value creation’. The concept can be defined as policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates

Allocation of wealth will depend on the respective capacities for negotiation of all the parties involved and on their respective perceptions of the opportunity prices and costs (Charreaux and Desbrières 2001:5).

Let us clarify this argument with an example. A corporation considers building a factory in City A. The corporation first assesses that the project will create a value of β[12] for the corporation (where, $\beta > 0$). Let’s assume there is only one external stakeholder group, the citizens of City A, and their interest (change in their wealth) as α. There are three possible value intervals that α can take, which will impact our analysis. Provided that there are no legal obstacles (requirement of both theories), Table 9.1 is on how adherents of each theory are expected to behave;

Based on the Table 9.1, we can conclude the below in terms of wealth creation and allocation.

In the **shareholder value theory**, shareholder interests override others. Provided that other considerations (such as reputation, marketing, and public relations) do not exist,[13] the decision will be to build the factory as long as β is greater than zero. Wealth created, β, will be taken by the corporation and thus the shareholders.

[12]β can be considered as accounting profit, (total revenue minus total costs), or economic profit (where cost of capital is also factored in), as we will discuss later.

[13]To the extent we release this constraint, the shareholder value adherents will converge to stakeholder approach.

Nonshareholder stakeholders may benefit, as in scenario 1, or lose, as in scenarios 2 and 3; however, these are not the concerns of the corporation.

In the **stakeholder value theory,** more has to be taken into consideration for a decision to be made. In terms of wealth creation: When $\beta > 0$ *and* $-\beta < \alpha$, we are in a state that the total welfare of all stakeholders combined has increased. Therefore, the factory will be built in scenarios 1 and 2, but will not be built in scenario 3. In terms of wealth allocation: In the first scenario where $\alpha \geq 0$, corporation will take β and stakeholders will take α.[14] In the second scenario where $-\beta \leq \alpha < 0$, the level of compensation will depend on negotiation (with a minimum of α). In the third scenario, there is no extra wealth that can be used to compensate the stakeholders.

Note that the citizens of City A are external stakeholders. As said earlier, through the competitive markets assumption, interests of internal stakeholders are already incorporated in the β of the corporation. Therefore, I will limit α to stakeholders of externality and assume the interests of internal stakeholders are already represented in β. *The differing outcomes of the two theories stem from the treatment of internalization of costs by the corporation.* ***That is to say, if the corporation were to internalize α, then automatically the stakeholder theory would collapse to the shareholder theory.***

Many critiques of the stakeholder theory argue that the theory does not provide a criterion for making decisions. For example, in his critique of the stakeholder value theory, Jensen (2001: 13) says *'...Any theory of corporate decision-making must tell the decision-makers, in this case managers and the board of directors, how to choose among multiple constituencies with competing and, in some cases, conflicting interests… Obviously, any decision criterion—and the objective function is at the core of any decision criterion—must specify how to make the tradeoffs between these demands'.*

However, I believe, and as can be seen in the above example, the **stakeholder theory provides a decision criterion** on whether to build the factory or not, through an extended version of the shareholder value criterion: $\beta > 0$ *and* $-\beta < \alpha$. Incorporation of α may make the maximization issue more complex, but we find justification for complexity in Jensen's (2001: 11) own words in defending the single objective function;

> … But even in these situations [when the function is non-monotonic, or even chaotic], the meaning of "better" or "worse" is defined, and managers and their monitors have a "principled"—that is, an objective and theoretically consistent—basis for choosing and auditing decisions… It is not necessary that we be able to maximize, only that we can tell when we are getting better—that is moving in the right direction.

[14] However, there might be negotiation due to *relative* increases in wealth. Wealth allocation may depend on the proportional wealth increase on the corporation versus the stakeholders. In the above example, if α is, say, 0.001, and β is 1, then the corporation may be asked to provide extra benefits to the stakeholders. For an interesting analysis on the impact of relative income, see Layard et al. 2009.

In summary, under the stakeholder value theory, as long as the action is expected to create wealth to the corporation, ($\beta > 0$), *and* the created wealth for the society is greater than zero, ($\alpha + \beta > 0$), decision for action will be taken, i.e., build the factory. The stakeholder theory provides the basis of wealth allocation as well. I now wish to briefly address the process in determining the actual portion of each stakeholder. I should also add that the below logic would apply to shareholder value theory, when other considerations (such as reputation, marketing, and public relations) are taken into account.[15]

Many prominent scholars have contributed to the contract theory, and it would be much beyond the scope of this paper to try to elaborate on them; however, I want to highlight their common focus: the—explicit and implicit—***contracts.*** Jensen and Meckling (1976) say that contractual relations are the essence of the firm, not only with employees but with suppliers, customers, creditors, and so on. The firm-as-contract view holds that legitimate stakeholders are identified by the existence of a contract, expressed or implied, between them and the firm (Donaldson and Preston 1995: 85). Eisenhardt (1989: 59) argues that the unit of analysis in agency theory is the contract between principal and agent. According to Williamson (1985: 20), transaction cost economics poses the problem of economic organization as a problem of contracting. Some contracts, say between a firm and its neighboring community, are relatively vague and informal; certainly, no documents exist to describe these contracts. At the other end of the spectrum are formal and specific contracts; the contract between a firm and its bondholders is an example (Jones 1995: 409). Managers have few options in meeting the terms of explicit contracts while they have much more discretion in satisfying implicit contracts (Ruf et al. 2004). Since implicit claims generally have no legal standing, the economics literature has analyzed them as self-enforcing relational contracts (Bowen et al.1995: 3). Introduction of implicit contracts to the nexus-of-contracts definition of the firm is critical, since this rationalizes the stakeholder theory; defining the firm as a nexus of explicit and *implicit* contracts might seem like a minor variation, but in fact it changes the conceptual framework in a dramatic way (Zingales 2000).

Power, legitimacy, and urgency of stakeholder claims, as defined by Mitchell et al. (1997), will determine the negotiation capacities of the parties involved and the provisions of contracts. The perception of management on how each stakeholder group possesses these attributes will also impact the outcome. We can find other potential determinants in the literature, but I believe the above three attributes implicitly contain them. Some of these can be found in Hill and Jones (1992); the power differentials among the participants (a condition of unequal dependence between the parties to an exchange), diffusion of stakeholder power, effectiveness of enforcement mechanisms (law, exit, and voice as deterrents), concentration of management power, limitations on access to information (asymmetric information), and trust (Pirson and Malhotra 2010) between the corporation and stakeholder. The

[15] This is the same logic where Jensen (2001) terms enlightened value maximization or enlightened stakeholder theory.

trust of the stakeholder will be based on the corporation's perceived *motivation* and *ability* to behave in ways that benefit the stakeholder.

Note that external stakeholders, without having some form of power, legitimacy or urgency,[16] will not have the base for claiming a contract; they will not possess any capacity for negotiation. Therefore, it will be necessary to provide them with some combination of the three attributes. For example, in cases where neighborhood sued nuclear power plants in Japan, courts granted them standing but dismissed on the merits (Ramseyer 2011).[17] I believe the Coase theorem[18] signals such a base by requiring property rights and liabilities being defined.

The theorem states that in a world with zero transaction costs, initial rights allocations are unimportant; they will be transferred to their highest-value use through private Coasean bargains. Thus, in the present context, if an action taken by a corporation harms one group of stakeholders more than it helps another, the former group will bribe the latter group to abandon the action in question. Maximizing the residual claim maximizes the size of the corporate pie. The way this pie will be allocated among the firm's various stakeholders will depend on the Coasean bargains they work out with one another (Bradley et al.1999: 38). Coase Theorem may provide justification to external stakeholders' claims, which brings us to the next question on the problem of justification.

9.3.3 The Problem of Justification

> The underlying epistemological issue in the stakeholder literature is the problem of justification: Why should the stakeholder theory be accepted or preferred over alternative conceptions? (Donaldson and Preston 1995: 73)

[16]Urgency by itself is not sufficient to guarantee high salience in the stakeholder——manager relationship. For example, neighbors of a nuclear power plant that is about to melt down have a serious claim on that plant, but they may not be aware of the time pressure and criticality and, thus, may not act on their claim. (Mitchell et al. 1997: 870).

[17]Neighbors also tried to earn legitimacy and power by buying stocks in the corporation. When the cooling system in one of the Daini reactors malfunctioned in 1989, they sued Tokyo Electric as shareholders to shut it down. Only then, they argued could the firm avoid irreparable harm to itself. The court dismissed their claim. Whether to restart a damaged reactor was a question on which the firm's board could turn to specialists. If those specialists thought it appropriate to restart the reactor, it could properly restart it (Ramseyer 2011: 9).

[18]Coase Theorem is the assertion that if property rights and liability are properly defined and there are no transaction costs, then people can be held responsible for any negative externalities they impose on others, and market transactions will produce efficient outcomes. (Kaul et al. 1999: 509). Coase Theorem holds that regardless of the initial allocation of property rights and choice of remedial protection, the market will determine ultimate allocations of legal entitlements, based on their relative value to different parties (Parisi 2007: 1).

Addressing the justification problem is critical, since it will allow us to justify the proposed modification to the corporate objective function. I start with the following question: '*How can management justify its decisions in the eyes of shareholders?*'

Recalling our example above, let's consider the manager of the corporation in scenario 3 ($\alpha < -\beta$), with the responsibility to make the decision.[19] What would be the manager's decision, knowing that the shareholders may fire him/her? In addition to the actual business decision to be made, he or she will probably also consider other questions: i.e., if I am fired, will the stakeholders defend me? Do they have the motivation and ability to do so? If I am fired, will the shareholders of other corporations hire me again?

It is often said that the stakeholder theory is managerial. However, in the current system, the management *alone* does not have the necessary tools to act in accordance with the stakeholder theory. The hands of management must be strengthened in order to make/enable them to act in accordance with the stakeholder perspective. I see three potential sources who can provide these tools: *government, society* (especially customers), and *shareholders*.

Government is the only stakeholder who has a privilege over the shareholders, by bringing penalties that are harsher than being fired. The threat of penalty, not only makes management make decisions in line with laws, but also strengthens their hands against the shareholders in protecting the rights of other stakeholders. Therefore, government involvement/regulation is a justification tool.

Additional justification tools for management to protect other stakeholders may come from the *society*. For example, a threat of boycott by customers can be a powerful tool for managers to justify their decision, who wish to act in accordance with the stakeholder theory. As the boycott will impact the profit, shareholder theory adherents will also accept this justification. This is the 'instrumental' variation of the stakeholder value theory, when managers attend to stakeholders as a *means* to achieving other organizational goals, such as profit or shareholder wealth maximization (Phillips et al. 2003: 479).

In fact, government and society pressures internalize the costs, and as I said earlier, internalization of costs makes the two theories converge. However, disputes remain due to the *ends-means* distinction, as also discussed earlier. From the shareholder value perspective, if the information that may lead to a boycott is not known to the customers who may boycott the corporation, then the corporation does not need to change its behavior. Even if it were known, unless customers have the motivation *and* ability to boycott, the corporation would not change its behavior either. However, from the stakeholder value perspective, since each stakeholder's claim is an end in itself, the corporation would by definition act in the stakeholders' best interest.

The result of the analysis is that the management *alone* cannot make the shift to stakeholder supremacy. Either legal or social elements should evolve to strengthen

[19]Other hypothetical exercises can also be made. For example, how would you react to such a manager (who decided not to build the factory) if you were the shareholder of the corporation?

the hands of management (or compel them) to pursue stakeholder value. Alternatively—or additionally—a change in the attitudes of *shareholders* should arise; for example, socially responsible investments may act as a tool to change corporate behavior. This section addressed the question of *how* external stakeholders' claims may be justified.

We can now start constructing the corporate objective function. The function should have properties that address the three previously listed areas. First, it should represent claims of external and internal stakeholders; second, it should define wealth creation and allocation under the two theories; third, it should create the base for discussions on the justification problem.

9.4 The Corporate Objective Function

> Just as the separation of the owner-manager-employee required a rethinking of the concept of control and private property as analyzed by Berle and Means (1932), so does the emergence of numerous stakeholder groups and new strategic issues require a rethinking of our traditional picture of the firm. We must redraw the picture in a way that accounts for the changes. (Freeman 1984: 24)

The corporate objective function stands at the center of the shareholder versus stakeholder debate. Though it is mentioned in numerous studies, it was surprising not to see an explicit function in a literature review.[20] In constructing the function, this paper starts with a proposition: ***the perception of the purpose of the firm has passed (and is still passing) through three phases.***

9.4.1 Phase I: Profit Maximization in Accounting Sense

In this phase, the aim of a corporation is to maximize its accounting profits. Accounting profit is calculated as total revenue minus total costs. Though it may seem primitive, this understanding still has a place in our daily lives; for example, the taxes are calculated based on this understanding of profits. The function is well-known;

$$\mathbf{\Pi} = \mathbf{P}.\mathbf{Q} - \mathbf{TC},$$

where; **Π**: Profit, **P**: Price, **Q**: Quantity and **TC**: Total Cost

Taking the derivative of the function with respect to Q, and setting equal to zero, we find the maximum is reached at P = MC. Assuming a perfectly competitive

[20]Jensen (2001: 11) provides a general outline of a possible multiple objective functions; however his variables are not stakeholder oriented, such as cash flow, risk and so on.

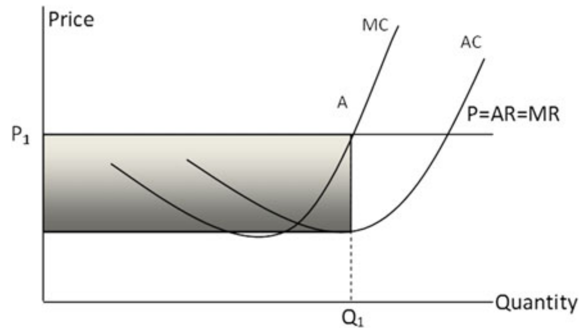

Fig. 9.2 Phase I: Profit maximization in accounting sense

environment in the short term, the graph of the analysis will be as below. Price is determined in the market and therefore it is a given for any corporation, P_1, and the production level is Q_1. The shaded area in Fig. 9.2 is the accounting profit.

However, the accounting profit does not take the cost of capital into account and thus fails in capturing the whole picture. We therefore need to modify the function to incorporate the cost of capital.

9.4.2 Phase II: Shareholder Value Maximization (Economic Profit Maximization)

With the introduction of the concept of opportunity cost, the understanding of profit has changed. Accounting profit was no longer seen as satisfactory. With this change in the perspective, shareholders claimed that the purpose of a corporation is to maximize economic profit. Economic profit is calculated by accounting profit minus opportunity cost. In order to illustrate this point, I will refer to the Economic Value Added (EVA) model.[21] EVA measures the dollar surplus value created by a firm on its existing investment. Damodaran (2002: 864) provides the below equation for EVA.

Economic Value Added = After tax operating income-(Cost of Capital) (Capital Invested)

EVA will not be analyzed in this paper, as the aim is to show the logic behind the shareholder value. What matters for this paper is the fact that EVA explicitly incorporates cost of capital into the function.[22] Maximizing this modified profit function will mean maximizing shareholder value. The modified function will be:

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[21]Stern Steward & Co, intellectual property owner of EVA, defines it as a measure of economic profit.

[22]EVA defines the cost of capital as the weighted average cost of Debt and Equity Capital ("WACC"), but this does not change our analysis.

$$\Pi = [(\mathbf{P}.\mathbf{Q} - \mathbf{TC})(\mathbf{1} - \mathbf{t})] - \mathbf{C_k}.\mathbf{K},$$

where C_k *is the cost of capital, K is the capital invested, and t is tax rate.*

It should be noted that, K, the capital invested will have fixed and variable components, where the variable component will increase as the output increases. Therefore, we can write K = a + b.Q and rewrite the above function as:

$$\Pi = [(\mathbf{P}.\mathbf{Q} - \mathbf{TC})(\mathbf{1} - \mathbf{t})] - \mathbf{Ck}.(\mathbf{a} + \mathbf{b}.\mathbf{Q})$$

For simplicity reasons, assuming t as zero and C_k as constant and taking the derivative with respect to Q, we find P = MC + C_k.b. This shows us that, the shareholder-maximizing equilibrium will stand at a point where the price is equal to MC (in the accounting sense) plus the marginal cost of capital. The graph of the above revised function will be Fig. 9.3 as below.

Under the shareholder value theory, the marginal cost curve will shift leftward in an amount of the cost of capital. Accordingly, the maximizing level of output will be at Q_2 at P_1. However, if the cost of capital is not factored in, as in the case of accounting profit maximization, the output will be at Q_1. The shaded area shows the shareholder value destroyed by producing at Q_1 rather than Q_2. The shareholder value approach explicitly addresses the wealth of shareholders. However, this is not the total value created by the firm and excludes benefits/costs to external

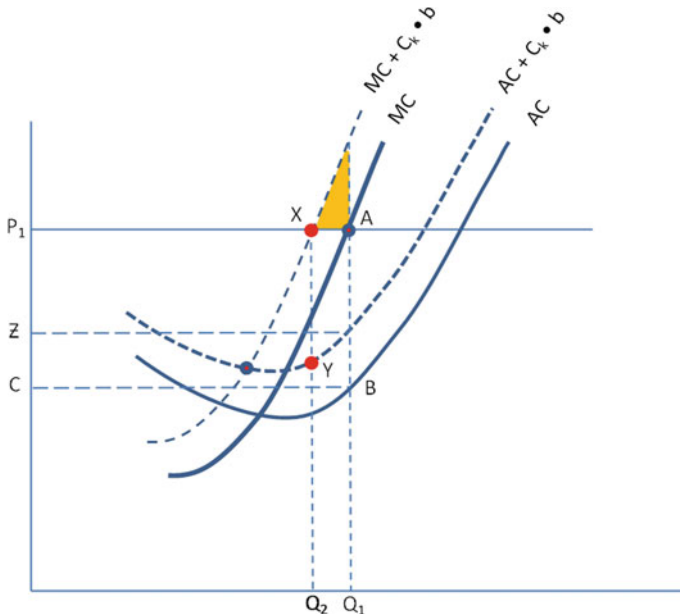

Fig. 9.3 Phase II: Shareholder value maximization (economic profit maximization)

stakeholders. As Bebchuk (1992) writes, from the perspective of efficiency, the socially desirable rule is the one that maximizes the aggregate wealth of society's members. As said earlier, we can assume that shareholder value approach addresses the costs/benefits to the stakeholders of internality; wages, interest payments, payments to suppliers are all included in the total cost, taxes are deducted from gross profit, and receipts from the customers are recorded in the total revenue. However, this approach does not answer the situation of external stakeholders; in fact, it assumes their interests as zero. Recalling the earlier example, this interest corresponds to α of the citizens of City A. The so-called externalities or third-party effects vitiate the claim that the freedom of individuals to enter into voluntary, mutually beneficial contracts will result in the optimal allocation of society's resources (Bradley et al. 1999: 39). I will now take the discussion one step further and search for ways to modify the corporate objective function, so that the external stakeholders and their interests can also be included.

9.4.3 Phase III: Stakeholder Value Maximization

> … Since the industrial revolution, firms have sought to internalize the benefits and externalize the costs of their actions… (Freeman 2004: 41)

As discussed earlier, in the stakeholder theory, distinct from the shareholder theory, we need to incorporate an externality component into the corporate objective function. All other interests are already internalized in the shareholder value maximization function. Obviously, this is simplification: stakeholders of internality have *explicit and implicit contracts* with the corporation (Stout 2002: 1196). Employees work, in part, for wages (explicit contract), but they may also expect that they may also get raises, job security and promotion (implicit contract). However, whether by implicit or explicit contracts, their interests are assumed to be represented in the internality portion of the corporate objective function. However, within the shareholder value theory, there is no contract with the external stakeholders, neither implicit nor explicit.

The firm's social responsibility is sometimes viewed even more broadly to include the protection of stakeholders who do not have a contractual relationship with the firm; namely, the firm should refrain from bribing officials in less developed countries even if the probability of being caught is small, or from polluting when pollution taxes or permits are not yet put in place. In a nutshell, the firm should internalize the externalities on the various stakeholders (Tirole 2000: 29). We need to incorporate a portion that will represent the interests of the external stakeholders.

> Two hundred years of work in economics and finance implies that in the absence of externalities and monopoly, (and when all goods are priced), social welfare is maximised when each firm in an economy maximises its total market value (Jensen 2001: 6).

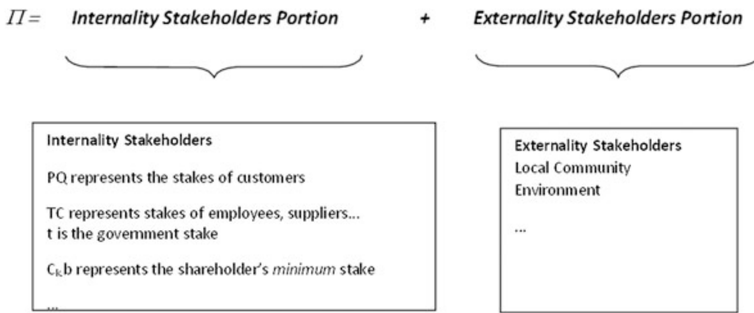

Fig. 9.4 Corporate objective function

As can be seen in Jensen's words, by assuming absence of externalities and that all goods are priced, the shareholder theory assigns a zero value to the portion of external stakeholders in the corporate objective function. **If you accept that argument, then stakeholder theory collapses to shareholder theory.** However, the portion of the external stakeholders must also be taken into account from the stakeholder value perspective. As a result, the corporate objective function should look like as in Fig. 9.4 below[23];

In the earlier hypothetical corporation, interests of internal stakeholders' portion would be represented in the calculation of β and external stakeholders' portion would be α.

Actions of corporations may impact their external stakeholders in different domains. In order to be in parallel with the CSR terminology, I will name these domains as economic, social, and environmental. BIS (UK Department for Business Innovation and Skills) define CSR as '... *how companies address the social, environmental and economic impacts of their operations and so help to meet our sustainable development goals.*' Note that other definitions by different institutions and authors also address it in similar ways. Taking these three domains as the basis, the corporate objective function can be revised to include impacts as below:

$$\Pi = [(\mathbf{P.Q}-\mathbf{TC})(\mathbf{1}-\mathbf{t})]-\mathbf{Ck}.(\mathbf{a}+\mathbf{b.Q})+(\mathbf{E_{econ}}+\mathbf{E_{soc}}+\mathbf{E_{env}})$$

where $E_{\mathbf{econ}}$ is economic externalities, $E_{\mathbf{soc}}$ is social externalities, and $E_{\mathbf{env}}$ is environmental externalities. For simplicity, I will use E to denote all three types of externalities. Taking the derivative with respect to Q, we find:

$$\Pi = \mathrm{MC}-\mathrm{Ck.b}+\mathrm{dE}/\mathrm{dQ}$$

[23]Note that it is possible to analyze the portion of internality stakeholders' interests under two sub-portions based on explicit and implicit contracts.

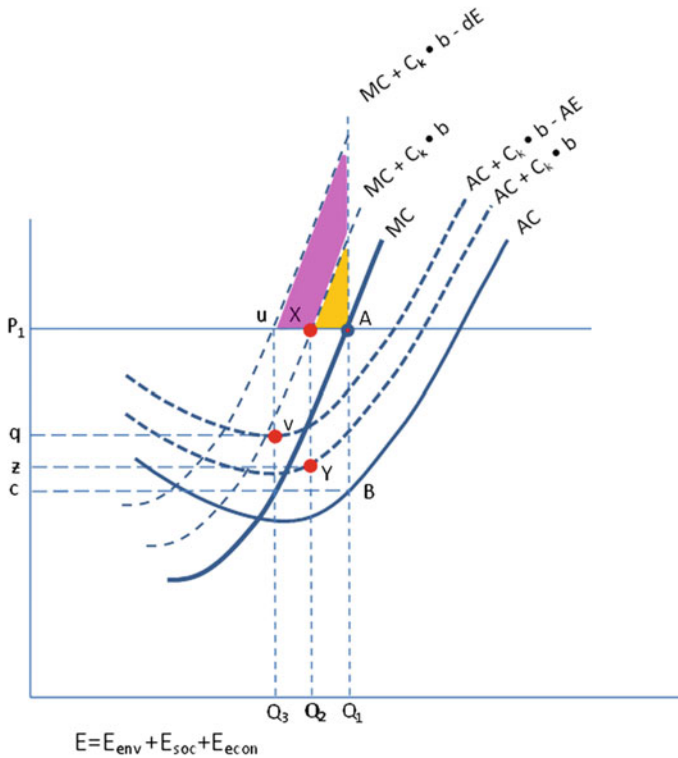

Fig. 9.5 Phase III: Stakeholder value maximization

It should be noted that the economic, social, and environmental externalities may be negative or positive. If there is negative externality, it will be assigned with a negative sign. Above is the graph of the function, assuming there is negative externality (Fig. 9.5).[24]

Under the stakeholder value theory, the marginal cost curve will further shift leftward in an amount of the negative externality. With positive externality, the curve would move rightward. Accordingly, the maximizing level of output will be at Q_3 at P_1. However, if the externality impacts are not factored in, as in the case of accounting profit maximization, the output will be at Q_1 at P_1. The dark shaded area shows the stakeholder value destroyed by producing at Q_1 rather than Q_3. Please also note that the size of the areas do not necessarily show the size of the shareholder value loss relative to the size of the stakeholder value loss.

[24]We follow the parallel logic for ‘adjustment for external costs’ graph (Musgrave and Musgrave 1989: 51).

Obviously, there will be the problem of measurement, i.e., the corporation and the stakeholders will attribute different values for α. However, as referred to Jensen's own words earlier, '… *it is not necessary that we be able to maximize, only that we can tell when we are getting better—that is moving in the right direction.*'

9.5 Conclusion

This paper attempts to write an explicit corporate objective function. This has the potential to address several questions surrounding the shareholder versus stakeholder supremacy debate. First, such an explicit function may create an analytical foundation for the debate. Additionally, it may assist in addressing issues such as: under which conditions the two theories converge and why each theory advises management to act differently in similar business conditions?

Before constructing the explicit corporate objective function, this paper has addressed three issues, which, in my view, is necessary to set the base for the function. I have proposed to classify stakeholders as internal and external stakeholders. This classification enabled us to present why and how the two theories define wealth creation and allocation. This paper also provided a hypothetical case to illustrate the differences. The justification problem is also discussed, which is critical in understanding the differences and outcomes of the two theories. Following the investigation of the three areas, constructing the explicit corporate objective function started.

In constructing the function, I started with a proposition: *the perception of the purpose of the firm has passed (and is still passing) through three phases*—(i) accounting profit maximization, (ii) shareholder value (economic profit) maximization, and (iii) stakeholder value maximization. I hope the proposed function will be regarded as starting point that may inspire others to further investigate such an explicit function.

CSR can be defined as 'the responsibility of enterprises for their impacts on society.' By addressing the claims of the stakeholders, CSR aims at enhancing the economic, social, and environmental welfare of the society. As stakeholders are the key for CSR, the shareholder vs stakeholder debate can be expected to further the works on CSR.

I believe further studies by releasing some of the assumptions in this paper may bring new insights into the debate. For example, what will be the impact of releasing the assumption of competitive markets for internal stakeholders under the stakeholder theory? i.e., should we discuss whether the wages paid by contracts are fair or not? Would such a move require us to differentiate between two forms of stakeholder value theory (strong and weak forms)? Further, what would be the implications of introducing implicit/explicit contracts classification into the theories? I hope the paper will ignite further discussions.

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Chapter 10
Employee Perceptions of Corporate Social Responsibility Activities and Work-Related Attitudes: The Case of a Greek Management Services Organization

Panagiotis Reklitis, Panagiotis Trivellas, Ioannis Mantzaris, Elisavet Mantzari and Dimitrios Reklitis

Abstract This chapter investigates the effect of employees' perceptions of corporate social responsibility (CSR) activities of their organization on work-related attitudes. Extant research on CSR and consumer perceptions neglects the core assumption of stakeholder theory that a firm's long-term value is grounded on the knowledge, abilities, and loyalty of its employees, as well as on its relationships with customers, local community, and other stakeholders. Our field survey is focused on employees of Greek port logistics management services. Building on the argument that employees' perceptions of CSR activities may be significantly related to workplace attitudes, behaviors, and performance, this chapter examines two CSR aspects (social and environmental) and several work-related attitudes (job performance, employee satisfaction, organizational commitment, OCBO, and OCBI). Our findings highlight that different CSR aspects exert selective direct effects on specific employees' attitudes, while the managerial implications on firms' accountability and transparency are also discussed. Even though the study is based on a case study of a port logistics management services organization in Greece, the organizational phenomena under investigation provide interesting evidence that can be applied to other national and organizational contexts.

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Keywords CSR · Social responsibility · Job performance · Job satisfaction · Greece

10.1 Introduction

Corporate social responsibility (CSR) is currently perceived as a core strategic necessity rather than an additional potential competitive advantage for an organization, while the successful implementation of CSR projects could improve a company's profile and enhance its image and market share (Falkenberg and Brunsael 2011). However, the general belief is that CSR could be an expensive strategy and only few companies can actually benefit from pursuing a CSR strategy (Bhattacharyya 2007; O'Brien 2001). Furthermore, the majority of CSR studies focus on analyzing the perceptions of external stakeholders, such as consumers, on companies' CSR activities consumers (Kim and Park 2009; Lee et al. 2008) and the impact of companies' CSR on consumers' behavior (Becker-Olsen et al. 2006; Klein and Dawar 2004; Sen and Bhattacharya 2001). Little research, however, is available on the effect of CSR activities on the attitudes of internal stakeholders, such as employees (Aguilera et al. 2007; Aguinis 2011; Lee 2008). In this chapter, we seek to contribute to these studies by investigating the relationship between CSR activities and employees' attitudes, in terms of job satisfaction and organizational commitment.

Researchers highlight the importance for corporate leadership to maintain an active relationship with various corporate stakeholders (Steurer et al. 2005) and promote stakeholder engagement (Greenwood 2007). Freeman (1984, p. 53) defines stakeholders as "any group or individual who can affect or is affected by the achievement of the organization's objectives." Different stakeholders—broadly categorized in the literature as internal and external—have different and often conflicting interests and information needs. This poses a challenge to organizations as they need to identify and find ways to meet the needs and interests of a variety of stakeholders. Organizations' responsibilities toward the society have increased, as the stakeholder demands grow and the expectations that companies should respond more directly to social challenges, such as the proactive protection of human rights, poverty alleviation, and protection of natural environment, rise (Tamm et al. 2010). Even though there are long-established arguments and rationales supporting that corporate responsibility should not go beyond profit-seeking and shareholder value maximization and/or justify CSR activities from a mainly economic perspective, there are advocates of the social responsibility of companies (see Carroll and Shabana 2010 for a historical review of these debates). Studies bring attention to the importance of other stakeholders, such as employees, and the need to implement CSR strategies in order to create value for them (Glavas and Kelly 2014). Without

the long-term support of their stakeholders in pursuing CSR activities and social objectives, companies are prone to fail to create value and enhance their financial performance.

In human resource (HR) literature, it is widely recognized that employees play a crucial role for the corporations they work for. Thus, they have been considered as key stakeholders for organizational effectiveness (Aguinis and Glavas 2012; Pedersen 2011; Sinek 2009). The growing awareness of CSR issues has raised many questions about the potential effect of firms' behavior on employees' satisfaction at the workplace. Although the effects of CSR on employees' behavior have been previously identified, only recently have these effects been studied in depth. A number of studies have explored the correlation between CSR and job satisfaction in order to assess well-being at work (Glavas and Kelley 2014; Tamm et al. 2010; Vlachos et al. 2013). Indeed, Tamm et al. (2010) indicate that employees' satisfaction level regarding various job aspects is noticeably higher in firms that are perceived as more engaged in CSR activities. Moreover, Vlachos et al. (2013) emphasize the negative correlation between firm size and CSR, indicating that smaller firms tend to achieve higher assessments regarding CSR. Similar correlations are also found between firm size and job satisfaction according to Glavas and Kelley (2014). In particular, Glavas and Kelley (2014) argue that employees have become more aware of the importance of a firm's social obligations toward society. This growing awareness means that employees evaluate CSR as one of the most important issues, as employees that do not pursue clear CSR strategies tend to be less satisfied and more critical of their companies, as well as less committed to the corporate culture.

In this chapter, we provide evidence on employees' perceptions of CSR and the way these perceptions have an effect on job satisfaction, individual performance, organizational commitment, and organizational citizenship behavior (OCB). We find the social aspect of CSR is related to OCB toward the individual and job satisfaction, while the environmental orientation is strongly associated with OCB toward the organization and individual performance. However, CSR activities appear to have no significant effect on affective commitment. The findings of this chapter should be of interest to management scholars and practice in further understanding the way employees perceive their companies based on corporate behavior toward other stakeholders (Glavas and Kelly 2014) in a diverse European context, such as Greece. The potential significance of the findings of this study is also enhanced due to the fact that it is conducted during a period of economic hardship and little evidence is available on how the economic crisis prompts companies to learn how to redeploy their resources spent on social causes and environmental concerns.

The next section provides an overview of the theoretical background and research design of the study. This is followed by the presentation of the findings while the chapter concludes with the discussion of the findings and contributions.

10.2 Theoretical Background and Hypotheses

10.2.1 Corporate Social Responsibility as Perceived by Employees

According to Glavas and Kelley (2014, p. 171), CSR is defined as: "… *caring for the well-being of others and the environment with the purpose of also creating value for the business. CSR is manifested in the strategies and operating practices that a company develops in operationalizing its relationships with and impacts on the well-being of all of its key stakeholders and the natural environment.*" CSR, hence, extends beyond legal and environmental obligations (Portney 2008). Establishing quality relationships based on trust, respect, and reciprocity with stakeholders is crucial for an organization as this determines its ability to access valuable resources (Wheeler et al. 2002) and minimize the risk of potential negative impact. From the stakeholder theory perspective, it is beneficial for firms to engage stakeholders in certain CSR activities that they perceive to be important, otherwise these groups might withdraw their support for the firm, or even resist to implement CSR activities. Firm's leadership should consider carefully the importance of CSR initiatives as they represent opportunities for more inspired, empowered, satisfied, committed, and productive employees.

The long-term value of a company is considered to lie mainly in employees' knowledge, abilities, commitment, and relationships with investors, customers, and other stakeholders (Wheeler and Sillanpää 1997). Employees are also interconnected with the organization, and they work for and interact with its structures and functions. They could be described as internal consumers, while companies often incorporate in their human resource management (HRM) policies processes, such as internal marketing, that aim at aligning and motivating employees to provide satisfactory customer services (Bowers et al. 1990; Greene et al. 1994). Internal marketing processes such as internal communication, relationship marketing, and training often integrate CSR initiatives in order to fulfill employee needs and increase their commitment, satisfaction, and performance. According to Glavas and Kelley (2014), there are two major CSR factors that contribute to job satisfaction and organizational commitment leading to improved job performance. First, the *social aspect* that contributes to the well-being of suppliers, customers, community, and employees. Second, the environmental aspect which refers to "…*a concept about companies extra effort integrating environment concerns in their business operations and in their interaction with their stakeholders. It is viewed as the contribution that firms make to sustainable development by balancing and improving environment impacts without damaging economic performance*" (Williamson et al. 2006, p. 317). The perceptions of employees about their companies' social and environmental CSR activities have become particularly important, as they can have a positive effect on employees' perceived organizational support adding value to the company by reinforcing job satisfaction and organizational commitment (Glavas and Kelley 2014).

Recent literature has explored more in depth employees' perceptions of a company's CSR activities in terms of the company's support for activities related to the environment and a social cause (Lee et al. 2013). Lee et al. (2013) conclude that when employees find organizational culture relevant to company's CSR activities, they consider those activities as positive and favorable improving employee performance and resulting in lower turnover intention. Moreover, as the goals and values of employees, managers, and employers are integrated and interconnected (Katz and Kahn 1978), CSR strategies should be realized through the values, vision, and culture of the corporation, formulating social dynamics, performance, and behaviors in each organization (Bargh and Burrows 1996; Cable and Judge 1996; Eisenberger et al. 1986; Snyder and Swanen 1978). In this way, the perceptions of CSR could be directly linked to employees' commitment, individual performance, and job satisfaction (Glavas and Kelley 2014; Maignan et al. 1999).

In a similar vein, relevant studies that are based on the societal perspective of CSR suggest that a company's actions have to "*protect and improve both the welfare of the society as a whole as well as the interest of the organization*" (Davis and Blomstrom 1975, p. 5). Managers should, therefore, communicate CSR policies to their employees' in a manner that is consistent to corporate culture and values (Bhattacharya et al. 2009). Moreover, a major challenge for corporations is to engage employees in their CSR initiatives and convert their unawareness to active involvement and engagement. Bhattacharya et al. (2009) note that several employees prefer to work for socially responsible companies, believing that such firms give them more opportunities for personal growth. Apart from the resources (wage), job satisfaction has socio-emotional dimensions, such as the approval and recognition employees receive from employers or managers and the CSR actions of their company (Eisenberger et al. 1986; Kotter 1973; Rousseau 1989). As a result, based on the reciprocity norm, the employees who believe that their company values and respects their work tend to increase job satisfaction and performance (Cialdini 1993; Lynch et al. 1999). Turnley et al. (2003) also stress that the fulfillment of the psychological contract has positive effects on employee performance. Further, they suggest that the psychological contract fulfillment is more strongly related to OCBO than to OCBI.[1] The well-being of employees is reflected on their willingness to further contribute to the organization, and, in turn, the concept of well-being at the workplace is linked with job satisfaction (e.g., Clark et al. 1997).

Based on the view that CSR should engage internal stakeholders and focus on activities addressed toward them, it is essential to identify employees' expectations of the firm. Extant CSR literature suggests that firms should respond to employees' expectations and demonstrate their social responsibility toward them by ensuring

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[1]Organizational citizenship behavior (OCB) is behavior that (a) goes beyond the basic contractual tasks of an individual, (b) is mainly discretionary and voluntary, and (c) is beneficial for the organization (Lambert 2006, pp. 503–525). Williams and Anderson (1991) have suggested two types of OCB, behavior that is directed toward other individuals in the workplace (OCB-individual) and behavior that is directed toward the organization intended for the benefit of the organization as a whole (OCB-organization).

considerable rewards and recognition, offering opportunities for personal development, work skills cultivation, and work–life balance, as well as ensuring that they will receive proper occupational health, safety provisions, and a well-planned retirement program (Maignan et al. 2005). Corporate social performance (CSP), which is an organization's framework of social responsibility principles, processes of responsiveness, programs, and observable outcomes that relate to the organization's social relationships (Wood 1991, p. 693), is a method of estimation on how organizations meet their CSR goals. Corporations that demonstrate higher levels of CPF have an increased capability to attract candidates (Albinger and Freeman 2000; Turban and Greening 1997).

As earlier discussed, several studies have also shown that employee engagement is also fundamental in order to involve primary stakeholders in a positive manner in company activities (Greenwood 2007) and influence employees' behavioral patterns for the benefit of the organization. These "modified" attitudes and behaviors stem from conditions at the workplace, and, as a consequence, literature suggests that employee engagement influences organizational effectiveness (Macey and Schneider 2008). Employees' involvement in decision-making is crucial not only in terms of employee satisfaction but mainly in order to keep up with the vision and the objectives of the organization (Greenwood 2007). Moreover, the corporate image seems to be strongly related to the success of the employee engagement process. Gray et al. (1995) stress that stakeholders' engagement and CSR reports are in fact mechanisms by which organizations respond to stakeholder demands to determine CSR performance.

Based on the understanding gained from current research on the relationship between CSR and employee behavior, in this study we investigate the effects of employees' perception of CSR on work-related attitudes (organizational commitment, job performance, employee satisfaction, OCBO, and OCBI). More specifically, the following hypotheses are formulated:

H1. CSR is related to organizational commitment

H1.1 Social aspects of CSR are related to organizational commitment
H1.2 Environmental aspects of CSR are related to organizational commitment

H2. CSR is related to job satisfaction

H2.1 Social aspects of CSR are related to job satisfaction
H2.2 Environmental aspects of CSR are related to job satisfaction

H3. CSR is related to job performance

H3.1 Social aspects of CSR are related to job performance
H3.2 Environmental aspects of CSR are related to job performance

H4. CSR is related to organizational citizenship behavior (OCBO) (organizational)

H4.1 Social aspects of CSR are related to OCBO
H4.2 Environmental aspects of CSR are related to OCBO

H5. CSR is related to organizational citizenship behavior (OCBI) (individual)

H5.1 Social aspects of CSR are related to OCBI
H5.2 Environmental aspects of CSR are related to OCBI

Before we proceed with the discussion of the research design and findings, we will provide the context within which the study is conducted and briefly discuss the state of CSR in Greece.

10.2.2 CSR in Greece

Since 2009, Greece has been struggling to deal with its debt deficit and the highest unemployment rate in the Eurozone, which has reached 25.6% (Eurostat 2016) following the implementation of austerity measures as a means of recovering from its economic, social, and environmental crisis. In these turbulent times, corporate managers are facing challenges such as unemployment, poverty, environmental pollution, and corruption. CSR could play a key role in supporting a "turnaround" strategy of converting unprofitable companies into profitable and sustainable ones based on accountable, transparent and responsible business behavior, and sustainable growth (European Parliament 2013).

The adoption of CSR in Greece, as a set of principles and practices, is rather limited, as indicated by a small number of published CSR reports and a small number of enterprises participating in CSR activities and networks (Hellenic Network for CSR 2006). However, there are important and encouraging initiatives aiming at developing corporate responsible behavior. For example, the Hellenic Network for CSR, as a business-driven and nonprofit organization, aims at promoting a CSR philosophy and practice for both business community and social environment, building on innovation, sustainability, and social cohesion at the regional and national level. Indeed, a number of studies have been conducted highlighting the obstacles for the successful implementation of CSR in Greece such as corruption, the difficulty of complying with the law, the small organizational size, the lack of resources (financial, time, and HR), the pursuit of short-term profit of small and medium-sized enterprises (SMEs), industrialization decline, absence of a solid-state policy supporting CSR and a concrete regulatory framework (Aravossis and Panayiotou 2008; Giannarakis and Litinas 2011; Metaxas and Tsavdaridou 2012, 2013; Skouloudis et al. 2011). As a result, CSR accounting and reporting appear to be less established and developed in Greece and the majority of companies are still reluctant to adopt CSR activities. Recently, the Flash Eurobarometer 363 (2013) reported that Greek respondents (53%) within EU countries are interested in, but do not feel informed about CSR. Furthermore, the 51% of Greek respondents believe that companies pay less attention to their influence on society than they did ten years ago. It is worth noting that 26% of the surveyed employees in Greece are not aware of what their company is doing or

planning to do in order to behave in a socially responsible way, while only 41% of them think that their company has taken measures to behave responsibly toward society in an effective manner. The 48% of the respondents also consider that job creation is the most significant positive effect of business on society. Thus, the Eurobarometer 363 survey reveals the public view on the social impact of business highlighting several areas for improvement and the necessity for companies to implement a successful CSR strategy. Finally, in terms of the nature of CSR activities, a survey on CSR in SMEs in Greece showed that a large percentage (34%) of CSR activities was aimed exclusively at intracompany issues, and specifically at HR, underlining the importance of CSR for the organizational internal environment and human capital (Hellenic Network for CSR 2006).

10.3 Research Design

The present study examines the relationship between CSR and work-related outcomes in the case of a Greek port logistics management services organization. Regarding the design of the survey instrument, the questionnaire was tested twice by five managers from different companies and by academics who confirmed the cognitive relevance of the questionnaire to the CSR activities of services firms across the supply chain. The field research was carried out by using a structured questionnaire, which was developed based on the study of Glavas and Kelley (2014). The survey respondents were selected on the basis of their awareness of CSR issues and their involvement in the implementation of the firm's CSR action plan, regardless of their hierarchical position. The outcome of this process yielded 78 valid questionnaires.

The in-role job performance scale was based on Williams and Anderson's (1991) study, and individual satisfaction was measured by adopting Wright and Cropanzano's (1998) model. In order to assess organizational commitment, we utilized the six-item affective component of the three-commitment components model as developed by Meyer et al. (1993).[2] Regarding the organizational citizenship behavior, we adopted the two-dimensional 12-item construct suggested by Williams and Anderson (1991) directed toward the organization (OCBO) and toward the individual (OCBO-I).

[2]Meyer and Allen (1991, 1997) proposed the three-component model of organizational commitment measured in terms of affective, normative and continuance commitment and developed scales to measure these commitment constructs. As affective dimension prevails in the relevant literature as the most significant predictor of job related outcomes (e.g. Mercurio 2015) we assess organizational commitment in this study by utilizing the 6-item affective component scale (Meyer et al. 1993).

10.4 Findings

10.4.1 Scale Reliability and Validity

Principal component analysis (PCA—exploratory factor analysis) was conducted to identify latent factors within the CSR construct. Two factors with eigenvalues greater than one were extracted from the data, based on the Kaizer criterion.[3] These principal components accounted for over 75% of the total variation. As the most standard computational method of rotation to bring about simple structure is the varimax rotation, we decided to apply a normalized varimax rotation. A cutoff of 0.60 was used for item scale selection. Following an inspection of the items' loadings on each factor, the two distinct principal components were corresponded to: "Social" (CSR-social aspect), "Environmental" (CSR-Environmental aspect), and orientations.

Preceding PCA, the Bartlett sphericity testing on the degree of correlation between the variables ($p < 0.001$) and the Kaiser–Meyer–Olkin (KMO) index verified the appropriateness of the sample. Cronbach's coefficient alpha[4] was calculated to test for the internal reliability of each scale, as recommended by Flynn et al. (1990), ranging approximately from 0.87 to 0.93. Thus, all sub-scales exhibited well over the minimum acceptable reliability level of 0.7. Table 10.1 presents the descriptive statistics, number of items, and reliability analysis indices of all scales.

10.4.2 Multiple Regression Analysis

Five multiple regression analyses were conducted in order to test the hypotheses put forth for the relationships between CSR (social and environmental aspects) and work-related attributes (i.e., job performance, employee satisfaction, organizational commitment, OCBO, and OCBI), controlling for gender, level of education, hierarchical level, and tenure. However, in four analyses, CSR aspects were found to be statistical significant antecedents, since social and environmental aspects of CSR failed to be associated with affective commitment.

Results show that the predictor variables have captured a rather significant proportion of change in the dependent variables, explaining 21.9% of job

[3]Kaiser (1960) suggested that only eigenvalues that are at least equal to one should be retained in factor analysis.

[4]Cronbach's alpha is a measure of internal consistency or internal reliability of a scale. It ranges from 0 to 1, and it describes the extent to which all the items in a scale evaluate the same concept. Thus, it corresponds to the interrelatedness of the items within the scale. An acceptable minimum value for Cronbach's alpha of 0.7 has been suggested in the relevant literature (Flynn et al. 1990).

Table 10.1 Descriptive statistics and reliability analysis

	Mean	S.D	Cronbach's alpha	KMO[a]
CSR-Social	4.96	0.953	0.881	0.798
CSR-Envir	5.33	0.939	0.897	
Commit	5.22	1.131	0.916	
JSatisf	5.38	1.096	0.890	
JPerf	5.17	1.280	0.935	
OCBO	5.30	1.335	0.871	
OCBI	5.45	1.015	0.893	

CSR-Social CSR-social orientation, *CSR-Envir* CSR-environmental orientation, *Commit* Affective commitment, *JSatisf* Job satisfaction, *JPerf* Job performance, *OCBO* OCB toward the organization, *OCBI* OCB toward the individual

[a]The Kaiser–Meyer–Olkin (KMO) indicator was calculated to assess sample size adequacy. The minimum acceptable level is 0.5. Bartlett's test of sphericity is significant at $p < 0.001$ for all scales. Valid $N = 78$

performance variance, 38.3% of job satisfaction variance, 24.5% of OCBO variance, and 23.4% of OCBI variance.

No serious problems of multi-collinearity exist between the independent variables as variance inflation factors (VIF) is far below the 10 points limit (Gujarati 2004). The results of regression analyses (standardized betas, adjusted R square, significance levels) are exhibited in Table 10.2.

Findings provide support for H2.1 and H5.1, as social aspects of CSR have significant positive relationship to job satisfaction (stand. $b = 0.487$, $p < 0.001$) and

Table 10.2 Multiple regression analyses results

	H1	H2	H3	H4	H5
Independent variables	Affective commitment Std. beta	Job satisfaction Std. beta	Job performance Std. beta	OCBO Std. beta	OCBI Std. beta
Control variables					
Gender	−0.045	−0.105	−0.074	0.031	−0.186
Educational level	−0.339**	−0.230*	−0.104	−0.096	−0.200
Hierarchical level	0.241*	0.078	−0.054	0.143	−0.074
Tenure	0.315**	−0.139	0.102	−0.170	−0.080
CSR					
Social aspect	0.219	0.487***	0.126	0.149	0.448***
Environmental aspect	0.048	0.155	0.505***	0.539***	0.039
Adjusted −R^2	0.325	0.383	0.219	0.245	0.234

*Significant at the 0.05 level, **significant at the 0.01 level, ***significant at the 0.001 level, $N = 78$

OCBI (stand. $b = 0.448$, $p < 0.001$). Similarly, H3.2 and H4.2 are supported, since environmental aspects of CSR are associated with job performance (stand. $b = 0.505$, $p < 0.001$) and OCBO (stand. $b = 0.539$, $p < 0.001$). On the contrary, both aspects of CSR failed to be related to affective commitment. Regarding control variables, hierarchical level (stand. $b = 0.241$, $p < 0.05$) and tenure (stand. $b = 0.315$, $p < 0.01$) exert significant positive effects on affective commitment, and the level of education exhibits a negative relationship to both affective commitment (stand. $b = -0.339$, $p < 0.01$) and job satisfaction (stand. $b = -0.230$, $p < 0.05$).

10.5 Discussion and Conclusions

This study aims at shedding light upon the effects of employees' perception of CSR on work-related attitudes (organizational commitment, job performance, employee satisfaction, OCBO, and OCBI). The results confirm that there is a relationship between CSR and employee attitudes contributing to the limited research in this field. The majority of studies on CSR investigate consumer perceptions but neglect the key assumption of stakeholder theory on which CSR is based that a firm's long-term value is grounded on the knowledge, abilities, and loyalty of its employees as well as on its relationships with customers, local community, and other stakeholders. This paper bridges this gap by focusing on employee perceptions of CSR activities on work-related outcomes.

Drawing on a sample of employees working at a port logistics management services company, we find that different CSR aspects exert selective direct effects on specific employees' attitudes. In particular, the social aspect of CSR is strongly related to job satisfaction, while the environmental orientation is strongly associated with individual performance. Recently, several studies in the field of well-being at workplace focus on the influence of CSR on job satisfaction (Glavas and Kelley 2014; Tamm et al. 2010; Vlachos et al. 2013). More specifically, Tamm et al. (2010) indicate that employees' satisfaction described by various job aspects is remarkably higher in firms that are perceived as more engaged in CSR activities. Given that CSR strategy is realized through the values, vision, and culture of the corporation, formulating system dynamics, performance, and behaviors in each organization (Bargh and Burrows 1996; Cable and Judge 1996; Eisenberger et al. 1986; Snyder and Swanen 1978), perceived CSR may produce direct effects on job satisfaction and performance (Glavas and Kelley 2014; Maignan et al. 1999).

Moreover, the social aspect of CSR is related to OCB toward the individual, while the environmental orientation is strongly associated with OCB toward the organization. CSR explicitly focuses on caring for the well-being of all stakeholders including internal stakeholders, such as employees. In other words, by treating organizational members well and fair, they tend to feel the obligation to reciprocate leading to positive behaviors toward the organization. In particular, the psychological contract literature suggests that employees' interpretations of positive past exchanges, such as organizational justice toward others, could indicate to

employees that the organization will treat them fairly as well (Rousseau 1995). Building on psychological contract literature, Turnley et al. (2003) stress that psychological contract fulfillment is more strongly related to OCBO than to OCBI. Therefore, CSR focused on a firm's social contribution in the community, such as proactive protection of human rights, poverty alleviation, supporting education, and public alertness activities facilitates enhanced employees' citizenship behavior toward the individual, while the environmental aspect of CSR aiming at the protection and preservation of natural environment yields higher level of OCB toward the organization.

However, it is interesting that affective commitment failed to establish any statistical significant relationship to CSR. This can be attributed to the fact that specific organizational phenomena may intervene and regulate the direct relationship of CSR, such as organizational culture and well-being. As a matter of fact, Glavas and Kelley (2014) empirically verified that employee perceptions of CSR are positively related to organizational commitment with the relationship being partially mediated by work meaningfulness and perceived organizational support (POS).

Due to the fact that this study is cross-sectional, the causality of the relationships under investigation cannot be justified, although robust theoretical background has been provided formulating research hypotheses. Furthermore, even though the field research is conducted in a single country and industry, we contend that the organizational phenomena under investigation could provide interesting evidence regarding business administration that can be applied to other national and organizational contexts.

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Chapter 11
The Impact of the Economic Crisis on the Corporate Social Responsibility Activities of Greek Companies

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Abstract The main objective of this chapter is to investigate the effect of economic crisis in Greece on companies' corporate social responsibility (CSR) budgets. We have content-analyzed the CSR reports of twelve companies operating in Greece during the period 2008–2014 in order to identify the companies' CSR activity patterns. In most of the companies examined, CSR activities reached their peak in 2009 and started declining since then, probably due to the adverse economic circumstances. Furthermore, the companies have reprioritized their CSR interests, doubling their society-related activities and reducing nearly by half those addressing the company personnel. Even though the study examines a limited number of companies, it makes an important contribution to the CSR literature in Greece, where CSR is a rather new concept both in terms of research and practice. Contrary to the majority of studies focusing on the effects of short recession periods on CSR, we focus on a long recession period and show how companies adapt to pressures during a period of adverse economic conditions and the way they learn to redeploy their resources allocated to social causes.

Keywords CSR · Greek enterprises · CSR activities · Greek economic recession

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11.1 Introduction

CSR has been arguably a major driver of the successful social performance of organizations (Carroll and Shabana 2010; Isaksson and Woodside 2016; Khan et al. 2015; Wang et al. 2016). CSR discourse, which is a dominant theme in Western academic journals and the business press, has increasingly gained momentum, following the unprecedented number of scandals near the turn of the century and immediately after that. Furthermore, the constantly changing business environment and stakeholder expectations have led companies to adapt to these new realities, as failure to satisfy these expectations could threaten their survival prospects (Bailey et al. 2016; Unruh 2016).

Volumes of writings on CSR were generated from the 1980s onward, with a large part of those, especially more recent ones, reviewing previous studies, using meta-analyses and other comparative studies, focusing primarily on the relationship between CSR and corporate financial performance (CFP) (Fernandez-Feijoo Souto 2009; Orlitzky et al. 2003; Wang 2015; Wang et al. 2016). Fernandez-Feijoo Souto (2009) suggested that there are mixed results regarding the CSR effect on financial performance. The study reviewed a number of other studies on the relationship between CSR and financial performance, shareholder's value and investor's perspective, reporting eleven studies with findings of a positive CSR–performance relationship, five studies showing a negative relationship and two reaching mixed conclusions. Nevertheless, more recent publications by large consulting companies suggest that CSR has direct and indirect positive effects on organizational outcomes both in financial and social terms. As a result, CSR along with sustainability issues have apparently made their way to become integrated to corporate strategies of large organizations (e.g., Bailey et al. 2016; Carroll and Shabana 2010; Wang et al. 2016). Listening to the concerns of society has become imperative to the executives and other strategy crafting personnel.

A strong association of CSR with high financial performance was also reported by Ni et al. (2015) in their study of 466 firms in Taiwan. Wang et al. (2016), in a meta-analysis of 42 empirical studies published between 2003 and 2012, examined the relationship between CSR activities and CFP, and reported a significant positive relationship accompanied by a causal link between CSR and CFP. This study followed a previous meta-analysis by Orlitzky et al. (2003), which examined the same variables between 1970 and 2002 with a sample of 52 studies reporting a positive but less strong relationship between CSR and CFP. In another study, Vidaver-Cohen and Brønn (2015) link CSR with reputational risks, stakeholder support, customer loyalty, employee commitment and satisfaction, and attracting more talented employees, while Lanis and Richardson (2015) conclude that the majority of studies find that CSR is associated with disclosure, financial performance, and earnings management.

Nevertheless, some scholars express skepticism over the validity of the above conclusions, attributing the findings to reporting biases. Rost and Ehrmann (2015) posit that CSR increases the costs of companies and it is inversely related to CFP, in

essence adopting Friedman's (1970, p. 33) argument that the "there is one and only one social responsibility of business–to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engaging in open and free competition without deception or fraud." The reason why more studies find a positive relationship between CSR and CFP, according to Rost and Ehrmann (2015), is that these results increase the probability of getting a paper accepted for publication or because the authors avoid being the carriers of unfavorable news. It is difficult for researchers, they argue, to find other studies supporting analyses that disprove the performance enhancing effects of CSR. However, Benabou and Tirole (2010) and Kopel (2009) find a negative relationship between corporate social performance (CSP) and CFP indicating that CSP is characterized by diminishing returns.

Other researchers propose that the relationship between CSR and CFP is a "shaky" one, whereby one should not expect that high overall CSP supports high CFP outcomes, but should expect that the consistent negation of CSP activities associates with low CFP outcomes (Isaksson and Woodside 2016). McWilliams and Siegel (2000), argue that the corporate environment is very complex and it is hardly possible to make a reasonably justified link between CSR and CFP. In their study of 524 businesses, they examined the relationship between the two concepts, using as predictor variables R&D intensity, firm size, and industry, concluding that there is no relationship, positive or negative. The authors attributed the earlier findings in the literature to methodological errors.

In another line of research, researchers have taken a different perspective examining not the link between CSR and CFP but the motives behind CSR actions. Kang et al. (2016) reported a strong correlation between CSR and corporate social irresponsibility (CSIrr). They found that after the year 2000, it became apparent that not only was there a strong correlation between CSR and CSIrr, but that increased CSR followed CSIrr actions by the companies.[1]

Despite the good intentions of managers, shareholders, and investors, the most recent global financial crisis of 2007–2008 has proven that during unfavorable economic conditions CSR activities become subject to severe cuts in a large number of companies (Karaibrahimoglu 2010; Kavoura and Sahinidis 2015; Manubens 2009; Placier 2011; Sahinidis and Kavoura 2014; Stoian 2013). While Kang et al. (2016) reported a positive relationship of CSR and CFP, where the first precedes the second, it is unclear how a company reacts in terms of CSR when the slack resources of the firm are scarce or nonexistent, as is the case with many businesses in times of economic crises (Godfrey et al. 2009; McGuire et al. 1990). Placier (2011) examined

[1]Kang et al. (2016) examined the CSR–CFP relationship, positing that (a) slack resources lead to CSR, (b) CSR enhances performance, (c) CSR will help compensate for past irresponsible behavior by the company, and (d) CSR will help prevent subsequent occurrences of social irresponsibility, acting as insurance. Their study found support for the CSR-CFP positive link and also that CSR often follows after an act of corporate irresponsibility. The authors, explaining the strong correlation they found between CSR and CSIrr, suggest that companies are trying to "wash away their sins" of the past; however, this "washing away of sins" usually does not happen.

three Czech corporations and concluded that the management of these companies chose to respond to the crisis by refocusing on areas of social and environmental responsibility, such as complying with relevant laws and directives, rather than spending in projects addressing a variety of stakeholders. Kavoura and Sahinidis (2015) studied the CSR behavior patterns of 26 large companies in Greece for the period 2008–2013, in terms of their commitment to CSR and found that although the companies reduced somewhat their social spending, they showed greater commitment and became more efficient in the programs that they engaged in.[2]

This chapter discusses the case of businesses facing an adverse economic environment for a prolonged period and seeks to understand the managers' response to the challenge of being socially responsible, at a time when company survival is at stake. We explore the behavior patterns of the studied companies depicting their CSR activity patterns before and during the Greek economic crisis until 2015. Specifically, this chapter addresses the question: Do companies maintain their CSR practices in light of major shifts in their environment? Also, if companies adapt to the socioeconomic environment changes, how do they respond? The case of the companies examined in this study is characteristic of an enduring anomaly in the economic environment, with serious repercussions in stakeholder behavior (employees, customers, suppliers, and other institutions related to each of the companies under study). The study aims at enhancing our understanding of how business organizations, in their quest for growth or survival, adapt to an extensive set of unfavorable circumstances, such as a seven-year-long economic depression, aligning their CSR resources appropriately, so as to appear more responsible and effective (to the public and the employees) and at the same time more frugal and cost-aware (to shareholders and investors).

The importance of the study lies in the fact that although a crisis of such length is rather rare, the conclusions drawn are useful to the managers of companies facing prolonged crises, such as in the case of Merck or the American automobile manufacturers, Ford and General Motors. Although there are several studies in the literature addressing the link between CSR and economic crises, the contribution of this study lies in that, it is the only one to our knowledge examining a long-term crisis. The majority of CSR studies focuses on the 2007–2008 economic crisis, which had an economic impact on the global market affecting all businesses and do not focus on the case a single country. Furthermore, in the case of short-term crises companies are able to react in a more "business as usual" way, since an effective CSR strategy often

[2]Kavoura and Sahinidis (2015) studied 26 large companies in Greece, from the nine largest industries to determine their CSP, for the years 2008–2013, using the Corporate Responsibility Index (CPI). The companies were assessed on their CSR activities in terms of categories such as the environment, society, market, and workforce. The author's findings indicated a decline in the number of activities the companies were getting involved with, following the course of the country's economic crisis. However, there was greater engagement (Most companies moved upward in the CPI index) in the projects the companies chose to support contrary to the author's expectations. Similar findings were reported by Placier (2011) in her study of two Czech companies.

acts as an insurance against crises, companies can cut costs affecting one or more classes of stakeholders, or they can even rely on their reputation in order to absorb some of the negative public image (Rost and Ehrmann 2015).

11.2 Literature Review

CSR is a concept that has been proved to be difficult to define and has been used in a variety of ways (Carroll and Shabana 2010; Holcomb et al. 2007; Sahinidis and Kavoura 2014). Terms with overlapping meanings such as corporate citizenship, business ethics, stakeholder management, and sustainability are frequently used, with the latter being more common in recent years (Carroll and Shabana 2010; Carroll 1999). CSR is broadly defined as "a commitment to improve societal well-being through discretionary business practices and contributions of corporate resources" (Du et al. 2010, p. 8). Another definition of CSR according to the European Commission is "…the responsibility of enterprises for their impact on society" (European Commission 2011, p. 6). In this study, we use Carroll's (1979) well-established definition of CSR as it is concise and inclusive of all relevant CSR categories and agrees with the methodological approach adopted in the current study (Carroll and Shabana 2010). CSR, thus, includes:

1. The economic responsibility to generate profits.
2. The legal responsibility to comply by local, state, federal, and relevant international laws.
3. The ethical responsibility to meet other social expectations, not written as law (e.g., avoiding harm or social injury, respecting moral rights of individuals, doing what is right, just, fair).
4. The discretionary responsibility to meet additional behaviors and activities that society finds desirable (e.g., philanthropic initiatives such as contributing money to various kinds of social or cultural enterprises, Carroll 1979).

In spite of the importance of the direct and indirect effects of CSR on CFP discussed earlier, the focus of this chapter is on the patterns of CSR activities before and during a crisis. Patterns are defined as "the set of corporate actions that positively affects an identifiable social stakeholder's interests and does not violate the legitimate claims of another identifiable social stakeholder (in the long run)" (Strike et al. 2006, p. 852). The diversity of a company's stakeholders and their interests makes it difficult for managers to effectively manage a good relationship with all relevant constituencies. Decisions need to be made by corporate management, as to how CSR-devoted resources ought to be allocated, bringing into play issues such as individual stakeholder power, urgency, and the need to gain or maintain legitimacy by the group (Barnett and Salomon 2006; Freeman 1984; Mitchell et al. 1997).

Ni et al. (2015) adopted Freeman's (1984) and Clarkson's (1995) categorization and discriminated between primary and secondary stakeholders. Primary stakeholders are involved directly with the company (e.g., employees, customers and

investors) and the secondary include the local community, the government, charity recipient organizations. The challenge for managers lies in finding the optimal resource allocation pattern, so as to meet the needs and interests of all stakeholders as best as they can. In times of crisis, however, the scarcity of the resources is bound to lead to decisions that will leave some stakeholders less happy than others, due to the precedence given to the more important and more powerful groups. It will also lead to the lessening or complete cutting of the resources available for CSR programs, which were to address the needs of secondary stakeholder groups. The changes in the organizational internal and external environment call for the reconfiguration of the CSR activity pattern, so as to stay in tune with the changing needs and demands of the stakeholder groups, especially the primary ones. A recession-ridden economy, accompanied by a number of social ills, affects all company stakeholders at least to some extent. Management is expected to reconcile the competing demands of customers and employees, with those of investors and shareholders. Social causes supported in normal times become less likely to get the same attention as prior to the crisis, even though supporting these social projects at the time of crises is of utmost importance (Placier 2011). Some companies opt to balance the bearing of the burden of the crisis, when they decide the allocation of their CSR resources. Others prefer to keep only the primary stakeholders satisfied, ceasing to support the secondary ones (Ni et al. 2015).

While some authors suggest that an economic crisis can become a threat to CSR activities, others propose that a crisis can also offer opportunities (Fernández-Feijóo Souto 2009; Karaibrahimoglou 2010; Manubens 2009; Porter and Kramer 2006). Indeed, stakeholder demands at a time of a crisis, and provide the ground for gaining a competitive advantage to companies meeting those demands and differentiating themselves from the rest (Carroll and Shabana 2010; Kurucz et al. 2008). Likewise, by responding to stakeholder needs, the company has an opportunity to minimize risks (by enjoying a good reputation) and to cut costs that would have to be incurred if a certain activity would become subject to government regulation (e.g., environment-related activities that can be initiated by the company before the government takes action, e.g., Berman et al. 1999; DiSegni et al. 2015; Shrivastava 1995; Taghian et al. 2015). Minor and Morgan (2011) found in their study that a company's extensive CSR activities could strengthen its reputation, reducing thus its vulnerability to potential crises. Porter and Kramer (2006) also suggest that through CSR activities, especially during periods of crises, companies can create "social value" benefiting both the companies and society. Similarly, Arevalo and Aravind (2010) studied the effects of the latest global crisis and found that companies with extensive CSR programs that had adopted the United Nations Global Compact principles suffered less from the crisis than those which did not adopt and conform to it.[3]

[3]The United Nations Global Compact is an initiative launched by the United Nations, bringing together businesses from 170 countries, which agreed to adopt sustainable and socially responsible practices and report to the UNGC accordingly. The UNGC is a framework

11.3 Methodology

The purpose of this study is to investigate whether and how the focus of CSR activities has changed in the case of Greek companies during the years of the economic crisis. We have used content analysis and reviewed the reports of the companies' CSR activities for the period 2008–2014. Neuman and Kreuger (2003, p. 219) define content analysis as "…a technique for gathering and analyzing the content of text. The content refers to words, meanings, pictures, symbols, ideas, themes, or any message that can be communicated." Content analysis provides an in-depth look into the information publicly available and it is very commonly used in management research (Aras et al. 2010; Holcomb et al. 2007; Orlitzky et al. 2003). As a method, content analysis is particularly suitable in the context of our CSR study, as it is replicable (i.e., limiting bias to a large extent) takes into account the context within the related decisions that are being made and the motivations of the actors involved, such as the managers and the employees, and it is flexible, allowing for the use of categories which is particularly important in the present study (Wang 2015).

Our methodological approach is similar to the one used by Aravossis et al. (2008) in their analysis of 28 companies operating in Greece in 2008. Due to the crisis and other reasons, some of these companies ceased their operations or merged with other companies reducing the sample of the qualifying companies to twelve. We then identified the CSR practice patterns of the following companies, starting from the precrisis years and ending in 2014, the period for which data were available:

- Alpha Bank,
- Athens International Airport,
- Coca-Cola Hellas*,
- Cosmote-OTE,
- Hellenic Exchange*,
- Hellenic Petroleum,
- OPAP,
- Piraeus Bank,
- Titan,
- Vivartia,
- Vodafone, and
- Wind.

For the companies with an asterisks (*), there were available data only for the period 2008–2012. We decided to include these companies as the four-year period can provide an indication of the trend that was followed.

(Footnote 3 continued)

comprising of ten principles, categorized in four areas: human rights, labor, anti-corruption, and environment (www.unglobalcompact.org).

For the purposes of this study, we used six broad categories of CSR areas that we expect to change as a result of the economic crisis. These categories are as follows: (i) economy, (ii) internal business processes, (iii) environmental impact, (iv) human resources, (v) society, and (vi) marketplace. Based on their published reports, we grouped the companies' activities according to the above categories for each year under investigation. This categorization enables us to compare our findings with the sample of companies used by Aravosis et al. (2008) as well as with studies adopting similar methodologies (e.g., Holcomb et al. 2007; Ni et al. 2015). Table 11.1 provides a brief description of what each category entails.

11.4 Results

Our analysis, as illustrated in Fig. 11.1, shows that there are major shifts in the configurations of the CSR practices post-2008. The category of *human resources* had a leading role in the business CSR programs in 2008 at 34.35%, while gradually decreasing in the following years to reach 18.53% dropping to the second place in 2014. The same trend is observed in the field of *environmental* issues which was second in the interest of companies in 2008 at 23.61% and was reduced gradually to reach the third place at 14.94% in 2014. On the other hand, there is a gradual increase in the interest of the companies to support activities related to the category of *society* where the percentage escalated from 21.11% in 2008 to almost double during the financial crisis, becoming a top priority for companies reaching close to 41%. The activities related to *economy* moved from the fourth to the fifth place and the interest for the *marketplace* from the fifth to the fourth place, respectively. Unchanged in the last place are the *internal business* activities with fewer actions being undertaken in this field.

Figure 11.1 illustrates the reconfigured corporate interest in the six CSR categories during the years 2008–2014. The changes are apparently related to the unprecedented economic crisis which gradually transformed both the economic and social landscape of the country. In light of this new reality, corporate management reconfigured the patterns of their CSR activities focusing, as expected, on the needs and demands of the society and the market stakeholder groups. This is in line with the results of other studies, claiming that when there is an imbalance in the power of the stakeholders, the management is trying to restore balance by reconfiguring its CSR activity patterns (Mitchell et al. 1997; Ni et al. 2015). The increased poverty levels and the precipitous decline in purchasing power of consumers, resulting from the 7-year long crisis, disrupted the established patterns of stakeholder power distribution, to the benefit of the society and market (customers) constituencies.

Table 11.2 presents the total number of activities in corporate social responsibility programs that the companies undertook during the period 2008–2014. While there was a sharp increase in the number of activities undertaken by the companies in 2009, after 2009 we observe a gradual decline. The increase in 2009 was probably due to the fact that the companies in Greece had remained unaffected by the global crisis of 2007–2008 which began to unfold in 2009, to reach its full

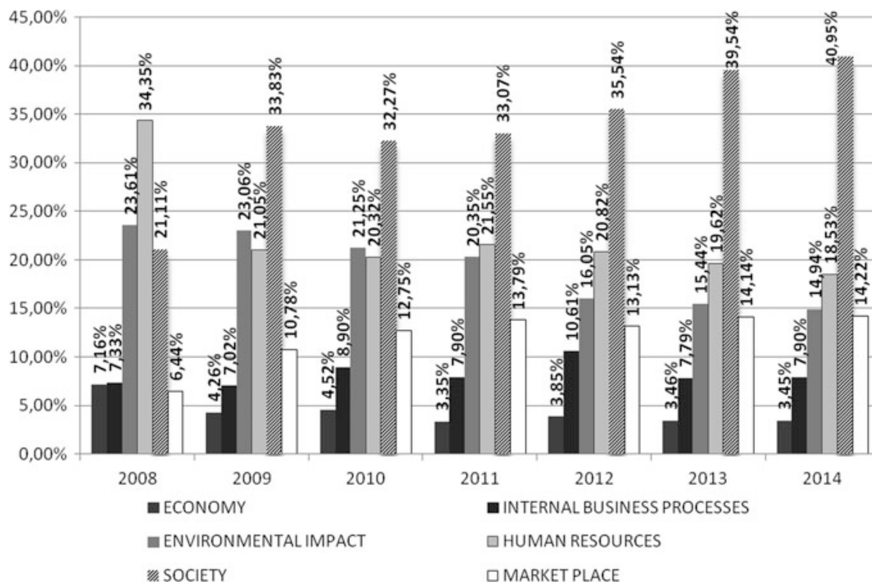

Fig. 11.1 Percentage of CSR activities reported between 2008 and 2014

proportions ever since. After 2009, the impact of the crisis began to appear in the number of the CSR activities reported by the companies which started to decline. Piraeus Bank reported the greatest number of CSR activities in most years (2009, 2011, 2012, 2013, and 2014) with the partly state-owned Cosmote and Hellenic Petroleum leading the pack in 2008 and 2010, respectively.

11.5 Discussion and Conclusions

The concept of CSR is based on the principle that companies can no longer operate entirely independently of the social system to which they belong and should behave in accordance to some basic principles regarding economic, environmental, and social responsibility. Corporate social responsibility has gained ground in the business world in Greece during the last decade. Corporate managers have started to realize that in order to be competitive, they should adopt CSR strategies, following the example of companies in more advanced economies that have adopted CSR practices for many years (Bailey et al. 2016; Unruh 2016).

During the prolonged period of the Greek economic crisis, when the interdependence of all stakeholders became apparent, the companies studied here demonstrated a clear responsiveness to society's needs, reconfiguring their CSR programs. Our findings are consistent with those of other studies, as we show a decrease in CSR-related spending by Greek businesses but find, at the same time,

that companies reorientate and refocus their CSR activities to adapt to the economic crisis conditions (Giannarakis and Theotokas 2011; Kavoura and Sahinidis 2015; Sahinidis and Kavoura 2014; Skouloudis et al. 2014). Our findings indicate that, even during the difficult years of the crisis, Greek companies have managed to successfully implement several projects in the context of CSR.

The turn toward social issues (see Table 11.1) and the responsibility that the companies demonstrated toward society was largely a reaction to the financial crisis that Greece suffered in the past several years. With the rates of unemployment and poverty reaching unprecedented levels, it is reasonable for enterprises to desire to demonstrate an enhanced social profile and highlight their contribution to social causes through donations, volunteerism, sponsorships, awareness programs, etc. Similarly to the findings of Fernández-Feijóo Souto (2009) and Carroll and Shabana (2010), we argue that companies will probably benefit by CSR activities when the crisis is over, since they will have gained or maintained a reputation of a socially responsible business. Legitimacy and reputation are valuable assets for companies as they can be used in times of corporate crises mitigating negative impact and protecting market share and profit levels (Taghian et al. 2015; Wang et al. 2016).

The results of this study also show a noteworthy shift of the emphasis of the CSR activities away from human resources and internal stakeholders in general. In order to economize resources and direct them to the prioritized stakeholder groups, the management of the companies has cut down in employee pay rates, tightened employees' benefits, reduced training investment, and even resorted to employment termination measures. At the same time, prices were reduced to attract customers who have lost cumulatively more than 25% of their household incomes in the first five years of the crisis. In addition to activities related to customer relations, the companies embedded in their CSR strategies activities that support social causes, alone or jointly with other organizations, such as providing support to non-governmental organizations (NGOs).

In summary, the CSR activities reported in this chapter during the seven-year period (2008–2014) changed in line with the findings of Ni et al. (2015) and focused more on the *society* and the *market* categories. Acting responsibly is highly likely to contribute to increased financial performance and company's future survival (Carroll and Shabana 2010; Fernández-Feijóo Souto 2009). Future studies may attempt to delve deeper into the dynamics of the corporate decision making as to which stakeholders are to be given priority in times when hard choices have to be made. Although it might be assumed that CSR is less important during a period of crisis, it has become clear both in previous literature and in this study that it should comprise a main pillar of the strategy of a company since some classes of stakeholders are in a greater need of it. If management is to build a sustainable relationship with its stakeholders, a crisis is indeed an opportunity to do so. Even though one cannot underestimate the importance of profitability for the survival of businesses, social value creation (Porter and Krammer 2006) can be the longer term perspective to harness these profits.

Table 11.1 The CSR categories

Economy	• Support of Greek entrepreneurship • Support of the Greek households • Tax consistency
Internal business processes	• Relation with the partners • Transparency • Fair corporate governance
Environmental impact	• Recycling • Actions for the environment • Awareness of environmental pollution
Human resources	• Fair salaries • Safe working conditions • Equal opportunities • Staff training • Health and securing • Extra grants
Society	• Charities • Educational activities • Cultural activities • Sponsorships • Volunteerism • Contribution to the society
Marketplace	• Relation with customers • Relation with suppliers • Responsible advertising

Table 11.2 CSR activities reported by companies

	2008	2009	2010	2011	2012	2013	2014
Alpha Bank	37	49	45	46	68	70	62
Athens International Airport	60	57	57	51	50	47	54
Coca Cola	41	27	47	32	29	-	-
Cosmote	86	83	74	64	66	56	69
Hellenic Exchange	24	34	32	20	32	-	-
Hellenic Petroleum	49	103	118	113	109	120	101
OPAP	16	97	60	74	60	78	64
Piraeus Bank	76	106	110	123	143	142	159
Titan	34	33	34	25	13	13	27
Vivartia	34	23	24	23	19	31	32
Vodafone	85	90	67	81	88	73	67
Wind	17	96	85	95	77	63	61
Total	559	798	753	747	754	693	696

ACTIVITIES 2008

	Economy	Internal business processes	Environmental impact	Human resources	Society	Marketplace	Total
Alpha Bank	1	4	11	12	6	3	37
Athens International Airport	5	0	10	25	15	5	60

(continued)

Table 11.2 (continued)

ACTIVITIES 2008							
Coca Cola	0	3	16	12	5	5	41
Cosmote	8	4	13	28	30	3	86
Hellenic Exchange	0	2	0	12	10	0	24
Hellenic Petroleum	5	0	11	28	5	0	49
OPAP	1	1	0	12	1	1	16
Piraeus Bank	6	14	25	22	6	3	76
Titan	2	0	17	9	6	0	34
Vivartia	7	6	7	6	3	5	34
Vodafone	4	7	16	23	24	11	85
Wind	1	0	6	3	7	0	17
Total	40	41	132	192	118	36	559
Rates	7.16%	7.33%	23.61%	34.35%	21.11%	6.44%	100%
ACTIVITIES 2009							
	Economy	Internal business processes	Environmental impact	Human resources	Society	Marketplace	Total
Alpha Bank	2	4	8	8	18	9	49
Athens International Airport	3	0	21	5	15	13	57
Coca Cola	0	3	10	5	4	5	27
Cosmote	5	3	14	14	34	13	83
Hellenic Exchange	0	4	4	16	10	0	34
Hellenic Petroleum	6	7	23	37	24	6	103
OPAP	1	1	17	10	66	2	97
Piraeus Bank	6	14	28	21	30	7	106
Titan	1	4	15	5	4	4	33
Vivartia	2	3	5	6	4	3	23
Vodafone	4	6	17	14	35	14	90
Wind	4	7	22	27	26	10	96
Total	34	56	184	168	270	86	798
Rates	4.26%	7.02%	23.06%	21.05%	33.83%	10.78%	100%
ACTIVITIES 2010							
	Economy	Internal business processes	Environmental impact	Human resources	Society	Marketplace	Total
Alpha Bank	3	3	6	9	15	9	45
Athens International Airport	4	5	11	6	20	11	57
Coca Cola	2	4	13	8	14	6	47

(continued)

Table 11.2 (continued)

ACTIVITIES 2010							
	Economy	Internal business processes	Environmental impact	Human resources	Society	Marketplace	Total
Cosmote	5	3	17	15	21	13	74
Hellenic Exchange	0	5	5	13	9	0	32
Hellenic Petroleum	5	7	27	32	38	9	118
OPAP	0	1	9	7	41	2	60
Piraeus Bank	4	15	23	19	39	10	110
Titan	2	4	13	5	5	5	34
Vivartia	3	3	5	6	4	3	24
Vodafone	3	11	17	9	14	13	67
Wind	3	6	14	24	23	15	85
Total	34	67	160	153	243	96	753
Rates	4.52%	8.90%	21.25%	20.32%	32.27%	12.75%	100%
ACTIVITIES 2011							
	Economy	Internal business processes	Environmental impact	Human resources	Society	Marketplace	Total
Alpha Bank	3	2	6	9	15	11	46
Athens International Airport	1	4	14	4	23	5	51
Coca Cola	1	3	8	7	7	6	32
Cosmote	2	3	17	14	15	13	64
Hellenic Exchange	0	0	5	8	7	0	20
Hellenic Petroleum	6	3	23	36	37	8	113
OPAP	0	2	7	13	48	4	74
Piraeus Bank	3	20	25	22	39	14	123
Titan	2	3	5	6	6	3	25
Vivartia	1	3	3	6	5	5	23
Vodafone	3	10	20	11	26	11	81
Wind	3	6	19	25	19	23	95
Total	25	59	152	161	247	103	747
Rates	3.35%	7.90%	20.35%	21.55%	33.07%	13.79%	100%
ACTIVITIES 2012							
	Economy	Internal business processes	Environmental impact	Human resources	Society	Marketplace	Total
Alpha Bank	4	2	12	8	25	17	68
Athens International Airport	2	2	16	2	24	4	50

(continued)

Table 11.2 (continued)

ACTIVITIES 2010							
	Economy	Internal business processes	Environmental impact	Human resources	Society	Marketplace	Total
Coca Cola	1	3	7	4	9	5	29
Cosmote	1	5	11	12	26	11	66
Hellenic Exchange	0	1	4	10	17	0	32
Hellenic Petroleum	3	3	16	42	33	12	109
OPAP	3	5	5	9	36	2	60
Piraeus Bank	4	27	16	30	49	17	143
Titan	2	3	3	0	5	0	13
Vivartia	1	3	2	5	4	4	19
Vodafone	4	21	17	14	23	9	88
Wind	4	5	12	21	17	18	77
Total	29	80	121	157	268	99	754
Rates	3.85%	10.61%	16.05%	20.82%	35.54%	13.13%	100%
ACTIVITIES 2013							
	Economy	Internal business processes	Environmental impact	Human resources	Society	Marketplace	Total
Alpha Bank	4	2	9	9	32	14	70
Athens International Airport	0	0	10	7	24	6	47
Cosmote	1	6	12	10	19	8	56
Hellenic Petroleum	6	4	19	35	37	19	120
OPAP	2	2	5	8	57	4	78
Piraeus Bank	4	22	19	29	52	16	142
Titan	0	0	5	1	6	1	13
Vivartia	1	3	2	6	11	8	31
Vodafone	2	11	16	15	21	8	73
Wind	4	4	10	16	15	14	63
Total	24	54	107	136	274	98	693
Rates	3.46%	7.79%	15.44%	19.62%	39.54%	14.14%	100%
ACTIVITIES 2014							
	Economy	Internal business processes	Environmental impact	Human resource	Society	Marketplace	Totals
Alpha Bank	2	4	5	6	33	12	62
Athens International Airport	0	3	11	6	25	9	54
Cosmote	2	5	11	8	34	9	69

(continued)

Table 11.2 (continued)

ACTIVITIES 2013							
	Economy	Internal business processes	Environmental impact	Human resources	Society	Marketplace	Total
Hellenic Petroleum	6	4	17	32	30	12	101
OPAP	3	2	5	8	43	3	64
Piraeus Bank	4	23	13	30	69	20	159
Titan	2	2	5	9	5	4	27
Vivartia	1	2	8	5	11	5	32
Vodafone	2	7	17	11	21	9	67
Wind	2	3	12	14	14	16	61
Total	24	55	104	129	285	99	696
Rates	3.45%	7.90%	14.94%	18.53%	40.95%	14.22%	100%

	2008	2009	2010	2011	2012	2013	2014
Alpha Bank	37	49	45	46	68	70	62
Athens International Airport	60	57	57	51	50	47	54
Coca Cola	41	27	47	32	29	–	–
Cosmote	86	83	74	64	66	56	69
Hellenic Exchange	24	34	32	20	32	–	–
Hellenic Petroleum	49	103	118	113	109	120	101
OPAP	16	97	60	74	60	78	64
Piraeus Bank	76	106	110	123	143	142	159
Titan	34	33	34	25	13	13	27
Vivartia	34	23	24	23	19	31	32
Vodafone	85	90	67	81	88	73	67
Wind	17	96	85	95	77	63	61
Total	559	798	753	747	754	693	696

Appendix: CSR Activities Per Year, Per Company, and Per Category

Tables

See Tables 11.1 and 11.2.

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Part III
Market Firm Issues

Chapter 12
Is Socially Responsible Investing More Risky? Australian Evidence

Ewan Mackie, Imon Palit, Madhu Veeraraghavan and John Watson

Abstract Prior studies, which analyse the performance of socially responsible investments (SRIs) compared to conventional funds, have thus far ignored the assessment of risk. In response to this identified lack of research, we make a major attempt to fill the void by investigating whether daily returns of Australian equity socially responsible investment funds have different tail risk exposure in the return distribution compared to matched conventional equity funds. The Australian funds management industry provides a natural setting within which to study the risk exposure of SRI funds. The Australian funds management industry has one of the largest and fastest growing funds management sectors in the world. This growth is underpinned by Australia's government-mandated retirement scheme. In addition, Australia is the first country to introduce regulations that require issuers of financial products and financial advisors to disclose and advise on ethical, social, and governance (ESG) considerations. Using a sample of 26 funds spanning the period 1998–2013, we establish several new findings. First, in assessing tail risk exposure we observe no evidence of significant difference in riskiness amongst socially responsible investment compared to that of conventional funds with similar investment styles. Second, when comparing two downside risk measures across socially responsible and matched conventional funds, namely Value-at-Risk and expected shortfall, we find that return distributions amongst Australian funds do not exhibit particularly heavy tails. Taken together, we show that investors do not pay a penalty (in terms of higher risk) to invest ethically.

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Keywords Socially responsibly investment · Risk · Value-at-Risk · Expected shortfall

12.1 Introduction

The central purpose of this study is to empirically test whether a penalty exists for pursuing an ethical approach to investing in Australia. In particular, we address two research questions. First, we investigate whether daily returns of Australian equity socially responsible investment funds have different tail risk exposure in the return distribution compared to that of matched conventional equity funds. We ask this question as Copp et al. (2010) identify that assessment of risk in SRIs is an area which is yet to be subjected to empirical investigation. Second, we compare two downside risk measures across socially responsible and matched conventional funds: Value-at-Risk and expected shortfall.

The literature on ethical investing is well established, as is the idea of costs/benefits incurred by investors in SRI funds, in search for an answer to the question of whether it is possible "to do well while doing good" as postulated by Hamilton et al. (1993). Traditionally, financial researchers assume that investors sole objective is to maximise returns for a given level of risk. This search for the holy grail of a mean-variance efficient portfolio necessitates holding a fully diversified portfolio of assets. This requirement of holding a well-diversified portfolio contravenes investing in SRI funds as they often impose negative screens restricting the opportunity set available for investing, resulting in the potential exclusion of entire industries (Humphrey and Lee 2011). Therefore, investing in SRI funds and having a fully diversified portfolio is simply not achievable (Hong and Kacperczyk 2009) implying further the likelihood of investors facing a penalty for following their social conscience. However, Humphrey and Lee (2011) state that the number of positive and negative screens has very little impact on returns but finds evidence to suggest the positive screening reduces risk. The literature fails to find conclusive support for the above argument with many empirical investigations reporting results that demonstrate that it is not necessary to sacrifice returns in order to pursue ethical considerations. We aim by way of an empirical investigation into SRI funds in Australia to fill this gap.

Research in this area traditionally focusses on whether SRI criteria for funds have any effect on performance compared to their conventional counterparts where performance may be measured by balance sheet or share price performance of the stocks in their investment portfolios. This type of analysis usually focuses on returns or excess returns as in, for example, Bauer et al. (2006) or Becchetti and Ciciretti (2009). We contribute to the literature by explicitly comparing the risk characteristics of SRI and conventional funds by studying tail risk exposures. This is a worthwhile question as conventional wisdom suggests that reduced diversification opportunities of SRI funds may lead to greater volatility in their portfolios. However, the less volatile nature of ethical investments could lead to steadier, more

sustainable returns. If there is a difference in terms of risk, it is of interest to investors who wish to invest ethically without incurring a financial penalty.

Specifically, we look at two risk measures; Value-at-Risk (hereafter VaR) and expected shortfall (hereafter ES).[1] VaR is a threshold for the worst possible loss over a target horizon with a given level of confidence. It was famously created as a response to the financial crises at the end of the twentieth century, and the need for an easily calculated, all-encompassing risk measure that could some summarise all the risk of a trading book in a single number. VaR is widely used throughout the financial industry and is the recommended risk measure in the Basel II and Basel III accords. ES was created as a response to several criticisms of VaR both mathematically and conceptually. Whereas VaR only provides an upper limit for the worst possible loss, ES tells us the expected loss once VaR is exceeded. Unlike VaR, ES is a subadditive risk measure, i.e., ES of a portfolio is less than the sum of ES from its constituent assets. Subadditivity is important as it encourages diversification. Like VaR, ES can summarise the risk of a large portfolio of several different assets in a single number. However, ES is still not as widely used as VaR and much less is known about its performance and modelling.

Recent media exposure (Collett 2013; Liew 2012)[2] has attracted greater flow of funds into this type of investment as investors are attracted by the opportunity of benefiting from financial gains associated with investing in a portfolio that is more consistent with their social conscience (Lee et al. 2010). An argument has also been made that, given the ethical considerations which drive socially responsible investments (SRIs), investors might be willing to accept lower financial returns (Statman 2011); that is, incur a penalty for pursuing ethical investments.

The Australian funds management industry provides an interesting setting within which to study the risk exposure of SRI funds. Much of the research, which has tended to concentrate on performance-related issues and the impact of screening, has been conducted on the US market. The Australian funds management industry has one of the largest and fastest growing funds management sectors in the world. This growth is underpinned by Australia's government-mandated retirement scheme. Further strengthening this sector is the sophistication of Australia's investor base (Nordkvelde et al. 2013) which has resulted in the need for greater regulation and

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[1]We use three different estimates of VaR and ES. The three estimates are based on (a) the historical distribution of returns, (b) the assumption that returns follow a Gaussian distribution, and (c) extreme value theory (hereafter EVT). EVT has gained popularity in the risk management literature over the last twenty years. EVT provides a formal framework with which to study the tail behaviour of distributions. A rich and detailed summary of EVT and applications to risk management can be found in McNeil et al. (2005). It is generally accepted that EVT methods fit higher quantiles better than competing approaches, especially where heavy-tailed data are involved. The historical approach, however, makes less assumptions about the distribution of returns and the Gaussian approach is easy to implement. The appropriate model thus needs to be chosen by backtesting methods such as those developed by Christoffersen (1998) and Berkowitz and O'Brien (2002).

[2]The Perpetual Wholesale Ethical SRI Fund is the top-performing fund in 2012 (39.70% return). According to Mercer's latest investment return figures, the average equities fund manager achieved 20.30%.

forced disclosure by fund managers within the SRI space. Additionally, Australia has a resilient economy, a world-class regulatory environment, and a multilingual skilled workforce who demand choice with respect to their investment opportunities.

Australia's funds management industry is the largest in the Asia-Pacific region. Its size and sophistication reflects the nation's strengths in having the regions: largest pension fund industry; the largest share market (ex-Japan) measured by free-float market capitalisation; the fastest growing foreign exchange market; and third largest high-net-worth market after Japan and China.[3] Despite this, growth fund managers within the Australian market still have fewer investment opportunities, than US counterparts, that satisfy ESG criteria as stipulated by the Social Investment Forum (SIF).[4] Therefore, as previously identified by Humphrey and Lee (2011), it is possible that Australian SRI funds performance and hence risk exposure through lack of diversification opportunities may actually be worse than that of SRI funds in the US or other developed markets.

We find evidence that investors do not pay a penalty (in terms of higher risk) to invest ethically and hence fund managers of ethical funds are performing as well as fund managers of more conventional funds. Socially responsible investment (SRI) typically refers to a style of investment that aspires to consider both financial return and social good. SRI strategies are usually monitored according to (a) environment, (b) social justice, and (c) corporate governance criteria, or ESG for short. The most common SRI approaches include the positive or negative screening of investments based on their ESG performance, and the integration of ESG factors in financial analysis where these factors represent a core driver of both value and risk in companies and assets.[5] Our results will be of interest to SRI investors in other countries other than the USA where limited investment opportunities that meet ESG criteria are available and hence impact directly on the risk associated with such investment practices.

The rest of the paper is organised as follows. Section 12.2 presents a literature review. Section 12.3 describes the methods of risk measurement, detailing VaR, ES, modelling assumptions, and our backtesting approach. Section 12.4 describes the data and methodology. Section 12.5 presents the empirical findings. Section 12.6 concludes.

12.2 Literature Review

The Social Investment Forum, a national not-for-profit organisation charged with promoting the concept, practice, and growth of socially responsible investing (SRI), describes socially responsible investing as "an investment process that considers the

[3]Lynch (2009).

[4]The SIF is a US membership association dedicated to advancing the concept, practice, and growth of SRI.

[5]In Australasia, the majority of SRI funds employ the ESG factor approach as noted by the O'Connor (2013).

social and environmental consequences of investments, biota positive and negative, within the context of rigorous financial analysis".

The early work within the SRI space trace back to the seminal work by Hamilton et al. (1993) who present three alternative hypotheses with respect to the relative returns of SRI shares compared with that of conventional companies. First, the authors postulate expected returns of socially responsible stocks are equal to the expected returns of conventional stocks. In such a world, supply and demand of such securities is matched resulting in no movement of the share price. This is termed the "no effect" hypothesis. The second hypothesis is the "doing good but not doing well" hypothesis. Here, the returns for SRI shares are lower than the expected returns of conventional shares. It is deduced there is a penalty for investing ethically.

The last hypothesis is the "doing well while doing good" hypothesis which assumes expected returns for SRI shares are higher than those of conventional shares. Proponents of such a way of thinking promote the benefit of social screening and argue that this enhances financial performance by eliminating companies of questionable business practices.

In more recent times, the literature has started to investigate these issues associated with SRI as it relates within the funds management industry. Much of this research has emerged post-2000[6] and has tended to concentrate on performance and in particular the effect of negative screening on performance (see, Lee et al. 2010; Humphrey and Lee 2011). Negative screening involves rejecting investment opportunities due to the nonsatisfaction of ESG criteria (e.g. shares are often excluded that invest in gambling, tobacco, and pornography industries amongst others), and the effect that this has on investment returns.

Theories advocating ESG propose that corporate social responsibility (CSR) increases NPVs and also acts as a signalling mechanism used by companies for indicating prosperity which in turn results in superior subsequent performance (Heal 2005; Fisman et al. 2006). These theories, however, are at odds with traditional economic thinking which states the imposition of noneconomic values by trustees of managed funds is inappropriate and that "the social responsibility of business is to increase profit" (Friedman 1970). Two main hypotheses are established within the SRI literature that associates SRI to share price (see, Derwall et al. 2011). First, the "shunned-stock hypothesis" which infers SRI leads to excess demand for CSR leader shares, and shortage of demand for CSR laggard shares, resulting in excess returns for the latter. Secondly, the "errors-in-expectations hypothesis" which implies that positive screens in favour of highly ranked CSR shares result in outperformance due to CSR signals not being priced correctly. Derwall et al. (2011) reconcile the two phenomena to coexist and show that outperformance of highly ranked CSR shares are eventually arbitraged away after longer time horizons where information contained in CSR is eventually impounded into share price.

[6]Table 12.7 summarises some of the key SRI studies dating back to 2000.

It has also argued that a reflexive effect could occur with investors diverting funds away from polluting companies which in turn cause companies to alter behaviour (Heinkel et al. 2001). From a financial perspective, yet an alternative theory predicts a cost in performance arises due to reduced diversification opportunities that are a direct cost of screening practices in place (Herzel and Nicolosi 2013).

Humphrey and Lee (2011) argue that due to the constraints in place for eliminating "sinful" industries from inclusion within their portfolios, it is logical to postulate that SRI funds are likely to underperform compared with both the broader market and unconstrained fund managers. Indeed, Ooi and Lajbcygier (2013) provide evidence that sinful industries outperform SRI both on average and with economic significance about 4% per annum.

Like the theoretical literature, much of the empirical literature is similarly split in its opinion of how much SRI penalises investors by way of lower returns or benefits an investment portfolio as a resulting of adhering to ESG criteria. In our review of this literature, we focus on studies which concentrate on the impact of SRI performance rather than on the strand of research that is concerned with investor behaviour.[7] Guerard (1997) finds no statistical difference exists in share returns when comparing ethically screened and unscreened universes. Similarly, Kurtz (1997) reports mixed evidence as to whether social factors such as environmental policies, employee relations, and research and development (R&D) spending is associated with abnormal returns. In contrast, Statman (2006, 2007) find evidence of higher SRI returns but also higher tracking errors of SRI portfolios compared to conventional benchmarks. Becchetti et al. (2008) look at performance of shares in the Domini Social Index and find that companies going into this index report higher return on equity and higher sales and productivity.

In two separate studies, Bauer et al. (2005, 2006) apply four-factor models to compare performance of ethical mutual funds against conventional counterparts. In both cases, the studies document that, after controlling for common factors (such as market, size, book-to-market, and momentum), there is no penalty in being an ethical investor. Interestingly, they observe a learning period where the performance of ethical fund managers gradually improves to catch up with the performance of conventional funds. Becchetti and Ciciretti (2009) investigate SRI performance comparing socially responsible portfolios versus a control sample and find no evidence of difference in excess returns. Renneboog et al. (2008) find evidence of underperformance of SRI funds and mixed evidence of a "smart money" effect in the case of SRI investors who are able to identify poorly performing funds but not outperforming funds. The link between SRI and book-to-market ratios is investigated by Galema et al. (2008) who find a negative effect exists which also affects alpha negatively. Hong and Kacperczyk (2009) look at sin shares from alcohol, tobacco, and gaming industries. They find less analyst coverage and institutional ownership which results in a significant price effect of 15–20%.

[7]For a discussion that relates to SRI and fund investor behaviour refer to the following articles: Bollen (2007), Benson and Humphrey (2008), and Renneboog et al. (2011).

They argue these shares tend to be cheaper as a result of higher litigation risk and being subject to more scrutinised accounting and regulation.

We now shift our attention to empirical evidence which investigates SRI within the Australian market. In an early study, Bauer et al. (2006) investigates the risk-adjusted performance of 25 Australian retail ethical funds and finds SRI underwent a significant catching up phase throughout the period 1992–1996, after which delivering returns similar to those of conventional funds in the later period 1996–2003. In a separate study which investigates the return performance of 89 SRI funds, Jones et al. (2008) document that ethical funds significantly underperform the market. In more recent times, Copp et al. (2010) find that systematic risk of SRI both in Australia and internationally increases more than that of conventional funds during economic downturns. Humphrey and Lee (2011) extend the work of Jones et al. (2008) in a study which investigates 24 Australian equity SRI funds. They find no significant difference between SRI and conventional counterparts with respect to return and postulate no penalty exists in terms of risk-adjusted returns for pursing a socially conscious investment strategy.

When examining the impact of SRI on market risk, one must consider that less-diversified SRI funds subjected to a restricted investment universe will be subject to more idiosyncratic risk. However, many SRI investors with would certainly be of the view that their investments are long term, sustainable, and above all else benefiting the world in which we live. Such an investment would be less volatile, less subject to corporate scandal, and offered more protection by the government. It is observed that ethical funds are less exposed to market variability than conventional funds (Bauer et al. 2005, 2006) and are more value-orientated than growth-orientated funds. Also, SRI portfolios exhibit lower conditional volatility and more robustness to shocks (Becchetti et al. 2008) after fitting GARCH(1,1) and APARCH(1,1) models. Prior research shows that negative screening significantly increases market risk and reduces funds abilities to form diversified portfolios (Humphrey and Lee 2011). Bollen (2007) compares volatility of monthly flows into SRI and conventional funds and finds SRI flows to be less volatile. He finds that US SRI fund flows are less sensitive to past negative returns than are conventional funds, but the flows of SRI funds are more sensitive to past positive returns. A similar study is carried out by Benson and Humphrey (2008) on monthly fund flows and the flow–performance relationship. They find more persistence in the case of SRI flows to that of conventional fund flows with SRI investors less sensitive to lagged returns and more likely to reinvest in similar shares. Renneboog et al. (2011) find that younger and smaller SRI funds have less volatile returns tending to attract more fund flows than other SRI funds but can find no evidence of superior performance.

It is important to consider how to measure risk. The volatility of returns is a standard tool used by investors to evaluate investments, for example, in technical analysis or Sharpe ratios. Despite this, however, volatility is not completely adequate because it does not contain information about tail behaviour, i.e. the extreme returns that can greatly affect an investments value. VaR and ES have provided potential solutions and EVT was developed with this practical application in mind. It is generally accepted that a risk measure should have the property of subadditivity

(McNeil et al. 2005). Subadditivity requires that the act of merging portfolios has no escalation in risk, i.e., it promotes diversification. ES demonstrates this property, as does VaR in most cases.

12.3 Methods for Estimating Value-at-Risk and Expected Shortfall

VaR and ES are risk measures used to determine expected losses with a given probability. Specifically, given a set of returns on an investment, the $(1-p)\%$ VaR, i.e. the VaR at the $(1-p)\%$ confidence level, is the p-quantile of the return distribution. VaR thus measures the maximum an investment can lose over a certain time horizon with probability p. One criticism of VaR is that it does not provide information on the shapes of the tails above or below the $(1-p)\%$ confidence level. Thus, we assign to each VaR an associated $(1-p)\%$ ES which measures the expected loss of the investment on the condition that the loss is greater than VaR. This study adopts the approach detailed in McNeil et al. (2005) and Jorion (1997) to measure and ES.[8] For our particular work, we study the 1-day VaR and ES for three confidence levels, 95, 99, and 99.5%. We are mainly interested in returns *less* than a certain amount, i.e. losses. Losses are generally described as the “left” tail of the distribution. If we define X_t as the time series of negative log returns, we can define the $(1-p)\%$ VaR at time t, denoted by $\mathrm{VaR}_{t,p}$, as

$$\mathrm{P}\left(X_{t+1} \leq -\mathrm{VaR}_{t,p}\right) = p, \tag{1}$$

with the associated $(1-p)\%$ ES given by

$$ES_{t,p} = \mathrm{E}\left[X_{t+1} \middle| X_{t+1} > \mathrm{VaR}_{t,p}\right] \tag{2}$$

where $\mathrm{E}[X|Y]$ represents the expectation of X conditional on Y.

We present three approaches for calculating the VaR in expression (1) and ES in expression (2).

The GARCH models are historically used to account for heteroscedasticity through a time-varying volatility. In this connection, we use the EGARCH which is more flexible than a standard GARCH as it can capture the asymmetric reactions of volatility to positive and negative shocks, i.e. the leverage effect. In addition to this, the volatility process should always be positive. The EGARCH model is characterised by the following return series dynamics:

[8] Fong Chan and Gray (2006) and (Gençay and Selçuk 2004) also perform similar risk analysis in the context of electricity and emerging markets.

$$X_t = \mu + \sigma_t Z_t \tag{3}$$

where the innovations $\{Z_t\}_{t \geq 0}$ are stationary i.i.d. and

$$\log \sigma_t^2 = w + \alpha \left| \frac{X_{t-1} - \mu}{\sigma_{\mathrm{t}-1}} \right| + \beta \log \sigma_{t-1}^2 + \gamma \frac{X_{t-1} - \mu}{\sigma_{\mathrm{t}-1}} \tag{4}$$

The model is stationary for $\beta < 1$; ω, α, and γ are parameters to be calibrated. We estimate the EGARCH model parameters using the semi-parametric approach of a quasi-maximum-likelihood estimation.

As in McNeil and Frey (2000), we then standardise the residuals and calculate one-day VaR and ES as

$$\mathrm{VaR}_{t,p} = \mu_{t+1} + \sigma_{t+1} \mathrm{VaR}_p(Z) \tag{5}$$

and

$$\mathrm{ES}_{t,p} = \mu_{t+1} \sigma_{t+1} \mathrm{ES}_p(Z). \tag{6}$$

As $\{\sigma_t\}t \geq 0$ is decided by the EGARCH calibration, the difference in modelling choices thus lies within the calculation of $\mathrm{VaR}_p(Z)$ and $\mathrm{ES}_p(Z)$. Different values will be obtained depending on the distributional assumptions our three modelling approaches make on (Z_t).

12.3.1 The Historical Approach

This approach estimates quantiles from the historical distribution of returns (Linsmeier and Pearson 2000). The underlying assumption of the historical approach is that the past distribution is a suitable proxy for the future.

For a sample of 1-day returns of length T, the $(1 - p)\%$ VaR is simply the estimated $(1 - p)\%$ quantile. ES can also be estimated empirically. We can write the ES of the marginal distribution of the residuals as

$$\mathrm{ES}_p(Z) = \mathrm{VaR}_p(Z) + e\left(\mathrm{VaR}_p(Z)\right) \tag{7}$$

where $e(u)$ is the average loss in excess of a threshold, u, conditional on the threshold having been exceeded.

12.3.2 The Gaussian Approach

A common approach is to assume that the marginal distribution of the residuals is a standard Gaussian (Jorion 1997). The $(1 - p)\%$ VaR is then simply given by the expression

$$\text{VaR}_p(Z) = N^{-1}(p), \tag{8}$$

where N (−) is the cumulative distribution function of the standard Gaussian distribution. In addition, ES is known in closed form for Gaussian models. In particular, it is well known that

$$\text{ES}_P(Z) = \frac{N'(\text{VaR}_p(Z))}{p} \tag{9}$$

.

12.3.3 The EVT Approach

Many financial time series exhibit heavy-tailed distributions. For this reason, it is desirable to have as much flexibility in modelling tail behaviour as possible. EVT was developed with this application in mind (McNeil and Frey 2000). Indeed, tail behaviour may be modelled directly using EVT without making assumptions on the return distribution as a whole. We adopt, in particular, the peaks over thresholds (POT) method where we identify extreme observations that exceed a high threshold u and model these "exceedances" separately from nonextreme observations.

For a sample of exceedances of size N_u the *exceedance magnitude* is the size of an exceedance over the threshold and is given by $Y_i = Z_i - u$ for $i = 1,\ldots, N_u$. We then let F (−) be the marginal distribution function of Z_t for each $t \geq 0$. The probability distribution of $\{Y_t\}t \geq 0$ for a given threshold u defined by

$$\begin{aligned} Fu(y) &= \text{P}(Zt - u \leq y | Zt > u) \\ &= \frac{F(y+u) - F(u)}{1 - F(u)} \end{aligned} \tag{10}$$

may then be written as

$$F(z) = [1 - F(z)]F_u(y) + F(u). \tag{11}$$

EVT provides the theory to describe the limiting distribution of (11) as $u \to z_+$, where z_+ denotes the upper (possibly infinite) limit of the distribution of Z_t. Indeed, Balkema and Haan (1974) and Pickands (1975) show that, for u sufficiently high, $F_u(-)$ is approximated by the generalised Pareto distribution (GPD). The cumulative distribution function of the GPD is given by

$$G_{\xi,\beta}(z) = \begin{cases} 1 - \left(1 + \frac{\xi z}{\beta}\right)^{-1/\xi} & \text{if } \xi \neq 0 \\ 1 - \exp(-z/\beta) & \text{if } \xi = 0, \end{cases} \tag{12}$$

where $\xi \in \mathrm{R}$ and $\beta > 0$ are called the shape and scale parameters, respectively. The parameters of the GPD can be found by a maximum-likelihood estimation (see, e.g. Embrechts et al. 1999). A value of $\xi > 0$ corresponds to heavy-tailed distributions.

For a data set of size T with N_u exceedances, we observe that $F(u)$ may be approximated empirically as

$$F(u) = 1 - \frac{N_u}{T}. \tag{13}$$

For sufficiently high u, Eq. (11) thus simplifies to

$$F(z) = 1 - \frac{N_u}{T}\left(1 + \frac{\xi(z-u)}{\beta}\right)^{-1/\xi} \tag{14}$$

Expression (14) is a *tail estimator*. It can be used to estimate VaR by observing that, by definition, we have

$$F\left(\mathrm{VaR}_{t,p}\right) = p. \tag{15}$$

By inverting this expression, we obtain

$$\mathrm{VaR}_p(Z) = u + \frac{\beta}{\xi}\left(\left(\frac{pT}{N_u}\right)^{-\xi} - 1\right) \tag{16}$$

Additionally, the ES can also be calculated in closed form through expression (7) to obtain

$$\mathrm{ES}_p(Z) = \frac{\mathrm{VaR}_p(Z) + \beta - \xi u}{1 - \xi}. \tag{17}$$

One downside of the POT analysis lies in the ad hoc determination of the threshold u. A certain balance needs to be struck between choosing a value of u high enough such that EVT is applicable and low enough such the number of exceedances is statistically significant. One method for choosing u is by analysis of the mean-excess function (MEF) plot (cf. Embrechts et al. 1999). The MEF for a GPD should be linear, and it may be possible to choose u such that the MEF is linear for all points above u. However, this method is time-consuming and often researchers will choose u such that the number of exceedances N_u is equal to some small, fixed percentage (e.g. 5%) of the size of the data sample.

12.3.4 Backtesting

Following, for example, Christoffersen (1998) and Berkowitz and O'Brien (2002), the relative performance of each VaR approach is determined by a *violation ratio*. The idea is that we compare the VaR estimated at time t with the actual return observed at time $t + 1$. A violation occurs if a realised loss is greater than the estimated VaR on a given day. The violation ratio is then defined as the total number of violations divided by the total number of estimated VaRs.

The motivation behind this is as follows. Given a VaR number at a certain confidence level $(1 - p)\%$, we can expect that approximately $p\%$ of the time it will be exceeded by the next days return. This follows from the definition of VaR as a p-quantile. The more accurate the model, the closer the violation ratio is to p. A violation ratio higher (lower) than the expected one indicates that the model consistently under (over-)-estimates the risk.

12.4 Data Description

12.4.1 Sample Selection

For the purpose of the empirical study within this chapter, we use daily time series return data sourced from Morningstar Direct for Australian open-ended equity SRI and matched conventional funds for the period January 1998–November 2013. The matching process is discussed in detail in Sect. 4.2. Our final data set consists of daily returns for 13 SRI and 13 matched conventional funds. In order to concentrate our analysis on the difference between SRI and conventional investing, we ensure that all funds satisfy the following two criteria; first, all funds must have at least 75% of their equity holdings in Australian markets; and secondly, we require at least 4 years of daily return data. We impose the minimum restriction of 75% because we wish to ensure that any difference in performance between SRI and conventional funds is driven by the SRI attribute and not by altering asset allocation. The requirement to have minimum of 4-year daily data is driven by the requirement to have sufficient data observations to enable us to be able to carry out EVT.

In addition to the daily returns of both the conventional and SRI funds sourced through Morningstar, we also access other variables such as base currency; share class; inception date; investment area; domicile; and assets undermanagement (AUM). For the sample period 1998–2013, there exist 92 equity funds that have a socially conscious classification and 2896 conventional funds. However, the same funds can be duplicated with different share classes of the same fund. To avoid duplication, we conduct analysis on a distinct portfolio basis by keeping only the parent share class. We concentrate solely on Australian equity funds and, to keep focus on issues relating to SRI, we eliminate funds that have less than 75% of their holdings in domestic equity. We remove funds with missing AUM, and we study

funds with at least four years of daily data to allow sufficient analysis of tail behaviour. This leaves us with 13 parent class, domestic Australian equity-focused funds.

12.4.2 Matching Methodology

For each SRI fund, we select the conventional fund with the lowest distance score as its matched fund to compare VaR and ES risk measures. In order to identify conventional funds with the best possible fit to the 13 SRI funds included within our final sample, we conduct the following matching algorithm. Our prematched final data set consisting of 92 SRI and 2896 conventional funds reduces to 13 SRI and 269 conventional funds. We run a matching algorithm to pair each of the 13 SRI funds with a conventional fund based on fund style, age, and size. The matching algorithm is based on the Carhart (1997) 4-factor model. The factors used are provided by the authors of Gray et al. (2014) who calculate market minus risk-free asset (RMRFT), small minus big (SMB), high minus low (HML), and momentum (MOM) factor returns using data for ASX-listed stocks over the 1990–2012 period.

The Australian factors are constructed in the spirit of Fama and French (1993) with modifications to reflect distribution of market cap amongst Australian stocks. Following the work of Brailsford et al. (2012), the Gray et al. (2014) 4-factor construction uses a modification regarding cut-offs. Brailsford et al. (2012) noted that the distribution of size and book-to-market ratios in Australia was heavily skewed and therefore justified the modification to the standard Fama and French methodology of using median market cap to partition into small and big stocks was not adequate. Gray et al. (2014) identify a portfolio of approximately 300 “large” stocks by taking the stocks that contribute the top 90% of total market capitalisation and a portfolio of about 1700 “small” stocks that contribute the remaining 10%.

In line with Fama and French (1993), small minus big (SMB) and high minus low (HML) factors are constructed by averaging across portfolios. For example, SMB is the difference in return between the small and large portfolios. A momentum (MOM) factor is also constructed using six portfolios double-sorted on size and prior 12-month returns. This procedure provides a time series of monthly returns to SMB, HML, and MOM factor-mimicking portfolios. Each of the SMB, HML, and MOM portfolios is constructed for the Australian market.

We run the Carhart 4-factor regressions using the fund monthly returns using the following equation:

$$\begin{aligned} r_t - r_{f,t} = \alpha + \beta_{\mathrm{MKT}}\left(r_{\mathrm{MKT},t} - r_{f,t}\right) + \beta_{\mathrm{SMB}} r_{\mathrm{SMB},t} \\ + \beta_{\mathrm{HML}} r_{\mathrm{HML},t} + \beta_{\mathrm{MOM}} r_{\mathrm{MOM},t} + E_t \end{aligned} \quad (18)$$

where r_t represents the monthly returns of the fund; $r_{\mathrm{MKT},t}$, the monthly returns of the market; $r_{\mathrm{SMB},t}$, the monthly returns of the SMB portfolio; $r_{\mathrm{HML},t}$, the monthly returns of the HML portfolio; $r_{\mathrm{MOM},t}$, the monthly returns of the MOM portfolio; and $r_{f,t}$, represents the risk-free rate. In addition, α is the risk-adjusted performance

estimate for the fund; β_{MKT}, β_{SMB}, β_{HML}, and β_{MOM} are the regression betas of the fund with respect to the market MKT, SMB, HML, MOM portfolios, respectively; and E_t are a series of i.i.d. innovations.

Our matching procedure is then similar to that of Bollen (2007) and Renneboog et al. (2011) who calculate a matching "score" for candidate funds that are no more than 2 years older or younger than the SRI fund and match whether they charge load fees or not. Specifically, for each SRI fund i and candidate fund j we calculate the score $S_{i,j}$ defined as

$$S_{i,j} = \frac{(\text{AUM}_i - \text{AUM}_j)^2}{\sigma^2_{\text{AUM}}} + \frac{(\beta_{\text{MKT},i} - \beta_{\text{MKT},j})^2}{\sigma^2_{\text{MKT}}} + \frac{(\beta_{\text{SMB},i} - \beta_{\text{SMB},j})^2}{\sigma^2_{\text{SMB}}} + \frac{(\beta_{\text{HML},i} - \beta_{\text{HML},j})^2}{\sigma^2_{\text{HML}}} + \frac{(\beta_{\text{MOM},i} - \beta_{\text{MOM},j})^2}{\sigma_{\text{MOM}}} \quad (19)$$

where AUM_k are the assets under-management of fund k. We also scale the difference in betas for variance where σ^2_{MKT}, σ^2_{SMB} σ^2_{HML}, and σ^2_{MOM} the cross-sectional variances of each beta across the total sample of funds for each of the MKT, SMB, HML, and MOM portfolios, respectively.

12.4.3 Summary Statistics

Table 12.1 reports descriptive statistics for daily returns for each SRI fund (refer Panel A) and each matched conventional fund (refer Panel B). For the SRI funds, the full sample sizes range from 1294 days for OnePath to 3035 days for the BT Ethical Share Fund, and for the matched conventional funds, the sizes range from 2113 of ANZ Australian Equity Share Fund to 3711 for Hyperion Small Growth Companies. On average conventional funds (0.04%) outperformed conventional funds (0.03.5%) although the SRI fund Perpetual Wholesale Ethical has the highest average return overall with 0.06%. In general, the funds have high standard deviations (volatility), are negatively skewed, and exhibit excess kurtosis indicating that log returns do not follow a Gaussian distribution. This helps to motivate the use of historical and EVT-based VaR estimates in our analysis. Indeed, the lowest kurtosis estimates are 3.83 for the SRI AMP Leaders Australian Share Fund and 3.80 for the conventional fund Advance Australian Smaller Companies which indicates heavy-tailed behaviour. It is clear that the Hyperion Small Growth Companies fund has the most extreme kurtosis.

In Table 12.2, we present the summary statistics for the residuals of each SRI fund and matched conventional fund, respectively. The residuals are obtained after fitting the EGARCH model described in Sect. 12.3. We can see from the kurtosis that in general the residuals show a reduction in heavy-tailed behaviour. We fit a GPD to each set of residuals and report the resulting parameter estimates (also in Table 12.2). For each fund, we chose the threshold u such that the number of

Table 12.1 Descriptive statistics for SRI and conventional funds

Panel A: SRI funds	Mean	Std. Dev.	Skew	Kurt	Min	Max	Q_1	Median	Q_3	JB test	p-value	Start	End	Count
AMP FLI AMP Sustainable Future Aus Shr	0.03	1.12	−0.29	4.96	−8.65	6.26	−0.50	0.06	0.63	4252.15	0.00	22/05/2001	13/11/2013	3020
BT Class Inv Ethical Shr	0.04	1.06	−0.36	4.41	−7.50	5.34	−0.49	0.10	0.61	3490.67	0.00	7/01/2002	14/11/2013	2808
BT Ethical Shr WS	0.04	1.05	−0.53	5.75	−8.20	5.48	−0.46	0.10	0.60	5754.06	0.00	2/05/2001	14/11/2013	3037
Perpetual Wholesale Ethical SRI	0.06	0.85	−0.62	6.86	−8.09	4.73	−0.34	0.13	0.51	7913.03	0.00	4/06/2002	14/11/2013	2698
Perennial Socially Responsive Shares Tr	0.03	1.11	−0.43	5.94	−8.68	5.42	−0.47	0.07	0.60	5521.31	0.00	3/01/2002	14/11/2013	2913
Hunter Hall Australian Value Trust	0.03	0.84	−0.71	5.85	−8.10	4.68	−0.37	0.06	0.48	5386.12	0.00	9/01/2002	14/11/2013	2934
Australian Ethical Smaller Companies	0.04	0.73	−0.57	4.12	−4.98	3.43	−0.32	0.06	0.46	2663.94	0.00	15/11/2002	14/11/2013	2687
Alphinity Socially Responsible Share	0.03	1.11	−0.11	8.61	−8.50	10.83	−0.46	0.07	0.58	11829.85	0.00	26/04/2002	14/11/2013	2751
BT Wholesale Australian Sustainable Shr	0.04	1.07	−0.29	4.63	−7.85	5.52	−0.49	0.07	0.60	3764.68	0.00	16/04/2002	14/11/2013	2728
BT PPSI Westpac Ins Aus Sust Shr	0.04	1.04	−0.34	5.06	−7.85	5.52	−0.46	0.06	0.58	4081.36	0.00	8/10/2001	14/11/2013	2980
AMP FLI Res Inv Leaders Aus Share	0.03	1.27	−0.16	3.86	−8.18	6.89	−0.61	0.05	0.75	1621.31	0.00	5/10/2005	13/11/2013	1989

(continued)

Table 12.1 (continued)

Panel A: SRI funds	Mean	Std. Dev.	Skew	Kurt	Min	Max	Q_1	Median	Q_3	JB test	p-value	Start	End	Count
OnePath OA IP AMP Cap Res Ldr Aus Shr EF	0.00	1.29	−0.40	4.05	−8.05	6.07	−0.61	0.03	0.73	2038.69	0.00	31/10/2007	12/11/2013	1302
SSgA Australian SAM Sustainability Index	0.04	1.06	−0.32	5.50	−8.30	5.92	−0.47	0.07	0.59	4563.22	0.00	15/11/2001	31/10/2013	2978
Panel B: Conventional Funds	**Mean**	**Std. Dev.**	**Skew**	**Kurt**	**Min**	**Max**	**Q_1**	**Median**	**Q_3**	**JB test**	**p −value**	**Start**	**End**	**Count**
Perpetual Wholesale Concentrated Equity	0.05	0.93	−0.35	4.96	−6.87	5.51	−0.42	0.10	0.57	4933.47	0.00	13/03/2000	21/11/2013	3255
ANZ OA IP −Vanguard Aus Shares Index EF	0.03	1.07	−0.08	7.12	−7.09	9.40	−0.46	0.05	0.57	10965.66	0.00	15/07/2003	20/11/2013	2120
Macquarie Australian Equities	0.05	1.20	−0.88	11.35	−14.02	5.86	−0.50	0.09	0.66	21591.77	0.00	14/07/2003	14/11/2013	2306
ANZ OA IP −Schroder Australian Equity EF	0.04	0.98	−0.44	5.04	−6.91	5.03	−0.42	0.04	0.54	5794.83	0.00	11/07/2003	20/11/2013	2140
CFS FC Inv −Ironbark Karara Aus Share Fund	0.03	1.21	−0.39	5.22	−8.94	5.76	−0.54	0.08	0.69	3201.06	0.00	1/12/2004	21/11/2013	2215
Advance Australia Smaller Companies	0.04	0.99	−0.58	3.81	−7.02	4.78	−0.42	0.09	0.57	2326.09	0.00	22/08/2002	21/11/2013	2769

(continued)

Table 12.1 (continued)

Panel B: Conventional Funds	Mean	Std. Dev.	Skew	Kurt	Min	Max	Q_1	Median	Q_3	JB test	p −value	Start	End	Count
Hyperion Small Growth Companies	0.05	0.92	−1.07	18.32	−11.31	10.43	−0.37	0.10	0.54	66196.97	0.00	4/08/1998	21/11/2013	3721
Maple−Brown Abbott Sharemarket	0.04	0.90	−0.30	3.91	−6,54	4.87	−0.43	0.07	0.53	3023.84	0.00	8/09/1999	22/11/2013	3461
Dimensional Aust Large Company Trust	0.04	1.08	−0.26	4.90	−8.24	5.96	−0.50	0.10	0.62	4884.68	0.00	15/09/2000	21/11/2013	3075
EQT Flagship Common No. 2	0.04	1.08	−0.23	4.87	−7.49	6.04	−0.46	0.07	0.60	3099.71	0.00	4/08/2003	21/11/2013	2563
AMP FLI−AMP Aus Share Enhanced Index	0.04	1.17	−0.30	4.54	−8.39	5.77	−0.53	0.06	0.67	2759.02	0.00	15/04/2004	21/11/2013	2325
BT−Vanguard Australian Shares Index	0.03	1.16	−0.32	4.47	−8.20	5.59	−0.54	0.06	0.67	2411.50	0.00	17/12/2004	21/11/2013	2187
BT Imputation Share Fund WS	0.05	0.01	−0.41	5.57	−7.81	5.58	−0.44	0.09	0.56	5934.28	0.00	15/06/2000	22/11/2013	3219

In this table, we report the descriptive statistics for the data set for each SRI fund (refer Panel A) and matched conventional fund (refer Panel B) including the mean, standard deviation, skewness, kurtosis, minimum, maximum, median, 25th (Q_1), and 75th percentile (Q_3) of each time series. Returns are reported in basis points (one hundredth of a percentage point). We also report the Jarque-Berra and associated p value, inception date for each fund, the last time series date for each fund, and the number of observations in each data set. The sample period is 2 May 2000 through 14 November 2013 for SRI funds; and 4 August 1998 through 22 November 2013 for matched conventional funds

Table 12.2 Summary statistics for EGARCH residuals

Panel A: SRI fund name	Mean	Sd	Skew	Kurtosis	ξ	β	u
AMP FLI-AMP Sustainable Future Aus Shr	−0.00	1.00	−0.35	1.23	0.37 (0.18)	0.35 (0.07)	2.15
BT Class Inv Ethical Shr	−0.01	1.00	−0.29	0.38	0.15 (0.15)	0.38 (0.07)	2.19
BT Ethical Shr WS	−0.01	1.00	−0.36	0.75	0.26 (0.16)	0.39 (0.07)	2.18
Perpetual Wholesale Ethical SRI	−0.02	1.00	−0.33	0.54	−0.11 (0.12)	0.58 (0.10)	2.22
Perennial Socially Responsive Shares Tr	−0.01	1.00	−0.37	0.72	0.03 (0.14)	0.62 (0.11)	2.06
Hunter Hall Australian Value Trust	−0.02	1.00	−0.17	1.58	0.06 (0.13)	0.60 (0.10)	2.12
Australian Ethical Smaller Companies	0.00	1.00	−0.11	4.03	0.05 (0.13)	0.66 (0.12)	2.10
Alphinity Socially Responsible Share	−0.00	1.00	−0.32	0.71	0.16 (0.17)	0.44 (0.09)	2.15
BT Wholesale Australian Sustainable Shr	−0.01	1.00	−0.20	0.76	0.33 (0.20)	0.32 (0.07)	2.11
BT PPSI-Westpac Ins Aus Sust Shr	−0.00	1.00	−0.37	1.08	0.47 (0.19)	0.32 (0.07)	2.12
AMP FLI-Res Inv Leaders Aus Share	−0.00	1.00	−0.22	0.50	0.14 (0.18)	0.42 (0.10)	2.07
OnePath OA IP-AMP Cap Res Ldr Aus Shr EF	−0.01	1.00	−0.29	0.64	−0.07 (0.17)	0.63 (0.15)	2.09
SSgA Australian SAM Sustainability Index	−0.00	1.00	−0.25	0.50	0.25 (0.17)	0.35 (0.07)	2.14
Panel B: Conventional fund names	**Mean**	**Sd**	**Skew**	**Kurtosis**	ξ	β	u
Perpetual Wholesale Concentrated Equity	−0.00	1.00	−0.28	0.65	−0.01 (0.11)	0.60 (0.10)	2.07
ANZ OA IP-Vanguard Aus Shares Index EF	−0.01	1.00	−0.32	1.31	0.23 (0.16)	0.43 (0.09)	2.15
Macquarie Australian Equities	−0.00	1.00	−0.35	0.96	0.31 (0.17)	0.35 (0.08)	2.14
ANZ OA IP-Schroder Australian Equity EF	−0.01	1.00	−0.19	1.85	0.12 (0.14)	0.51 (0.10)	2.11
CFS FC Inv-Ironbark Karara Aus Shr	−0.01	1.00	−0.35	0.55	0.27 (0.19)	0.36 (0.08)	2.12
Advance Australia Smaller Companies	−0.02	1.00	−0.26	0.76	0.04 (0.15)	0.54 (0.10)	2.11
Hyperion Small Growth Companies	−0.03	1.00	−0.39	5.49	0.20 (0.12)	0.69 (0.11)	2.00

(continued)

Table 12.2 (continued)

Panel B: Conventional fund names	Mean	Sd	Skew	Kurtosis	ξ	β	u
Maple-Brown Abbott Sharemarket	−0.00	1.00	−0.29	0.81	0.14 (0.14)	0.47 (0.08)	2.14
Dimensional Aust Large Company Trust	−0.00	1.00	−0.31	0.56	0.08 (0.16)	0.52 (0.10)	2.12
EQT Flagship Common No. 2	−0.01	1.00	−0.30	0.91	0.16 (0.14)	0.47 (0.09)	2.08
AMP FLI-AMP Aus Share Enhanced Index	−0.01	1.00	−0.29	0.58	0.12 (0.16)	0.45 (0.09)	2.10
BT-Vanguard Australian Shares Index	−0.01	1.00	−0.31	0.50	0.30 (0.22)	0.35 (0.09)	2.13
BT Imputation Shr WS	−0.01	1.00	−0.34	0.64	0.25 (0.17)	0.38 (0.08)	2.20

In this table, we present the summary statistics for the data sets of the residuals of each SRI and matched conventional fund including the mean, skewness, and kurtosis of each time series. Returns are reported in basis points (one hundredth of a percentage point). This table presents a generalised Pareto distribution to extreme losses and reports the scale and shape parameters, ξ and β. Standard errors are reported in parentheses. We identify extreme observations as those that exceed a high threshold u which we have chosen to be the 5% quantile of returns

exceedances N_u would be 5% of the total length of the time series. We also report the threshold parameter for transparency. As discussed, the parameter ξ indicates heavy-tailed behaviour in the range $\xi > 0$. On average, the funds in our data set appear to be heavy tailed, although this is not true in general. The "heaviness" of each tail is also not especially strong as values of $\xi = 0.5$ are not uncommon in financial markets (see, e.g. Fong Chan and Gray 2006) compared to our highest value of $\xi = 0.37$ for the AMP Sustainable Future Australian Share fund. Lastly, we note that there appears to be no noteworthy difference in the ξ parameter between SRI and their conventional funds.

12.5 Results

12.5.1 The Relative Risk of SRI and Conventional Funds

We now present the main result of our paper. We calculate the 95, 99, and 99.5 percentile 1-day VaR and ES for each SRI and matched conventional fund using the full data sample. Results are reported in Tables 12.3 and 12.4. We compute rolling VaR and ES using Eqs. (5) and (6). The methodology that we adopt to obtain our rolling estimates is as follows. We utilise a sliding window that is 70% of the size of the data set for each fund. The method is adaptive in that each model, VaR and ES are re-estimated as the window rolls through the data points. In this type of exercise, it is impractical to optimally determine a threshold value for each window as it

Table 12.3 Estimated VaR of SRI and conventional funds

	Gaussian VaR			Historical VaR			EVT VaR		
SRI fund name	95%	99%	99.5%	95%	99%	99.5%	95%	99%	99.5%
AMP FLI-AMP Sustainable Future Aus	1.65	2.33	2.58	1.67	2.53	3.00	2.15	2.93	3.44
BT Class Inv Ethical Shr	1.66	2.34	2.59	1.76	2.50	2.80	2.18	2.87	3.22
BT Ethical Shr WS	1.66	2.34	2.59	1.77	2.49	2.99	2.18	2.95	3.40
Perpetual Wholesale Ethical SRI	1.66	2.34	2.59	1.76	2.66	3.06	2.21	3.07	3.40
Perennial Socially Responsive Shares Tr	1.65	2.33	2.58	1.72	2.59	2.97	2.05	3.07	3.52
Hunter Hall Australian Value Trust	1.67	2.36	2.61	1.64	2.67	3.15	2.12	3.14	3.61
Australian Ethical Smaller Companies	1.65	2.33	2.58	1.64	2.72	3.00	2.10	3.21	3.71
Alphinity Socially Responsible Share	1.65	2.33	2.58	1.76	2.53	3.03	2.14	2.95	3.36
BT Wholesale Australian Sustainable Shr	1.65	2.33	2.58	1.73	2.41	2.97	2.11	2.80	3.22
BT PPSI-Westpac Ins Aus Sust Shr	1.65	2.33	2.58	1.69	2.40	3.08	2.11	2.88	3.44
AMP FLI-Res Inv Leaders Aus Share	1.65	2.34	2.59	1.77	2.49	2.71	2.07	2.82	3.20
OnePath OA IP-AMP Cap Res Ldr Aus Shr EF	1.66	2.34	2.59	1.71	2.65	2.96	2.08	3.05	3.43
SSgA Australian SAM Sustainability Index	1.65	2.33	2.58	1.70	2.47	2.90	2.13	2.82	3.22
	Gaussian VaR			Historical VaR			EVT VaR		
Conventional fund Name	95%	99%	99.5%	95%	99%	99.5%	95%	99%	99.5%
Perpetual Wholesale Concentrated Equity	1.65	2.33	2.58	1.72	2.59	2.91	2.07	3.02	3.42
ANZ OA IP-Vanguard Aus Shares Index	1.65	2.33	2.58	1.72	2.53	2.88	2.15	2.98	3.45
Macquarie Australian Equities	1.64	2.32	2.57	1.75	2.49	2.74	2.13	2.87	3.32
ANZ OA IP-Schroder Australian Equity	1.65	2.33	2.58	1.72	2.60	2.94	2.11	3.01	3.45
CFS FC Inv-Ironbark Karara Aus Shr	1.65	2.33	2.58	1.79	2.46	2.83	2.12	2.85	3.27
Advance Australia Smaller Companies	1.66	2.35	2.59	1.73	2.56	2.88	2.10	3.00	3.41
Hyperion Small Growth Companies	1.67	2.36	2.60	1.59	2.64	3.33	2.00	3.31	4.03
Maple-Brown Abbott Sharemarket	1.65	2.33	2.58	1.72	2.59	2.95	2.14	2.98	3.41

(continued)

Table 12.3 (continued)

	Gaussian VaR			Historical VaR			EVT VaR		
Conventional fund Name	95%	99%	99.5%	95%	99%	99.5%	95%	99%	99.5%
Dimensional Aust Large Company Trust	1.65	2.33	2.58	1.71	2.62	3.03	2.11	3.01	3.43
EQT Flagship Common No. 2	1.65	2.33	2.58	1.74	2.52	2.85	2.07	2.93	3.38
AMP FLI-AMP Aus Share Enhanced Index	1.65	2.33	2.58	1.73	2.55	2.85	2.09	2.90	3.30
BT-Vanguard Australian Shares Index	1.65	2.33	2.58	1.75	2.48	2.97	2.13	2.84	3.27
BT Imputation Shr WS	1.65	2.34	2.59	1.72	2.57	3.01	2.20	2.96	3.39

This table calculates the 1-day Value-at-Risk (VaR) for each SRI and matched conventional fund. We use the historical, Gaussian, and extreme value theory approaches to calculate the VaR. VaR is calculated for the 95, 99, and 99.5% confidence levels

progresses through the data set via examining the mean-excess function. Therefore, at each step we choose the number of exceedances to be equal to the upper 5% of ranked losses (negative returns). The literature is not clear in terms of what constitutes an appropriate threshold (cf. Hult et al. 2012). We selected 5% quantile of returns following a visual inspection of the mean-excess plots (essentially plots of exceedances verses u, see Hult et al. 2012) of a random sample of funds. It was found that this heuristic approach left a suitably ample sample size.

Table 12.3 presents the 1-day VaR for each SRI and matched conventional fund using the historical, Gaussian, and EVT estimates of VaR. The VaR estimates show that the SRI and matched conventional counterparts exhibit similar overall risk characteristics, e.g. a 95% VaR around 1.66. This lack of discernible significant difference is consistent when conducting sensitivity analysis at 95, 99, and 99.5% confidence levels. We can see similar results in Table 12.4 for the 1-day ES measure. Roughly half of the sample of SRI funds exhibit higher risk and roughly half exhibit lower risk than their matched conventional counterparts although the differences are slight. On this evidence, we are not able to reject the hypothesis that there is no significant difference in risk between SRI and conventional funds.

It is possible to draw very similar conclusions from both the results of the rolling VaR and ES estimations when observed graphically as in Fig. 12.1. Thus, to save space we have elected to present only the results for the 95% VaR.[9] The VaR numbers that we provide here are estimated using the Gaussian approach, except for the Hyperion Small Growth Companies fund where we use the historical approach. This is consistent with the backtesting procedure introduced in Sect. 12.3, the results of which are discussed below.

[9]The figures and tables for other confidence levels are available upon request.

Table 12.4 Estimated ES of SRI and conventional funds

	Gaussian ES			Historical ES			EVT ES		
SRI fund name	95%	99%	99.5%	95%	99%	99.5%	95%	99%	99.5%
AMP FLI-AMP Sustainable Future Aus Shr	2.05	2.64	2.86	2.28	3.26	3.75	2.71	3.95	4.76
BT Class Inv Ethical Shr	2.04	2.61	2.83	2.26	3.00	3.38	2.63	3.44	3.85
BT Ethical Shr WS	2.04	2.61	2.83	2.31	3.18	3.66	2.70	3.74	4.33
Perpetual Wholesale Ethical SRI	2.02	2.57	2.78	2.32	3.16	3.45	2.73	3.51	3.80
Perennial Socially Responsive Shares Tr	2.05	2.64	2.86	2.28	3.26	3.69	2.69	3.73	4.19
Hunter Hall Australian Value Trust	2.00	2.51	2.7	2.30	3.36	3.85	2.76	3.85	4.35
Australian Ethical Smaller Companies	2.06	2.65	2.86	2.32	3.42	3.91	2.79	3.97	4.50
Alphinity Socially Responsible Share	2.06	2.66	2.89	2.28	3.16	3.56	2.66	3.62	4.12
BT Wholesale Australian Sustainable Shr	2.04	2.63	2.85	2.24	3.05	3.48	2.59	3.61	4.24
BT PPSI-Westpac Ins Aus Sust Shr	2.06	2.66	2.89	2.27	3.27	3.83	2.71	4.16	5.21
AMP FLI-Res Inv Leaders Aus Share	2.04	2.61	2.82	2.22	3.02	3.41	2.55	3.43	3.87
OnePath OA IP-AMP Cap Res Ldr Aus Shr EF	2.03	2.59	2.8	2.28	3.2	3.49	2.67	3.58	3.93
SSgA Australian SAM Sustainability Index	2.06	2.66	2.88	2.24	3.06	3.45	2.60	3.52	4.05
	Gaussian ES			Historical ES			EVT ES		
Conventional fund Name	95%	99%	99.5%	95%	99%	99.5%	95%	99%	99.5%
Perpetual Wholesale Concentrated Equity	2.05	2.64	2.86	2.25	3.14	3.51	2.66	3.60	4.00
ANZ OA IP-Vanguard Aus Shares Index	2.04	2.62	2.84	2.31	3.24	3.77	2.70	3.78	4.38
Macquarie Australian Equities	2.06	2.67	2.91	2.28	3.15	3.65	2.64	3.72	4.38
ANZ OA IP-Schroder Australian Equity	2.05	2.64	2.87	2.29	3.21	3.67	2.68	3.71	4.21
CFS FC Inv-Ironbark Karara Aus Shr	2.06	2.66	2.89	2.27	3.08	3.48	2.61	3.60	4.17
Advance Australia Smaller Companies	2.02	2.57	2.78	2.27	3.18	3.62	2.66	3.60	4.03

(continued)

Table 12.4 (continued)

	Gaussian ES			Historical ES			EVT ES		
Conventional fund Name	95%	99%	99.5%	95%	99%	99.5%	95%	99%	99.5%
Hyperion Small Growth Companies	1.99	2.52	2.71	2.32	3.73	4.45	2.87	4.52	5.41
Maple-Brown Abbott Sharemarket	2.06	2.66	2.88	2.29	3.20	3.60	2.68	3.66	4.15
Dimensional Aust Large Company Trust	2.05	2.65	2.87	2.26	3.20	3.56	2.68	3.65	4.11
EQT Flagship Common No. 2	2.06	2.66	2.89	2.25	3.15	3.61	2.63	3.65	4.18
AMP FLI-AMP Aus Share Enhanced Index	2.05	2.65	2.88	2.25	3.10	3.47	2.61	3.53	3.98
BT-Vanguard Australian Shares Index	2.05	2.64	2.87	2.25	3.11	3.54	2.62	3.64	4.25
BT Imputation Shr WS	2.04	2.62	2.83	2.29	3.18	3.61	2.71	3.72	4.30

This table calculates the 1-day expected shortfall (ES) for each SRI and conventional fund. We use the historical, Gaussian, and extreme value theory approaches to calculate ES. ES is calculated for the 95, 99, and 99.5% confidence levels

Figure 12.1 therefore presents our key result, that is, the dynamic difference between risks as measured for SRI and conventional funds. We provide the 95% VaR for the SRI and conventional funds, the difference between the two, and 95% confidence levels for the value of this difference as calculated via bootstrapping. The main conclusion we can draw from this analysis is that there *does not* seem to be a consistent penalty of greater risk for SRI investors. In particular, the difference between risk measures is rarely above or below zero with 95% confidence.

On closer inspection, it appears that just after the beginning of 2011, many funds do enter into a period of decoupling, with regard to risk, from their matched counterparts. Once again the SRI funds are neither consistently more nor less risky than the conventional funds, with the actual ratio being near to 61% in favour of a decrease (SRI less risky). However, the average difference in risk does seem to be significantly different from 0. Observing the graphs again we may be convinced that this decoupling has something to do with a large increase in VaR numbers that also occurs at the beginning of 2011. This period in time actually corresponds to a decrease in Australian stock prices and volatility of the ASX share index. We therefore propose that the increase in VaR numbers is due to funds increasing their exposure during the low volatility period. The difference in risk numbers between SRI and conventional funds may be due to the different mechanics involved in rearranging the holdings of each style of fund. For example, in an SRI fund one

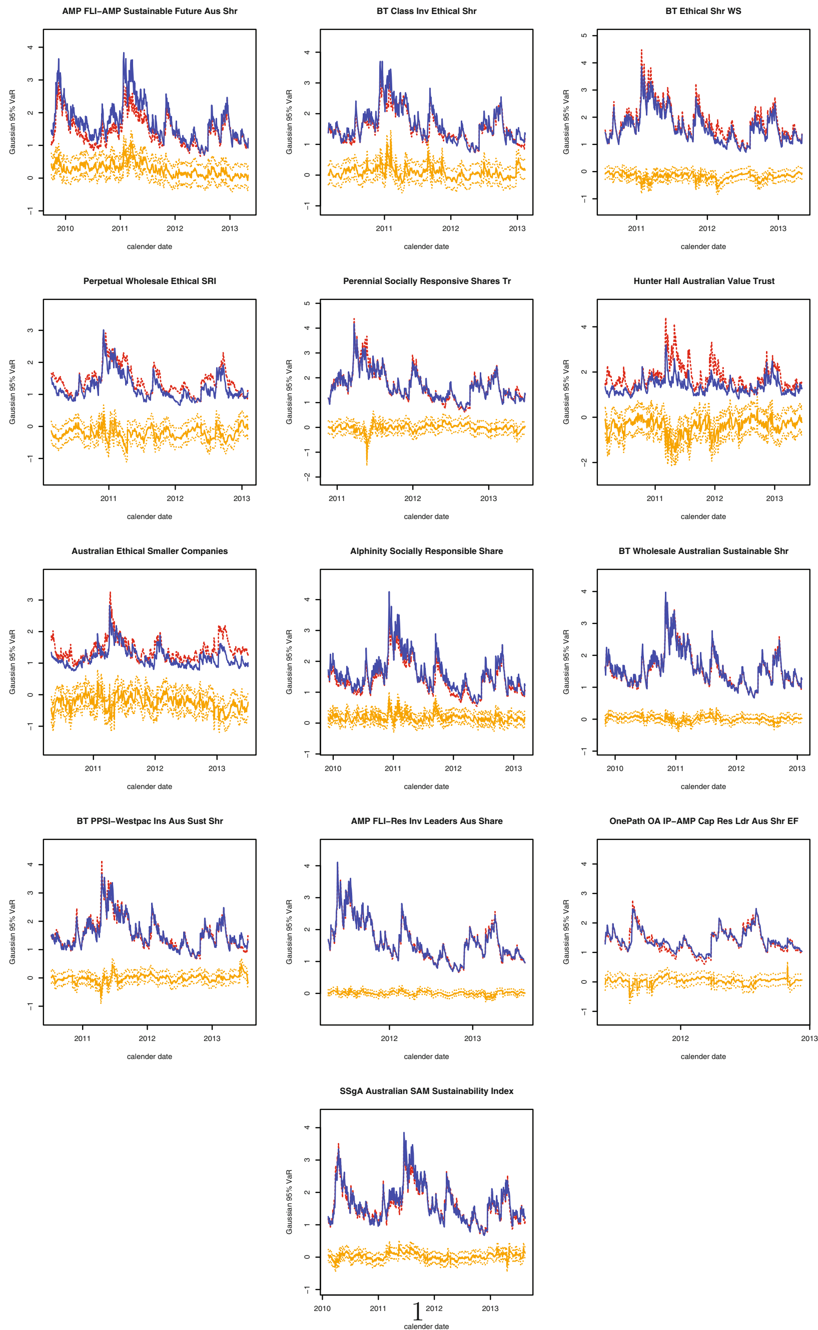

Fig. 12.1 Rolling 1-day Value-at-Risk at the 95% confidence level calculated with the Gaussian approach for each SRI fund (*blue*) and its matched conventional fund (*red-dashed*). We also give the differences (*orange*) with 95% confidence levels (*orange-dotted*) estimated via bootstrapping

must consider screening results and the inherent sinfulness of investments before acting. However, we possess the data regarding the number of positive and negative screenings that each SRI fund uses and can see no correlation between these and the increase or decrease in the risk difference to conventional funds in 2011. However, we also noticed the five funds with the largest AUM; BT Ethical Share, Perpetual Wholesale Ethical, Perennial Socially Responsive Shares, Hunter Hall Australian Value Trust, and Australian Ethical Smaller Companies all increased their risk to a lesser extent than their conventional counterparts. This may be due to their size making the mechanics of increasing risk more difficult. Coincidentally each of these funds have a large number of negative screens (6–8).

12.5.2 Robustness Checks

As discussed in Sect. 3.4, in order to check the validity and the robustness of the result to the model specification, backtesting procedures are conducted. Table 12.5 contains the violation ratios for each confidence level of VaR for each of the historical, Gaussian, and EVT approaches for the SRI and conventional funds. For a VaR with confidence levels $(1 - p)\%$, we select the model that has a violation ratio closest to $p\%$. In the event of a tie, we decided to favour the Gaussian due to its simplicity and on the strength of its overall performance.

We can see that the Gaussian approach proves more often to be the appropriate risk measure, especially for the lower confidence levels. In fact the Gaussian approach can be considered to perform better in the backtesting for every fund except for Hyperion Small Growth Companies at the 95% confidence level where the historical approach seems best. This result may be surprising since the Gaussian distribution is often considered to be an inadequate description of asset returns. However, on closer examination of QQ plots generated by the log returns,[10] we can see that our fund data are not as heavy tailed as various other financial time series. For example, the electricity markets or emerging markets studied in Fong Chan and Gray (2006) and Gençay and Selçuk (2004).

The violation ratio test also shows us that all three approaches seem to be consistently over estimating risk. This could be because the sliding window generally covers the credit crunch event and associated crises of 2008–2011 and is thus calibrated to a "riskier" state of the world. In order to test this, we repeated the analysis with a smaller rolling window such that we would not include the whole crisis period in every calibration. However, the numbers obtained were similar to those presented in this study.

[10]An example of a QQ plot demonstrating the tail distribution for the fund, AMP FLI-AMP Sustainable Future Australian Shares is presented in appendix Fig. 12.2. For interested readers, a full copy of all QQ plots is available upon request.

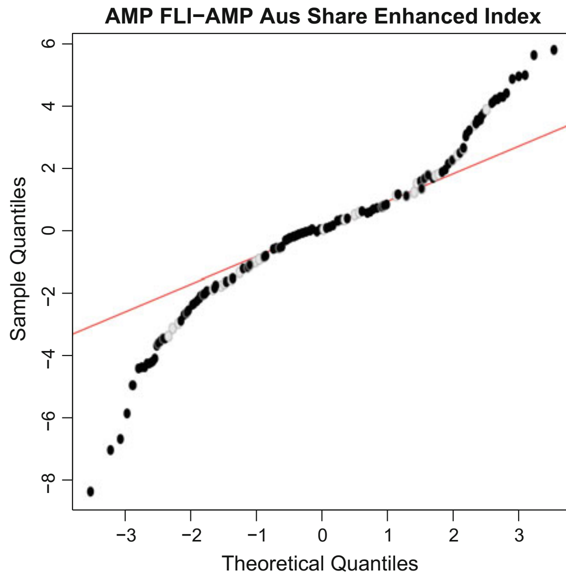

Fig. 12.2 QQ plots for the AMP FLI-AMP Sustainable Future Australian Shares fund overlaid with a Gaussian distribution

12.5.3 Performance Metrics of SRI and Conventional Funds

In this section, we compare risk-adjusted monthly fund performance metrics for our sample of Australian SRI and matched conventional funds. Fund mangers are mostly interested in overall performance comparison using monthly time horizons. Table 12.6 shows monthly Sharpe (1964), Treynor and Mazuy (1966), and Sortino and Forsey (1996) ratios for the funds. Along with the standard Sharpe ratio (returns minus risk-free rate divided by standard deviation), two other "modified Sharpe" ratios are calculated with the usual excess returns divided by VaR and Expected Shortfall. Treynor ratios are calculated as the excess return divided by CAPM beta, and Sortino ratios are calculated as excess returns divided by downside deviation (standard deviation of negative returns). The risk-free rate and CAPM market returns for the performance metrics are used from the series used in the matching process outlined in Sect. 4.2.

The results in Table 12.6 show slight outperformance (a paired t test for 65 metric differences shows significance at 1%) with the conventional funds, suggesting although SRI funds are not significantly riskier on a daily basis, they potentially can suffer in terms of performance over a 10-yr period. These reasons could be due to the costs that SRI funds face compared to conventional funds. These are reduced diversification opportunities but also the cost of researching,

Table 12.5 Violation ratios for SRI and conventional funds

	Gaussian ES			Historical ES			EVT ES		
SRI fund name	95%	99%	99.5%	95%	99%	99.5%	95%	99%	99.5%
AMP FLI-AMP Sustainable Future Aus Shr	2.10	0.11	0.00	1.88	0.00	0.00	0.33	0.00	0.00
BT Class Inv Ethical Shr	0.95	0.00	0.00	0.71	0.00	0.00	0.12	0.00	0.00
BT Ethical Shr WS	1.32	0.00	0.00	0.77	0.00	0.00	0.11	0.00	0.00
Perpetual Wholesale Ethical SRI	1.48	0.00	0.00	0.99	0.00	0.00	0.12	0.00	0.00
Perennial Socially Responsive Shares Tr	1.49	0.00	0.00	1.15	0.00	0.00	0.23	0.00	0.00
Hunter Hall Australian Value Trust	0.69	0.12	0.12	0.69	0.00	0.00	0.23	0.00	0.00
Australian Ethical Smaller Companies	2.73	0.50	0.37	2.23	0.37	0.12	0.87	0.12	0.00
Alphinity Socially Responsible Share	1.58	0.00	0.00	0.73	0.00	0.00	0.24	0.00	0.00
BT Wholesale Australian Sustainable Shr	1.34	0.00	0.00	0.98	0.00	0.00	0.24	0.00	0.00
BT PPSI-Westpac Ins Aus Sust Shr	1.57	0.11	0.00	0.89	0.00	0.00	0.22	0.00	0.00
AMP FLI-Res Inv Leaders Aus Share	2.18	0.17	0.00	1.34	0.17	0.00	0.34	0.00	0.00
OnePath OA IP-AMP Cap Res Ldr Aus Shr EF	1.80	0.26	0.00	1.55	0.00	0.00	0.52	0.00	0.00
SSgA Australian SAM Sustainability Index	2.02	0.11	0.00	0.79	0.00	0.00	0.22	0.00	0.00
	Gaussian ES			Historical ES			EVT ES		
Conventional fund name	95%	99%	99.5%	95%	99%	99.5%	95%	99%	99.5%
Perpetual Wholesale Concentrated Equity	1.94	0.10	0.00	1.23	0.00	0.00	0.10	0.00	0.00
ANZ OA IP-Vanguard Aus Shares Index	1.76	0.16	0.00	1.44	0.00	0.00	0.16	0.00	0.00
Macquarie Australian Equities	0.87	0.00	0.00	0.73	0.00	0.00	0.15	0.00	0.00
ANZ OA IP-Schroder Australian Equity	3.37	0.16	0.16	2.21	0.16	0.00	0.47	0.00	0.00
CFS FC Inv-Ironbark Karara Aus Shr	1.81	0.15	0.00	0.75	0.00	0.00	0.30	0.00	0.00
Advance Australia Smaller Companies	1.08	0.00	0.00	0.60	0.00	0.00	0.24	0.00	0.00
Hyperion Small Growth Companies	1.35	0.18	0.09	1.62	0.09	0.00	0.45	0.00	0.00

(continued)

Table 12.5 (continued)

	Gaussian ES			Historical ES			EVT ES		
Conventional fund name	95%	99%	99.5%	95%	99%	99.5%	95%	99%	99.5%
Maple-Brown Abbott Sharemarket	2.99	0.19	0.10	1.54	0.19	0.00	0.39	0.00	0.00
Dimensional Aust Large Company Trust	1.41	0.11	0.00	0.98	0.00	0.00	0.22	0.00	0.00
EQT Flagship Common No. 2	1.17	0.26	0.13	0.91	0.13	0.00	0.39	0.00	0.00
AMP FLI-AMP Aus Share Enhanced Index	1.72	0.14	0.00	1.29	0.14	0.00	0.29	0.00	0.00
BT-Vanguard Australian Shares Index	1.52	0.15	0.00	1.37	0.00	0.00	0.30	0.00	0.00
BT Imputation Shr WS	1.45	0.10	0.00	0.93	0.00	0.00	0.10	0.00	0.00

This table presents the number of Value-at-Risk (VaR) violation ratios for each SRI and conventional fund as a percentage of VaR estimates. For example, VaR measured at the $(1 - p)\%$ confidence level should approximately have a violation ratio of $p\%$

Table 12.6 Monthly risk performance metrics for SRI and conventional funds

SRI fund name	Sharpe Ratio (Std. Dev)	Sharp Ratio (VaR)	Sharp Ratio (ES)	Treyno Ratio	Sortin Ratio
AMP FLI-AMP Sustainable Future Aus Shr	0.0410	0.0239	0.0173	0.0096	0.0533
BT Class Inv Ethical Shr	0.0472	0.0279	0.0217	0.0128	0.0620
BT Ethical Shr WS	0.0686	0.0413	0.0321	0.0230	0.0919
Perpetual Wholesale Ethical SRI	0.1416	0.0966	0.0578	0.0642	0.2079
Perennial Socially Responsive Shares Tr	0.0321	0.0183	0.0119	0.0054	0.0410
Hunter Hall Australian Value Trust	0.0714	0.0437	0.0292	0.0260	0.0980
Australian Ethical Smaller Companies	0.1026	0.0686	0.0495	0.0505	0.1498
Alphinity Socially Responsible Share BT Wholesale Australian Sustainable Shr	0.0371	0.0222	0.0133	0.0108	0.0485
BT Wholesale Australian Sus-tainable Shr	0.0689	0.0417	0.0324	0.0238	0.0924
BT PPSI-Westpac Ins Aus Sust Shr	0.0421	0.0251	0.0199	0.0111	0.0555
AMP FLI-Res Inv Leaders Aus Share	0.0003	0.0001	0.0001	−0.0116	0.0003

(continued)

Table 12.6 (continued)

SRI fund name	Sharpe Ratio (Std. Dev)	Sharp Ratio (VaR)	Sharp Ratio (ES)	Treyno Ratio	Sortin Ratio
OnePath OA IP-AMP Cap Res Ldr Aus Shr EF	−0.1410	−0.0771	−0.0642	−0.0912	−0.1684
SSgA Australian SAM Sus- tainability Index	0.0537	0.0323	0.0239	0.0162	0.0717
Conventional fund name	**Sharpe Ratio (StdDev)**	**Sharp Ratio (VaR)**	**Sharp Ratio (ES)**	**Treyno Ratio**	**Sortin Ratio**
Perpetual Wholesale Concentrated Equity	0.1646	0.1073	0.0751	0.0699	0.2380
ANZ OA IP-Vanguard Aus Shares Index EF	0.0637	0.0374	0.0277	0.0211	0.0828
Macquarie Australian Equities	0.1047	0.0636	0.0474	0.0406	0.1415
ANZ OA IP-Schroder Australian Equity EF	0.1153	0.0743	0.0544	0.0481	0.1617
CFS FC Inv-Ironbark Karara Aus Shr	0.0038	0.0022	0.0016	−0.0096	0.0048
Advance Australia Smaller Companies	0.1038	0.0614	0.0406	0.0413	0.1391
Hyperion Small Growth Companies	0.1568	0.1064	0.0637	0.0888	0.2303
Maple-Brown Abbott Share- market	0.0925	0.0614	0.0460	0.0382	0.1314
Dimensional Aust Large Company Trust	0.0698	0.0423	0.0323	0.0235	0.0938
EQT Flagship Common No. 2	0.1237	0.0788	0.0620	0.0530	0.1736
AMP FLI-AMP Aus Share Enhanced Index	0.0507	0.0296	0.0223	0.0151	0.0653
BT-Vanguard Australian Shares Index	0.0251	0.0146	0.0114	0.0020	0.0323
BT Imputation Shr WS	0.1201	0.0748	0.0562	0.0475	0.1669

This table presents monthly fund Sharpe, Treynor, and Sortino ratios for each SRI and conventional fund in the sample period 1998–2012. Sharpe ratios are calculated in 3 variants where the denominator is either standard deviation, VaR, or ES. For the Treynor ratio, the benchmark ratio is the market return, and for the Sortino ratio, the minimum acceptable return is the risk-free rate

reviewing, and maintaining the portfolios meet corporate and socially responsible criteria. These aforementioned criteria can also mean costs adapting to changes where the threshold for exclusion should be set are constantly evolving, e.g. proposal and adoption of new screens such as exclusion of utilities due to fossil fuel exploration.

12.6 Conclusion

The main purpose of this paper is to contribute to the SRI literature by investigating if investors pay a penalty (in terms of higher risk) for pursuing ethical investment strategies. We do this by evaluating the performance of 13 selected SRI equity-managed funds in Australia using daily returns to see whether these funds have different tail risk exposures in the return distribution compared to that of matched conventional equity funds. The motivation for this work is that the assessment of risk in SRIs is an area still in its infancy with higher moments and the tails of the return distribution yet to be subjected to empirical investigation.

We show that overall risk is unlikely to differ between an SRI and a conventional portfolio. We have analysed the theoretical underpinning that suggests that fund managers who opt for reduced diversification opportunities as a result of positive and negative screens (which are common place with SRI funds) are likely to face greater volatility in their portfolios. However, we show that investors who wish to invest ethically do so without incurring a financial penalty in terms of tail risk. Even if an SRI manager avoids sin stocks, he or she is still likely to be able to hold at least 30–40 stocks together and therefore get most of the benefits of a Markowitz diversified portfolio. We show evidence therefore that a SRI-constrained investment universe is unlikely to affect risk and even more unlikely that any differences will manifest themselves in extreme returns in the tail(s) of the distribution.

We do observe slight outperformance by conventional funds compared to that of SRI across all of the performance metrics reported in this study. Our study is one of the number of studies for SRI funds in Australia. Cummings (2000), Tippet and Leung (2001), and Humphrey and Lee (2011) all find that the performance of SRI funds is similar to that of conventional funds in Australia. Our findings contradict these earlier studies but find support for Jones et al. (2008) who like us find that Australian SRI funds underperform conventional funds in comparison with the market benchmark. Like Jones et al. (2008) who examined the sample period 1986–2005 we also use a sample period exceeding 15 years. In contrast the previous studies which found no differences in return performance between SRI and conventional funds used shorter time periods within their analysis. As SRI is relatively in its infancy, the comparable performance of SRI versus conventional over a long term is still open for further debate.

There are several interesting possible directions for future research. Firstly, it is of great interest to further investigate the screening practices and sizes of SRI funds and determine whether the number of positive and negative screens has an impact on risk. A large cross section of SRI funds across different countries would thus represent a significant contribution to the literature. Secondly, it would be interesting to investigate the riskiness of sustainability indices as compared to the composite indices globally across different markets. This could be done using various models such as the variance-covariance, historical simulation, and extreme value theory approach to forecast VaR and ES, respectively. Finally, a closer look at performance measures on indices, such as Dow Jones Sustainability Index (DJSI)

Table 12.7 Some of the key SRI studies dating back to 2000.

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2000	FAJ	Statman	US	1990 1998	US Equity funds listed in Morningstar as September 1999 (31)	Dow Stock Index, S&P 500, Morningstar and Lipper	Jensen's alpha and risk-adjusted returns	Dow Stock Index (DSI) did as well as the S&P 500 Index over the 1990–1998 period; social responsible investments did worse than the S&P 500 and the DSI but no worse than conventional mutual funds
	JBF	Bauer, Koedijk and Otten	German, Uk & US	1990 2001	Ethical Mutual Funds (103)	CRSP	CAPM & 4-factor Carhart model	After controlling for investment style, no evidence of significant differences in risk-adjusted returns between ethical and conventional mutual fund (MF); the ethical MFs underwent a catching up phase, before delivering financial returns similar to conventional MFs; inclusion of ethical indexes is not incrementally capable of explaining ethical MF return variation

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2006	PBFJ	Bauer, Otten and Tourani Rad	Australia	1992 2003	Retail Ethical Funds (25)	Morningstar	CAPM & 4-factor Carhart model	By applying conditional 4-factor model and after controlling for investment style, time-variation in betas and home bias, no evidence of significant differences in risk-adjusted returns between ethical and conventional funds; during 1992–1996, domestic ethical funds underperform their conventional counterparts significantly, whereas during 1992–2003 ethical funds matched the performance of conventional funds more closely

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2006	JBE	Benson, Brailsford and Humphrey	US	1994 2003	Equity Funds (102)	Morningstar	Time series	SRI funds exhibit different industry betas consistent with different portfolio positions, but that these differences vary from year to year; It is also found that there is little difference in share-picking ability between the two groups of fund managers
2006	JPM	Statman	US	1990 2004	1 conventioanl index; 4 SRI indexes	KLD Research & Analytics	Sharpe ration, tracking error	Find that SRI indexes vary in composition and social responsibility scores but the mean social scores of each is higher than that of the S&P 500 Index (conventional index)
2007	JFQA	Bollen	US	1961 2002	Equity SRI (205)	CRSP	CAPM & 4-factor Carhart model; OLS	Monthly volatility of investor cash flows is lower in socially responsible funds than in conventional funds; strong evidence that cash flows into socially

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
								responsible funds are more sensitive to lagged positive returns than cash flows into conventional funds, and weaker evidence that cash outflows from socially responsible funds are less sensitive to lagged negative returns
2008	JBE	Jones, van der Laan, Frost and Loftus	Australia	1986 2005	SRI funds (89)	Morningstar	Fama & French 3-factor model	Find that ethical funds significantly underperform the market in Australia
2008	JBF	Galema, Plantinga and Scholtens	US	1992 2006	all shares covered by KLD	KLD Research & Analytics	Fama & French 3-factor, Fama-MacBeth, 4-factor Carhart model	Find that socially responsible investing (SRI) impacts on stock returns by lowering the book-to-market ratio and not by generating positive alphas

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2008	JBF	Benson and Humphrey	US	1991 2005	US Domestic equity funds (144 SRI & 4449 conventional)	CRSP	GMM	SRI Fund flows are less sensitive to returns than conventional funds; Flow is persistent and SRI investors are more likely to invest in a fund they already own relative to conventional funds
2008	JCF	Renneboog, Ter Horst and Zhang	Global Study (17 countries in total)	1991 2003	432 equity SRI funds	CRSP & Datastream	CAPM & 3-factor and 4-factor models	SRI funds in the USA, the UK, and in many continental European and Asia-Pacific countries underperform their domestic benchmarks; also find that the underperformance of SRI funds is not driven by loadings on an ethics style factor; finally, corporate governance and social screens yield lower risk-adjusted returns

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2008	AFE	Becchetti and Ciciretti	US	19902003	Domini Social Index 400 & Standard & Poor's 500 Composite Index	KLD Research & Analytics	APARCH & GARCH	Find that individual socially responsible shares have on average significantly lower returns and unconditional variance than conventional shares when controlling for industry effects; find individual socially responsible shares are significantly less risky when controlling for conditional heteroskedasticity; find there are no significant differences in risk-adjusted returns between the two buy-and-hold strategies on socially responsible and conventional portfolios; find the buy-and-hold strategies on the socially responsible portfolio exhibits significantly lower exposition to systematic nondiversifiable risk

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2009	JFE	Hong and Kacperck	US	1962 2003	Fama & French Portfolio (48)	CRSP & Compustat	Time series, cross-sectional regression	Sin shares are less likely to be held within pension plans that in mutual fund and hedge fund portfolios
2009	FAJ	Statman and Glushkov	US	1992 2007	198 Shunned Shares	KLD Research & Analytics	CAPM & 4-factor Carhart model.	Socially responsible investors tilt their portfolios towards shares of companies with high scores on social responsibility characteristics and shun shares of companies associated with tobacco, alcohol, gambling, firearms, and military or nuclear operations
2010	ARJ	Copp, Kremmer and Roca	Australia	1994 2009	4 Price Indexes	Morningstar	CAPM	Find the beta risk of SRI, both in Australia and internationally, increases more than that of conventional investment during economic downturns

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2010	AF	Lee, Humphrey, Benson and Ahn	US	1989 2006	61 US Equity Funds	Morningstar	4-factor Carhart model	Find a significant reduction in alpha of 70 basis points per screen using the Carhart performance model; increased screening results in lower systematic risk–in line with managers choosing lower beta shares to minimise overall risk
2010	RAF	Rodriguez	US	1997 2005	Morningstar Principia CD & CRSP (31)	CRSP	Graham & Harvey measure — volatility-match benchmark, Carhart model	On the basis of the raw returns, SRI performed better than some indexes, but this evidence of outperformance disappears once risk is incorporated into the analysis
2010	RAF	Rodriguez	US	1997 2005	Socially responsible mutual funds (31)	Morningstar Principia CD	Graham & Harvey measure	On the basis of the raw returns, socially responsible funds performed better than some market indexes, but this evidence of outperformance

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
								disappears once risk is incorporated into the analysis; consistent with previous studies, no evidence was found of outperformance by socially responsible funds. also, the difference between the performance of socially responsible mutual funds and conventional mutual funds is not statistically significant
2011	JBE	Humphrey and Lee	Australia	1996 2008	Conventional Funds (514); SRI funds (27)	Morningstar Direct; Ethical Investor; AGSM-CRIF; Datastream	1- and 4-factor models	No significant difference between the returns of SRI and conventional funds; positive screening significantly reduces funds risk; negative screening significantly increases risk + reduces ability to diversify portfolios

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2011	JFI	Renneboog, Ter Horst and Zhang	Global Study (17 countries in total)	1992 – 2003	Equity SRI funds (410)	CRSP & Micropal	CAPM & 3-factor & 4-factor Carhart	SRI money flows are less related to past fund returns; social attributes of SRI funds weaken the relation between money inflows and past positive returns; find no evidence of a smart money effect
2011	JBF	Derwall, Koedijk, and Horst	US	1992–2008	US public-listed shunned shares	KLD Research & Analytics	4-factor Carhart model	Although the profit-driven (positive screen) segment earns abnormal returns in the short run, these profit-generating opportunities do not persist in the long run for SRI shares
2011	JBE	Climent and Soriano	US	1987:03–2009:12	US Open-ended Equity funds (7 Greens & 19 SRI)	CRSP	Matched-pair analysis, CAPM & 4-factor	Environmental funds had lower performance than conventional funds with similar characteristics; for a subsample 2001–2009, green funds achieved adjusted returns nor significantly different from the rest of SRI and conventional mutual funds

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2012	AJM	Pérez-Gladish, Benson and Faff	Australia	2008	SRI funds (145)	Survey	Ordered probit analysis, principle component analysis	Socially responsible investors seek financial return as well as nonfinancial benefits; Social conscience and social health issues, as opposed to environmental issues, are relevant to investors; investor risk tolerance is a relatively unimportant factor in the choice of socially responsible investments; finally, in terms of socio-demographics, socially responsible investors tend to be middle-aged, be middle-income professionals and have tertiary qualifications

(continued)

Table 12.7 (continued)

Year	Journal	Authors	Country	Sample period	Sample fund (size)	Data source	Methodology	Major findings
2013	JBE	Ooi and Lajbcygier	US	1985–2006	US SRI Equity Mutual Fund (66)	CRSP/Compustat	Novel 3-factor (excluding SRI-prohibited industries)	When estimating alpha using the new 3-factor Fama and French model, evidence of statistically and economically significant alpha

The table reports the names of the authors, place, and year of publication, together with the sample period, sample size, source of data, methodology adopted within the study, and a summary of the main findings. The following abbreviations indicate the journal in which the studies are published: Accounting & Finance (AF); Applied Financial Economics (AFE); Australia Journal of Management (AJM); Accounting Research Journal (ARJ); Financial Analysis Journal (FAJ); Journal of Business Ethics (JBE); Journal of Banking and Finance (JBF); Journal of Corporate Finance (JCF); Journal of Financial Economics (JFE); Journal of Financial Intermediation (JFI); Journal of Financial and Quantitative Analysis (JFQA); Journal of Portfolio Management (JPM) Pacific Basin Finance Journal (PBFJ); and Review of Accounting and Finance (RAF)

and DJSI Australia Index, that incorporate risk and downside risk, such as Sharpe, Sortino, and Treynor ratios, would further aid the discussion on the financial value of SRI.

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Appendix

See Table 12.7

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Chapter 13
Corporate Social Disclosures by Banks: Between Legal Institution and Cultural Dimensions

Ismail Adelopo, Musa Obalola and Ramiro Cea Moure

Abstract Recent studies have articulated the dearth of cross-country investigation of corporate social responsibility (CSR) disclosure behaviours in the broader CSR discourse. The impacts of national institutional frameworks on CSR disclosure behaviours also remain under-researched. Consequently, this study examines the impact of legal origin and culture on CSR disclosures by large banks in fourteen Western European countries. The study is based on the CSR disclosure and other firm-specific information in the sustainability and annual reports for 2005 and 2008 of the companies in the sample and uses multiple regression analysis. It finds that country's legal origin and cultural dimension affect disclosure behaviours of banks. Surprisingly, banks in civil law origin countries make more employee and shareholders social disclosures than banks in both common law and Scandinavian countries. Banks in high-uncertainty avoidance cultures make more social disclosures than banks in low-uncertainty avoidance cultures, but no relationship is found between CSR disclosure and individualism/collectivism cultural dimensions. The study finds support for institutional theory and highlights the importance of cross-country studies in expanding the current CSR dialogue.

Keywords Institutional effects · CSR disclosure · Cultural dimension and legal origin

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13.1 Introduction

The antecedents of corporate social responsibility (CSR) discourse have been traced to the 1950s (Carroll 1999). However, the Union Carbide incident in Bhopal, India, in 1984 and Alaska oil spill in 1989 were critical in increasing the spotlight on CSR issues (Idowu and Towler 2004). Studies have also identified various incentives for firms' voluntary corporate social disclosures. Reasons include legitimacy factors (Deegan and Rankin 1996), corporate mimicry, stakeholders' pressures and reputational risk management (Bebbington et al. 2008). Different theories have been used to discuss CSR issues including, for example, legitimacy (Lindbolm 1994; Suchman 1995), stakeholders (Freeman 1984), institutional (Jackson and Apostolakou 2010; Scott 1995) and, recently, reputational risk management theories (Bebbington et al. 2008).

Although substantial studies have been undertaken on determinants of CSR disclosures, to the best of our knowledge, these are mostly country-specific (with few exceptions such as Aguilera et al. 2006; Matten and Moon 2008; Chen and Bouvain 2009),[1] and rather general in focus. These approaches are limited in allowing a broader cross-country and industry specific in-depth analysis. Recent literature has also articulated the urgent need for more cross-national studies to explore this area (see Chih et al. 2010; Jackson and Apostolakou 2010; Matten and Moon 2008; Williams and Zinkin 2008).

This study therefore adds to the available cross-country evidence on the effects of different national institutional frameworks on firms' CSR behaviours, specifically their disclosures. This study also highlights the implications of CSR disclosure for cross-border analysis for firms in the financial sectors. It achieves this by examining CSR disclosure in fourteen Western European countries, focusing on the CSR disclosures in their banking sector. This is important for several reasons including its exclusion from the majority of empirical accounting and finance research on the basis that banks and financial institutions' reporting and organisational structures are different to others. A better understanding of the influence of institutional factors on CSR disclosure by banks should deepen our understanding of how a specific industrial sector interacts with the community in which it operates.

Consequently, our main question is, do country-specific legal origin and cultural dimensions affect CSR disclosures by the biggest banks in Western Europe? Previously, using neo-institutional theory (Di Maggio and Powell 1991) and comparative institutional advantage analysis (Hall and Soskice 2001), Jackson and Apostokalou (2010) argued that the more liberal market economies of the Anglo-Saxon countries scored higher on most dimensions (economic, environmental and social dimensions) of CSR than firms in the more coordinated market economies in Continental Europe. They suggested that voluntary CSR disclosures substitute for institutionalised forms of stakeholders' participation. Similarly, Wanderley et al. (2008) found that different countries of origin and industries have

[1]None of these studies addressed CSR in the banking sectors across the countries.

significant effects on CSR disclosures on the Internet by 127 companies from eight emerging economies.

However, these studies involved both high and low impact industries without teasing out the disclosure pattern in the sectors. The only other study, to our knowledge, that directly addressed CSR disclosures in the financial sector was Chih et al. (2010). They examined the empirical consistency of Campbell's (2007) institutional theoretical postulations on firms' socially responsible behaviours and found that firms would act in more socially responsible ways to enhance their competitive advantage in a highly competitive market. They also reported that financial firms operating in countries with stronger levels of legal enforcement engage in more socially responsible activities, but financial firms in countries with stronger shareholder rights engage in less CSR activities. However, our study is different from their investigation because it examines legal origins, rather than enforcement. Legal origin determines the types of law, legal institutions and, to a great extent, the effectiveness of the enforcement of those laws and therefore constitutes a more important consideration. Furthermore, Chih et al.'s work failed to systematically trace the subtle and interesting connection between legal enforcement and the nature of CSR activities of the firms in the study. For example, to what extent was legal enforcement instrumental in shareholders-, environmental- and social-related CSR activities of the firms in the sample? Unpacking firms' CSR disclosures in this way is important in order to understand the incentives for such disclosures and also important for a number of other stakeholders, not least for public policy.

This study also extends the literature on the role of culture and cultural dimensions on CSR discourse. In this sense, it shares similarities with Williams and Zinkin (2008), but while their focus was on the effects of cultural differences on consumers' willingness to punish irresponsible corporate behaviours, this study is concerned with the effects of cultural differences on CSR disclosure behaviours of banks and financial institutions. Thus, this study addresses the intersection of culture and CSR from the viewpoint of the firm rather than individuals. This is an area that has enjoyed little attention in the literature. This study uses two cultural dimensions from Hofstede's propositions contained in several of his work (Uncertainty Avoidance and Individualism/collectivism dimensions) to study the influence of culture on CSR disclosures by banks in Western European countries (Hofstede 1980; 83, 2001; Hofstede and Bond 1984, 1988). This approach allows an in-depth examination of specific institutional dimensions on CSR disclosure for a specific sector across eminently heterogeneous institutional frameworks.

The other defining feature of this investigation is the integration of institutionalism and culturalism in CSR discourses. These two concepts are often treated in the literature as if they are independent and mutually exclusive. Indeed, in recognition of the huge potential benefit of such integration, a whole issue of the Academy of Management Journal (Volume 53, issue 6, 2010) was devoted to a theme that seeks to bring back culture into institutionalism. Thus, this study takes the view that both concepts are mutually complementary and provide a very strong logical basis for explaining firms' CSR disclosure behaviours. We are not aware of

any study that has attempted such integration in the recent CSR discourse. The remainder of the paper is structured as follows: Sect. 2 provides a theoretical context and literature review. In Sect. 3, we present the hypotheses for the study. Section 4 focuses on methodology issues, and in Sect. 5, we present results, before concluding the paper in Sect. 6.

13.2 The Theoretical Context of the Study and Literature Review

This section discusses the theoretical context and presents the literature review in the study.

13.2.1 Theoretical Context

Firms as economic units operate within sociocultural contexts, which affect their behaviour and impose expectations on them (Campbell 2007). Studies have used institutional theory to explain social and environmental disclosures (Chih et al. 2010; Jackson and Apostolakou 2010; Chen and Bouvain 2009; Campbell 2007) in addition to the usual social contract and legitimacy and stakeholder theories. The theory contends that the institution is at the heart of the social structure. An institution has multiple self-reinforcing dimensions including its normative and regulative dimensions. Institutional norms are durable, transferable and are the basis of social behaviours and interactions (Scott 1995: 33, 2001: 48). North (1990) provides an influential description of institutions suggesting that it is

> the rules of the game in a society; (and) more formally, (as) the humanly devised constraints that shape human interaction.
>
> (p. 477)

According to North (1990), institutions provide the rule of the game and organisations are the players. There are formal and informal constituent of every institution. Over time, social actors (including organisations) re-enact the institution through compliance with its norms, which are dynamic (Campbell 2007). Firms as social actors operate within a nexus of institutions including economic, legal and political institutions, all of which impact on its behaviours (Campbell 2007; Hall and Soskice 2001). Differences in institutions lead to variations in actors' behaviours and consequently in outcomes (Campbell 2007; La Porta et al. 1997).

Hall and Soskice's (2001) varieties of capitalism arguments suggest that comparative institutional advantages are derivable by firms depending on the predominant mode of coordination in their institutional environment. They distinguished between market-coordinated strategy found in liberal market economies such as

USA and UK, and the strategic-coordinated strategy found in coordinated market economies such as Germany. In the liberal market economies, firms achieve coordination through formal contracting, fierce market competition and arm's length exchange compared to the coordinated strategic mode which fosters coordination through non-market mechanisms such as informal contracting, relationships, networks, intercompany cooperation and collaborations. These variations define the nature of possible outcomes within each mode. From a different perspective, Whitley's (1998) national business system suggest that countries' national business and economic behaviours are reflected in the operations and structures of firms within the national context, while La Porta et al. (1997) argued that differences in national legal origin and enforcement could explain variations in governance systems, market developments and economic growth.

An important determinant of national institution that has received some attention in the literature is culture. Culture is a particularly difficult concept to define and operationalise. However, Kuper suggests that it is 'a matter of ideas and values, a collective cast of mind' (Kuper 1999: 227). Hofstede's (1980; 83) and Hofstede and Bond (1984, 1988) studies on culture identified five different cultural dimensions (power distance, Individualism, masculinity, Uncertainty avoidance and long-term orientation) and their effects on actors' outcomes (also see Hofstede 2001). However, while studies in corporate governance and financial reporting have explored the various impacts of institutional differences on outcomes, this phenomenon is just developing in the growing CSR discourse (Jackson and Apostolakou 2010; Wanderley et al. 2008; Campbell 2007). Consequently, we premised this current paper on institutional theory and on the conjecture that differences in institutional framework, specifically the legal institution and the prominent cultural dimensions in a society could provide salient explanations for the difference in firms' social reporting behaviours and outcomes.

One of the distinctions of this study from the few that have examined the effects of institutional factors on CSR discourse is its focus on CSR disclosure practices by firms in the banking sector. Although Branco and Rodrigues (2006: 233) suggested that 'by comparison with other sectors such as chemicals, paper and pulp, etc. the financial services sector has significantly lower direct environmental impact', they acknowledged that 'the activities of banking and finance companies, such as their lending and investment policies, can be considered as equally environmentally-sensitive when compared with the direct impacts of companies in polluting industries'. This is consistent with concern expressed by Thompson and Cowton (2004, p. 199), who argued that banks 'can be seen as facilitators of industrial activity which causes environmental damage'. Heyes (1996) showed that penalising lenders (i.e. banks) for the environmental damaged caused by their borrowers would not necessarily lead to increase in interest rate or cost of financial intermediation and so would not adversely affect economic development. However, very little is known of CSR disclosure in this sector. For example, what do financial companies disclosure and why? Who do they target in their disclosure and how is this undertaken? These are some of the questions that the literature on CSR in the

banking sector has not addressed sufficiently. Below we present a review of the few studies that have featured CSR disclosures in the sector.

13.2.2 Literature Review on CSR Disclosures in the Financial Sector

Current literature shows a number of themes regarding CSR in the financial sector. These include the theoretical underpinnings shaping the debate on CSR in the sector, which largely falls between stakeholders and legitimacy theories (Sweeney and Coughlan 2008; Branco and Rodrigues 2006; Bravo et al. 2012), banks' CSR disclosures on the Internet (Bravo et al. 2012; Coupland 2006; Hinson et al. 2010) and its comparison to disclosure in the standard annual reports.

Majority of the studies are country-specific with few cross-country studies. Emerging views from the literature also suggest that banks use CSR disclosure strategically for instrumental (Aguilera et al. 2007) reasons including for competitiveness (Porter and Kramer 2006) and for managing their stakeholders' expectations (Holme and Watts 2000). It also seems that banks prioritise their CSR communications as reflected in the weight, prominence and language used in those discourse (Coupland 2006). Furthermore, it seems that more significant attention is placed on communications relating to customers and employees than community and environments, as is the case in high impact and more 'sinful' sectors (Campbell et al. 2003). Banks' CSR disclosures seem to focus on products and services, rather than enunciating social giving and community involvement (Hamid 2004). They also reflect implicit CSR behaviour compared to more explicit CSR approaches (Matten and Moon 2008), found in the high-impact sectors. This may be due to their low legitimacy threat arising from low visibility and indirect impact on the environment (Branco and Rodrigues 2006) at least before the recent financial crisis. On the Internet, it seems that banks privileged their financial performance disclosures as these are easily accessible compared to their corporate social performance (Coupland 2006).

Similarly, Hamid's (2004) study on Malaysian banks and financial institutions found that they reported more on their product and services than on strictly environmental issues such as energy consumption, or on human resources- and community-related disclosures. These studies show that although banks make CSR disclosures, and in some cases, they make more disclosures than other industries (Tsang 1998), their focus is somewhat different. Douglas et al.'s (2004) research on CSR disclosure practices by Irish banks and international financial institutions found that Irish banks are far behind in terms of their environment disclosure practices. They found that Irish banks report more on corporate governance (CG) and human resources and least reports were in the area of community involvement, compared to international financial institutions who report more on community involvements.

Chih et al. (2010) is the only study we are aware of that considered the effects of institutional framework on CSR by financial firms. Chih et al. (2010) empirically tested Campbell's (2007) postulations on the institutional environment that determined CSR behaviours by focusing on firms in the financial sector in 34 countries between 2003 and 2005. They distinguished between financial firms that are constituent of the Dow Jones Sustainability Index (the CSR group) and Dow Jones Index firms that are not (the non-CSR group). The authors used several regression models with a series of explanatory variables and reported that CSR is an increasing function of firm size, but is not related to firm' performance. Furthermore, they found that firms would employ CSR as a competitive tool if they are operating in an intense competitive market. Financial firms' engagement in CSR activities was found to be positively related to country's legal enforcement environments. On the other hand, financial firms' engagement in CSR is a reducing function of the strength of shareholders' rights. However, their study failed to disentangle CSR disclosure into its various components; this severely limits our understanding of what financial companies in the study disclose.

Although there is evidence of research into CSR in the banking and financial sector, this is still negligible. There are quite a lot of missing links in the current literature that need unpicking. For example, although we know a bit about the content (what?) and mechanism (how?) through which banks disclose, we do not know enough about the external factors that could possibly impact on both the 'what' and 'how' factors in banks' CSR communications. How much of 'what' and 'how' of CSR communications by banks are informed by institutional factors in which they operate? It is possible to think that globalisation and cross-listing make the consideration of such issues as legal institution and cultural dimensions irrelevant, but the reality is still that firms are influenced by both their internal and external environments, both of which are, strictly speaking, embedded in the institutional framework within which firms operate, irrespective of whether they operate locally or internationally. In fact, it could be argued that globalisation has made the consideration of national uniqueness a crucial competitive tool in today's global market place. This is indicated by the World Bank and IMF initiatives on observation of codes and standards and the assessment of the national business system information. These include the consideration of the ease with which enterprises function, which is very much determined by the existing institutional framework. Thus, the consideration of the institutional frameworks within which banks and financial firms make their CSR disclosures is a very relevant and important issue that has surprisingly escaped rigorous investigation.

Table 13.1 presents countries' classifications, with Panel A showing classifications based on the legal origin of countries, while panel B shows classifications based on cultural dimensions. In panel B(1), countries were categorised based on whether they have more or less score to the median index score in the original Hofstede's (1980, 1983) studies, while in panel B(2), countries were categorised based on whether they have more or less than 50 index score for the cultural dimensions.

Table 13.1 **a** Panel A: Legal Origin dimension of Institution. **b** Panel B: Cultural dimension

a

Institutional factor	Common law origin	Civil law origin	Scandinavian civil law origin
Legal origin and enforcement	UK and Ireland	Germany, France, Italy, the Netherlands, Spain, Belgium, Portugal, Austria and Greece	Sweden, Denmark and Finland

b

Factor	Uncertainty Avoidance	Individualism/collectivism
(1) Based on median scores	High: Italy, France, Austria, Spain, Greece, Portugal and Belgium Low: UK, Denmark, Sweden, Ireland, Germany, Finland and the Netherlands	High: UK, Germany, France, the Netherlands, Belgium, Spain, Denmark, Sweden, Ireland, Finland, Austria and Italy Low: Portugal and Greece
(2) Based on '50' index score	High: Italy, Belgium, France, Germany, Finland, Austria, Spain, Greece, Portugal and the Netherlands Low: UK, Denmark, Sweden and Ireland	Same as above

13.3 Development of Hypotheses

We limit our analyses here to two issues, viz. the legal institution and cultural dimensions, for clarity.

13.3.1 Differences in Legal Institutions

European countries have ancestral and, to some extent, cultural similarities (Guillen et al. 2002; Enderle 1996). They are nevertheless different in some important ways, particularly in their legal origin and institutions. For instance, while the UK has a common law origin which impacts on the organisation, structure of institutions and outcomes within it, countries such as France, Spain, Italy and the Netherlands have a civil law origin in the French Napoleonic code, with different institutional structures and outcomes. La Porta et al. (1996; 1997; 2000) showed that differences in legal origin, enforcement and history affect economic institutions, governance structures and institutional outcomes, but they did not examine their effects on CSR disclosures. They observed that common law origin countries tend to have more formal institutions and stronger law enforcement mechanisms. They also have more developed shareholders' protection laws, more dispersed ownership structures, and

government intervention in the market is rare. This is consistent with the market-coordinated mode (Hall and Soskice 2001). In contrast, countries with a civil law origin have a significant government involvement in the corporate structures. Market structures are not as active and robust as in common law origin countries, such as the UK. The market for corporate control is not as active since share ownership is concentrated, with banks and financial institutions playing dominant roles in corporate ownership. The Scandinavian countries also have a distinctive legal system built on the old German body of law, with little or no influence from common or civil law systems. These institutional arrangements have impacts on disclosure practices (Aguilera et al. 2006). While firms in common law origin countries have a wider stakeholders' responsibility and therefore report accordingly, firms in the civil law countries, with concentrated ownership structure, have limited stakeholder demands.

Furthermore, while common law countries have stronger more developed property rights and shareholders' protection laws, civil law origin countries seem to have more developed employees' rights and protections laws (Chih et al. 2010; Idowu and Towler 2004; Ferner and Quintanilla 1998). Due to these distinctive features and their potential to impact firms' social disclosure behaviour, we propose that banks in the common law countries have a greater need to make more social disclosures than firms in the civil law countries due to their diverse stakeholders' reporting demands. Similarly, ownership structure and diverse stakeholders' reporting demand arguments also motivate the conjecture that banks in the common law countries would make more shareholder-related social disclosures than banks in the civil law countries where firm ownership is concentrated. On the other hand, it is likely that banks in the civil law countries have incentives to make more employee-related social disclosures than banks in the common law countries. Whitley (1998) argued that the employer–employee relationship in the Anglo-Saxon could be characterised with flexible external labour markets with a high rate of employment change, compared to a more intermediate relationship in the Continental European and Scandinavian countries. Employers in Continental Europe tend to see employees as part of the strategic strength and resources of the firms and are more prepared to spend on their training and development (Ferner and Quintanilla 1998). In fact, employees in some of these countries play more active roles in firms through works councils and codetermination (Idowu and Towler 2004). Chih et al. (2010) found that financial firms act in more socially responsible ways in countries with a more cooperative employer–employee relationship. These arguments inspire the following null hypotheses:

H1a : There are no relationships between the CSR disclosures by the biggest banks in Western Europe and their legal origin.

H1b : There are no relationships between the employee (social)-related CSR disclosures by the biggest banks in Western Europe and their legal origin.

H1c : There are no relationships between the shareholder (economic)-related CSR disclosures by the biggest banks in Western Europe and their legal origin.

13.3.2 *Differences in Cultural Institutions*

We focused on two of Hofstede's cultural dimensions that are most relevant to the issues of corporate disclosure addressed in this paper rather than all the dimensions.

13.3.3 *Uncertainty Avoidance Cultural Dimensions*

Despite its criticisms, which have often centred on its replicability and equation of nation to culture (Baskerville 2003; Smith et al. 1996; Gernon and Wallace 1995), Hofstede's studies on culture continues to contribute to subsequent insights on the subject (De Mooji and Hofstede 2010; Hofstede 1980: 83, 2001). In this study, we project Hofstede's Uncertainty Avoidance and Individualism/collectivism dimensions of culture on CSR disclosures by banks in some Western European countries. Our argument is that societies that are high uncertainty avoiders are likely to motivate CSR disclosure through specific idiosyncratic measures in order to reduce uncertainty by prescribing behavioural codes for societal actors. This may be because this type of culture needs rules and formality to structure life, as it is less tolerant to change and innovation (Yaveroglu and Donthu 2002). National institutional frameworks reflect these rules and enforce the measures, which could be regulatory or of other forms, within which firms operate and thus determine actors' action in response to the requirements of the institutions. For example, we would expect banks operating in a high-uncertainty avoidance environment to be more likely to make CSR disclosures, possibly due to coercive isomorphism (Di Maggio and Powell 1991). On the other hand, it is likely that countries with low-uncertainty avoidance index would be less rigid on CSR issues. Such countries are not likely to motivate disclosures through coercion and are more likely to be flexible in their approach to the disclosures of CSR issues. This may be because such a society is more likely to allow the opportunity to explore possibilities even if they are unusual. Consequently, we anticipate that banks operating in this type of environment do not have a compelling motivation for CSR disclosures and are therefore less likely to make such disclosure. These arguments motivate our next hypotheses stated below:

H2a : There is a positive relationship between banks in high-uncertainty avoidance cultural and CSR disclosures.

H2b : There is a negative relationship between banks in low-uncertainty avoidance culture and CSR disclosures.

13.3.4 *Individualism/Collectivism Cultural Dimensions*

In terms of Individualism/collectivism cultural dimensions, Hofstede (1983) suggests that social actors in the former see themselves as, and act as, individuals rather

than as a collective. Therefore, such societies have more individualised survival instincts and more developed personal protection rights including property rights. The individual has a weak link to other groups or other members of the society. High individualistic societies are likely to be more 'I' conscious and hold self-actualisation and reliance in high importance. Greif (1994) referred to this society as an 'integrated' society, where economic transactions are more likely to be conducted among people from different groups, contract enforcements are achieved more through specialised organisation such as the legal system. On the other hand, individuals in a high-collectivist society are likely to be more 'WE' conscious, inclusive, and see themselves more as a member of a group with a stronger link to the society (Williams and Zinkin 2008; Hampden-Turner and Trompenaars 1997; Greif 1994). Group cohesion and actions are likely to be more valued than individual-centred behaviours. Thus, firms as part of the actors in the society imbibe its norms and interact with its expectations. As firms reflect the individualised societal expectation of 'I' rather than 'WE', we would expect firms in a highly individualised society to be more self-centred and be less responsive to other objectives than the individualised objectives fused into firm's corporate goals, since firms are likely to reflect the society they operate in. As a result, we propose that firms in such a cultural setting would be less willing to make CSR disclosures.

Equally, we expect firms in a collectivist society to share values such as the concern for others, building trust, inclusiveness, loyalty and selflessness, with individuals in the society. Firms' corporate objectives would therefore reflect these collective-centred objectives and behaviours. Consequently, such firms may be more willingly to disclose CSR issues in keeping with the tenets of 'being good' and 'doing good' (Coupland 2006) for the overall benefits of the collective rather than the individual social actor. We examine these propositions with the hypotheses below:

H3a : There is a positive relationship between banks in collectivism culture and CSR disclosures.

H3b : There is a negative relationship between banks in individualism culture and CSR disclosures.

13.4 Methodology

13.4.1 Data and Model

We concentrated on the biggest banks in each of the fourteen Western European countries (see Table 13.1), based on size. We determined the size of the banks using two criteria. First, the bank has to be in the top 10 banks in the country, and secondly, it has to have at least €600 m in total assets—we applied the second criteria after finding the average asset value of the banks selected using the first

criteria. We concentrated on large banks because they are more likely to make CSR disclosures and are also more likely to impact on institutional frameworks than smaller ones (Chih et al. 2010; Campbell 2007). We chose these countries because of data availability and their relatively similar level of development and awareness on CSR issues, and their membership in the European Union. We grouped the countries into three legal origins (common, civil and Scandinavian civil law origin) to reflect the fact that Scandinavian civil law countries are different from the continental European countries and this is consistent with the approach in La Porta et al. (1996, 1997). As a slight departure from La Porta et al. (1996, 1997), we merged the French and German civil law countries because of their common European origin. We chose the sustainability report rather than the embedded CSR reports in the annual report because a separate sustainability report gives it more CSR focus and visibility, although it may create distance (Coupland 2006). We collected CSR disclosure information by hand from the sustainability reports of the companies for 2005 and 2008; both reports were sourced online from the website of the banks in the sample. We chose these two periods to examine potential variation in CSR disclosures practices; we considered three years to be sufficient gap to notice variations. Firm size and performance information were also hand collected from the annual reports of the companies. We used the Euro exchange rate at 31 December of each year to translate the financial information. Our sample consists of the 50 biggest banks in Western European countries studied for two financial years, i.e. 100 firm-year samples.

We used content analysis as our analytical tool; the content of the sustainability report of the companies involved was 'quantified objectively in a systematic and replicable manner using predetermined categories, thereby allowing data to be analysed quantitatively' (Duff 2011; Saunders 2008, p. 58). Content analysis is a popular technique in the accounting literature (Duff 2011). Using content analyses involves resolving concerns about reliability, reproducibility, coding and intercoder reliability (Krippendorff 2004; Milne and Adler 1999; Gray et al. 1995) and the best unit of analysis to employ. Word analysis provides the simplest unit of analysis in a content analysis, but word count only endows an analysis with frequency of occurrence of a particular word. It does not allow a contextual analysis of the word used in the document. Although sentence or phrase analysis may provide a more refined picture of the document, because of the context, its implications are lost if they are interpreted individually. A thematic approach to content analysis, used in this study, involves identifying, analysing and reporting patterns in the data (Braun and Clarke 2006; Boyatzis 1998). It encompasses both words and sentence analyses which provide a more flexible and complete picture of the corpus. The subjectivity involved in deciding the theme or categories to use is one of the main defects of the method. Resolving intercoder reliability and assuring replicability is therefore very important (Krippendorff 2004; Milne and Adler 1999). It enhances the transparency of the process and improves the validity of the study (Beattie and Thomson 2007). In addition to clear coding rules and coding reviews, used by the three experienced researchers, which fostered shared meaning as suggested by Gray et al. (1995), we also benchmarked our theme identification and scoring pattern against the widely

used methods adopted in the development of the CSR index by Sustainable Asset Management, Dow Jones Index and GRI. We provide examples of some of the themes used below:

Employee-related disclosures:

- Internal communication with employees (working relationships, trade unions and collective bargaining) and
- Processes for selecting, development and promotion for employees (creating human capital).

Economic or shareholders-related disclosures:

- Evolution of shareholders' stock prices and other relevant banking data and
- Presentation of reports for shareholders and financial analysts.

Environmental-related disclosures:

- Declaration regarding environmental issues and
- Direct and indirect environmental impacts caused by the firm.

We used a simple but broad scoring method for the classical CSR triple-bottom-line items of economic (shareholders), environmental, and social (employees) disclosures in the reports (see Appendix 1 for the scoring methods). This is to enable future studies to replicate our findings and to ease the access to the central arguments in our study. We used independent t test and ANOVA to establish statistically significant differences between disclosures across legal institutions and cultural dimensions, and a series of multiple regression analyses. We used natural log of assets to measure firm size and return on assets to measure firm performance. To test hypotheses H1a and H1c stated above, we used the model below:

$$totalscore = \alpha + \beta_1 firmsize + \beta_2 performance + \beta_3 G1 + \beta_4 G2 + \beta_5 G3 + \beta_6 year + \varepsilon \quad (13.1)$$

$$disaggregatedscore = \alpha + \beta_1 firmsize + \beta_2 performance + \beta_3 G1 + \beta_4 G2 + \beta_5 G3 + \varepsilon \quad (13.2)$$

where

G1 group dummy variable equal to 1 if bank is from common law origin countries and 0 otherwise
G2 group dummy variable equal to 1 if bank is from civil law origin countries and 0 otherwise
G3 group dummy variable equal to 1 if bank is from the Scandinavian civil law countries and 0 otherwise

To test hypotheses H2a and H3b, we grouped countries into two groups depending on whether their score in each of the cultural dimensions is above or

below the median (50) index score for all the countries on these cultural dimensions. We undertake an independent mean test as a preliminary analysis and multiple regressions with the model below:

$$totalscore = \phi + \beta_1 firmsize + \beta_2 performance + \beta_3 H1 + \beta_4 H2 + \varepsilon \tag{13.3}$$

$$disaggregatedscore = \phi + \beta_1 firmsize + \beta_2 performance + \beta_3 H1 + \beta_4 H2 + \varepsilon \tag{13.4}$$

H1 group dummy variable equal to 1 if bank is from country with higher index score in the Uncertainty Avoidance cultural dimensions and 0 if otherwise
H2 group dummy variable equal to 1 if bank is from country with high index score in the Individualism/collectivism cultural dimensions and 0 if otherwise

The other variables are as defined in Eq. 13.1 above. We used the same method for the disaggregated scores of economic, environment and social CSR disclosures.

13.5 Results and Discussion

13.5.1 Descriptive Statistics

Table 13.2 presents the descriptive statistics. Panel A shows that firms in the sample are of fairly similar size as measured by their total assets. On the other hand,

Table 13.2 Descriptive statistics for all the variables in the model

Panel A: Continuous data								
Variable	N	Mean	S.D	Min.	0.25	Median	0.75	Max.
Lnasset	100	12.36	1.35	9.88	11.26	12.57	13.40	14.89
Roe	100	9.74	11.93	−55.94	5.28	12.88	16.81	37
Toscore	100	13.06	7.80	0.00	6.50	13.50	19.00	28
Environ	100	4.29	2.69	0.00	2.00	5.00	6.00	12.00
Social	100	5.47	3.61	0.00	2.50	7.00	8.00	12.00
Economic	100	3.30	3.27	0.00	0.00	2.50	6.00	12.00
Panel B: Dummy variables								
Year 05	100	0.50	0.50	0.00	0.00	0.50	1.00	1.00
Year 08	100	0.50	0.50	0.00	0.00	0.50	1.00	1.00
Common	100	0.18	0.39	0.00	0.00	0.00	0.00	1.00
Civil	100	0.72	0.45	0.00	0.00	1.00	1.00	1.00
Scancivil	100	0.10	0.30	0.00	0.00	0.00	0.00	1.00
UADlow	100	0.42	0.50	0.00	0.00	0.00	1.00	1.00
UADhigh	100	0.58	0.50	0.00	0.00	1.00	1.00	1.00
IDVlow	100	0.14	0.35	0.00	0.00	0.00	0.00	1.00
IDVhigh	100	0.86	0.35	0.00	1.00	1.00	1.00	1.00

there is a considerable variation in their level of CSR disclosures with approximately eight standard deviations in the total CSR disclosures. Their financial performances also show wide variation. As expected, there are fewer variations in the dummy variables in panel B. We provide the sample composition information in appendix 2. Selection into the sample was based on size of the banks.

13.5.2 Legal Institutions

Hypotheses H1a to H1c test the effects of countries' legal origin on CSR disclosures by banks. Table 13.3 presents the result of the ANOVA tests. The F-statistics shows that there are significant differences in the total CSR disclosures by the banks, with F-statistics of 5.47 significant at 5% level. There are also significant differences in both social and economic disclosures by the banks (with F-statistics of 4.95 and 6.58 at 5% level, respectively). However, the environment-related disclosures did not show significant differences in disclosure by the banks. The Bonferroni test for multiple comparisons shows that there are significant differences in the total CSR disclosures by banks in the common law countries compared to the civil law countries, and between the civil law countries and Scandinavian law countries at 5% level (4.85 and 6.60, respectively). Table 13.3 also shows that there are significant differences in the social- and economic-related CSR disclosures by the banks in the civil law countries compared to Scandinavian law countries, and banks in the civil law compared to common law countries (3.46 and 2.77, respectively) at 5% level. These outcomes provide incentives to explore the relationship further using multiple regression models.

Table 13.4 presents the multiple regression model results. It shows a significant positive relationship between size and total CSR disclosure for banks in common law countries, a marginal significance for civil and no significance for Scandinavian countries.Banks based in all the three legal origins showed significant positive relationship between total CSR disclosures and firm performance; this conflicts with findings in Chih et al. (2010). Surprisingly, banks based in the common law

Table 13.3 ANOVA: Legal institutional factors on CSR disclosures by banks

	F	Sig	Bonferroni test		
Total score	5.47	0.006	2–1 2–3	4.85 6.60	0.054* 0.031*
Environment	0.95	0.391			
Social	4.95	0.009	2–3	3.46	0.012**
Economic	6.58	0.002	2–1	2.77	0.004*

1 = Common law countries; 2 = Civil law countries; 3 = Scandinavian countries.* and** represent significance at 5 and 1%, respectively

Table 13.4 Regression results on CSR disclosures and legal institutional factors

Variables	Total disclosure			Social			Economic		
Size	1.44 2.12**	1.06 1.74*	0.65 1.03	0.76 2.59**	0.65 2.45**	0.43 1.65	0.13 0.42	−0.44 −0.17	−0.22 −0.77
Performance	0.19 2.33**	0.19 2.31**	0.18 2.69**	0.09 3.62***	0.09 3.45***	0.09 3.75***	0.08 1.74*	0.08 1.75*	0.08 2.06**
Common	−5.17 −2.24**			−1.67 −1.62			−2.29 −2.24**		
Civil		5.36 2.98***			2.22 2.79***			2.31 3.27***	
Scand			−4.48 −1.81*			−2.60 −2.41**			−1.98 −2.51**
Constants	−6.42	−6.43	3.22	−4.89	−5.33	−0.68	1.25	1.30	5.39
R^2	0.14	0.18	0.12	0.13	0.18	0.15	0.15	0.19	0.13
N = 100									

*, ** and *** represent significance at 10, 5 and 1%, respectively

countries showed a significant negative relationship with total CSR disclosures (coeff. −5.17: t-stat. −2.24), while banks based in the civil law countries showed significant positive relationship with total CSR disclosures (coeff. 5.36: t-stat 2.98), and banks in the Scandinavian countries showed a marginal negative relationship with total CSR disclosure. These results indicate that banks in the civil law countries are more likely to disclose CSR issues than banks in the common law countries. However, this surprising result extends Chih et al.'s (2010:115) finding that 'firms in countries with stronger shareholder rights tend to engage in less CSR activities' by showing that they also make fewer CSR disclosures. We expected that banks based in the common law countries would have greater incentive to disclose due to the diverse nature of their shareholding and their advanced shareholders' protection rights compared to banks in civil law origin countries. However, one plausible explanation for our finding could be that while banks in the common law countries may have higher incentives to disclose financial performance- and shareholders'-related financial information, due to their ownership structure, this may not be applicable to CSR issues and their disclosures. Similar explanations could be applicable for civil law origin countries. Our result allowed us to reject the null hypothesis H1a.

Table 13.4 also shows the results of the disaggregated disclosures (Social and Economic columns) and legal origin.

13.6 Employee-Related (ER) Disclosures and Legal Institutions

Table 13.4 shows a significant positive (coeff. 2.22: t-stat. 2.79) relationship between ER (social) disclosure and banks based in the civil law origin countries. There is no significant relationship between ER disclosures and banks based in the

common law (coeff. −1.69: t-stat. 1.6), but a significant negative relationship between Scandinavian legal origins (coeff. −2.60: t-stat. −2.41) and ER disclosures. This indicates that while banks based in the civil law countries are more likely to make ER disclosures, banks based in the Scandinavian law origin countries are less likely to make ER disclosures. This is the case at least in their sustainability and annual reports. This mirrors the result from the total disclosures regression model presented earlier. While current literature such as Hamid (2004) and Douglas et al. (2004) showed that banks make more employee- and customer-related CSR disclosures than environment-related CSR disclosure without considering the impact of legal origin, this study extends the literature by showing that such disclosures are sensitive to firms' legal origin. Based on this result, the null hypothesis (H1b) of no relationship between banks ER disclosures and legal origin is rejected.

13.7 Shareholder-Related (SR) Disclosure and Legal Institutions

The regression result in Table 13.4 (economic column) relates to hypothesis H1c which examines the relationship between countries legal origins and banks' shareholder-related or economic (SR) disclosures. The result shows a significant positive (coeff. 2.31: t-stat. 3.27) relationship between SR disclosures for banks in the civil law origin countries, a significant negative relationship for banks in both common law (coeff. -2.30: t-stat. -2.24) and Scandinavian civil law (coeff. -1.98: t-stat. -2.51) origin countries. This indicates that big banks operating in countries with civil law origin are more likely to make economic-related CSR disclosures than banks in either the common law or Scandinavian law origin countries. Although this result is broadly consistent with Chih et al. (2010), it is strange as one would expect banks in common law origin countries to have higher need for disclosure. However, a reason for this finding may be that banks in common law origin countries are particular about core economic and shareholder information not necessarily those that are related to corporate social disclosure. These results enable us to reject the null hypothesis of no relationship. Next, we examine the effects of cultural dimensions on CSR disclosures by banks in the sample.

13.7.1 Cultural Dimensions and CSR Disclosures by Banks

Hypotheses H2a and H3b examine the effects of cultural dimensions on CSR disclosures by banks in the sample. Our regression results are presented in Tables 13.5 and 13.6.

Table 13.5 Cultural dimensions and CSR disclosures by banks

	Total disclosure UAI		Total disclosure IDV	
Variables		Low		Low
Size	1.83 (3.45***)	1.83 (3.45***)	1.23 (1.83*)	1.23 (1.83*)
Performance	0.16 (2.15**)	0.16 (2.15**)	0.19 (2.76**)	0.19 (2.76**)
UAI high	7.81 (5.26***)			
IDV high			−1.96 (−0.80)	
Constants	−16.26 (−2.31**)	−8.46 (−1.23)	−2.91 (−0.36)	−4.87 (−0.55)
R^2	0.30	0.30	0.09	0.09
N = 100				

*, ** and *** represent significance at 10, 5 and 1%, respectively. UAI and IDV stand for Uncertainty avoidance and individualism/collectivism, respectively

Table 13.6 Disaggregated CSR disclosure and UAI

Variables	Environmental	Social	Economic
Size	0.59 2.87**	0.97 4.27**	0.27 1.05
Performance	0.01 0.45	0.08 3.19**	0.07 1.66
UAI high	1.37 2.27*	3.28 4.55**	3.16 5.33**
Constants	−4.22 −1.52	−9.49 −-3.2**	−-2.55 −0.76
R^2	0.10	0.30	0.30
N = 100			

* and ** represent significance at 5 and 1%, respectively

Table 13.5 shows a strong positive (coeff. 7.81: t-stat 5.26, significant at 1%) relationship between banks in high-uncertainty avoidance (UAI) countries and total CSR disclosures, and a significant negative (coeff. 7.81: t-stat. 5.26, significant at 1%) relationship for banks in high UAI (and a high negative of the same coefficient and t-stat for banks in low UAI). Firm size and performance show significant positive relationship with total CSR disclosures at 1% and 5%, respectively, and R^2 of 30% for both UAI high and low. We therefore accept hypotheses H2a-b. Table 13.5, column IDV, presents the result of the relationship between the individual/collectivism dimension of culture and CSR disclosures by the banks in the sample. It shows that there is no relationship between these variables. We therefore could not accept hypotheses (H3a-b). Current literature is surprisingly silent on the relationship between culture and CSR disclosure by firms although studies have examined customers' cultural disposition and their tendencies to punish irresponsible behaviour by firms (Williams and Zinkin 2008).

Table 13.6 presents the regression result on the relationship between the disaggregated CSR disclosure and UAI. The result shows some resemblance with the results of the total disclosures presented in Table 13.5.

Banks in high-UAI countries show significant positive relationship between environment and social-related CSR disclosures and firm size, but shareholder-related disclosures are not a function of firm size. This indicates that the bigger the firms' size, the more they are likely to make social- and environment-related social disclosures, but firms' size does not determine the disclosures of economic-related social disclosures. We found similar results for banks in low-uncertainty avoidance countries. In addition, we found that only social- or employee-related CSR disclosures show statistical significance with firm performance. We found a statistically significant positive relationship between environmental disclosures and banks operating in a high-uncertainty avoidance society, and a significant negative relationship between banks operating in a low-uncertainty avoidance society and environmental disclosures. Similarly, there is a significant positive (negative) relationship between banks operating in high (low) uncertainty avoidance and social- and shareholder-related social disclosures. These are all consistent with our H2a-b hypotheses.

13.8 Conclusions

Previous studies have identified the dearth of studies on CSR disclosures by banks. This is presumably because the sector is often categorised as low impact in terms of its environmental effects on the society, but it certainly has high indirect impact through funding high-impact sectors. Consequently, this study investigated the effects of legal origin and cultural dimensions on CSR disclosures by big banks in 14 Western European countries for 2005 and 2008 year ends. Countries were categorised based on their legal origin and on their scores on two of Hofstede's (1983) cultural dimensions—Uncertainty Avoidance and Individualism/collectivism. Independent t test and ANOVA show that banks in civil law origin countries disclose more than banks in common and Scandinavian countries.

Multiple regression analysis shows a significant positive relationship between total disclosure and banks in civil law origin countries, and a significant negative relationship with common law origin countries. Consistent with findings in previous studies, banks in the sample do not make significant environment-related disclosures, but more importantly, such disclosures are neither affected by legal origin of country of operation nor by the predominant cultural dimension of the countries. In terms of customer- and employee-related CSR disclosures, banks in civil law origin countries have higher propensity to make both customer- and employee-related disclosures than banks in common law origin countries. This contradicts the

popular thinking in the broader corporate governance and accounting literature which suggests that firms in the common law countries have stronger shareholders right and protection which, all thing being equal, should provide incentives for more disclosures. A plausible explanation for our finding could be that while banks in common law origin countries make financial- and performance-related disclosures more than banks in civil law origin countries, this may not be the case in respect of CSR-related shareholder disclosures. This finding shows that it is important to disaggregate CSR disclosure into their specific components as this could enhance our understanding of firms' social disclosure behaviours.

Furthermore, while consideration of the impact of culture on CSR disclosure discourse is rare, integration of culture into institutional debate is even more uncommon. This study considered the effects of two of Hofstede's cultural dimensions on CSR disclosure by banks. Consistent with our conjecture, we found that banks in high-uncertainty avoidance cultures, such as Italy, Spain and Greece, make more CSR disclosures than banks in low-uncertainty avoidance cultures such as UK and Germany, but we did not find any relationship between Individualism/ collectivism cultural dimensions and CSR disclosures. This finding suggests that financial firms operating in a high-uncertainty avoidance country are more likely to make CSR disclosure due to idiosyncratic factors of such countries compared to similar firms operating in low-uncertainty avoidance countries. Uncertainty in this sense is framed in terms of the effects of the activities of banks in the society, especially the effects of their CSR behaviour. The implication of the findings from this investigation is that financial firms in high-uncertainty avoidance countries probably have to do more to convince the society of their legitimacy to continue to operate and explore societal resources than financial firms in low-uncertainty avoidance countries. This is particularly striking in view of the recent financial crisis and the growing debate over banking regulations. The interesting paradox here is that while banks in Italy, Spain and Greece, countries with high uncertainty avoidance, were severely affected by the recent crisis and are being bailed out, banks in low-uncertainty avoidance countries such as UK and Germany are less affected.

This study provides further evidence on the impact of institutional frameworks on CSR disclosure behaviours. The majority of existing studies suggest that common law origin countries have more compelling institutional frameworks to motivate more disclosures compared to civil law origin countries. However, our study suggests that this may not be the case in respect of CSR disclosures and for large banks in Western European countries. Our findings suggest the need for further studies in this research area to establish whether the effects of institutional frameworks on disclosure are issue and sector specific. Furthermore, future studies could explore the impact of other institutional frameworks such as political and other cultural dimensions on CSR disclosures for other countries, for example, Eastern European countries and developing economies.

Appendix 1: Scoring Basis—We Award 1 Point for Disclosure Related to Each Theme

Shareholders related	Environment related	Employees related
(1) Communication with shareholders	**(1)** Declaration regarding environmental issues	**(1)** Types of employees (gender, working position, types of contract, educational level, age…)
(2) Property of the firm	**(2)** Declaration regarding sustainability issues	**(2)** processes for selecting, form and promotion for employees (creating human capital)
(3) Presentation of reports for shareholders and financial analysts	**(3)** Politics programs and action to handle	**(3)** Pay, incentives and provision systems
(4) Types of shareholders and its main features	**(4)** Declaring realisations and financial budget handled	**(4)** Health and safety
(5) Information regarding relevant facts	**(5)** Environmental (prizes, certificates and auditing)	**(5)** Internal communication with employees (working relationships, trade unions and collective bargaining)
(6) Buy and sell off own shares	**(6)** Investing in environmental issues (improvement, control and saving)	**(6)** work life balance
(7) Compromise to buy and sell own shares	**(7)** Green products	**(7)** Suggestions and complaints
(8) Shares to shareholders (value creation)	**(8)** Direct and indirect environmental impacts caused by the firm	**(8)** Knowledge and talent management
(9) Evolution of shareholders stock prices and other relevant banking data	**(9)** Environmental exposure	**(9)** Working absence
(10) Shareholders webpage	**(10)** Emissions, consume and energetic saving	**(10)** Working climate
(11) Loyalty programs and products offer	**(11)** Energies (renewable and non-renewable)	**(11)** Communicate and participate in management issues
(12) Stock and sustainability indexes	**(12)** Recycling and waste	**(12)** Helping disfavoured groups
(13) Shareholders meeting	**(13)** Climate change and Green house effect gases	**(13)** Volunteering
(14) Others	**(14)** Main indicators regarding environmental issues	**(14)** Others
	(15) Others	

Source Sustainability and annual reports of the companies in the sample

Appendix 13.2: Sample Composition

Country/number of banks	Names of banks	Country	Names of banks	Country	Names of banks
Austria/2	Kommunal Kredit AG	Germany/5	Commerzbank	Spain/7	Banco Popular
	OeKB		Deutsche Bank		Banco Sabadell
Belgium/2	Dexia		HVB		Banesto
	KBC Group NV		West LB AG		Bankinter
Denmark/1	Danske Bank		KfW Bankengruppe		BBVA
France/6	BNP Paribas	Italy/5	MPS		Banco Pastor
	Credit Agricole		SAN PAOLO IMI		Banco Santander
	Socgen		UniCredit Group	UK/7	Abbey**
	Caisse D´ Epargne		Banca Intesa		Barclays Bank
	GBP		Banca Nazionale di Lavoro		HSBC
	Natixis				Lloyds TSB
Finland/2	OKO Bank	*Ireland/2	Allied Irish Bank		HBOS**
	Sampo OYJ		Bank of Ireland		Bradford and Bingley**
*Greece/4	Alpha Bank	*Portugal/3	Caixa General Depositos		Royal Bank Scotland**
	Emporiki Bank		Banco Espirito Santo		
	Eurobank Ergasias		Millennium BCP		
	Piraeus Bank	Sweden/1	SEB		
Holland/3	ING Group				
	Rabobank				
	ABN AMRO				

Source Authors

- T*

* These countries banks/economy were bailed out by the European Union and World Bank's loan packages

**The financial crisis affects these banks significantly. They were either nationalised or taken over by another bank.

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Chapter 14
Social Reporting in a Health Care Organization: A Case Study of a Regional Italian Hospital

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Abstract The Italian Health System (herein abbreviated as IHS) is principally financed by public funds; the individual health units present difficulties in defining and measuring health care output and, at the same time, in the communication process to stakeholders about the clinical and ethical impacts of the use of economic resources. A reporting model based on a triple bottom line approach (social, environmental, and economic) could offer a system of multidimensional analysis, and it could increase external communication, thereby reducing information asymmetries between the health unit and its stakeholders. Despite the understanding that there are theoretical schemes proposed by previous literature and current guidelines, practitioners are still lacking appropriate models and tools to guide the social accountability process of the IHS entities. It is the absence of a single specific framework, applicable to social reporting for the particular reality of hospital health units, which has guided the research project illustrated in the present chapter. In order to understand how a health manager could adopt a suitable reporting format,

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starting from the current available standards, an Italian case study is discussed. The research is based on a constructive approach methodology. The design of the accountability model is centred on the basic levels of care (according to Italian regulations), and, for each of them, a wide range of performance indicators is presented so as to offer an idea of what is—or what could be—disclosed in the report. The project has required collaboration between an university and a regional public hospital. The chapter is composed of five main parts: a brief overview of the IHS regulations and the compulsory accountability system; the need for social reporting by hospital units; the empirical accountability process, including stakeholder engagement activity which represents an example that an health care organization can follow; reflections on social reporting as a stakeholder engagement tool and a guide for the patient; future research areas.

Keywords Health organization · Social accountability · Stakeholder engagement · Reporting · Italian health system

14.1 Introduction

In Italy, 78.2% of total health spending is public (World Health Organization 2014), financed through general taxation; the remainder is private health spending, supported by private resources, individual citizens' insurance and not-for-profit contributions (in kind and in money). In the current Italian health care system—affected by spending review actions—it appears very difficult to find a balance between needs and services provided, due to limited resources.

In a dynamic and changing context, where resources and powers change, health care organizations must continually demonstrate their actions to society in order to gain legitimacy and relevance, consent, protection, recognition for their work, and the resources entrusted to them (Brinkerhoff 2004). Implementing a system of indicators, which enables the performance evaluation to be carried out according to multiple targets inherent in the mission of the health care organization, would respond to this requirement. Furthermore, a system of multidimensional analysis and reporting increases communication, while reducing information asymmetries between patient and professional. In this way, the organization acts to adopt a transparent management approach, emphasizing the responsibility of each professional for the well-being of the patient, while working towards the achievement of a common goal (Bruzzi 2006).

The development of a reporting system, with time comparison, connects the economic, social, and environmental aspects (expressed through monetary and non-monetary indicators) and puts a greater emphasis on narratives (Cooper 1992; Lehman 1999) that are able to better describe the clinical and ethics variables related to the health sector. In other words, through social reporting the health unit could demonstrate that it is pursuing its objectives, by balancing economic goals

with the management of social and environmental issues (Tschopp et al. 2004; Henriques and Richardson 2004).

The multidimensionality of the analysis and co-participation in the identification of the most appropriate measures to monitor the different economic, social, and environmental activities of a business organization can overcome the limitations of relying on only accountants for economic and financial assessments and interpretation of the data (Söderbaum 2004). Moreover, the introduction of stakeholder engagement practices may result in being able to supply useful information for a social accounting system (Thomson and Bebbington 2005; Brown 2009). In fact, the dialogue between the parties tries to identify the value and the results of the decisions made in the economic, environmental, and social fields (Bebbington et al. 2007) and provides information to stakeholders to help them understand the levels of responsibility intrinsic to those decisions.

In order to discern how a health care facility manager could adopt and implement a suitable reporting format, able to achieve the potential described above, the current available standards could provide a response. In particular, the conceptual framework proposed by Lamberton (2005) could serve as a reference for which factors and variables to consider in developing the accountability process and which attributes should guide the entire path. At the same time, the accountability process could be inspired by the logic presented in the Copenhagen Charter (ISEA 1999a), as well as the AccountAbility1000 (ISEA 1999b) principles and the AA1000SES (AccountAbility 2005) phases. The building of the indicator system is best described in the Global Reporting Initiative Framework and Guidelines for public utilities. The identification of the dimensions of analysis, specifically applied to health units, is outlined in the "Italian standard for social accountability in health care organizations", available only in the Italian version (G.B.S. 2008). However, considering the peculiarities of the health units in the Italian Health System, each of these available documents, schemes, frameworks, and so on may have some features that are applicable to the dimension of analysis in the operative implementation of social reporting in the context of this study.

The international standards mainly serve to guide the general definition of the accountability process and to state the essential phases and values; the Italian standard encompasses health units without taking into account the specific configuration of the various hospital units. These kinds of health units represent the organizational nodes of the national health network (Lega 2007), together with the local health units and the accredited facilities (public and private). However, contrary to the other realities (i.e. hospital units), they are used only for the provision of health care services, with funding flows deriving mainly from the volume of services provided. Hospital health units can obtain and maintain autonomy if the following requirements are met: the presence of a departmental organization; an accounting system classified by cost centres; an organization with highly specialized medical units; and a second-level emergency treatment and admission department. The hospital health units must be mentioned as referral health facilities in the integrated programs of health care assistance, developed on a regional and interregional basis. Moreover, the regulation ratifies specific measures (referred to a

specific period) that must be complied with: for example, the number of patients who come from other Regions should be higher than the regional average and at the same time, the complexity index of the diseases or illnesses (treated during the hospitalization period) should be higher than the regional average. Finally, hospital health facilities must have their own buildings for the development of institutional activities. Their financing system is dependent on the number of hospitalizations and is not linked to the population living in a specific geographic area (as is the case, instead, for the local health units). On the opposite end of the spectrum, the local health units are the providers of hospitalization services or outpatient services through their operating units (territorial districts and non-autonomous entities); their function is to ensure basic levels of care for the community which lives in its assigned geographic area; to fulfil this purpose, they are financed through State funds. The local health units use the funds to either provide health care services or purchase services not only from other local health units, but also from hospital health units and other accredited facilities (private or public).

This brief description is intended to shed some light on the difference between *local* health units and *hospital* health units in the organizational aspect, on the one hand, but above all, and on the need for hospital units to communicate their performance in order to account for their use of resources and to attract users (patients).

The absence of a single standard, which can be applied to the particular reality of hospital units, has motivated the research project illustrated in the present chapter. The aim of the study is to design a social reporting model that can be specifically adopted by hospital units in order to communicate their multidimensional performance to a plurality of stakeholders.

The definition of the socio-economic accountability model to apply to a health care organization started from the Italian standard and other international guidelines (ISEA 1999b; Alesani et al. 2006; G.B.S. 2008).

The research project also considered existing case studies (Chua and Preston 1994; Peursem 1999; Gigli and Tieghi 2012; Kastberg and Siverbo 2013; Ursillo 2012; Kuntner and Schallmeiner 2013), the observation and analysis of corporate events, as well as the results of stakeholder engagement activities.

The methodology used for this case study is the constructive approach which is generally linked to some researchers' volition to bridge the gap between research and reality in management accounting (Kasanen et al. 1993). Such an approach is aimed at finding a solution to a practical problem, and based on the solution found, it provides a theoretical contribution. So, the constructive approach is directed towards both addressing emerging issues of corporate practice and giving a scientific contribution (Chiucchi 2012). This approach is characterized by a strong orientation to problem-solving through an innovative construction (Chiucchi 2004). In this case, the use of the constructive approach allows the model to be built during the research process and later, implemented through the collaboration between researchers and practitioners.

The context of the case study is the health care organization named AOUOORR—*Azienda Ospedaliero Universitaria Ospedali Riuniti Umberto I, G.M. Lancisi, G. Salesi* (teaching hospital group) of the Marche Region, which represents a hospital

health unit (with specific differences from the local health units, as described in-depth in paragraph 2). The peculiarities of the regional context and the various sources of information, including direct observation and interviews with stakeholders (internal or external), are taken into consideration in presenting the process that was implemented. Data collection took place through the analysis of documentary sources, participant observation (Atkinson and Shaffir 1998) of processes, and the performance of semi-structured interviews with human resources operating (Yin 2003) in AOUOORR at the time of the analysis. The work also highlights the specific dialogue that was initiated with the different categories of stakeholders, to engage them, to understand their expectations, and to identify the strong and weak points of the health unit—stakeholder relationship.

The chapter structure is the following: after an analysis of the Italian Health System regulation and its compulsory accountability system (Sect. 14.2), the focus is mainly on the current status of social reporting with an illustration of the currently available standards and guidelines in order to highlight the absence of a specific framework for hospital units (Sect. 14.3). Subsequently, the study presents the empirical basis used to demonstrate how to develop the AOUOORR's social report, representing an example that a health care organization can follow (Sect. 14.4). Finally, based on information provided by national legislation, there follows a reflection on the importance of accountability tools, which serve not only to report to stakeholders about the entity's services and performance, but also to generate value through the education of the same stakeholders to the aware use of the analyzed entity's services, thus contributing to the protection of the right to health (Sect. 14.5).

14.2 The Italian Health System: The Regulation Scenario and the Compulsory Accountability System

The organization and operation of the IHS are completely regulated by national (and regional) laws. The current legal framework derives mainly from two reforms (Legislative Decrees no. 502/1992 and no. 229/1999), founded on the logic of "regionalization" and corporatization of the public health sector. The empowerment of the Regions, the introduction of accounting principles, and the focus on the criteria of effectiveness and efficiency are the key points of these Nineties-era reforms (France and Taroni 2005). Legislative decree no. 502/1992 established that the health care agencies would become "health authorities", with the same characteristics and guiding principles of a business company (in the accounting logic), but finalized to serving the public interest and with a public juridical personality. Thus, the same decree introduced economic criteria in the public management of the health care agencies, and it renewed the IHS's internal organizational set-up and its financing system. The figure of a Director General and a Board of Auditors were introduced in the public governance of the health care organizations. The funding of

every public organization comes from several sources; one part is from the national health fund, and another part comes from its own revenues and, if needed, some forms of regional self-financing (regional taxes, increase in contribution rates or others).

Legislative decree no. 502/1992 also introduced the financing system of tariffs, called "per rate", specifically defined for each class of patient admission and classified according to the diagnostic related group (DRG—system created by Robert B. Fetter and John D. Thompson of Yale University, introduced by Medicare in 1983). This legislation was the forerunner to the implementation of accounting tools such as budget and performance indicator systems. Their implementation helped to define cost-cutting policies in the pursuit of management efficiency and efficacy related mainly to financial savings. Consequently, the budgeting and reporting system—as ratified by the reform—partly influenced the decision-making processes.

The subsequent Legislative decree no. 229/1999, entitled "Reorganization of the IHS" completed the transformation process that made the IHS a business (corporation) by introducing organizational and managerial tools for the phases of planning, providing, and reporting of health care activities. Additionally, the 1999 legislation recognized the *department* as the business unit of the health service management model (from Legislative decree no. 502/1992). It abolished the monetary perspective in favour of the financial accounting logic and introduced new management control tools.

The laws that went into effect at the end of the twentieth century also determined the difference between "local health units" and "hospital health units". Specifically, the two decrees established the minimum performance requirements for hospital health units, which are juridically independent from the local health units. The difference between the two organizational entities influences their accountability needs in terms of the different aspects that relate to recording and to accounting.

Legislative decree no. 229/1999 (derived from the normative architecture ratified in Legislative decree no. 502/1992)—reinforced with the Reform of Title V (year 2001)—which introduced reform founded on "regionalization" criteria. This reform established that the Regions' responsibility covers organization of services and activities for health protection, definition of funding criteria for regional health units, management control, and assessment of health care quality. The Regions have the responsibility to regulate the regional health facilities and the consequent geographic zone of reference (district), the principles and the criteria for the definition of corporate documents, the rules related to the financing system and the accreditation model, the management control system, and the outcome evaluation procedures. Finally, the Regions define the ways in which their regional local units deliver health care services that are outside the uniform levels of assistance. The regional funding share (called capitation share) that goes to each local facility (as established in the legislation in question) is defined through parameters that consider the characteristics of the population in the district (area of reference of a single unit). It is up to the Regions to select suppliers through specific accreditation procedures, to define regional tariffs, and to control (at the formal and substantial

level) the documents and the accounts prepared by the administrative staff of the local units and approved by their own Director General.

The national system is highly decentralized, with twenty Regions enjoying virtually complete autonomy in administrative and organizational matters. The harmonization and the regulation system are performed by governmental organizations. To wit, the Ministry of Health ratifies the laws and defines the rules and the financing quotas in order to guarantee the equitable supply of essential levels of care; other national institutes (such as the Superior Institute of Health, in Italian, *Istituto Superiore della Sanità*—ISS) and national agencies (such as the National Agency for Regional Health Services in Italian, Agenzia Nazionale per i servizi sanitari Regionali—AGENAS) ensure scientific coordination and research improvement.

The Regions ensure that health care services are provided, based on the health needs of the target population, through health units. The set of rules in force in the current national panorama constitutes the legal framework of these organizational structures. Principally, they provide levels of care (established by the central Government) for which the Region receives public funds. In particular, they have a legal personality, organizational and administrative autonomy, and conduct their own accounting, managerial and technical governance. However, the autonomy of the single regional organizations is not full but subordinated to the larger economic entity (the State and Regions). The latter defines the extent of the limitations and thus the degree of autonomy of the regional organization. However, each organizational structure works with its own assets, prepares its own financial statement, and has its own governing bodies that are distinct from the political ones.

14.2.1 The Compulsory Accountability System: A Partial IHS Vision

The first step required to respond to the prescriptions of the reforms, for both hospital and local health units, was to adopt a structured management control system—mainly with financial and economic values—composed of planning tools, cost accounting techniques, and a reporting sheet. These mechanisms aim to manage public funds and, at the same time, to guarantee the efficacy and the efficiency of the IHS. The minimum applicability of each tool is specified in the cited laws (Legislative Decrees no. 502/1992; no. 229/1999 and subsequent updates) as well as in the technical and economic protocols (the financial and economic sheets are presented in a specific governmental decree of the Ministry of Health, last updated in June 2012). In particular, health planning strategies define the mode in which assistance is provided and the types of intervention connected with the different Italian geographical areas.

Health planning takes place on three levels, which are national (national health plan), regional (regional health plan), and local (local implementation plan and area plan). On the first level, there is the national health plan, which is an administrative

act containing the three-year plan, broken down into identified targets, planned activities, and tools to achieve it within a given period. The national plan is drawn up by taking national economic planning into account.

Briefly, the last document available contains an analysis of the socio-economic scenario (demographic parameters, opportunities, and constraints related to scientific development and changing needs), the health strategies previewed for the next three years (regarding innovation, research, management, clinical governance, and quality) broken down into health and economic objectives (considering each stage of life, the different typologies of diseases, and the needs of families), the assessment procedures and the monitoring system.

(*Three-year plan of the Italian Health Care System, available only in Italian at* www.salute.gov.it)

On the next level, there is the regional three-year health plan which contains the regional attribution of funds, linked to local objectives and the needs of regional citizens, considering the objectives identified by the national health plan as well as the municipalities, social groups, universities, and trade unions of the operators. Finally, after the national and regional health plans, there is the local implementation plan and the area plan that also adopt a three-year format. At the bottom, the single health unit—either local or hospital unit—adopts is own document: the multiyear budget and the annual budget (Table 14.1).

The documents allow the management and planning, scheduling, and programming of the future economic and financial flows. The multiyear budget estimates the financial revenues and expenses for the upcoming three years, related to public funds received by the regional administration (as branches of the national Government), taking into consideration the supplied levels of care by the health structure. The annual budget represents, in economic and financial terms, the first year of the multiannum budget.

Table 14.1 Structure of the annual economic budget and three-year economic budget

(In euros)

short version	Year "n" (Annual Budget)	Year "n + 1"	Year "n + 2"
(A) Value of production			
(B) Production costs			
(C) Financial Revenues and Expenses			
(D) Extraordinary Revenues and Expenses			
EARNINGS BEFORE TAXES EBT (A − B ± C ± D)			
Income taxes (current, deferred, and prepaid)			
Net income (loss) of the year			

(according to the scheme reported in the Intragovernmental decree of 20 March 2013)

The annual reports are prepared in accordance with the statutory regulations and are composed of the income statement, the balance sheet, the financial statement, (see examples in the following tables), and notes in order to provide a clear picture of the economic situation and financial position of the health care organization at the end of the financial period.

The income statement underlines the nature of costs (mainly: human resources, medical devices, rentals, transports, consumptions, other products and services, amortizations) and revenues (mainly: regional public funds, private contributions by patients, European or National aids for specific research projects, donations), without to emphasize the quantitative and qualitative information related—for example—to the hospital health assistance, emergency care, hospitalization, day hospital and day surgery, long-term facilities for rehabilitation, and so on.

The primary aim of the balance sheet is to illustrate the assets of the health entity, to ensure the supply of health care services (broken down by different units; e.g. for surgery, biology and immunohematology tests, and radiology tests). Thus, it includes the liabilities and equity of the health care organizations. The specific use of each asset or the description of its function is excluded from the scheme.

The financial statement highlights only the expenses and income related to each management operation (Table 14.2).

The compulsory accountability tools allow the accounting of the financial resources derived from public sources. They do not report the nature of health care activities aimed at meeting the social and welfare needs of citizens, which is the real mission of the IHS (Ancona and Alesani 2005).

14.3 The Strong Need for Social Reporting by Hospital Units: The Current Response of Standards

The hospital units must aim to achieve effectiveness in a double logic: on one hand, the entity (which obtains funds only related to disbursed services) has to pursue an entrepreneurial effectiveness connected with economic and financial balances in order to maintain and to expand its "market" share; on the other hand, the hospital unit has to achieve social efficacy related to the consensus of users (in order to attract the demand for services), of the community, of the authorities, and of the personnel. The assessment of the achievement of the economic entity's objectives cannot stop at the economic-financial aspects linked to the provision of health care services, but must embrace other variables that lead to a multidimensional analysis (Caselli 1998) in the medium–long term, oriented towards social aspects and not solely focused on quantitative information about economic transactions (Gray 1992; Milne 1996; Lamberton 2005; Yongvanich and Guthrie 2006). The financial information must be integrated with the social information about the different activities, aimed at health protection. In fact, on the one hand, the regionalization process has led to a strengthening of the regional governments' role in the health

Table 14.2 Structure of Annual Report year "n"

Income Statement *short version*	*(In euros)*
	Year "n"
(A) Value of production	
(B) Production costs	
(C) Financial Revenues and Expenses	
(D) Extraordinary Revenues and Expenses	
EARNINGS BEFORE TAXES EBT (A − B ± C ± D)	
Income taxes (current, deferred, prepaid)	
Net income (loss) of the year	

Balance Sheet *short version*
(In euros)

Assets	Year "n"	Liabilities and equity	Year "n"
(A) Fixed assets		(A) Equity	
I Intangible fixed assets		*I Endowment fund*	
II Tangible fixed assets		*II Funds for investments*	
III Financial fixed assets		*III Reserve from donations and bound legacy by investments*	
		IV Other reserves	
		V Contributions for distribution of losses	
		VI Retained (losses) Earnings	
		VII Net income for the year	
(B) Current assets		(B) Provisions for risks and charges	
I Inventory			
II Trade receivables			
III Financial current assets			
IV Cash and Equivalents			
(C) Accruals and Prepayment		(C) Termination Indemnity	
		(D) Payables	
		(E) Accruals and Deferred Income	
Total Assets		Total liabilities	

Financial statement (*short version)*	*(In euros)*
	Year "n"
(A) Total income operations	
(B) Total investment activities	
(C) Total financing activities	
TOTAL CASH FLOW (A + B + C)	

(according to the scheme reported in the Intragovernmental decree of 20 March 2013)

units, causing (for the health units in general) a need to boost the information flow for the process of decision-making and, also, to increase the reporting tools for demonstrating the achievement of conferred institutional objects, under both a clinical and an economic-financial profile (Alesani et al. 2005). On the other hand, the process of corporatization, begun in the 1990s, has attributed organizational autonomy to operators in the health sector, who are made responsible for pursuing institutional objectives and guaranteeing an effective and efficient management of the activities carried out and the highest qualitative levels of health care (Borgonovi 2005). This is relevant above all for the hospital units, which have the duty not only to act responsibly according to the regional (and national plans), but also to meet the criteria of efficiency and efficacy in the management of their specialized medical units and the supplying of the level of health care. The issues related to clinical appropriateness, quality of health care services, economic operation, and other factors (choices about the allocation of resources, the location of services, and the supply of combinations of treatments) affect the social legitimacy of the single unit and the political consensus around its activities (Tanese 2006). In fact, even if the access to health services is independent of the individual's ability to pay (out-of-pocket expenditures) because the State takes on the task of meeting people's health needs through public spending (Murray and Frenk 2000), hospital units obtain their income thanks to the demand for services derived from local units, other hospital units, or from the private citizen. In addition, a development of multidimensional accountability practices may encourage decision-makers to reflect critically on the (un)sustainability of the unit's organizational practices, making the decision-making process more open and transparent (Thomson and Bebbington 2005), thus facilitating the pursuit of social goals (Bebbington et al. 2007).

This accountability process (Gray et al. 1987) requires the collection of quantitative and qualitative information (in financial and non-financial terms), which have to be transmitted through different communication tools (e.g. the annual report, social report, or environmental report) to a large group of social partners (Gray et al. 1996). In keeping with this line, stakeholder participation in the accountability activity and the subsequent adoption of stakeholder engagement practices are fundamental in order to institute a dialogue aimed at understanding stakeholders' concerns and their involvement in the activities and decisions (Dansky and Gamm 2004; O'Dwyer 2005a, b). In this sense, social reporting becomes a tool used to reflect on strategies, governance, risk management, and decision-making. The stakeholders dialogue practices, the management and measurement of business performance, and the communication processes (Bebbington et al. 2008; Adams 2008) constitute the accountability process, which can promote significant organizational changes geared towards the reduction of unethical and unsustainable practices (Gray 2002; Dey 2007). Stakeholder engagement practices generally require the development of a two-way interaction between instruments based on the organization and its stakeholders (Thompson and Bebbington 2005; Bebbington 1997, Bebbington et al. 2007), adapted to receive information to guide the management of and to create value for the organization itself and society. Moreover, the preparation of the social report, especially for organizations of a

public nature, requires more interaction with stakeholders who, directly or indirectly, interact with the organization. In fact, the social report embraces the totality of relations with stakeholders, providing information that is more understandable than that found in the compulsory financial statements. Indeed, it must control compliance with the financial budgets and, at the same time, provide a detailed account of the social/institutional purpose. In this sense, social reporting represents an opportunity for the practical implementation of the principles of responsibility and accountability promoted by recent reforms in management of the public system, with particular reference to the involvement of external stakeholders in the planning and evaluation of public interventions; ultimately, it serves to support governance systems that control not only the effectiveness and efficiency of internal processes, but also social efficiency. In fact, those who manage resources from public sources try to fulfil the duties entrusted to them by the economic entity (the Region in the specific context) and under the contract that it has with the health care business entity, expressed in terms of guaranteeing health protection services for citizens. Through social reporting, the public "manager" follows a dialoguing process to communicate the impacts of the actions of the organization in order to receive remarks and comments in return. In addition, as cited in the introduction, hospital units are required by law to monitor and pursue the targets imposed by specific measures (referred to a specific period). These measures are of a qualitative and quantitative nature, but are not expressed in economic-financial terms. In this sense, social reporting helps to fill this gap by helping hospital units to meet the legal requirement.

The practice of social reporting for external communication to a plurality of stakeholders is not a new aspect in the entire process of accountability for public institutions. Several studies (Chua and Preston 1994; Peursem 1999; Gigli and Tieghi 2012; Kastberg and Siverbo 2013; Ursillo 2012; Kuntner and Schallmeiner 2013) have touched on this theme, emphasising the motivations related to accounting and accountability tools in the public health sector (in several European countries, including Italy) or supplying a contribution for the determination of economic indicators for external communication. However, for the specific context of hospital units, there is a gap in the literature as regards defining the implementation process of accountability tools and illustrating the qualitative–quantitative information that a social report must include. Although some international and national organisms (composed of practitioners, researchers, experts, managers) have, in the last twenty years, developed and presented specific guidelines or standards to address the case of public organizations in the social reporting process, none of these standards is focused on the reality of hospital units. There are no current frameworks that consider the peculiarities (according to the Italian regulation) of these health care units.

A brief overview of the standard contents can help to verify the cited gap.

The conceptual framework proposed by Lamberton (2005) suggests the main accountability phases to be followed and it defines the process characteristics and values. According to this logic, after having established the objectives of the report and determined its internal and external validity, the organization must define its

own sustainability concept and the aim of the reporting process. Subsequently, the nature of the performance indicators, as well as the dimension of the analysis, should be delineated. The attributes which guide the process are transparency, completeness, accuracy, auditability, relevance of the information, comparability, clarity, neutrality, and inclusiveness of all stakeholders. Before this framework was proposed, the path was opened by a group of researchers who defined the accountability process presented in the Copenhagen Charter (ISEA 1999a) and articulated in the seven phases:

– Phase one: Definition of scope and resources
– Phase two: Accountability areas and themes
– Phase three: Stakeholder mapping and definition of stakeholder engagement practices
– Phase four: Definition of performance indicator system and monitoring of the results
– Phase five: Definition of improvement target and evaluation of future actions
– Phase six: Writing and publication of the social report
– Phase seven: Consultation with stakeholders.

Stakeholder engagement and the involvement of the top manager in the implementation process represent the key factors of the Copenhagen Charter. Also, this last contribution can be applied to a range of several organizations. The focus on stakeholder engagement is the principal theme of the AccountAbility1000 (international organism), which developed a list of general principals to consider in the dialogue activities (ISEA 1999b) and other operative standards regarding the tools and mechanisms to adopt (i.e. AccountAbility 2005). If the attention is focused on the indicator system, the GRI guidelines can help the health manager and the researcher in the process of building the economic, environmental, and social indicators. However, in this case, too, there are no references to the hospital unit.

In the national scenario, a group of experts (known as the GBS—*Gruppo di Bilancio Sociale* or "Social Report Group") produced a document which illustrates an outline for a social report that can be applied to health units. This is useful on two fronts. Firstly, the framework facilitates the writing process of the social report as it presents the different paragraphs and chapters into which the report should be articulated. Secondly, the GBS Standard illustrates (with specific explanations) the reclassification schemes to use into the economic section. Nevertheless, while this document could be the main guide for writing the social report for a health unit, it does not present a clear view of the process which precedes the writing and it does not contain a list of possible social and environmental indicators that could be applicable in the external accountability process of an hospital unit. At the same time, as recognized by Boesso (2009), "the extant research provides little insight into how managers actually go about according priority to a diverse range of multiple stakeholder groups and reaching and engaging them about their respective concerns and contributions" (p. 163). Following this brief overview, the next

paragraphs offer a description of the reporting process and of the social report, as well as a presentation of the operative steps, the barriers, and the discussion meetings. In order to achieve the objective of designing a specific accountability model applicable to hospital units, the development of the current study starts from the explanation of the process (with the evidence from the case study) and it ends with a proposal of a social report model. The entire empirical research considers the cited studies and standards.

14.4 The Reporting Process: An Empirical Development

From the collaboration between researchers and practitioners, the constructive approach has allowed the authors to develop a social reporting model suitable for describing the complexity of the health care network and to account for the way in which resources are used to multiple stakeholders. In order to highlight the health units' peculiarity and to present an empirical research study of the reporting process addressed to the stakeholder expectations, the development of the first "Social Report of the AOUOORR" is presented in this paragraph. The case study constitutes the empirical basis for demonstrating how to prepare such a document, one able to link the regulatory requirements, the legitimacy owed to citizens, management control, and transparent behaviours. The information on objectives and results is presented through qualitative and quantitative indicators but only with reference to those activities carried out by AOUOORR. Moreover, to outline a systematic framework and to analyze the process of care services provided over a period of three years (2011–2013), the reporting scheme proposed follows the activities logic based on the basic levels of care (as ratified by Ministerial decree of 29 November 2001 and subsequent amendments and additions).

The entity that is the object of the case study is the AOUOORR, as mentioned above. It represents the legal form of hospital health unit. The AOUOORR operates within the Regional Health System in collaboration with three other organizations dedicated to health care assistance (two local health units and one other hospital health unit). It is also integrated with the Faculty of Medicine of the Polytechnic University of Marche in order to guarantee the development and the improvement of research and teaching activities, and the training of future professionals. Its user base—with patients who come from the entire territorial area of the Marche Region—characterizes this organizational unit as a Regional Hospital. The services provided are inpatient treatments (ordinary and day hospital care), outpatient services and include medical, surgical, and emergency services. The AOUOORR also coordinates with the territory to ensure continuity of care through relationships with the local health care units which take charge of patients after their condition is stabilized and they return home or with other institutions to provide different levels of care.

The case study constitutes the empirical basis for demonstrating how to prepare such a document, one able to link the regulatory requirements, the legitimacy owed

to citizens, management control, and transparent behaviours. The information on objectives and results is presented through qualitative and quantitative indicators but only with reference to those activities carried out by AOUOORR. Moreover, to outline a systematic framework and to analyze the process of care services provided over a period of three years (2011–2013), the reporting scheme proposed follows the activities logic based on the basic levels of care (as ratified by Ministerial decree of 29 November 2001 and subsequent amendments and additions).

Phase one: Definition of scope and resources

The accountability process started with the Director General's decision to draw up the social report in order to create a tool able to account for programs and activities to all citizens and stakeholders and to motivate the decision taken by the regional (and national) authorities. A team was created, composed of the AOUOORR management staff (Director General, Health Director, Administrative Director and Head of the management control and accounting function) and of the Professors and Researchers from the Department of Management of the Polytechnic University of the Marche (*Università Politecnica delle Marche*). Moreover, prior to drawing up the report itself, the human, technical, economic, and financial resources necessary for the entire process had to be determined.

Phase two: Accountability areas and themes

The definition of the accountability areas represents the real starting point of the process: the accountability area—corresponding to basic health care levels are defined following the scheme proposed by Ministerial decree 29 November 2001 (and subsequent modifications and additions). In general terms, the above-mentioned laws define and categorize the basic levels of care in three macro classes:

1. collective health care in the living and working environments, including all prevention activities addressed to the community and to the individual (protection from the effects of pollution, risks of accidents in the workplace, veterinary health, food protection, prevention of infectious diseases, immunization, and detection programs);
2. district health care, namely the activities and health and social services disseminated throughout the territory, pharmaceuticals, diagnostic services, and outpatient specialists, supply of prostheses for the disabled, home care for the elderly, local services (family counselling, mental health services, rehabilitation services for the disabled, etc.), semi-residential, and residential facilities (homes for the elderly and disabled, day care centres, group homes and therapeutic communities);
3. hospital health care, emergency care, hospitalization, day hospital and day surgery, long-term facilities for rehabilitation, and so on.

Considering the specific services provided by the hospital health unit AOUOORR, the team weighed the option of limiting the social reporting project to just the level

effectively disbursed, i.e. district assistance and hospital health care. The first comprises territorial health emergency care, pharmaceutical care (directly provided), and specialist care (clinical, laboratory, imaging, and instrumental diagnostics); the second includes first aid activities, hospital health care for acute cases (Day Hospital and Day Surgery, for inpatient care), hospital health care for rehabilitation, blood components and blood transfusion services, and organ and tissue transplants. In particular, the operations included in the first macro class (collective health care in the living and working environments) are not provided by AOUOORR, and they are excluded from the report because the AOUOORR is a hospital unit and presents the peculiarities described in sub-paragraph 2.1. Moreover, as mentioned in the introduction, the AOUOORR is also a teaching hospital group. For this reason, research activities (experimentation and participation in national and international research programs) were also considered and promoted in collaboration with the Università Politecnica delle Marche. In order to include all health activities and to give transparent and complete information to stakeholders, the team decided to also include in its accounting the private activities that medical personnel and other professionals practice, in compliance with the restrictions imposed by the current laws (e.g. limitations in terms of number of hours of total work time or typologies of diseases to treat). Finally, some additional services provided to patients, to ensure the humanization of their care and safety, were also included.

Phase three: Stakeholder mapping and definition of stakeholder engagement practices

Once the activities were defined, the next phase was the identification of the stakeholders. This sub-process was carried out in keeping with the AccountAbility AA1000 (ISEA 1999b) standard, based on the principles of inclusivity, materiality, and relevance, which underlie the interaction between the organization and its stakeholders. The AA1000 guidelines require the organization's commitment to involve stakeholders at all stages of the reporting process and, in general, to increase their participation in the decision-making process. The AA1000 framework was followed also for the definition and implementation of the stakeholder engagement activities. In fact, stakeholder engagement is analyzed in the AA1000 Stakeholder Engagement Standard (AccountAbility 2005), which describes the process of involving the various stakeholders as a process directed towards "*the identification and the understanding stakeholders' needs, expectations, challenges, and opportunities; the alignment of strategies and activities with the needs of sustainability development; the measurement and reporting of performance, and the implementation of performance indicators that might enable stakeholders to assess organization activities*". Then, after the stakeholders were mapped, the next step was to define tools to learn about their expectations and needs and, in addition, to foster an open and participatory dialogue aimed at improving the management approach and developing new strategies (Unerman 2000). The AOUOORR finds its legitimacy in the consensus and satisfaction of the expectations of its patients and

Fig. 14.1 AOUOORR stakeholder map

also in the feedback provided by the human resources who work in the facilities, the suppliers of goods and services, the volunteers who dedicate their time to helping patients, the health authorities (with tasks described in the previous paragraph), and the other health units in the regional and national contexts. After mapping the stakeholders, the team represented the framework of the relationship between the stakeholders and the AOUOORR (as seen in Fig. 14.1). In it, the nature of the relationship was illustrated with the explicit description of the links and responsibilities in order to highlight the level of influence of each stakeholder in the organization's activities.

Furthermore, the specific stakeholders with whom to start a process of engagement and on-going dialogue were identified in order to obtain useful information to understand their concerns and improve future activities. The tools used in stakeholder engagement in 2013 consisted of interviews, questionnaires, and voluntary unstructured documents (as presented in the following tables). First, Table 14.3 presents extracts of interviews with the Dean of the Faculty of Medicine and Surgery, the District Councillor, the President and the Chief Operating Officer of two foundations, in which they gave positive feedback on the topics analyzed. The dialogue was conducted by e-mail using a semi-structured format, that is, open-ended questions. The extracts, below, are an example of the interview results for these stakeholders (University, Marche Region and the two foundations).

In Table 14.4, the dialogue conducted through questionnaires to representatives of voluntary associations, suppliers of goods and services, and of human resources is schematized by category of stakeholder. The answers concerning the analyzed topics range from strongly agree, slightly agree, slightly disagree to strongly disagree. The questions were administered by structural e-mail, that is, with multiple choice answers. The percentage of the responses is distributed as follows: 30.3% of

Table 14.3 Stakeholder engagement activities—Interviewed subjects and analyzed topics

Stakeholder	Analyzed topics and interview results (quoted extracts in italics)
Università Politecnica Delle Marche *Interview with the Dean of the Faculty of Medicine and Surgery*	In the fields of health services, research and teaching, on the strengths and the weaknesses of the projects, and the initiatives carried out in collaboration with the entity. Indication of the growth opportunities. *"(..)development of projects and the results (..) based on the exchange of experiences and professionalism, as an integrated system required. (..)the doors opened to internationalization, with all the benefits that it entails. (..) investment in technological innovation such as the introduction of robotic surgery, the reorganization of the ethics committee and the preservation of the unique regional expertise and the excellence already present in our Organization. (..) participation of colleagues in degree courses and the introduction of vocational training activities for the degree course in Medicine."* On the management criticalities as a member of the corporate governance in the analyzed year. Improvements to be proposed to facilitate the effective and efficient management of resources and the pursuit of institutional purposes. *"(..) In general, the digital implementation of clinical activity could represent a way to improve the efficiency and performance of administrative governance. (..) on the path already taken in terms of identification of coded clinical pathways. It is important that the patient feels s/he is at the center of the organization and not the opposite; upgraded outpatient service not only provides the patient a kind of modern and efficient care, but it allows the clinician to improve the effectiveness of care. (..) appropriate to invest in similar pathways for hospitalized patients: you must test preferential pathways for disease, ensuring access to diagnostics and therapy in a way that is as streamlined as possible. (..) encouraging the formation of multi-disciplinary teams (..)"*

(continued)

Table 14.3 (continued)

Stakeholder	Analyzed topics and interview results (quoted extracts in italics)
Marche Region *Interview with the District Councillor*	On the adequacy of the role assigned by the Region in health and economic planning for the analyzed year. *"(..) the respect for health and economic plans requires the combined efforts of healthcare organizations. In this framework, the company has been shown to contribute successfully to the achievement of the social and institutional goals, while staying within the economic constraints and ensuring the pursuit of high levels of clinical effectiveness and appropriateness. Measures with high organizational impact - implemented by the company—have also contributed to the start of the reorganization of the regional clinical networks"*
Foundations *Interview with President of one foundation and Chief Operating Officer of another foundation*	The strengths and the weaknesses inherent to managing the relationship with the entity *"Strengths: the company's employees have demonstrated collaboration and participation has and have been able to welcome the various initiatives and make them their own; the motivation of those who work and support the foundation; availability to monitor the projects together with the Foundation with periodic meetings and with annual reports. Points of weakness: the scarce resources available that limit the possibility of extending all of the company's proposed initiatives; the lack of communication in the company; the space is not always appropriate for the realization of the projects"*

Source AOUOORR 2013 Social Report—available only in Italian (www.ospedaliriuniti.marche.it)

the associations contacted, 21.4% of the suppliers contacted, and 45% of the human resources contacted. Once the data was analyzed, the findings were included in the social report, using tables and graphs

Lastly, Table 14.5 reports the dialogue with patients (and relatives) who provided positive and negative comments about different topics. In this case, the dialogue was conducted through voluntary unstructured documents, either in chapter copy or sent by e-mail. The number of communications is divided into the following categories: 133 negative comments (complaints), 78 suggestions, and 15 positive comments (praise). The most significant parts of these comments were selected and transcribed in the social report

Table 14.4 Stakeholder engagement activities—Questionnaire recipients and analyzed topics

Stakeholder	Analyzed topics and main results for each topic (in italics)
voluntary associations	The availability of personnel working to provide information *strongly agree 20%; slightly agree 50%; slightly disagree 30%; strongly disagree 0%* Adequacy of services provided (as catering, cleaning, etc.) to meet the needs of patients *strongly agree 10%; slightly agree 40%; slightly disagree 40%; strongly disagree 10%* Suitability of the premises, spaces and signage made available for promotional activities for the needs of the association *strongly agree 10%; slightly agree 40%; slightly disagree 30%; strongly disagree 20%* Suitability of support given to emerging issues and for applications submitted to the association *strongly agree 20%; slightly agree 30%; slightly disagree 20%; strongly disagree 30%*
suppliers of goods and services	Specification of the facility with which a supplier comes into contact *28% with operative units* Knowledge about the organization of the entity and about its activities *yes, I have a good understanding 47%; yes, I have a fairly good knowledge 33%; I heard about it but I do not know them well 20%* Ease of understanding of the instructions and specifications contained in the tender documentation *strongly agree 13%; slightly agree 80%; slightly disagree 0%; strongly disagree 7%* Reasonableness of response times for the procedure *strongly agree 20%; slightly agree 67%; slightly disagree 0%; strongly disagree 13%* Approval of requests and clarifications in case of contact by the contracting Authority *strongly agree 40%; slightly agree 53%; slightly disagree 0%; strongly disagree 7%* Terms, payment methods, and logistics *strongly agree and slightly agree more than 73% in different aspects; slightly disagree and strongly disagree less than 27%* Assessment of the adequacy of the work performed by staff *strongly agree and slightly agree more than 80% in different aspects; slightly disagree and strongly disagree less than 20%* Sharing of product innovation and process between the entity and suppliers *strongly agree 20%; slightly agree 53%; slightly disagree 20%; strongly disagree 7%* Effective communication and transparency of the entity *strongly agree and slightly agree more than 60% in different aspects; slightly disagree and strongly disagree less than 40%*

(continued)

Table 14.4 (continued)

Stakeholder	Analyzed topics and main results for each topic (in italics)
human resources	Cooperation and kindness of colleagues *strongly agree 17%; slightly agree 61%; slightly disagree 21%; strongly disagree 1%* Attention to the needs of all the departments with which the entity relates *strongly agree 4%; slightly agree 50%; slightly disagree 38%; strongly disagree 8%* Incentives for collaboration between business units within the company *strongly agree 6%; slightly agree 51%; slightly disagree 42%; strongly disagree 1%* Assessment of preparedness, competence, and availability of the administrative and health staff *strongly agree and slightly agree more than 86% in different aspects; slightly disagree and strongly disagree less than 14%* Transparency of the activities performed by the entity *strongly agree 17%; slightly agree 57%; slightly disagree 24%; strongly disagree 2%* Adequacy of training and learning received by the entity up to now *strongly agree 13%; slightly agree 59%; slightly disagree 23%; strongly disagree 5%* Good planning of the objectives entrusted to the direction of the entity *strongly agree 7%; slightly agree 55%; slightly disagree 30%; strongly disagree 8%* Effectiveness and efficiency of its activities *strongly agree 8%; slightly agree 65%; slightly disagree 25%; strongly disagree 25%*

Source AOUOORR 2013 Social Report—available only in Italian (www.ospedaliriuniti.marche.it)

Table 14.5 Stakeholder engagement activities—Subjects and principal topics related to patients

Stakeholder	Principal topics and results (quoted extracts in italics)
Patients (and relatives)	The information regarding complaints was divided into distinct categories: relational, humanization, information, waiting time, hotel, logistics, bureaucratic/administrative, professional. *The main reasons are related to the most critical: technical and professional expertise, organizational aspects, and food service* Extracts of received praise – *"I wanted to express my deepest appreciation and all my gratitude and esteem for an example of good health care… where I found highly qualified personnel and 360° health service (..) Despite the few resources available, today all the cuts imposed by the crisis, these people with their professionalism and dedication make the difference (..)"* – *"Collaborators have always performed their duties with mastery, professionalism, keen sense of duty, kindness, and humanity."*

Source AOUOORR 2013 Social Report—available only in Italian (www.ospedaliriuniti.marche.it)

Phase four: Definition of the performance indicator system and monitoring of the results

Another important phase is the system definition of economic and social indicators to represent objectives, to measure the results of actions undertaken, and to guide future management. Indicators of efficiency, effectiveness, input, and output have to be collected and determined, according to the accountability area to which they belong. In other words, for each area, a performance system has to be created in order to account the objectives, the actions, the technical resources used, the results, and also, the spent economic value. In fact, compared to the strategic objectives related to the different activities, these performance indicators allow management to review future choices. The building model has to provide qualitative and quantitative information on the organization's performance in carrying out different activities in addition to financial information. The parameters must be chosen considering the available data (and then extended, if needed), but also in relation to the planned targets and whether or not they are in line with the mission. In this phase, management needs to develop an assessment method. Operatively, to understand the nature of such activities, interviews with various department heads should be carried out. This approach could push the limits of "subjectivity", but it is inherent in the nature of social and environmental accounting (O'Dwyer 2005a, b), because it includes data analysis based on stakeholder engagement, participatory decisions on policies, on ethical values commonly accepted by decision-makers and on empirical analysis of the phenomena (Gray 2010). In order to build a systemic report, the team defined social indicators for each area. The environmental impact was reported only in terms of ecological impact. An example of the indicators related to the activities is outlined in Table 14.6, below.

Table 14.6 Example of social performance indicators

Accountability area	Topics	Indicators (numeric examples are reported in the Table 13)
Hospital health services	Emergency	– number of flight hours of the helicopter rescue service – typologies of territorial emergency services, discharged by ambulance or helicopter
Hospital health services	Hospitalization, day hospital, day surgery	– number of admissions – number of accesses to day hospital service – number and type of organ transplants – number of patients divided by gender, age, and country of origin (for each type of hospitalization)
Environmental impact	Policies implemented	– amount of hazardous medical waste and disposal methods – consumption of electricity (kwh) – consumption of natural gas (m^3)

Source AOUOORR 2013 Social Report—available only in Italian (www.ospedaliriuniti.marche.it)

Phase five: Definition of improvement target and evaluation of future actions

The results of the dialogue with stakeholders, the analyzed variables and subsequent indicators, calculated starting from the available information systems (derived from data, information, and knowledge within the organization) was discussed with the heath managers (Director General and staff). The various meetings and discussions generated reflections on the use of resources, the activities, the results (compared with the objectives). This process allowed performance to be monitored and it fostered a reflection on the strategies, actions, and objectives that could be addressed by management so there could be improvement. In addition, the reflection also focused on the appropriate means to involve stakeholders and to increase their satisfaction.

From these moments, there ensued improvement objectives for the future, explained in a specific section of the social report.

Phase six: Writing and publication of the social report

In this phase, financial and non-financial information was presented in a formal document. According to the scheme proposed by the Italian research team Social Report Group, the social report document should be divided into sections or areas to be addressed: identity, social, environmental, economic, and improvement objectives. To understand the main content of each section, a brief description is given for each area, with some relevant parts translated from the original Italian version.

This is preceded by the preface—*Methodology and reading guide*—summarized in the following table along with some extracts from the social report provided as an example to follow (Table 14.7).

The first section, *Identity*, describes different elements such as the economic and social scenario, the organizational structure, its culture and values, and its mission. Moreover, this section discloses the stakeholder map as well as strategies, objectives, and policies. The following table provides a more detailed description of these items and includes some extracts of the social report of the empirical case in question (Table 14.8).

Table 14.7 Methodology and reading guide—principal content and examples (quoted extracts in italics)

The presentation of the scope of the document
"To account to all categories of stakeholders (citizens, users, human resources, suppliers, etc.*) the choices made based on the healthcare needs of the community and the objectives arising from the regional health planning, of the activities and services rendered, giving account of the allocated resources to their final use"* (www.ospedaliriuniti.marche.it)
The standards followed for each phase
"The use of standard AA1000 (ISEA 1999*b) with the explanation of the stages of the process (planning the whole process of ethical-social reporting—information collection—verification and communication of final document on the achieved performance)"* (www.ospedaliriuniti.marche.it)
The structure of the document
"The document is divided into five sections as explained in the following part" (www.ospedaliriuniti.marche.it)

Table 14.8 Identity—principal content and examples (quoted extracts in italics)

The economic and social scenario, in which the organization operates, giving information on historical evolution, characteristics of the territory (topography, demographic characteristics, social and productive context), health-related activity (minimum levels of health care and specialties), and any constraints (explicit or implicit), such as rules or medical standards, which bind the strategies
The description of the system of governance and the composition of the governing bodies, with regard to the nature of the mandate, the experiences and the emoluments
The mission This consists of the main goals that the health organization pursues (related to minimum levels of health care and specialties) *"Mission: To achieve the highest level of response to the demand for healthcare in a process that includes both training and research. To achieve this goal, the Health Service and the Faculty of Medicine and Surgery contribute their scientific and clinical knowledge"* (www.ospedaliriuniti.marche.it).
The values and principles arising from laws, regulations and statutes, and the ethics code. The formal criteria to ensure the intelligibility of the values are compliance, stability, capability to generalize, impartiality, universalizability *"Vision: To orient strategies and actions to the full integration in the Health Service of the Marche Region, in the consolidated role of "regional reference Organization", linchpin of the regional health support network for the level of appropriate complexity, pole of attraction also for nearby Regions"* (www.ospedaliriuniti.marche.it)
The strategies, objectives and policies The articulation of the mission in strategies, objectives, policies, plans, and operational programs is carried out in line with the national and the regional health plans, taking into account the specific needs of the context. Areas of overlap and difficulties (exogenous and endogenous) encountered in the implementation of the objectives (and their degree of dependence on inter-institutional relations) or situations of uncertainty are also identified. *"Strategic objectives: Quality of healthcare services to guarantee the supply of the basic level of care; Cost optimization of the services provided in order to stay within public finance constraints; Public administration transparency to citizens"* (www.ospedaliriuniti.marche.it)
The stakeholder map The identification of the key stakeholders and the description of the relationship between each stakeholder group and the health organization *The key stakeholders represented are: human resources (employees), patients, suppliers of goods and services, not-for-profit organizations (volunteers, protection associations, service support, benefactors), universities and research institutes* (www.ospedaliriuniti.marche.it)
The description of the human resources working for the organization, with the results of staff involvement. *"In 2013, human resources—employees of the National Health System and the Università Politecnica delle Marche—totalled 3597 units"* (www.ospedaliriuniti.marche.it)

Once the organization's identity has been described, the *social section follows*. In this part, the qualitative and quantitative results of the activities undertaken in relation to the commitments and programs are described, considering the effects on the different categories of stakeholders for each identified reporting area (Table 14.9).

Table 14.9 Social section—principal content and examples

A quantitative/qualitative description of the results achieved in the different areas of intervention, in this case the different levels of health care and specialties, is provided in consideration of the expectations of the different categories of stakeholders and the objectives identified in the programming.
The Essential Level of Health Care encompasses: *• District health care:* *– territorial health emergency (emergency ambulance service and helicopter rescue: 865 service calls)* *– pharmaceutical care (11,061 patients)* *– specialist services (928,696 laboratory tests-microbiology/virology/pathology/genetics/immunohematology; 122,517 performance imaging; 539,444 specialist treatments in outpatient clinic, of which 83,566 accesses to first aid services which did not result in hospitalization)* *• Hospital care* *– first aid activities (10,735 patients)* *– hospital care for acute cases (34,116 inpatient admissions; 31,390 Day hospital and Day surgery)* *– hospital care for rehabilitation (1106 accesses)* *– blood components and transfusion services (123,124 services)* *– organ and tissue transplants (73 transplants and 47 organ harvesting)* *• Research (over 200 studies per year)* *• Activities by health care professionals* *• Personal services (humanization and safety of care)* *(*www.ospedaliriuniti.marche.it*)*

The social data as well as the narrative and quantitative information should be made public in order to enable the various categories of stakeholders to assess:

– the planned objectives, the expected results, and the achieved results,
– the impacts generated on the health (of the community and of the territory), and, in general, all the economic, social, and environmental impacts of the various activities,
– the reliability and the relevance of the information provided,
– the consistency of selection criteria and the representation of results and the degree of stakeholder participation.

The main sources of information are:

– national and regional health action programming documents;
– general plan, multiyear budget forecasting, management report;
– strategic control documents;
– continuous improvement documents (quality report, service charters);
– qualitative description, quantitative reports.

When reporting the resources used and the results achieved, each health care organization should have a system of indicators in place, which should comply with the following principles: consistency with and relevance to the purposes of social

reporting, coherence and relevance to the mission, completeness and reliability of the data, comparability of results over time, and verifiability of results by stakeholders.

The organization should complete the explanation of the reported data and information with comments, assessments, and evaluations.

In addition, for each area, the following items should be specified:

- the perception of the results and the opinion expressed by the various stakeholder groups, comparing the quality supplied/perceived;
- the stakeholder group involved in the evaluation process,
- any sampling criteria, selection parameters, and modality of contact used (related to the identification of the stakeholder engagement practices),
- the evaluation process of the results derived from stakeholder engagement practices as well as any suggestions for improvement received by the stakeholder group involved.

The section dealing with the *environmental impact* gives a qualitative and quantitative description of the activities that have an ecological impact on the natural landscape and the environment. For example, in this part, the following data is reported: *waste disposal policies (reduction of 4% from 2011 to 2013 for disposal of hazardous waste) and energy saving policies (reduction of 8% for electricity and water than the previous year's results*-www.ospedaliriuniti.marche.it*).*

After the explanation of the environmental impact, the next section is about the *economic component* of public health management; it concerns the economics of the operation results obtained in the different management areas. This section outlines what financial resources are used, invested, and distributed by the entity, specifying the intervention areas (levels of health care or specialties) for the analyzed year.

The economic balance between the positive and negative components should be demonstrated, as well as the ability of regional funds and of other revenues *(Production value: 370,900,832.98 euros*—www.ospedaliriuniti.marche.it) to cover the costs related to the various levels of care, the activities, and the services provided (*Production costs: 360,240,911.86 euros*—www.ospedaliriuniti.marche.it).

The fifth and final section defines the *target objectives* (*Implementation, expansion, improvement, facilitation, consolidation, and compliance*—www.ospedaliriuniti.marche.it). These can be both quantitative and qualitative and are classified in areas. The targets for improvement are defined and set as an outcome of the management control system, the stakeholder engagement practices (connected to the previous results and to the opinions expressed), and according to the economic, social, and environmental objectives for the next fiscal year.

The document was also accompanied by *a questionnaire* in which the readers could evaluate the clarity and transparency of the information. The first edition (2013) of the social report document was published in August of 2014. The document gained recognition by an Italian not-for-profit organization, as demonstrated by the following award (Fig. 14.2).

English Translation:
Oscar winner in 2014
The documentation referring to the 2013 annual report is comprehensive and it follows the instructions of Legislative Decree 118/2011. The information is presented clearly and analytically.
The social report is drawn up clearly and it presents a remarkable graphics quality.
An excellent tool for corporate communication, it presents extracts designed for the various categories of stakeholders.
The resummarized form.
Overall, the organization is distinguished by a high level of documentation that is outstanding for completeness, clarity, and innovation of content presentation.
references to the financial statements are included

Fig. 14.2 Social report oscar—2013

Phase seven: Consultation with stakeholders

The result of the implemented process must be transmitted to the stakeholders, in order to demonstrate the health unit's socially responsible behaviours to the community and to gain legitimacy and consensus. This allows stakeholders to be involved and follow conscious behaviour in the corporate governance of the hospital and of the Health System.

In general, making information accessible to stakeholders is possible using different formats, such as web forums, conferences, meetings, flyers, press releases, or the Internet (Patten 2002; Unerman and Bennet 2004; Adams and Frost 2006; Gallhofer and Haslam 2006; Sikka 2006). Moreover, the AA1000SES (AccountAbility 2005) standard also recommends the use of online mechanisms, focus groups, public meetings, surveys, or multistakeholder forums.

The AOUOORR decided to present the document by organizing a public press conference and publishing the report on its website (downloadable by anyone). During the conference, a debate was initiated among some key stakeholders (human resources working in the hospital, heads of the political institutions and of the regional health authorities, representatives of not-for-profit organization). The dialogue revealed a general appreciation of the main contents of the first edition of the social report. There also emerged constructive comments and suggestions related to:

- the gap in information about some specific activities,
- the graphic representation of some data (related to results),
- the need to increase stakeholder engagement practices, involving more people or other stakeholder groups.

Others suggestions similar to those above were also received by e-mail during the months following the presentation of the report. The feedback received was helpful for compiling the 2014 social report (written a year later).

14.5 Social Reporting: A Stakeholder Engagement Tool and a Guide for the Patient?

The description of the accountability process offers the opportunity to understand how to build a social report aimed at increasing transparency towards both health authorities and private citizens (who are also tax-payers) and to reflect on the achievement of effectiveness and efficacy by the health system, without forgetting its institutional aim.

To develop an educational process and to improve transparency, as recognized by the literature, in fact, stakeholders must be involved in the accountability process in a variety of different ways. An organization can create complete engagement by identifying what issues are important to report on, reporting how well the company has performed on specific issues, and deciding how to communicate this performance (Thomson and Bebbington 2005). To carry out these activities, in the AOUOORR social reporting process only selected human resources, representative subjects of health authorities, and the research team were engaged in the process of content definition. This was done in order to keep the discussion of the practicalities of the process from becoming largely superfluous (Owen et al. 2001). Consequently, the process was quickly and efficiently implemented, but only the engaged subjects could participate in the presentation, manifest their personal opinion on what improvements to make, and reflect on the specific activities. For the other stakeholders, instead, there was a total absence of interaction and participation.

In some cases, promoting a participatory and educational process means allowing selected "stakeholder voices" to form part of the report (Unerman and Bennett 2004): see, for example, the attempt by the AOUOORR to engage some stakeholders (e.g. Presidents of Foundations, Dean of the Faculty of Medicine and Surgery, District Councillor) through interviews (totally disclosed in the report).

In others cases, the organization can adopt a structured approach, founded on the use of mechanisms such as questionnaires (see the empirical case illustrated in Table 14.4), focus groups, open forums/workshops, meetings, in-house newspapers, interviews, briefing sessions, Internet "web forums" (Unerman and Bennett 2004), and working meetings (or summits) (Powley et al. 2004).

The existing literature highlights that these tools have the potential to involve stakeholders in an active corporate governance role (Harrison and Freeman 2004; Low and Cowton 2004; Powley et al. 2004); the stakeholders can hold organizations to account for decisions impacting on their welfare. Thus, a successful stakeholder democracy can be developed (O'Dwyer 2005a, b) taking into account the need to supply stakeholders with post-engagement feedback. In a specific sense, the last objective is achieved during the social reporting process of the AOUOORR. On the one hand, the results of questionnaires assisted the organization in defining the improvements to target (see Tables 14.3, 14.4, and 14.5). On the other hand, the absence of participation by the "other" stakeholders (that were not part of the human resources, research team, and selected voices, as mentioned above) helped the health management group to better reflect on how to achieve full interaction

with stakeholders and to identify the gaps in the accountability process. Several meetings were held on the accounted issues (reported in the 2013 edition) as well as on a re-design of the information system, an expanded stakeholder group to involve, linked to a revamping of the structure of the social report. These are the first improvements to preview in the second edition, currently in progress. In this sense, the accounting tools could represent a process of education that can encourage critical reflection on the accounting technologies themselves as well as the impacts of their application on citizens and all other stakeholders (Thomson and Bebbington 2005).

During the implemented phases, the team also saw the potential of reporting to inform patients (and citizens, in general) about the health activities of an organization, thereby increasing its legitimacy, knowledge about it, and consequently, promoting aware choices, at the same time.

The fruit of the social reporting process—a published tool available to everyone—can generate awareness and knowledge about how the system works, understanding its criticalities and difficulties. The additional "informative power" gained could give a single health care organization a competitive advantage over others. In fact, informed citizens are, firstly, able to better evaluate the organization activities and to orient their spending opportunities and also their time (e.g. dedicating time to voluntary services inside the organization where necessary); secondly, thanks to stakeholder engagement activities, they could help the organizations to implement actions with positive impacts on the health system; thirdly, as informed patients, they will choose the organization which demonstrates transparent, efficient, and effective management. The consequence could be an increase in private and public incomes, considering the financing process (described in the first part of the paragraph) of the IHS and the contextual ability to achieve the institutional aims. Here, it is possible to recognize the pillar of the stakeholder theory proposed by Freeman (1984): a company creates value when it can achieve the purposes of an economic entity and also the economic (or not) expectations of all other stakeholders.

14.6 Conclusions and Further Research Horizons

For each activity conducted by the health care organization (mainly related to the essential health care levels), the chapter illustrates, through the empirical case study, the possible indicators and the narrative descriptions considered relevant by health care managers after consultation with key stakeholders (both formally, during the stakeholder engagement process, and informally, during meetings and the data collection phase).

The framework could serve as a guide for a hospital unit which operates in the IHS. The logic of the reporting process, as well as the typology of information and the different variables to consider, could be replicated in other similar organizations; the peculiarities of each unit should be taken into account during the information

system definition phase and, subsequently, during the determination of the social and economic indicators.

The research project demonstrated the importance of adopting multidimensional communication tools, comprehensive of quantitative and qualitative information able to allow an evaluation process by the key stakeholders. In particular, the document legitimizes the consumption of resources (financial, technical, and human) by explaining the link between the planned objectives, the expected results, and the achieved results (per area). In addition, the presentation of stakeholders' perceptions (derived from stakeholder engagement practices) enriches the report.

Monitoring the social results, categorized by area (connected to the key stakeholders, health and economic objectives, plans), as well as gathering feedback on stakeholder expectations, allowed AOUORR managers to reflect on their strategies, policies, and daily behaviours, thus helping them to define the management improvements that needed to be brought about.

Furthermore, the multidimensional report has the potential to develop an educational path directed at each citizen, which would provide knowledge tools to legitimize the health unit's activities and, consequently, to allow the individual to make an informed choice. In this logic, social reporting is viewed as an assessment model for health care agencies' social responsibility, and, as stated by Thomson and Bebbington (2005), the accounting tools could represent an educational process that can encourage critical reflection on the accounting technologies themselves, as well as on the impacts of their application on citizens and all other stakeholders.

The research project also shows that external stakeholders (patients, citizens, associations) can be educated on the use of the health unit services, while internal stakeholders (human resources) are able to assess the rational use of resources as well as economic and social efficacy and efficiency. At the same time, for the public (regional) authorities, the integration of social variables in the accountability process helps to improve the management of the activity and it assists the decision-making process during the institutional planning phase: the quantitative and qualitative information (related to health issues) are linked to economic data, imposed by compulsory accountability. Monetary information is integrated with narrative disclosure, statistical summaries, and social indicators (Gray et al. 1987) able to describe the physical impacts of the economic, social, and environmental activities supplied by the health units.

Above all, in the health sector, this integrated accountability system can allow the health care organizations to inform stakeholders of the organization's performance and to manage the public's impression of organizational performance (Neu et al. 1998). At the same time, this process helps organizations gain legitimacy and relevance (Shocker and Sethi 1973), consensus, protection, and recognition regarding the resources entrusted to them (Gray and Guthrie 2007). In fact, along with national compulsory disclosure laws, reporting social, environmental, and ethical strategies and performance to stakeholders (Adams 2002; Deegan 2002; Gray 2002) could promote value creation (Moore 2003) in three different directions:

- outside an organization, through community involvement;
- among the single public organizations, through dialogue with the other entities in order to receive legitimacy and support;
- inside an organization, in order to effectively and efficiently produce the expected results.

So, one can recognize the role of social accountability tools as part of a process by which those who manage resources (not just financial ones) and report the positive and/or negative effects of their operations, demonstrating the socially responsible and ethically correct behaviour of their management activity.

However, if the continuous financial monitoring and the social and environmental outcome increase awareness regarding the efficient and effective use of public resources, one must also take into account the limitations of the system. In fact, empirical studies have highlighted potential factors such as the completeness and reliability of the information (Belal 2002; Adams 2004) and the control and manipulation of the dialogue process with stakeholders (Owen et al. 2001; Unerman and Bennet 2004; Thompson and Bebbington 2005). To overcome such limitations, one possible course of action is to implement a verification process similar to that used by an insurance provider in order to obtain a certificate of verification, as recommended by the AA1000 Insurance Standard (AccountAbility 2005), the so-called social audit. This procedure involves an external audit by independent and professionally qualified parties to judge the veracity of the social balance sheet, the output of the social reporting process, or even the adoption and the reliability of the process followed to get to the drafting of the document (Zadek and Evans 1993; Johnson 2001).

Future implications of the research project are directed towards testing the adoption of social auditing practices and towards implementing the changes suggested by stakeholders during engagement activities (see Tables 14.3, 14.4, and 14.5) and the post publication phase. Additionally, the report can be developed considering the accountability areas "per stakeholder"; in other words, it must include a collection of information related to each group of people, that have influence on or interest in the activities of the health unit. Consequently, the information system will also be updated with data on each typology of stakeholder (e.g. patients, professionals, and health authorities).

Moreover, subsequent research horizons consist in identifying a measurement model for the value generated by health units (social value added), a model which integrates social, environmental, and economic variables, derived from the synthesis of compulsory information and social accounting practices.

There is a global need to develop a tool that can provide legitimacy and consensus and that can also be a strategic tool. It would be best used in the operational management of health units, in light of the objective of guaranteeing health protection in a constantly changing context, one that is currently characterized by reforms to contain public spending and clinical–medical changes involving technological upgrading to satisfy the increasing need for health protection.

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Chapter 15
Iran's Privatization Policy Analysis Based on Good Corporate Governance Principles

Amin Naseri, Rahmatollah Gholipour and Bita Mashayekhi

Abstract This paper investigates the factors of corporate governance in the public-sector companies, in accordance with the principles of good corporate governance in the public sector and the guidelines of the Organization for Economic Cooperation and Development (OECD) as a global organization making policies for corporate governance. Based on the established theoretical framework, the Enforcement Law of the privatization policies of Article 44 of Iran's constitution will be analyzed. These policies are the most important legal reference for the economic activities of the public sector's enterprises in Iran. Next, the strengths and weaknesses of the law in terms of good corporate governance rules will be examined. The research methodology is based on the qualitative content analysis. The obtained findings demonstrated that the most important weaknesses of Iran's privatization policies are as follows: (a) lack of a clear ownership policy for the state-owned enterprises; (b) insufficient consideration of the private and cooperative sectors and minority shareholders' concerns when privatizing large state-owned enterprises; (c) lack of an appropriate mechanism for a balanced relationship with all stakeholders. Moreover, the following are major strengths of the privatization policies: emphasis on transparency and disclosure of clear information by the businesses directly/indirectly owned by the public bodies to Iran's Competitiveness Council and obliging these businesses to present their financial reports to Iran's Securities and Exchange Organization.

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JEL Classification G38; L38

15.1 Introduction

"Corporate governance" refers to a set of control mechanisms, transparency, and accountability of the companies, whose concepts have been mainly developed for the private sector. The key purpose of the mechanisms and systems of corporate governance is to give a partial guarantee to shareholders for protecting their interests by managers. Through drawing the interests of these two groups, the agency costs will diminish, and the company value and performance will increase (Clarke 2004).

Given the competing interests of various stakeholders, a few questions need to be meticulously considered. First, if the main owners and shareholders of an organization are people/public or the government (on behalf of the people), what will be the suitable corporate governance for preventing the conflict of interests between shareholders and managers, and what will be the governance mechanism deal with the accountability to shareholders and other stakeholders? Second, should the governance of such businesses be distinct from that of the private-sector businesses? In response to these questions, it should be stated that "corporate governance in the public sector" has been less researched. Thus, it is of very high importance for the development of different countries, particularly emerging countries such as India and South Africa, which have special policies and charters for corporate governance in the public sector. This issue is greatly important that the Organization for Economic Cooperation and Development (OECD), which is a major global reference for making corporate governance policies, published a precious collection of guidelines on corporate governance for the state-owned enterprises (OECD 2005).

In Iran, approximately 60–80% of the country's budget is annually allocated to the state companies, institutions, and banks, and the rest to the country's general budget. The estimates indicate a high load of the activities performed by state enterprises in the field of economy. Considering different interpretations, it can be claimed that nearly 80% of Iran's economic activities are done by the "public sector" through three central ways as follows: (1) activities of state administrative agencies and public institutions (e.g., the organizations for water, electricity, gas, post, railway, ports and shipping, health care, education at different levels, and services of the state-owned enterprises and institutions such as municipalities, insurance companies, social security organization, their affiliates, charitable foundations); (2) activities of state enterprises/organizations (e.g., banks, and oil, petrochemical, energy and gas, steel, copper, and other corporations); and (3) activities of quasi-governmental organizations (the companies partly privatized but with a governmental management, such as private insurance companies and telecommunication offices) (Nikou-Eghbal 2010; Meidari and Kheirkhahan 2004).

Despite the increasing share of the public sector in Iran's economy, the corporate governance policies have been only expressed in the Business Law for the private-sector firms. Consequently, the governance of companies belonging to the state and the public sector has fallen into abeyance (Arabi and Zare 2011). This is while given the high load of activities of the state and the public companies in Iran, corporate governance in the public sector requires independent principles/policies. This requirement has been taken into account to some extent by the Iranian legislators in "the enforcement law of the policies of Article 44 of the Iran's constitution." Therefore, the purpose of this paper is to analyze the enforcement law of the policies of Article 44 of the constitution in terms of observing the principles of good corporate governance in managing the public-sector enterprises.

The remainder of the paper is organized as follows: Sect. 2 presents the research background, in two main categories of theoretical and empirical background. Next, the research methodology is elucidated in Sect. 3. In Sect. 4, the research findings are demonstrated and finally, the conclusions and recommendations of the paper are revealed in Sect. 5.

15.2 Research Background

According to Article 44 of the Iran's constitution, the economic system of the Islamic Republic of Iran is generally organized based on three sectors: public, cooperative, and private sectors. According to this Article, the private sector complements the presence of public and cooperative sectors in the activities of the agricultural, industrial, and service sectors. The policies of Article 44 of the Iran's constitution can be expressed under the following categories (Expediency Council 2005):

1. The general policies for developing the non-public sectors and preventing the enlargement of the public sector.
2. The general policies of the cooperative sector.
3. The general policies for developing the non-public sector through privatizing the public activities and businesses.
4. The general policies of privatization and ownership transfer.
5. The general policies for enforcing governance and avoiding monopoly.

These policies have been declared, aiming at realizing the acceleration of national economic growth, expanding the ownership at the public level and guaranteeing social justice, enhancing the efficiency of enterprises and productivity of the material and human resources and technology, increasing competitiveness in the national economy, increasing the share of the private and cooperative sectors in the national economy, lessening the financial and managerial burden of the government in managing economic activities, enhancing the general level of employment and encouraging people to deposit and invest, and improving the household income.

The enforcement law of the policies of Article 44 was offered to the Islamic Consultative Assembly (Iran's Parliament) as "an emergency bill for enforcing the general policies of Article 44 of the constitution of Iran and transferring the state activities and enterprises to the non-public sector." This law, containing 10 chapters, 92 articles, and 90 notes, was approved in an open meeting on Monday, 28 January, 2008, in the Islamic Parliament of Iran. It was consequently recognized as conforming to the principles of the Iran's Expediency Council in May, 2008. All the chapters of this law contain some subjects about governing and managing companies in the public, private, and cooperative sectors, which were analyzed in this research. However, Chaps. 2, 4, and 9 of the law, entitled, respectively, as "the scope of the activities of the public, cooperative, and private sectors," "organizing state enterprises," and "facilitating competition and avoiding monopoly," were more deeply analyzed by the authors, since they were more extensively related to the research subject. Furthermore, the law of "amending the articles of the enforcement law of the general policies of Article 44," which includes 3 articles and was approved by the Iran's Parliament and the Guardian Council in June, 2014, was also analyzed in this research. In this paper, the phrase "documents of the enforcement law of Article 44" means the text of the mentioned laws.

15.2.1 Theoretical Background

There are extensive investigations on corporate governance, which generally consider the issues about ensuring investors to provide managers with their capitals (Shleifer and Vishny 1997). Corporate governance deals with the solutions through which the suppliers of financial resources can ensure themselves of the return of their capital (Davis and Useem 2002).

Corporate governance dates back to the separation of ownership from control, where the board of directors, as a group distinct from shareholders, takes the responsibility of decision making and provides the possibility of establishing modern corporations (Bainbridge 2008). After this separation, different mechanisms were established for consistency and non-conflict between the interests of shareholders and managers. In an analysis of the new form of companies, Berle and Means in 1932 stated that shareholders, by transferring the company's supervision and responsibility to managers, relinquish their own right of directing the company's operations toward their absolute interests. Consequently, they position the society in a situation to request from a modern corporation, not only to serve the owners, but also the entire society (Berle and Means 2007).

During the last two decades, corporate governance has become a leading topic in financial, managerial, and legal researches. The main purpose of these researches is to find optimal organizational mechanisms so that while protecting the rights of all stakeholders, the economic efficiency can be also increased. Understanding the theory of corporate governance can lead to the application of tools for restricting agency problems in the public sector (Hess and Impavido 2003).

In developing the concept of corporate governance, the discussions are usually focused on the board of directors and the related theories. Reviewing the literature on governance indicates that the main focus of corporate governance is on the structure, tasks, and performance of the board of directors (Bailey 2012).

While the board of directors plays the main role in corporate governance, the concept of corporate governance is indeed something beyond that and refers to the practice of power in an organization (Clarke 2004). In fact, corporate governance includes institutional structures, legal laws, and patterns and determines that which section in an organization can make special decisions, how the members of that section are chosen, and what are the existing norms for decision making (Bainbridge 2011). Different frameworks and theories have been so far expanded to clarify various issues emerging in corporate governance studies. These theories consider different factors for corporate governance in accordance with the assumptions on the relationships between owners and managers. The set of factors affecting corporate governance on the basis of the theoretical basics and the corporate governance literature is summarized in Table 15.1.

Considering the mentioned factors and the principles of good corporate governance, in accordance with the guidelines of the OECD as a global policy-setting organization for corporate governance, the theoretical framework of the research for analyzing the content of the "enforcement law of the policies of Article 44" is shown in Fig. 15.1. Therefore, obtaining a good corporate governance structure in the public sector will be possible through observing the following principles (OECD 2005):

1. Legal framework for the activity of state enterprises
2. State's goal-oriented ownership
3. Equitable treatment of shareholders
4. Reliable relations with stakeholders
5. Information disclosure and transparency
6. Clear responsibilities of the board of directors.

Table 15.1 The factors affecting corporate governance based on the previous studies

Corporate governance dimensions	References
Stewardship process	Huse (2007), Keasey and Wright (1997)
Structure and composition of the board of directors	Fung (2003), Kendall (1999), Vo and Phan (2013), Maher and Andersson (2000)
Control, supervision, and risk management	IFAC (2001), Ryan and Ng (2000)
Strategic leadership and behavioral standards	Huse (2007), Ho (2005)
Capital focus and structure	Demirag et al. (2000)
Stakeholder management	Jamali et al. (2008)
Transparency, accountability, and external reporting	Ryan and Ng (2000)

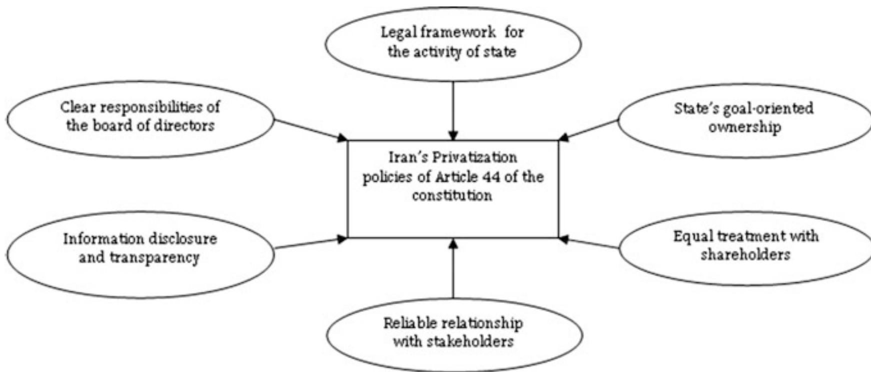

Fig. 15.1 Factors affecting the analysis of Iran's privatization policies in terms of good corporate governance

15.2.2 Empirical Background

There are extensive researches throughout the world on the efficiency and effectiveness of the economic policies of countries in the field of the interaction between the government and the market and also, the analysis of different political, economic, social, managerial, and legal causes and outcomes. There is no empirical literature in Iran on the analysis of the policies of Article 44 of the constitution, in terms of the corporate governance principles. However, considering the high importance and the vastness of the subjects mentioned in Article 44 of the constitution, there is a significant background about the economic, social, and managerial analysis of the Iran's policies on the interaction between the government and the market, and privatization, with an emphasis on the policies of Article 44 of the constitution.

Investigating the financial, economic, and commercial conditions of the Iranian public sector's enterprises during the last decades has indicated their inefficiency in the domains of policy-setting, planning, supervision, and management. These enterprises, which have a decisive and essential effect on Iran's markets and economic activities, have been managed during the past decades in a way that their outcome has largely lacked the acceptable socioeconomic principles. Lack of motivation of the non-public sectors to be present in economic activities has not been merely due to the lack of permission for attending these sectors, but it is also caused by the disturbances that the public and the state enterprises have created in the respective markets. Such obstacles have led to some problems in the general process of privatization in practice. Among these issues, the following items can be enumerated (Khoshpour 2006):

1. Impossibility of performing an accurate cost-benefit analysis in economic markets.
2. Lack of transparency about the advantages/limitations of the economic activities and target markets.

3. Senselessness of the financial statements and performance reports of the state enterprises in financial and commercial terms.
4. Impossibility of valuing the enterprises and separating the interests and benefits of the government and the public sector from the private sector.

In an empirical survey in Iran, the factors influencing the deviance and vulnerability of the enforcement law of the general policies of Article 44 of the constitution were evaluated. Then, the factors affecting the deviance of this law were modeled. According to this research, weakness in the law enforcement (30.5%), incapability of the law (26.5%), deficiency in the private sector (23.2%), and empowerment of the quasi-public sector (19.7%) were among the most important vulnerability criteria. The research findings demonstrated that the success of this law solely depends on the reinforcement and empowerment of the private sector. It should be stressed that the main topic in privatization is transfer of management to private sector, and the ownership transfer is of the second priority. This means that the purpose of privatization is to release the corporate governance out of the government's control and make the transfer of ownership embodying the transfer of management. Otherwise, changing the type of ownership will not assist the privatization objectives (Din-Mohammadi and Azhdari 2012).

Another study portrayed that the implementation of the privatization policies of Article 44 of Iran's constitution has not been effective as expected and has achieved none of the enterprises' performance improvement objectives (microlevel) and the public interest objectives (macrolevel). In terms of the micro-level objectives, the hypothesis of the positive effect of the enforcement of these policies on the components (such as enterprise profitability, enterprise productivity, competition facilitation, and stock value) was rejected. Moreover, in terms of the macro-level objectives, the hypothesis of the enhancement of the components (such as equity, public welfare, employment, and environment) for enforcing this law was rejected (Azar et al. 2011).

By analyzing the policies of Article 44 of the constitution about the interaction between the government and the market as well as the role of the government in economic adjustment, it can be concluded that the extreme viewpoints about the government and the market for ensuring the economic efficiency at the national level have been failed. In recent years, public tendency is toward the government-market cooperation approach. According to this approach (known as good governance approach, agreed by institutional economics), the government plays a guiding, supervising, and adjusting role and complements the market mechanisms. It also provides the mechanisms required for creating a suitable context for the activities of other sectors, particularly the private sector. However, in order for this approach to be effective and to assist the government for achieving its objectives, governance must possess four essential characteristics: democracy, justice-orientation, accountability, and participation (Hosseini and Shafiei 2007).

The general policies of privatization in Iran concentrate not only on the government's action to transfer the ownership and management to non-public sectors, but also on receiving the people's participation and empowering the private and

cooperative sectors to involve in economic activities. Hence, whereas the government's obligation for privatization is the necessary condition, the acceptance of the private sector and people for substitution is the sufficient condition. Moreover, the susceptibility of the business context and the economic freedom is among the prerequisites of this success (Nobakht 2008). Added to them, in another research, improving the business context was mentioned as the prerequisite to successful enforcement of the general policies of Article 44. In this regard, the most important aspect is the attraction and participation of the private sector. According to this research, among the most significant detriments of the privatization process, we can refer to the privatization of the state enterprises without preparing the private sector for the governance of large enterprises and also, lack of proper rules/regulations for the privatization procedures. All of these mismanagement practices will make the involvement of the private sector in Iran's economic activities remarkably difficult (Tabatabaei-Yazdi and Mafi 2007).

Moreover, Kianpour (2009) emphasized on this concept and believed that making the country's economy non-public will be infeasible without developing the private sector and providing the suitable institutionalization. With the expansion of the activities of the private sector, the public-sector enterprises have come into competition and should consequently improve the productivity of their activities; otherwise, they will have no option but to terminate their operations. In other words, the privatization policies will be unsuccessful, unless two essential factors exist: (a) efficient money market and (b) non-public competitive capital. Implementing privatization in the current conditions of Iran is practically equal to changing the ownership of state enterprises from one public sector's institution to another. In fact, what occurs in reality is that the powerful monetary and financial non-private institutions will attempt to buy the offered enterprises, and this will be to defeat the goal of privatization (Kianpour 2009).

In total, it should be expressed that despite the advanced goals of the general policies of Article 44 of the constitution (known as the economic revolution in Iran), which have been codified according to the theoretical basics and the global experiences, there is a significant difference between the objectives and the performance of these policies. In analyzing the lack of success in proportion to the expectations, it should be mentioned that in spite of the accomplished privatization cases, new shareholders do not possess any part of the managerial decisions. As a result, these companies have ultimately remained under the management of the government or public institutions. Therefore, due to the lack of delegation of the management authority along with the transfer of ownership, the objectives of Iran's privatization policies, which include enhancing the productivity and increasing the competitiveness, have not been realized yet (Nobakht 2008).

Based on the mentioned theoretical and empirical background, it seems that reforming the type of corporate governance, which plays a very effective role in enhancing the performance of the private corporations and consequently in flourishing Iran's economy, can be a more suitable solution than mere privatization. The literature review demonstrated that implementing privatization policies in Iran has

encountered a variety of problems that have impeded reaching the intended objectives. As explicated above, a part of these issues has been due to unclear corporate governance mechanism of the public-sector enterprises.

15.3 Research Methodology

15.3.1 Research Method

The strategy of this research is of qualitative type. The used method is a descriptive technique with a qualitative content analysis approach. In this method, the authors analyzed the content of the enforcement law of Article 44 of the constitution based on an analytical framework. This framework was adopted from the principles of governance of state-owned enterprises, published by the OECD. In this work, the *Summative and Directed* content analysis methods were employed (Hsieh and Shannon 2005).

Therefore, the coding scheme required for the content analysis of the enforcement law of the policies of Article 44 was first codified by the *summative* content analysis method. Then, using the coding scheme and the directed content analysis method (Hsieh and Shannon 2005), the research findings were extracted. To do so, all the contents of the privatization policies, encompassing the enforcement law of the policies of Article 44 (approved in 2007) and its amended law (approved in 2014), were uploaded in the software as the main content. After that, according to the coding scheme of corporate governance, the content was coded. Next, the codes were categorized according to "the presence of positive evidence," "presence of negative evidence," or "lack of evidence" in the samples selected from the qualitative data. In the following, each of these stages is fully described.

15.3.2 Coding Scheme

The coding scheme of this research was prepared based on the principles of corporate governance of the Organization for Economic Cooperation and Development (OECD). Each of these principles has its associated subsections, which are presented based on the authors' summative coding in Table 15.2. In fact, this table has been the main foundation of the content analysis of the enforcement law of the policies of Article 44. In this coding, which was conducted using the software, the coding was first conducted for the semantic units (samples). Then, the codes from Table 15.2 with a (positive or negative) semantic relationship were assigned to samples.

Table 15.2 The coding scheme for the qualitative content analysis of the enforcement law of the policies of Article 44, extracted from (OECD 2005) by the authors

Principles	Subsections/codes
Legal framework for the activity of state enterprises	1. Separation of the ownership and governing duties of the state 2. Legal simplification and transparency of the public firms' activities 3. Presence of a legal expression for the services, to be offered to the public by public firms 4. Informing the public about the services, offered by firms 5. Covering the costs related to public services, beyond the business 6. Non-discrimination for public firms, and equality in legal duties 7. Presence of a legal possibility for changing the firms' capital structure 8. Equal competitive conditions for the private and public sector's firms
State's goal-oriented ownership	9. Clear policies for the ownership of the public sector 10. Non-intervention of the state in daily management of public firms 11. Independence of the members of the board of directors in decision making 12. Existence of a central entity in the government for ownership policy-setting 13. Existence of an ownership entity to be accountable to parliament and other authorities 14. Observance of the firms' legal framework by the public sector
Equitable treatment of shareholders	15. Ensuring a fair interaction with all shareholders 16. Providing a high level of transparency for all shareholders 17. Clear policies for the relationship and consultation with all shareholders 18. Participation of minority shareholders in the firm's decisions
Reliable relations with stakeholders	19. Respecting the stakeholders' rights 20. Reporting on the relationship with stakeholders 21. Codification and implementation of the code of ethics for interacting with stakeholders
Information disclosure and transparency	22. Annual reports on the performance of public firms by the ownership entity 23. Information disclosure and developing viable internal auditing mechanisms 24. External independent auditing based on international standards 25. High-quality standards for the accounting and auditing of firms 26. Information disclosure, in the areas of public interest

(continued)

Table 15.2 (continued)

Principles	Subsections/codes
Clear responsibilities of the board of directors	27. Accepting the ultimate responsibility of the firm's performance by the board 28. Strategic guidance and monitoring of managers by the board of directors 29. Appropriate composition of the board for independent decision making 30. Separation of CEO and chairman 31. Improvement of the skills, knowledge, and independence of the members of the board of directors 32. Establishment of the auditing, risk management, and compensation committees in the board of directors 33. Assessment of the annual performance of the board of directors

15.3.3 Qualitative Data and Sampling Method

The qualitative data in this research include all words and *meaning units*, related to corporate governance, in the text of the "enforcement law of the policies of Article 44 of Iran's constitution" and its amendment.

The meaning units are the implicit concepts, which can be interpreted based on the *analysis units*. The analysis units are sentences with the meaning, related to the subject and questions of the research (Iman and Noshadi 2012). In this study, considering the type of the data, the research method (qualitative content analysis), and the lack of need for the generalization of the results, the theoretical sampling method was selected. In this method, the sample size was not predetermined, and the criteria for the completion of sampling were saturation, stability of the classes, and formation of a theoretical explanation based on the qualitative data. Therefore, all the meaning units, related to corporate governance, in the enforcement law of the policies of Article 44, were selected and analyzed as the research sample. In total, 32 meaning units were chosen as the sample. Some instances of these samples are presented here, in the form of quotations from the law:

Sample (**1**) "Any type of governmental assistance/concession (in Iran's Rial or foreign currencies, in the form credit, exemption, discount, priority, information, etc.), which is discriminately provided to one/several enterprises/companies and leads to their dominance in the market or obstruction of the competition, is forbidden."

Sample (**2**) "The government is obliged to privatize eighty percent (80%) of the total value of the state enterprises' shares, in any activity included in Article 2 of this law (except for railway) and transfer to the private, cooperative, and public non-state sectors."

- Note 1: In order to maintain the optimum share of the public sector, for the protection of state governance, country's independence, social justice, and economic development and growth, the government is allowed to invest to the extent that the government's share does not exceed twenty percent (20%) of the value of these activities in the market.

Sample (**3**) "All the rights related to the ownership of state enterprises will be delegated to the Ministry of Economic Affairs and Finance, and from the time that the privatization is approved, any transfer of properties and fixed assets of the state-owned enterprises without a permit issued by the Ministry of Economic Affairs and Finance will be regarded as illegal possession and will be prosecuted."

Sample (**4**) "The board of privatization is allowed to make the required amendments in the letter of association and the regulations, governing the companies transferable to non-public sector. This is to facilitate the privatization of companies and can be done only during one year, extendable to two years. In the mentioned period, these companies are not subject to the regulations of the state-owned enterprises."

15.3.4 The Software Used for Content Analysis

For data analysis, special software for content analysis was used in this research. In this software, the scripts and documents of the enforcement law of the policies of Article 44 and its amendments were primarily uploaded. Then, the required codes for *directed coding* were entered into the software based on the coding scheme presented in Table 15.2. After coding the scripts, the related reports and outputs were extracted using the software analytical and graphical tools.

In summary, in this section, in accordance with the intended objectives, the qualitative content analysis method was employed to meticulously analyze the privatization policies in Iran, from the perspective of observing good corporate governance principles in the public sector.

15.4 Research Findings

The purpose of this research was to consider and analyze the enforcement law of the policies of Article 44, in terms of observing the principles of good corporate governance in managing the public-sector enterprises. This law was accordingly categorized based on the existence of evidence for the comprehensive codes stated in Table 15.2. In the following, the content details of the documents of the enforcement law of Article 44 (the script and the amendment) were analyzed in the analytical networks of the software. The gained findings are presented in the below tables.

Table 15.3 The results of the quantitative analysis for the principles of good corporate governance in "documents of the enforcement law of Article 44" (The figures indicate the number of words in the analysis units of the mentioned documents)

Principles of good corporate governance in the public sector	Document A: Article 44, approved in 2007	Document B: amendment of Article 44, approved in 2014	Total
Reliable relations with stakeholders	Zero	Zero	Zero
Information disclosure and transparency	Zero	30	30
Equitable treatment of shareholders	83	34	117
Legal framework for the activity of state enterprises	584	29	613
State's goal-oriented ownership	224	Zero	224
Clear responsibilities of the board of directors	Zero	Zero	Zero
Total	891	93	984
Total words of each documents	17,366	1749	18,119
Percentage of the related words to total words	5%	5%	5%

Table 15.4 The results of analyzing the enforcement law of Article 44, in terms of existence of the evidence for the principles of good corporate governance in the public sector

Coding for good corporate governance in Article 44 (families)	Evidence in Article 44 (the number of codes grounded in the related family)
Presence of positive evidence	12
Presence of negative evidence	7
Lack of evidence	15
Total codes, related to evidence	34
Total codes for good corporate governance	33
Total codes, shared between positive and negative evidences	1

The descriptive statistics of the analysis, along with the number of the related words in the enforcement law of the policies of Article 44 approved in 2007 (document A) and its amendment approved in 2014 (document B), are presented in Table 15.3.

In Table 15.4, the findings related to the presence of positive/negative evidences (in compliance or non-compliance with the corporate governance principles) or lack of evidence in the analysis of the enforcement law of the policies of Article 44 are

disclosed. In fact, the codes that had agreeable semantic relationship were categorized as "presence of positive evidence," and those with contrasting semantic relationship were classified as "presence of negative evidence." The remaining codes were labeled as "lack of evidence."

As can be seen, out of 34 codes related to the existence of evidence of good corporate governance, 12 were indicative of the presence of positive evidence and 22 were indicative of the presence of negative evidence or lack of evidence in the law.

Moreover, among the 12 positive codes found, which were considered as the strengths of the privatization policies with respect to the observation of corporate governance principles, the most evidences (7 related codes) were associated with the principle of "legal framework for the activity of state enterprises." This shows the adequate attention paid to this principle at the time of codifying the policies. The details of this analysis can be witnessed in the analytical network of Fig. 15.2.

Furthermore, according to the software results, 22 codes conveyed the presence of negative evidence or lack of evidence in the content analysis. These cases are considered as the improvable points in good corporate governance. Based on the software results, out of the 22 mentioned codes, the principle of "clear responsibilities of the board of directors" had 5 codes for lack of evidence and 2 codes for negative evidence. This principle has been ignored at the time of codifying the privatization policies in terms of corporate governance principles. The related details are shown in the analytical network of Fig. 15.3. In the following, the

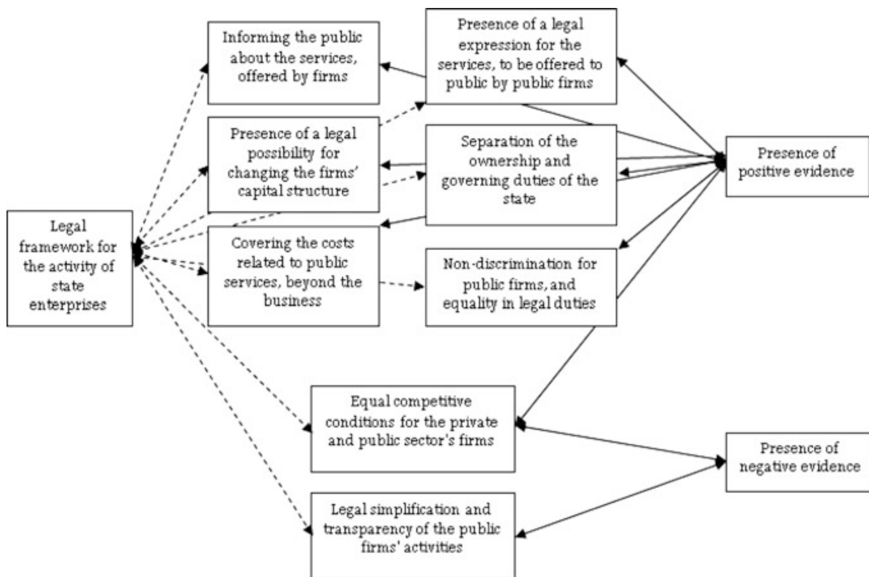

Fig. 15.2 The relational network for the position of the principle of "legal framework for the activity of state enterprises" in the Iran's privatization policies

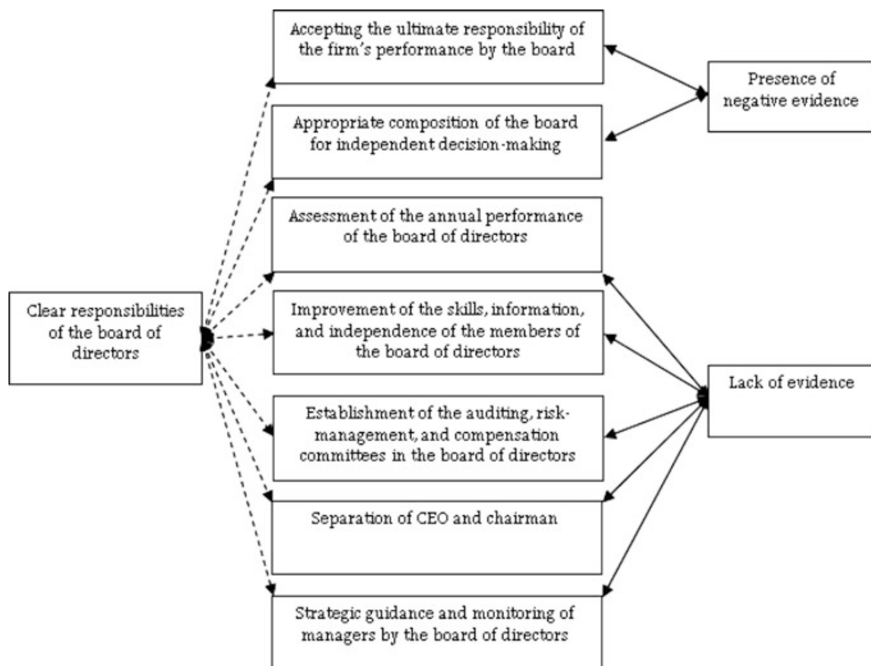

Fig. 15.3 The relational network for the position of the principle of "clear responsibilities of the board of directors" in the Iran's privatization policies

analytical networks of the principles mentioned in the software are extracted and described.

Figure 15.2 exhibits the relationship between the good corporate governance indices (from the perspective of "legal framework for the activity of state enterprises") and the enforcement law of the policies of Article 44. As can be seen, most of the mentioned principles of the law of Article 44 have positive evidence, and only the principle of "legal simplification and transparency of the public firms' activities" has not been observed in this law and has negative evidence. In addition, the code of "equal competitive conditions for the private and public sector's firms," which pertains to the principle of "competitiveness" in good governance, has both positive and negative evidences, which is also presented as an instance in Table 15.5.

Figure 15.3 displays the relationship between the good corporate governance indices (in terms of "clear responsibilities of the board of directors") and the documents of the enforcement law of Article 44. According to the results, no positive evidence for this principle was found in the law of Article 44. This signifies

Table 15.5 The evidences existing in the law for the code of "equal competitive conditions for the private and public sector's firms"

The evidence existing in the law documents of Article 44	Related code	Type of evidence	Description
Article 2 of the amendment of the enforcement law of the policies of Article 44 (approved in 2014): "The public non-state institutions, which are subject to Article 5 of the General Accounts Law, along with all their affiliates, which possess a legal permission to perform economic activities, can operate in the market of goods and services production, unless their activity causes disturbance in the competition. These institutions are obliged to send the report of the total direct/indirect ownership of all their affiliates in each of the markets of goods and services production, to the Competitiveness Council, every 6 months"	Code 8: Equal competitive conditions for the private and public sector's firms	Positive	As can be observed, the amount of the state enterprises' shares, which will be allocated to public non-state institutions, must be to the extent that does not cause monopoly and disturbance in the competition. In addition, companies are obliged to present their reports to the Competitiveness Council. This article has positive evidence for the principles of "competitiveness" and "transparency" in good governance
Note 1 of Article 13 of the enforcement law of the policies of Article 44 (approved in 2007): "Participation and investment of any state company in other state enterprises is only allowed if the subject of the activity of the investee company is related to that of the investor company and the government has issued its permit. This directive does not include banks, credit institutions, insurance firms, and their investor companies"	Code 8: Equal competitive conditions for the private and public sector's firms	Negative	This note that has excluded banks, insurance firms, and the state investor companies from the relatedness of their activities with the investee companies is in conflict with the principles of competitiveness in good governance. In fact, the state banks and insurance firms, referring to this clause, can found some so-called private investee companies as their subgroup using public capital, while the real private sector will be unable to compete with them in terms of the volume of the required capital

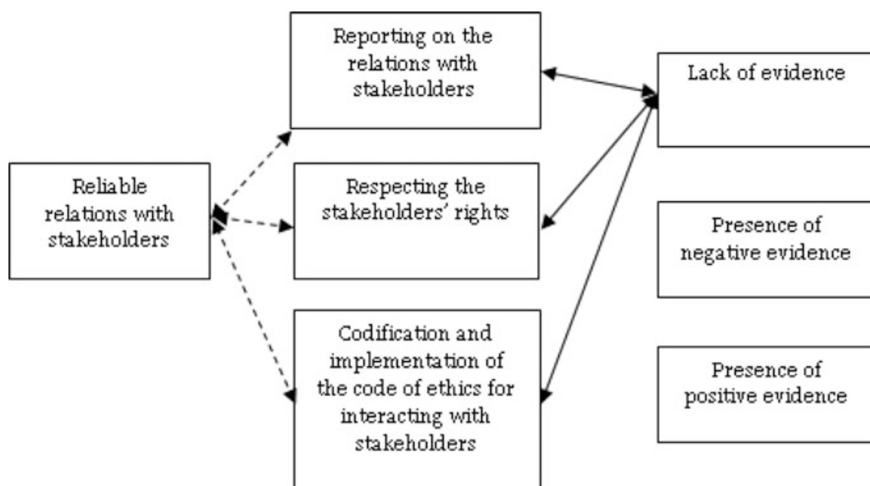

Fig. 15.4 The relational network for the position of the principle of "reliable relations with stakeholders" in the Iran's privatization policies

that policy-makers have only focused on the transfer of ownership and have not sufficiently thought on the governance of the public-, private-, and cooperative-sector firms after privatization. Such a situation can lead to lack of transparency, rent, and corruption in the economy. In particular, in the board of directors of state enterprises, the members will be selected through corrupted processes, which will bring about their dependence in decision making and is clearly in contradiction with good governance. The other relational networks of the principles of good corporate governance are exhibited in Figs. 15.4, 15.5, 15.6, and 15.7.

The above networks were codified and analyzed for the sextet principles of good corporate governance in the public sector. In analyzing and interpreting these networks, it should be stated that the principles of "state's goal-oriented ownership," "equitable treatment of shareholders," "clear responsibilities of the board of directors," and "reliable relations with stakeholders" have not been taken into account in preparing the privatization policies and lack sufficient positive evidence. However, there is a positive evidence for the principles of "legal framework for the activity of state enterprises" and "information disclosure and transparency." This indicates that they have been properly taken into account in policy-setting for the economic activities of the public sector.

The research findings demonstrated that the law for implementing the privatization policies in Iran has not appropriately elucidated the good corporate governance principles in the public-sector companies after privatization. Therefore, there still exists some vagueness in these enterprises that will consequently cause abusing the law and the country's general budget and lead to financial corruption.

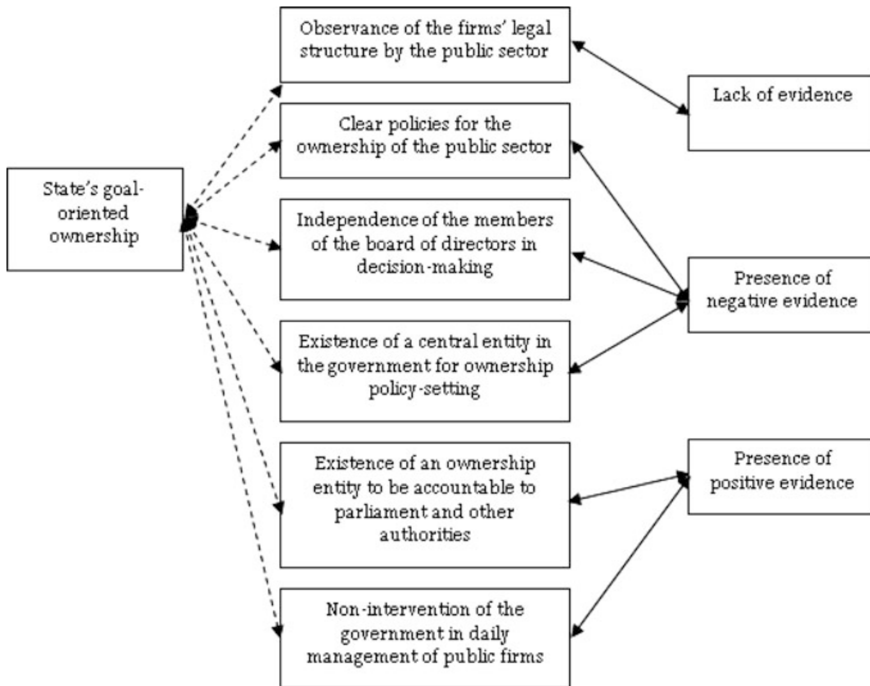

Fig. 15.5 The relational network for the position of the principle of "state's goal-oriented ownership" in the Iran's privatization policies

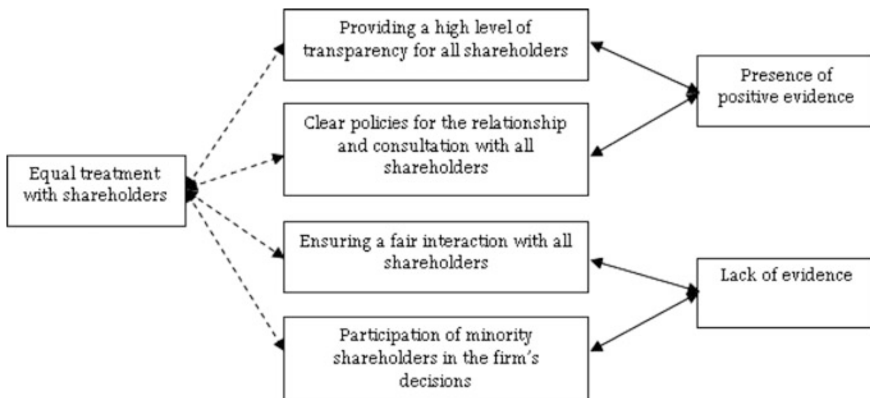

Fig. 15.6 The relational network for the position of the principle of "equitable treatment of shareholders" in the Iran's privatization policies

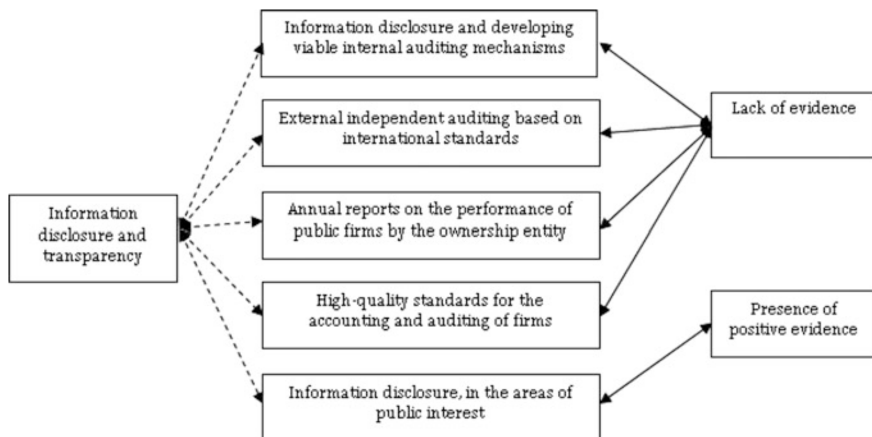

Fig. 15.7 The relational network for the position of the principle of "information disclosure and transparency" in the Iran's privatization policies

15.5 Conclusions and Recommendations

After presenting the theoretical concepts of corporate governance in the private and public sectors, this paper investigates the documents of the enforcement law of the policies of Article 44 of the Iran's constitution based on the good corporate governance principles of the OECD. The findings showed that the enforcement law of the policies of Article 44, as the most important official reference for the privatization policies and the economic activities of Iran's public sector, has some weaknesses as follows: (1) lack of a clear policy for the state-owned enterprises; (2) insufficient heed to the proper preparation of the private and cooperative sectors and minority shareholders for ensuring a competitive environment after privatization; (3) lack of an appropriate mechanism for a balanced relationship with stakeholders. Among the strengths of this law, in terms of good corporate governance, we can refer to two major points: (1) developing a legal framework and emphasizing transparency and disclosing the related information to Iran's Competitiveness Council by the businesses directly/indirectly connected to the public sector; and (2) obliging these businesses to present their financial reports to Iran's Securities and Exchange Organization. With regard to the improvement strategies, the findings of this paper conform to the results of Nobakht (2008), Tabatabaei-Nejad (2008), and Kianpour (2009).

Considering the fact that today, the Iranian government eagerly intends to expand the participation of the private sector; it is suggested to revise the enforcement law of the policies of Article 44 of the constitution toward an extensive empowerment and participation of the private sector. The focus needs to be shifted from the transfer of ownership to the improvement of management and governance of public-sector companies. This revision is especially recommended for Chaps. 2 and 4 of the law, which are related to the scope and manner of the activities of

state-owned firms. In other words, the only way to achieve the objectives of Iran's privatization policies and flourish the economy is not laid in the ownership transfer. Rather, exploiting the management and innovation capabilities in the private sector is definitely more essential than the capabilities of the private-sector ownership. It is apparent that this recommendation does not negate the transfer of ownership, but emphasizes a proper and effective prioritization. Hence, it is proposed to codify the mechanisms required for the economic activities and good corporate governance of the public-sector companies. It is worth mentioning that this issue is currently suffering from legal obstacles and research gaps.

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Chapter 16
Role of Management, Corporate Governance, and Sarbanes-Oxley in Fraud: A Focus on the Precious Metals Industry

Tomeika Williams

Abstract There is a connection between fraudulent behavior and lack of ethical principles and values in a corporation. Prevention of fraud in any organization is successful when there is a proper, preexisting "tone at the top" in an organization. The importance of setting an example of ethical behavior within an organization is a responsibility of executive management. In this study, a review of board composition characteristics, more specifically, the ratio of corporate boards, is conducted to find a possible correlation with a total of 11 fraud cases of publicly traded corporations in the precious metals industry from the year 2012. This study examines several theories to find a possible linkage between internal and independent corporate board members of publicly traded precious metals firms that possibly have been in violation due to lack of strong corporate culture. Due to the strict regulation of enterprises and financial reporting, companies are now being governed by economic legislations such as the Sarbanes-Oxley Act of 2002 to ensure investor protection and confidence. The Sarbanes-Oxley Act of 2002 is the legislation that connects corporate governance qualities to fraud prevention by enforcing rules that govern management relations for accurate financial reporting. The confidence stems from good leadership, sound corporate culture, and high ethical principles. After notable financial scandals in 2002, enforcement of the Sarbanes-Oxley Act has served as reinforcement for public firms and financial reporting accountability. This study did not include any cases before 2012. The conclusion of this study is that the emphasis on legislation within financial reporting is a vital area of implementation within an enterprise. Understanding and following accounting rules and regulations is not only critical to corporate governance, but also in contributing to the enhancement of management's role in accountability. The improvement of the management role and expectations serves as a catalyst for prevention of fraud in public companies.

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Keywords Forensic accounting · Corporate governance · Sarbanes-Oxley Act · Precious metals industry · Foreign corrupt practices

16.1 Introduction

According to James (2008), Congress developed the Sarbanes-Oxley Act, enacted in August 2002, to change the rules of financial reporting for public firms. The Act guarantees investors that financial statements from publicly traded corporations will be accurate and not misleading. The Sarbanes-Oxley Act assists the Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board by implementing accounting standards within public enterprises. While applying accounting standards is helpful, enforcing the standards for publicly traded firms is a more complicated task for the SEC. The purpose of this study was to find a possible correlation between internal and independent corporate board members within companies of the precious metals industry. Also, this study sought a potential relationship between the ratio of board members and the number of violations of the Sarbanes-Oxley Act of 2002 within companies in the same industry.

A shareholder's primary goal is to maximize returns on investments. Shareholders expect board members of a corporation to make good decisions that will yield higher earnings and change the culture of the organization. Corruption and fraud occur when the company uses dishonesty about company earnings to mask fraudulent misreporting. Ramdani and Witteloostuijn (2012) state that the act of pleasing a shareholder under any circumstance promotes unethical behavior and coerces management to be dishonest about financial earnings and growth. The tendency is to cast the company's financial situation in the best light. If shareholders fear of losing possession of the equity stake in a corporation, then worry that they will pull their support could lead to an act of corruption. Ramdani and Witteloostuijn (2012) state that the greater the share in ownership for an investor, the more encouragement there will be for fraudulent behavior. According to Goel and Nelson (2011), restructured organizations can reveal inaccuracies in a corporation's financial records, thus encouraging more unethical interests and behavior that will go unnoticed by executives. Due to the seemingly unpredictable falling and rising stock earnings over the past decades, it is not uncommon to hear of shareholders willingly participating in fraudulent activities.

16.2 Literature Review

16.2.1 Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 has had a significant, positive impact on modern corporations today in terms of financial reporting. An enormous amount of scandals

occurring before the year 2002 contributed to the development and establishment of the Sarbanes-Oxley Act, including the cases of Enron and WorldCom. The Sarbanes-Oxley Act was enacted to guarantee the accuracy of financial statements for investors. The Act, driven by the SEC (Securities and Exchange Commission), envisioned goals to use the legislation to help with the implementation of the rules and regulations that govern financial reporting. The goal of Sarbanes-Oxley was to interpret financial reporting rules that already seemed complicated and inadequate (Dodwell 2008). One positive result of the Sarbanes-Oxley Act is that the legislation shed light on fraudulent corporation members. Corrupt organization members can include board members, stakeholders, shareholders, and, most importantly, management.

Leaders can identify the factors that make a decision corrupt and use that insight to explain the fraudulent behavior. Bargeron et al. (2010) explain that some major decision making can be a form of reinventing the wheel, making Sarbanes-Oxley violations more evident and increasing the number of violations. It is imperative that committed managers produce the best evidence possible to solidify the decision-making process. According to Armstrong et al. (2010), the freedom and preference for management to take care of financial reporting should be evidence enough to demand a stronger role in producing a return on investments. Managers have to evaluate what works for an organization's culture and purpose before using evidence as a guide for better decision making. Evidence-based management is important because decisions can be made rationally or based off of what may have been experienced or worked in the past. This type of management style leads to stronger decisions that are more beneficial for the corporation.

In a corporation, the act of fraud can take many forms depending on the agent and principal that is involved. There can be many issues and influences that convey how or why many members of corporations continue to commit fraudulent activities readily. Even if ethics exist within an organization, there can still be a lack of morality and increase of fraudulent activities. Some corporations seem vulnerable and defenseless to fraud because many tend to misinterpret the idea of stealing and dishonesty. In other words, corporations may act in a way that they believe does not result in violations, but which actually does go against the guidelines against such acts. The controversy in Sarbanes-Oxley is its ability to regulate internal control. Financial reporting has requirements that challenge both internal control as well as predictability. The real goal behind Sarbanes-Oxley was to create reliability and decrease the lack of transparency that financial statements produced (Akhigbe and Martin 2006). Sarbanes-Oxley supports reliability, but the actual effectiveness of the legislation is questionable.

16.2.2 Fraud and Social Influence

Social influence and coercion are possible contributory characteristics to fraudulent activity. Social influence is impacted by the authority of an individual or group with

distinct characteristics and behavior on those in an organization. According to Stevenson and Radin (2009), corporate boards are affected by the network of directors and the use of human capital. It is the wrong assumption that social impact is contributory to fraudulent activity and behaviors. Social influence must be connected to psychological behavior to explain coercion. Ramamoorti (2008) explains that psychological context should explain the behavioral patterns in those who commit fraudulent acts. According to Stevenson and Radin (2009), it is easier to evade fraudulent oversight because executives have more familiarity with the corporation. Schelberg and Bitman (1999) indicate that corporate board directors have a significant influence on those with certain fiduciary responsibilities. Ramamoorti (2008) explains that internal responses to decision making related to the amount of power that the act of fraud has over an individual. Schelberg and Bitman (1999) focus on the corporate board director and the need to control earnings, while Ramamoorti (2008) focuses on the study of psychology and criminology, implying that there are behavioral causes of fraud. According to Schelberg and Bitman (1999), many principals allow corruption to take place when they trust the agent to make responsible decisions. Interestingly, Ramamoorti (2008) reinterprets Cressey's fraud triangle and indicates that its basis is on police force and detective ideas of motives and opportunity. Ramamoorti feels that people should seek psychological answers and explanations to fraud instead of focusing on logical ones, such as what is perceived and driven by human behavior.

Goncalves (2013) believes that a corporate board can see the importance of following the interest of the leader by doing what it takes to enhance the culture of the corporation. The strength of social influence lies in trust and socialization. Social influence can be positive if a leader will incorporate the support of individuals to complete a mission, assignment, or task. Leadership involves enlisting someone to complete a common goal. The leadership approach is important and is also the corresponding variable to positive social influence. Alniacik et al. (2011) suggest that negative shareholder intentions could influence negative behavior and, therefore, distort the purpose of corporate responsibility and promote fraudulent activity. An individual can be susceptible to social influence based on culture, characteristics, and demographics.

Social influence can encourage acts of corruption, especially when the decision maker focuses on what may be in the better interest of the agent. Social influence may have an impact on why individuals or corporations participate in fraud. Ramamoorti (2008) states that the mentality of corruption is significant to the behavior of a person who believes that corruption is actually ethical due to their prior understanding of what actions are right or wrong. The standard of social influence is that others are to be pleased based on the warped decisions and impacts of another. Pinto et al. (2008) state that there are different heights of fraud not limited to the justification of the fraud, creation of the fraud, accountability of the fraud, or its severity. In other words, different wrong actions can be more or less wrong based on the process behind it or the effects of it.

Corruption embodies deceit, fraudulence, distinct objectives, heightened ambitions, and overall dishonesty. Ramamoorti (2008) states that some individuals

misunderstand corruption due to a misperception of wrongdoing. Ramamoorti's (2008) study further states that there are differences in the stages of business and cultures that battle among the alleged ethical and legal ideals of behavior. Corruption can be a sign of commonness according to an early sociological theory called "differential association." This theory explains that fraud is categorized and understood as constructive versus disapproving. Corruption is a pillar of realism in all forms and is significant according to who discusses it. The intention of factors pertinent to crime shows that many individuals and corporations involved in corrupt activity under a multitude of circumstances are not limited to natural instincts or meeting the rigorous expectations of corporate shareholders as their rationalization.

16.2.3 Corporate Governance

According to Brickley and Zimmerman (2010), corporate governance is not explicitly stated; moreover, while there are many standard definitions mentioned, functions of board mechanisms control the focus on corporate governance. Bebchuk and Weisbach (2009) state that corporate power can cause issues in the rights of incentives, and, therefore, governance's focus becomes stakeholders and the splitting of ownership. Bushman et al. (2004) state that corporate governance is dependent on organizational culture, management, and leadership within a company. Fombrun (1983) defines corporate governance as an organization of structure as well as social protection meant to uphold the interests of shareholders. According to Stein (2008), corporate governance is defined as the actions of managers and the obligation for fiduciary responsibilities. Fombrun (1983) believes that the culture within an organization has long-term expectations of governance through corporate collaboration. The determinants that drive corporate responsibility can be exhaustive, and the factors that sustain corporate responsibility can be even greater.

Brickley and Zimmerman (2010) state that corporate governance needs to be re-evaluated based on who handles the guardianship of practices and honest management. If the responsibility is for the shareholders to demand the presence of corporate governance practices within a corporation, the incentive of return for the shareholders should be meeting the expectation, not expecting compensation or even executive value. Ostas (2007) states that corporate firms are more favorable when they provide guidance and signal monitoring of efficiency, which in turn decreases the likelihood of fraudulent acts. Stein (2008) argues that the business setting and beliefs surrounding shareholder objectives and purpose contribute to fraudulent events. There is a thin line between expectations of corporate governance versus the overall success of the CEO and the corporate board's expectations from the investor. Ostas (2007) states that problems that arise as a result of lack of agency can be changed and solved as long as investors can allow corporate boards the opportunity to address those concerns first. CEOs have a responsibility to be

corporate citizens regardless of whether the support given is to maximize profits and meet shareholder expectations. A primary concern in corporate governance is the enforcement of regulation and control when fraud is present.

16.2.4 Sarbanes-Oxley—Impact on Corporate Governance

Canada et al. (2008) identify that the effects that Sarbanes-Oxley has on a corporation depend on the size of the firm. In contrast, Choi et al. (2008) state that Sarbanes-Oxley is merely for the sake of protecting the shareholder regardless of any size or structure of the firm. Irrespective of the size of a firm, the interests of shareholder protection should take precedence over other factors involved in Sarbanes-Oxley. Choi et al. (2008) express that the justice for shareholders was feeble, but after the enactment of Sarbanes-Oxley, the yields were greater. Scandals that took place before the Sarbanes-Oxley era such as Enron, WorldCom, Global Crossing, Dynegy, and Tyco ranged from small to large. The high-profile firms such as Enron and WorldCom had notable auditing and assurance firms such as Arthur Anderson. Despite this backup, the violations were still present and prevalent. Canada et al. (2008) indicate that Sarbanes-Oxley has not gained enough respect or support socially due to irregularity for corporations and business affairs. Sarbanes-Oxley was not intended to be the know-it-all of regulating financial reporting, but sought to be the backbone for stakeholders and ultimately the governance of public firms.

According to Dalton and Dalton (2010), provisions created as a result of Sarbanes-Oxley have been related to governance, board composition, and said positions and responsibilities. Dalton explains that Sarbanes-Oxley's progress over the years has made it apparent that the legislation changes the tone of what a public firm discloses. In contrast, (Filbeck et al. 2011) suggested that firm disclosures after Sarbanes-Oxley have depended on the type of industry and how regulated the industry appeared to be before legislation. Many companies that fell under the Sarbanes-Oxley umbrella were already heavy regulated and guided by the accepted accounting principles in order to remain competitive and compliant to attract more shareholders. What Sarbanes-Oxley did for these types of firms was to reinforce the purpose; of course, this reinforcement came at a higher cost. According to Filbeck et al. (2011), the intention to improve confidence in investors can be achieved by being transparent and providing complete disclosure. Filbeck et al. (2011) also state that the SOX legislation inflicts an expensive cost on corporations as further and more in-depth disclosure requires more man power.

Foote and Neudenberger (2005) state that corporations are forced to act in compliance with Sarbanes-Oxley due to the lack of correct processes. Previous complaints before Sarbanes-Oxley increased changes and compliance issues, contributing to the fact that too many firms have faced ridicule since the legislation enactment. Gordon et al. (2006) state that disclosing information that goes beyond the requirements of Sarbanes-Oxley is helpful. The more information that is made

available, the more clearly and correctly a company's financial situation can be seen. A part of correcting the processes in compliance also involves correcting internal controls and changing the culture of the firm.

Internal and independent board composition is prevalent in public companies because of the influence that corporate boards have on financial decisions about the corporation. Zahra and Pearce (1989) summarize the research on the impact of corporate boards and boards of directors based on critical elements of the agency theory. Legally, it is important to protect the shareholder interest while still managing the corporation. For class hegemony, corporate boards are expected to preserve control of the ruling capitalist versus social-economic institutions. Agency theory practices the role of monitoring the actions of agents—or the board executives—in order to protect the principal owners' interest while stakeholder theory methods are monitoring the actions of agents to protect external stakeholders' interest. This study expanded the research focused on public corporations integrated with constant changing regulations. The study also demonstrated how the change in regulation correlates with companies upholding consistent obligations to shareholders, stakeholders, and the company based on the implementation of the Sarbanes-Oxley Act.

16.2.5 Agency Theory

Trust is the association that links a principal and agent, where a principal entrusts an agent to carry out the best interest of an organization. The agency theory suggests that both principals and agents have possible conflicting personal interests. More specifically, the agent may follow their own personal interests and goals, causing a clash with the principal in decision making and upholding shareholder values. According to Miller and Sardais (2011), in many cases, agency independence is larger than the initial agent-principal conflict. Agency independence threatens shareholder and stakeholder relationships by creating ideas of opportunism. In contrast, in earlier works of Eisenhardt (1989), the core of the agency theory is when agents and principals have similar organizational interest but differences in how they participate in supportive efforts for the organization's goals. What causes agency issues? Cheffins and Bank (2009) mention that agency loss refers to dissimilarity among results from actions taken by the agent and potential adverse outcomes of those actions. Obviously, there would not be an agency loss to consider if the goals of the principal match those of the officer. It is questionable whether the activities in which the agent participates offer assurance that it will be beneficial to the principal's goals.

French (1995) argues that agency is about rationality instead of self-interest among the agent–principal relationship. Karni (2008) states that a principal is concerned about the ending result. The compensation of an agent drives self-interest to enhance overall incentive payoff. According to Darus (2011), who describes an approach similar to Karni's, overshadowing occurs by a principal's interest. When

the agent chooses to use self-interest as a compromise for profitability in the organization in which the incentive is more significant, that is a conflict. According to Bonazzi and Islam (2007), agency theory contributes to decisions that separate ownership from actual monetary control. In contrast, Arce (2007) argues that there is a shareholder-principal movement that dictates corporate control by enforcement of both principal and agent interests, despite differences and lack of alignment with the corporation's goals. Potentially, the agent's or the principal's interest are aligned with the objectives of the organization to support the principal-agent model.

16.2.6 Agent—Principal Relationships

The conflict of interest exists when an agent has a conflict between their own personal interests and the interests of the corporation served. Conflict is prevalent in the concepts of agency theory, but the conflict may not always arise just for an agent but for any party with fiduciary responsibility in the organization. Sandrick (2003) states that clashes in a corporate board stem from a lack of corporate culture and resources. One of the eight predicaments that Bennis (2001) describes as impairments of corporate boards is conflict and the major scrutiny that the board relationships cause. Loewenstein et al. (2012) argue that there are three different common conflicts, including conducts of business with the same organization, seizing the potential prospects of that same organization, and subjecting competition against that organization. The way in which a board addresses conflict as it relates to the corporation's policy can dictate the frequency and controversy behind most presented conflicts.

According to Bennett (2002), conflict is prevalent in corporate boards who use interest as leverage for building corporate value. In doing this, those same corporate boards undermine business operations and purpose. Similarly, Demski (2003) describes corporate boards' interest as the center of the conflict because it dominates the actual purpose of sufficiently safeguarding the interests of the shareholders. According to Bennett (2002), corporations must have more than intelligence about the organization; they must also be able to leverage a skillset to encourage viability in business. Economic goals become the center of purpose for a corporation rather than monetary compensation and corporate control. French (2008) argues that the level of contract a company is in with its shareholders contributes to conflict. If a corporation's sole purpose is to produce a return for shareholders, then the conflict becomes minimal until the point where a return is no longer feasible because other goals are evident and take precedent over shareholder earnings. One of the reasons upholding corporate governance is so important is that it continues to provide structure so that if a shareholder return is a primary goal, efforts are not deterred. French (2008) states that conflict between the agency and the principal is hard to comprehend until there is an appreciation of the composition and structure of a corporation to explain where agency expenditures arise.

16.2.7 Stakeholder Theory

The stakeholder theory is an emergence of connection with a global society and provides cohesion between what is normative to stakeholders and what is justifiable for the principals of a corporation. The stakeholder theory suggests that both directors and stakeholders (internal and independent parties) have possible conflicting societal interest. More specifically, the principal may make decisions based on what seems best for the corporation without general involvement from the stakeholders who embody civil societal input. In many enterprises, the culture is strained because there is a lack of respect for the stakeholder's opinions. Chances for opportunism to make conscious contributions to the improvement of the corporation exist. Pesqueux and Damak-Ayadi (2005) state that stakeholders want to contribute to decisions within a firm because they can be directly affected by the aftermath of a positive or negative outcome. Pesqueux and Damak-Ayadi's thought insists that stakeholders have more than legitimate concerns and interest but also have a contractual relationship with the principal and should be considered an essential part of corporate objectives. There is no rule that says that only shareholders, agents, and directors have the right to make decisions without the stakeholder, but the stakeholder is not the primary group to consult.

Van and Greenwood (2011) argue that the value of a stakeholder has extended past normative or primary value in a corporation. Van and Greenwood feel that it is no longer the priority to focus only on returns to shareholders. While stakeholders seek no monetary return, stakeholders do benefit from enhancements and adaptability to the global demands and changes. Looking at the many classifications of stakeholders, the returns expected from a corporation will vary. Stakeholders tend to adopt the objectives and values of the principal, but they are ultimately unable to maintain that relationship when the principals act in agreement with the interests that are tailored only to a stockholder to increase returns on investments. Stakeholders are secondary to shareholders as the monetary component does not exist for stakeholders. Stakeholders such as employees and consumers work to recommend changes within corporations but lack the general power to execute the recommendations. The principals, or the board members and management team, have characteristics of power and legitimacy in their roles but lack urgency in changes unless the corporate shareholders support the proposed amendments.

16.3 Methodology

At least 11 out of the 95 corporations in the precious metals industry have been involved in violations of corrupt practices in 2012 since enactment of the Sarbanes-Oxley Act of 2002. This study expands the knowledge of stakeholder theory characteristics, such as corporate constituency, independence, and diverse board member composition.

There is one important question that focuses on the change in Sarbanes-Oxley Act standards, and on the significance in a change in board composition mentioned in the problem statement. The question is as follows:

1. Is there a significant correlation between the ratio of independent to internal board members and potential fraud in firms in the precious metals industry? The above research question results in the following hypothesis:

   H01: The populations represented by the never convicted, first-time convicted, and repeat convicted firms in the precious metals industry have the same distribution of independent and internal board members.

   H_A1: The populations represented by never convicted, first-time convicted, and repeat convicted firms in the precious metals industry have at least one different distribution of independent and internal board members.

16.3.1 Research Design

This study used a quantitative correlational research case study approach. Correlational research is appropriate when the research can define and explain the connection among variables in efforts to make an assumption (Creswell 2003, 363). The population for this study is 95 corporations in the precious metals industry. The census of this population is all 95 corporations in the precious metals industry. There are 84 never convicted firms and 11 convicted firms used for this study.

According to Cormode et al. (2012), uniformity in data is an ongoing issue in sampling. The firms selected for this study are from a single industry of all the publicly traded corporations on the stock exchange. The stakeholder theory characteristics may show a correlation between the ratios of internal to independent board members and the frequency of violations of the Sarbanes-Oxley Act of 2002. The sample is intended to focus on one industry in violation of Sarbanes-Oxley in publicly traded firms within the 2012 fiscal year. Ultimately the data for litigation cases from the SEC database served as a variation of data, as the cases were viewed to determine the characteristics of the violations (date, violation, and conviction).

In quantitative research, measurement bias is evident when data and results sway to a particular conclusion. Measurement bias is present when variables remain uncontrolled. Measurement bias can deter the overall purpose of quantitative research, which is to interpret numerical data. Analyzation of the litigation cases of the publicly traded companies measured the type of violation (including what code and what section violations) if any. Extraction of litigation cases used for this study comes from the SEC Edgar. Post-SOX cases are defined as litigation cases after August of 2002 to current year October 2013.

An Excel coding sheet was the instrument used to collect data. The coding sheet is a breakdown of the corporations, the number of inside and independent board members, and the number of counts of any kind of SEC violations for the three

groups. The three groups studied were never convicted, first-time convicted, and repeat convicted firms. This study used a quantitative correlational non-experimental approach, more specifically a quantitative case study approach. Investigated cases in this study explained the counts of violations of the 11 convicted firms, as well as 84 never convicted firms, and their number of board members. According to Creswell (2003), the extensiveness of variables and how those variables relate are the purpose of a correlational study. Correlational research is appropriate when the research can define and explain the connection among variables in efforts to make an assumption. Thompson et al. (2005) state that causative evidence will enlighten a researcher as a result of correlational research. The research does not imply change but observes change and relationships among variables. This study is longitudinal and observed the 2012 period for companies, post-enactment of Sarbanes-Oxley.

This study utilized the Kruskal-Wallis test, a nonparametric test of the distributions of numbers on variables from at least two or more groups. The hypothesis may present that never convicted, first-time, and repeat convicted public corporations in the precious metals industry may have the same distribution of independent and internal board members. The statistic is the "H" (hypothesis), and the observation results from the distribution ranks are whether or not they support the critical value of the testing. The assumption is that there could be fewer violations by precious metal corporations that have a lower ratio of independent to internal board members.

Using N as the total number of observations and arranging the observations into ranks, the following equation is used:

$$H = \frac{12}{n(n+1)} \sum_{i-1}^{k} \frac{R_i^2}{} - 3(n+1)$$

H = Kruskal-Wallis Statistic
N = Total number of observations (95 corporations)
T_i = Sum of ranks Assigned

16.3.2 Sample

The population for this case study is 95 corporations operating within the precious metals industry. Eleven of the mentioned companies were in violation in the year 2012; researchers broke these categorizations down by first-time convictions and repeat sentences. This study sampled 84 firms for comparison of never convicted firms. It is important to have a quality sample size for the sake of quality results based on relatively different variables such as conflict of interest and changes in accounting standards. Only analyzing a little over 12% of the population inadequately represents the population and limits the results for better data analysis.

Companies who trade stock publicly are required to be in compliance with the Sarbanes-Oxley Act. Publicly traded firms that have registered with the SEC via proxy filing serve as the population for this study. Deciding to do a case study on one single industry out of the list of publicly traded companies—in this case, the precious metals industry—makes the scale sufficient for a small case study and measure of distribution. Due to the size of the population, a census was taken for the purposes of framing the sample. The dates of the SEC proxy filing within the post-SOX period of the year 2012.

16.3.3 Sampling Methods

The census is determined based on the non-normal distribution of tests performed on two or more of the groups defined as being never convicted, first-time convicted, or repeat convicted firms in the precious metals industry. Daniel (2012) states that there should be a good fit between the objectives of a study and the sampling choices a researcher makes. In keeping with these guidelines, this census of 95 companies was selected to use based on a small but significant industry on the US stock exchange.

Activities of falsification of financial information, insider trading, corrupt foreign practices, securities offerings, and delinquent filings were the categories in the fraud cases selected for this study. By reviewing both the disclosure and comments pulled from the annual reports of the corporation, the selection of first-time and repeat convicted firms represent true convictions and may include plea agreements and pending trials. Taking into account any cases that settled in a plea agreement, fines, or even jail time, the statistics of violations are also matched with litigation statistics from the United States Department of Justice regarding the fines and penalties imposed on these corporations.

16.3.4 Data Collection

Data collected for this study came solely from secondary sources. For each corporation included in this study, the EDGAR system was used to collect the filing of the individual company's Schedule 14-4 proxy statement in order to locate the date of stock sale, the number of board members, and the type of committees served. According to Nelson and Ketelhut (2007), scientific inquiry is the process of developing knowledge and general understanding of the studies of the world and scientific ideas. The data collected was observed, analyzed, and yielded a correlation within the study.

16.3.5 Violations of 2012

There were a total of three first-time convicted firms. At least three companies in the year 2012 were in violation of one of the SEC categories. The SEC categories include broker-dealer, delinquent filings, foreign corrupt practices, insider trading, issuer reporting and disclosure, market manipulation, and securities offerings. Each of the following corporations is a part of this group. In researching and collecting litigation data for each of the 11 convicted precious metals corporations in this study, several significant violations have occurred in 2012 since the enactment of the Sarbanes-Oxley Act of 2002. The precious metals corporations had similar common violations under Sections 13, 13(a), 13(b), and Section 10 of the Securities Exchange Act, FCPA, and Anti-Bribery Provisions Act.

There were a total of eight repeat convicted firms listed in Table 16.1. At least eight companies in the year 2012 were brought up on violation of two or more of the SEC categories including broker-dealer, delinquent filings, foreign corrupt practices, insider trading, issuer reporting and disclosure, market manipulation, and securities offerings.

Table 16.1 Overview of corporations, ratio of board members, and counts of violations

Precious Metal Corporations	Internal/Independent Board Members	Counts	Groups
Gold Standard Mining Corp.	1/2	4	Repeat Convicted
Jaguar Mining, Inc.	3/2	1	First-time Convicted
Advanced Mineral Technologies, Inc.	3/3	3	Repeat Convicted
Silvermex Resources Inc.	3/1	1	First-time Convicted
Tornado Gold International Corp.	1/0	4	Repeat Convicted
Blue Earth Refineries, Inc.	2/3	5	Repeat Convicted
American United Gold Corporation	3/1	4	Repeat Convicted
Savoy Resources Corp.	1/1	3	Repeat Convicted
Alderox Inc.	1/2	3	Repeat Convicted
Qiao Xing Universal Resources, Inc.	1/2	1	First-time Convicted
Enwin Resources Inc.	1/0	6	Repeat Convicted

16.4 Results

Correlational tests such as the Kruskal-Wallis test are performed to support non-parametric data in the hypothesis. For the single hypothesis, there were three Kruskal-Wallis tests completed for this study. Table 16.1 presents a summary of the convicted firms, ratio of board members, number of violation counts, and respective category.

The Kruskal-Wallis test was performed to test the following hypothesis:

$H_0 1$: The populations represented by the never convicted, first-time convicted, and repeat convicted firms in the precious metals industry have the same distribution of independent and internal board members.

The rejected hypotheses are due to only one of the groups—the never convicted group—having no significant difference between internal and independent board members. With comparing means, the never convicted group had more independent board members than internal board members.

$H_A 1$: The populations represented by never convicted, first-time convicted, and repeat convicted firms in the precious metals industry have at least one different distribution of independent and internal board members.

The null hypothesis was accepted as the results show that two out of three of the groups—first-time convicted and repeat convicted firms—show significant differences between the number of internal and independent board members. More specifically, both the first-time and repeat convicted firms have more internal board members than independent board members. Table 16.2 presents a summary of all findings for hypothesis testing for this study. The ranks are as follows: 0—Never Convicted, 1—First-time Convicted, and 2—Repeat Convicted.

16.4.1 Ratio of Board Members

The two independent variables in this study are the ratio of internal board members to independent board members for each of the 95 firms in the population. Table 16.3 shows the results of the ratio of internal board members to independent board members for all three groups of corporations. The results show that there are

Table 16.2 Summary of hypothesis testing results

Research question	Hypothesis	Ranks	Sig-IND	Sig-INT	Accepted/Rejected
RQ1	$H_0 1$	0, 1, 2	0	0.581	Rejected
		0, 1	0.012	0.334	
		1, 2	0.832	0.303	
RQ1	$H_A 1$	0, 1, 2	0	0.581	Accepted
		0, 1	0.012	0.334	
		1, 2	0.832	0.303	

Table 16.3 Ratio table—by group

Ratio statistics for INT/IND					
Group	Mean	Median	Minimum	Maximum	Std. Deviation
Never convicted	0.765	0.250	0.000	11.000	1.685
First-time conviction	1.667	1.500	0.500	3.000	1.258
Repeat conviction	1.111	0.833	0.500	3.000	0.953
Overall	0.818	0.286	0.000	11.000	1.635

fewer internal board members than independent board members for the never convicted firms group. The results show that there are more independent board members than internal in firms with first-time convictions. The results show that there are fewer internal board members than independent in repeat convicted firms as compared to first-time convicted firms.

Table 16.3 explains the minimum as well as a maximum number of internal members and independent board members in each respective group. For never convicted firms, the minimum of internal and independent board members is 0, while the maximum is about 11 members per corporation. For the first-time convicted firms, the minimum of internal and independent board members is 0.5, which is closer to one member, while the maximum is about three members per corporation. The same numbers are comparable for the firms with repeat convictions.

The standard deviation for never convicted companies in the table is 1.685, which is a higher deviation and widely spread among internal to independent board members. The standard deviations for first-time convicted and repeat convicted firms in the table are 1.25 and 0.95, respectively.

16.4.2 Discussion of Results

For the first hypothesis, there were three Kruskal-Wallis tests performed. For the frequency of violations among the three groups, a frequency test was also performed. A ratio test was performed to show the ratio of internal to independent board members in each of the three groups. There was not much of a similarity between the ratio of internal to independent board members in never convicted firms and the same ratio in the other two groups of first-time and repeat offenders. The results did show a correlation between board members in the firms with first-time and repeat convictions, where there are far more internal board members than independent board members. It is astonishing, but it seems that even after the Sarbanes-Oxley legislation, convictions in the year 2012 appeared to have a trend of being violations of foreign corrupt practices, delinquent filing, insider trading, and issuer reporting and disclosures.

The limitations of this study include the sole reliance on the stakeholder theory to explain the lack of corporate governance, the changes in corporate board

composition, and the relevance of Sarbanes-Oxley. There is potential for this study to be a part of mixed methods research. Time, fraud claims outside of the statute of limitations, and sample and population sizes are all limitations as well. With the amount of firms who have never been convicted of any violation, it was surprising to see a low significance of the internal to independent board members ratio against the other two groups. The beginning assumption of the study was that if there were no convictions of a violation, then the chance of the company having more internal board members than independent would be more likely. In contrast, the opposite assumption was that the larger the internal board, the less likely the possibility for fraud and violations to occur. This assumption turned out to be the contrary, looking at the significance of the first-time convicted and repeat convicted firms in violation had more internal board members than independent board members.

For the hypothesis testing, the results show that there are more internal board members than independent in firms with repeat and first-time convictions. Having a significantly higher ratio of internal board members suggests that, for the convicted firms, there are potential corrupt directors internally. Corrupt directors contribute to corrupt board members. More than three companies violated these foreign corrupt practices provisions within the convicted firms, and the same firms were found guilty of delinquent filings. The reasons for delinquent filing in previous years contributed to the lack of disclosures and the violations of other practices.

Many of the 11 convicted corporations had violations for delinquent filing. The delinquent filing of financial statements affects investors because they cannot determine the accurate profitability of the corporations in which they have a stake. With all of the convicted companies in violation of the delinquent filing guidelines having their registration revoked, the amount of publicly traded precious metals corporations will further decrease. Due to the size of the precious metals industry, the ratio of never convicted to convicted firms will be greater, ultimately skewing the ratios of violations to board members in future studies.

Many other elements—such as board composition factors and breaking down corporations based on one industry—seem to have had some effect on the results and data collection. The only factor used for this study was ratio of the number of internal to independent board members. Breaking down corporations based on their market capitalization would be more interesting for any future research; higher capitalization can correlate to higher violations as opposed to lower capitalization, which may correlate to fewer violations and more independent board members. With this said, the study did not account for limitations that occurred in corporations having solely independent or solely internal board members.

16.5 Conclusions and Areas for Future Research

The intention of the Sarbanes-Oxley Act of 2002 was to create accuracy and full financial disclosure to protect shareholders. It has had a significant impact on publicly traded corporations since its enactment. For others, as seen in this study,

the Sarbanes-Oxley Act has unintentionally created a platform for corporations to breach integrity and disregard governance characteristics. This study contributes to the existing body of knowledge concerning accountability and responsibility of corporations. Corporate social responsibility should be concerned with more than controlling functions but should also focus on controlling procedures and regulation.

16.5.1 Future Research

Expanding this study is necessary in order to understand the further implications and impacts of fraud and Sarbanes-Oxley Act violations within the precious metals industry. Future research should focus on specific violations of the Sarbanes-Oxley Act. Once narrowing down the specific violations, the CPA firms responsible for the audits and other services should be identified, as well as the effects that the fraud in 2012 has had on the ratio of board members. There should be a more specific definition of what internal and independent board members are and a conceptual model of dependent to independent variables to show the relating constructs and how all the research ties back into corporate governance. Lastly, the sample of litigation cases should be expanded to include those that date back ten years or more to improve the quality of research on impact and contribution to the Sarbanes-Oxley enactment.

If regulation is not a critical focus of corporate governance within an organization, fraud can potentially occur. Because accounting standards should govern all public corporations, if fraud does happen, the corporations should be held fully accountable for all violations of those standards. Sarbanes-Oxley encourages corporations to pay close attention to independence mechanisms and avoid any conflicts of interest. However, while the Sarbanes-Oxley legislation regulates corporations to practice accountability, judging by the increase in repeat violations, corporations are failing to act responsibly. In another ten years, violations may potentially increase as corporations converge to more uniform accounting standards such as IFRS. This research is an indication that the Sarbanes-Oxley Act of 2002 will continue to change the structure and governance of corporations.

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Chapter 17
Financial and Sustainability Reporting: An Empirical Investigation of Their Relationship in the Italian Context

Marisa Agostini and Ericka Costa

Abstract "Integrated reporting" has gained prominence during the last few years. Investors have required more information also about how sustainability issues and initiatives are expected to contribute to the long-term growth strategy of a business. This communication, which should be provided by top management, leads toward the convergence of sustainability and financial reporting into a single "narrative." Both financial reporting and non-financial reporting together provide all stakeholders with a comprehensive view of the position and performance of a company. This process has also been encouraged by some European regulations. However, despite these, social and environmental information is still disclosed differently in consolidated annual reports and social–environmental reports. The present work focuses on such differences of content. The analysis regards both (mandatory) consolidated annual reports and (voluntary) stand-alone social–environmental reports prepared by Italian-listed corporate groups for two different accounting periods (both before and after the implementation of Directive 2003/51/EC). The final results show relevant and persistent differences in the disclosure of environmental and employee matters between financial and sustainability reporting.

Keywords Integrated reporting · Content analysis · Environmental disclosure · Employee issues

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17.1 Introduction

The present work focuses on financial and sustainability reporting in order to emphasize the differences with respect to the reported social and environmental information. In a previous paper (Costa and Agostini 2016), the authors highlighted the impact of the 51/2003 European Directive in the Italian context by considering the disclosure of environmental and employee matters both before and after the implementation of the so-called *modernization directive*. Indeed, Article 14 of that regulation requires that "*both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters*" be included in the consolidated annual reports in order to enable a balanced and comprehensive analysis of the development and performance of the business. This European prescription was introduced in Italy by Legislative Decree 32/2007, which integrated Article 2428 of the Italian Civil Code.

Such an integration is extremely interesting, mainly for two reasons. Firstly, it implied a relevant change in the regulation but is extremely concise; it does not provide a specific framework and operative suggestions about the disclosure of non-financial information such as environmental and employee matters. So, the law requires mandatory disclosure of such issues, but there are no precise constraints[1] for the willingness of management to signal corporate strategies about environmental and employee matters. Secondly, the integration regards management commentary reporting (MC). This is also known as management discussion and analysis (MD&A) or operating and financial review (OFR). It is a narrative report the relevance of which has been recognized by a consolidated stream of research (Schleicher and Walker 1999; Flöstrand and Ström 2006; Seah and Tarca 2006; Beattie et al. 2004). The International Accounting Standard Board recently demonstrated new interest in such a report (as emphasized in the IFRS Practice Statement Management Commentary) in order to improve the disclosure of financial and non-financial information encompassed in MC (Beattie et al. 2004). Such a report represents (according to the Italian Civil Code) a mandatory document to be included in the annual statements of Italian companies, both listed and unlisted ones. This is especially relevant given that in Italy the financial reporting model is mainly affected by law (Nobes and Parker 2008). So, the Legislative Decree 32/2007 does not only lead to any increase in disclosed information; it also implies a change in the nature of the information provided. In such a report, a stakeholder should find financial, social, environmental, and strategic information. It seems to

[1]The Italian Civil Code does not provide any constraints. The National Board of Chartered Accountants (CNDCEC 2009a, b) addressed this issue and tried to provide some indication about the disclosure of environmental and employee information. The same was done by the International Accounting Standard Board (IASB). This board provided a framework for the presentation of management commentary reporting. It reflects a precise decision: the standardization of such reporting could reduce its informative power, so it must be avoided.

be the definitive recognition that something more about corporate performance must be included in traditional financial reporting in order to increase the ability of accounting to represent and report information that is useful in assessing firm value and management performance.

For these reasons, so-called "integrated reporting" has gained prominence during the last few years. Investors have been requiring more information about how sustainability issues and initiatives are expected to contribute to the long-term growth strategy of the business (Alniacik et al. 2011). This communication, which should be provided by top management, leads toward the convergence of the sustainability report and the financial report into a single "narrative."

Starting from these considerations, the present work aims to analyze the actual roles of financial and sustainability reporting; should they concern the same employee and environmental information? Is there an overlap between the contents of consolidated annual and social–environmental reports?

The initial literature review focuses on the relationship between financial and sustainability reporting (Sect. 17.2). It is followed by the analysis (Sect. 17.3) of both types of reporting in the Italian context. The final results (Sect. 17.4) show relevant and persistent differences between financial and sustainability reporting in the disclosure of environmental and employee matters.

17.2 Financial and Sustainability Reporting: Their Relationship in the Accounting Literature

This section is about the relationship between financial reporting and sustainability reporting within academic debates about financial, social, and environmental accounting.

Over the last two decades, social and environmental accountability research has emerged as an urgent topic of investigation both at national and at international levels (Parker 2005, 2014). Social and environmental accounting research has thus moved from the margins of accounting and management accounting research to the center of scholarly debate. During this period, a large number of studies have been carried out in order to answer multiple research questions (Mathews 1997). The most important reviews provided regarding social and environmental accounting research start with the work of Mathews (1997) and continue with the papers of Gray (2002) and Parker (2005, 2011, 2014). Over the last 40 years, environmental responsibility has been the dominant focus (Mathews 1997; Parker 2005). However, as Parker (2014) noted, there has been a change in the balance between social and environmental areas in the last years. Both Mathews (1997) and Gray (2002) have highlighted the urgent need to focus on the social dimension of accountability because of massive issues in the academic debate that still remain unexplored. So, a variety of different topics have been addressed in the last

40 years. Parker (2005, 2011) reviews the most frequent studies from 1990 to 2008 and highlights that the majority of the research has focused on the following:

(i) National levels (Spain, Finland, and the Netherlands are the European countries with most analyses, Parker 2011);
(ii) Comparisons across different countries;
(iii) Regulations; and
(iv) Standards and international codes.

Minor attention has been devoted to other topics, such as social responsibility investment, SMEs, education, ethical issues, and others. Many research topics still need to be investigated. In particular, the relationship between consolidated annual reports and sustainability reports is still unexplored, and Parker (2005) explicitly calls for further investigation of the burgeoning media on disclosure.

17.2.1 Multiple Theoretical Frameworks

Environmental and social issues are voluntarily disclosed by Italian entities in stand-alone social–environmental reports; they are mandatorily communicated in management commentary reporting (with the limitations explained in the Introduction) after the 51/2003 European Directive. Different theories have been developed to explain why firms have an incentive to provide voluntary information (Healy and Palepu 2001). One of the main reasons seems to be related to companies' desire to favorably distinguish themselves (Dye 1985; Grossman 1981; Milgrom 1981; Pae 2002; Verrecchia 1983; Welker 1995). According to this stream of literature, the use of voluntary communication emerges as a tool to overcome the adverse selection mechanism (Dainelli et al. 2013). Moreover, the reporting of social and environmental matters should help organizations to be accountable not only to shareholders but also to a wide range of stakeholders affected by the organization's activities (Gray et al. 1996). Indeed, the conventional accounting framework has been criticized as being unable to consider the inconsistencies, injustices, invisibilities, and inequalities of modern Western life and thus to deliver social change (Gray 2002; Mathews 1997). "Critical accounting" scholars argue that accounting should be grounded on the principles of democracy and accountability and should serve as an intermediary between (and within) *organizations* and *society*, thus considering its role within the societal context in a broader sense (Lehman 1992). Despite the willingness to adopt a "meta-theory" as an all-embracing unitary theory (Gray et al. 1995a), it is by now recognized that within the social and environmental accounting field, different theoretical perspectives can coexist and could mutually help interpretations of the same empirical evidence. "*Nevertheless, as the accounting history community has gradually discovered, pluralism in theoretical lenses and methodologies applied to common research problems can yield incremental and accumulating insights that are enriched by both commonality and difference. All are valuable*" (Parker 2005, p. 849).

Stakeholder theory, political economy theory, legitimacy theory, decision usefulness, agency theory, and other theoretical frameworks have to date been employed in order to explain or interpret the empirical settings.

17.2.2 Empirical Methodologies Employed to Account for Environmental and Social Issues

A wide range of methodologies (both quantitative and qualitative) have been employed in order to account for environmental and social accounting issues. While content analysis has remained the most popular method (Parker 2014), a variety of other methodologies have been considered, such as statistical relationships, case and field studies, ethnographic accounts, survey research, historical analysis, experimental studies, and mixed methods. The first empirical accounting studies that accounted for social and environmental matters (1970–1980, Mathews 1997) were mainly descriptive and not particularly sophisticated. Later on, content analyses/statistical relationships, as well as more ethnographic research, case-field studies, surveys, and experimental studies emerged as methods of research. Therefore, after a considerable period where the dominant methodological approach was literature/theory/commentary/historical, there has been a shift in the balance of methodologies in favor of greater employment of content analysis and more varied ethnographic research (Parker 2011). This shift from theoretical studies to empirical ones has been supported by Adams' (2002) and Gray's (2002) arguments that theorizing in social and environmental accounting studies needs a much closer engagement with practice. In the present work, an analytic content approach (Parker 2014) has been followed.

17.2.3 European Regulatory Framework

In the last 40 years, there has been an increase in regulations on social and environmental issues. Most of these regulations have involved financial accounting. Some examples of such regulations are the following: the Corporate Report, Accounting Standards Steering Committee, 1975; the UK Government Green Paper, HMSO, 1977; Directive 2003/51/EC; Directive 2006/43/EC; Directive 2013/34/EU (on annual financial statements, consolidated financial statements, and related reports of certain types of undertakings); and Directive 2014/95/EU. The European Commission recently (January 2016) launched a public consultation on the non-binding guidelines on the methodology for reporting non-financial information following Article 2 of Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups. The purpose of this public consultation is to collect views from stakeholders.

The present work focuses on Directive 2003/51/EC which renews many aspects of the annual report, as emphasized in the Introduction. All above-mentioned regulations and directives have progressively consolidated the idea that both financial reporting and non-financial reporting provide all stakeholders with a comprehensive view of the position and performance of companies. Large public-interest entities (listed companies, banks, insurance undertakings, and other companies that are so designated by Member States) with more than 500 employees should disclose in their management report relevant and useful information on their policies, main risks, and outcomes relating also to environmental matters, social, and employee aspects. There is significant flexibility for companies to disclose relevant information (including reporting in a separate report), as well as being able to rely on international, European, or national guidelines (e.g., the UN Global Compact, the OECD Guidelines for Multinational Enterprises, ISO 26000). At the same time, academic scholars agree that there is a need to increase the disclosure of qualitative and non-financial information in annual reports (Lev and Zarowin 1999; Beattie et al. 2004). On the other hand, there seems to be a sort of reluctance on the part of professional organizations to develop specific compulsory standards or regulatory frameworks for social and environmental accounting (Mathews 1997). The exception of France needs to be emphasized, where the *Bilan Social* was introduced as employee-related reporting in 1977.

Since the above-mentioned regulations have been applied only to annual reports and firms have an incentive to provide voluntary information (Healy and Palepu 2001), there has been a proliferation of international accountability standards for the preparation of social–environmental reports. These have been developed and published by independent bodies with the aim of encouraging and guiding organizations along the whole social and ethical accounting, auditing, and reporting process (Gray 2002; Lober et al. 1997). They represent voluntary procedures that could be implemented by organizations that intend to deal with the measurement, assessment, and communication of social and environmental impacts of activities toward stakeholders.

One of the most important developments for effectively increasing voluntary social and environmental accountability has been the creation of the Global Reporting Initiative (GRI GRI 2002; Cho et al. 2015). While GRI promotes the development of stand-alone sustainability reports, the majority of the social and environmental accountability research considers the annual report as *the* (prominent) document to analyze (Adams et al. 1995; Adams and Harte 1998; Beck et al. 2010; Gray et al. 1995b). Thus, some literature has an exclusive focus on annual reports in order to account also for social and environmental matters (Unerman 2000; Zeghal and Ahmed 1990); other scholars emphasize the adoption of stand-alone sustainability reports as the main source of information about social and environmental issues (Roca and Searcy 2012; Belal 2002; Lober et al. 1997).

The relationship between financial reporting and sustainability reporting is still unexplored, and Parker (2005) explicitly calls for further investigation of the burgeoning media on disclosure. In order to answer to this call, the present chapter is

aimed at considering the relationship between consolidated annual reports and stand-alone sustainability reports with reference to environmental and employee matters.

17.3 The Analysis: Sample, Method, Variables, and Results

The present work aims to emphasize the differences in financial and sustainability reporting of 24 Italian-listed corporate groups through the analysis of both consolidated annual reports and stand-alone social–environmental reports prepared for two different accounting periods (both before and after the implementation of Directive 2003/51/EC).

17.3.1 Sample

The sampling process consisted of the following steps. First of all, the authors selected all the corporate groups listed on the Italian stock exchange (i.e., Borsa Italiana Spa), which drew up social–environmental reports in both 2005 and 2010; there are 24 entities. Then, the consolidated annual reports of the same Italian-listed corporate groups were considered both in 2005 and in 2010 in order to verify the change in both the mandatory and the voluntary disclosure of environmental and employee matters. For this reason, the analysis is based on 96 reports, equally divided into consolidated/social–environmental reports and by 2005/2010 (Table 17.1).

The management commentary reports and the social reports of each Italian entity were found online (through the link provided by Borsa Italian Spa’s Web site) and downloaded in PDF format for both accounting periods considered (2005 and 2010).

17.3.2 Method

The starting point of the analysis is represented by the quantitative content analysis performed in order to verify the extent of mandatory disclosure both before and after the Italian Legislative Decree 32/2007 (as highlighted in the Introduction). Such an empirical research tool consists of calculating the number of sentences devoted to the specific issues under examination. An analytic content approach (Parker 2014) was followed: the authors employed a pilot test, three different

Table 17.1 Sampled entities listed on the Italian stock exchange drawing up both consolidated annual and social–environmental reports in both 2005 and 2010

ID	Name of entity
1	Banca Carige
2	Banca Monte dei Paschi di Siena
3	Banca piccolo credito valtellinese
4	Banca Popolare dell'Etruria
5	Banca Popolare di Milano
6	BNL
7	Unicredit
8	Unipol gruppo finanziario
9	Fondiaria–Sai
10	Cattolica Assicurazioni
11	Acea
12	Acegas Aps
13	Hera
14	Iren
15	Italcementi
16	Buzzi Unicem
17	Fiat
18	Pirelli & C.
19	Autogrill
20	Enel
21	Edison
22	Indesit company
23	Sabaf
24	Telecom

coders, and a deep reanalysis of discrepancies in order to guarantee reliability (Unerman 2000; Gray et al. 1995b; Milne and Adler 1999).

Such an analysis focuses on environmental and employee matters that are not specifically defined by the Italian Legislative Decree 32/2007. For this reason, it considers the areas of disclosure identified and described by the GRI for both environmental and human resources.

For the environmental category, 11 areas of disclosure were employed. They are labeled as follows:

1. *Materials*: materials that are used to produce and package an organization's primary products and services during the reporting period.
2. *Energy*: consumption and intensity.
3. *Water*: water withdrawal by source, recycled and reused water.
4. *Bio*: operational sites owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas; description of significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas; and habitats protected or restored.

5. *Emissions, effluents, and waste*: the emissions aspect includes indicators on greenhouse gas emissions as well as ozone-depleting substances and other significant air emissions; effluents and waste include information about water discharge by quality and destination, waste by type and disposal method, significant spills, transported, imported, exported, or treated waste.
6. *Products and services*: extent of impact mitigation of environmental impact of products and services, percentage of products sold and their packaging materials that are reclaimed by category, monetary value of significant fines, and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.
7. *Compliance*: monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.
8. *Transport*: significant environmental impact of transporting products and other goods and materials for an organization's operations, and transporting members of the workforce.
9. *Overall*: total environmental protection expenditures and investments by type.
10. *Supplier environmental assessment* (i.e., percentage of new suppliers that were screened using environmental criteria, significant actual, and potential negative environmental impacts in the supply chain and actions taken).
11. *Other* (*residual category*).

Nine areas of disclosure were employed for the employee category. They are labeled as follows:

1. *Employment*: total number and rates of new employee hires and employee turnover by age group, gender, and region; benefits provided to full-time employees that are not provided to temporary or part-time employees, by significant locations of operation; and return to work and retention rates after parental leave, by gender.
2. *Labor/management relations*: minimum notice periods regarding operational changes, including whether these are specified in collective agreements.
3. *Occupational health and safety*: percentage of total workforce represented in formal joint management–worker health and safety committees that help monitor and advise on occupational health and safety programs; type of injury and rates of injury, occupational diseases, lost days, absenteeism, and total number of work-related fatalities, by region and by gender; workers with high incidence or high risk of diseases related to their occupation; health and safety topics covered in formal agreements with trade unions.
4. *Training and education*: average hours of training per year per employee by gender and by employee category; programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career ending; percentage of employees receiving regular performance and career development reviews, by gender and by employee category.

5. *Diversity and equal opportunity*: composition of governance bodies and breakdown of employees per employee category according to gender, age group, minority group membership, and other indicators of diversity.
6. *Development programs* (any type regarding employees).
7. *Social:* social impact assessments, including gender impact assessments.
8. *Communications* (any type regarding employees).
9. *Other* (residual category).

After the preliminary descriptive analysis, the following regression model was implemented in order to deepen the comparison between financial reporting and sustainability reporting about the disclosure of environmental and employee matters[2]:

$$Y_{i,t} = \beta_0 + \beta_1 PAGE_{i,t} + \beta_2 DISCLTYPE_{i,t} + \beta_3 REGULATION_{i,t} + e_{i,t}$$

where

$Y_{i,t}$	is the dependent variable which regards either environmental or employee disclosure (mention, description, evaluation, good, bad, neutral, past, present, and future)
$PAGE_{i,t}$	is the number of pages of consolidated annual reports (i.e., financial reporting or mandatory disclosure) and social reports (i.e., sustainability reporting or voluntary disclosure)
$DISCLTYPE_{i,t}$	is a dummy variable indicating the type of disclosure. $DISCLTYPE_{i,t} = 0$ for the voluntary disclosure (in social reports) and $DISCLTYPE_{i,t} = 1$ for the mandatory disclosure (in consolidated reports)
$REGULATION_{i,t}$	is a dummy variable about the application of the examined regulation. $REGULATION_{i,t} = 0$ before such application (2005) and $REGULATION_{i,t} = 1$ after such application (2010)
$e_{i,t}$	is the term error

17.3.3 Variables

In the present analysis, the authors use two dummy variables (i.e., *discltype* and *regulation*). The first one (called *discltype*) represents the main focus of the present analysis because it identifies the type of disclosure; its value equals 0 if we consider social reports (i.e., voluntary disclosure), while it equals 1 if we consider consolidated reports (i.e., mandatory disclosure). The second dummy variable (called *regulation*) was employed (Costa and Agostini 2016) to identify the accounting period in which we consider environmental and employee disclosure; its value

[2]In previous work (Costa and Agostini 2016), the regression model was introduced considering only the variable called *regulation*. Here, the analysis is mainly focused on other new independent variables called *discltype* and *page*.

equals 0 if we consider 2005 consolidated and social reports (i.e., before the application of Directive 2003/51/EC in the Italian context), while its value equals 1 after the application of the examined regulation (i.e., when we consider 2010 consolidated and social reports).

The quantitative content analysis (described above) requires calculation of the number of sentences devoted to each environmental and employee category (listed in the previous paragraph). The variable called *environmental disclosure* regards the total amount of environmental disclosure (i.e., the total amount of sentences devoted to environmental matters). The variable called *employee disclosure* regards the total amount of employee disclosure (i.e., the total amount of sentences devoted to employee issues). In order to check whether there is a correspondence between the change in the amount of environmental and employee disclosure and the total amount of corporate disclosure, we introduce the variable called *page,* which represents the number of pages of consolidated (i.e., mandatory disclosure) and social (i.e., voluntary disclosure) reports.

The last set of variables, employed in the present work, is needed to analyze the completeness of disclosure, the willingness to reveal also unfavorable news, and the attempt to use such information also for prospective purposes. In order to take into account the first aspect (i.e., the completeness of disclosure), we introduce three variables and count the number of sentences that are presented vaguely (*mention*), descriptively (*description*), and exhaustively (*evaluation*). *Good*, *neutral*, and *bad* news variables refer to the second aspect and regard the type of information disclosed by the selected entities, which can promote (or not) their corporate image and reputation. Lastly, we consider the "temporal orientation" of the reported information which can refer to the *past*, the *present*, or the *future*; these three variables also permit us to verify whether the selected entities use the issues analyzed in a perspective way.

17.3.4 Results

The analysis aims to verify the differences in contents between consolidated reporting (i.e., mandatory disclosure) and sustainability (i.e., voluntary disclosure) reporting about environmental and employee matters considering also the impact of 51/2003 European Directive in the Italian context.

17.3.4.1 Environmental Issues

The first relevant result is about the different amounts of disclosure between financial and sustainability reporting. Both total and average numbers of sentences (Table 17.2) dedicated to environmental matters are greater in social–environmental reporting. So, Italian-sampled entities reserve more voluntary disclosure to environmental issues.

Table 17.2 Total (sum) and average (mean) amount of environmental disclosure in Italian sustainability reporting (the variable *discltype* equals 0) and financial reporting (the variable *discltype* equals 1)

Environmental disclosure	discltype	Sum	Mean	Sd	Min	Max
Sustainability reporting	0	8924	185.9167	186.1061	0	875
Financial reporting	1	2112	44	61.32821	0	244
	Total	11036	114.9583	155.1912	0	875

Table 17.3 Total (sum) and average (mean) amount of environmental voluntary disclosure (the variable *discltype* equals 0) and mandatory disclosure (the variable *discltype* equals 1) both before (the variable *regulation* equals 0) and after (the variable *regulation* equals 1) the application of the 51/2003 European Directive in the Italian context

Regulation	Sum	Mean	Sd	Min	Max
Social reporting (*discltype* = 0)					
0 (before)	3635	151.4583	144.1144	0	621
1 (after)	5289	220.375	218.0135	8	875
Total	8924	185.9167	186.1061	0	875
Financial reporting (*discltype* = 1)					
0 (before)	892	37.16667	56.41436	0	219
1 (after)	1220	50.83333	66.37618	0	244
Total	2112	44	61.32821	0	244

After examining the overall environmental disclosure according to the distinction between mandatory and voluntary reporting, the time variable is introduced in the analysis (Table 17.3) in order to consider two different accounting periods, i.e., before (2005) and after (2010) the application of the Directive 2003/51/EC in the Italian context.

The total number of sentences devoted to environmental issues increases after the application of the regulation examined in both consolidated annual reports (+26.89%) and social–environmental reports (+31.27%). There is an increase also in the average and in the maximum numbers of sentences in both consolidated and social reports (2010). Going more into detail, the above-listed environmental categories identified by the GRI are then used in the present analysis in order to consider the total number of sentences for each environmental category in the examined reports. Except for three categories (i.e., “supplier environmental assessment,” “overall,” and the residual category), there is an increase of at least 40% (Fig. 17.1) in the disclosure of all the other environmental categories after the application of the regulation examined, but some differences of content emerge between financial and sustainability reporting (Fig. 17.2). Both consolidated annual reports and social–environmental reports put emphasis on the categories labeled “energy” and “emissions, effluents, and waste.” On the other hand, neither consolidated annual reports nor social–environmental reports deepen “compliance.” There are differences in content in the other environmental categories. For instance,

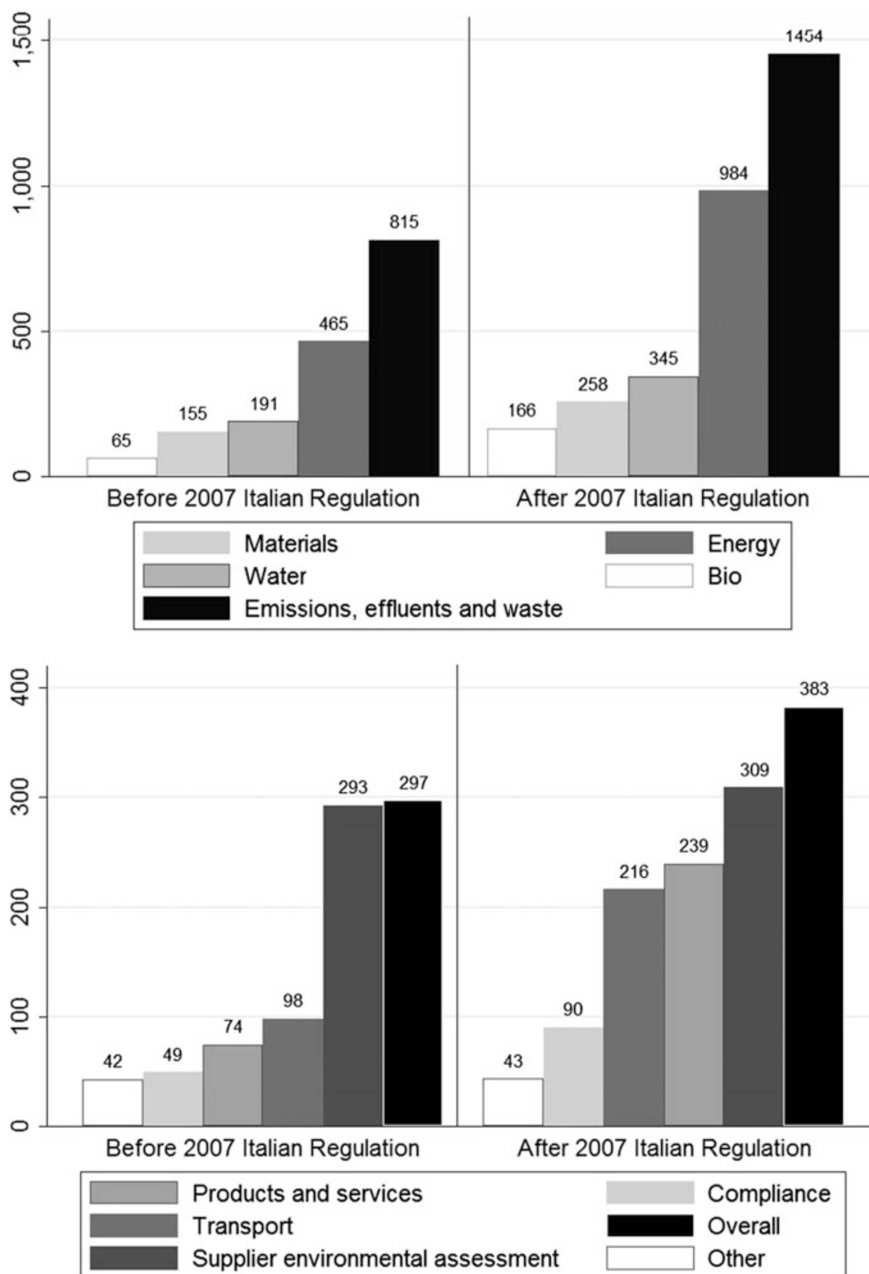
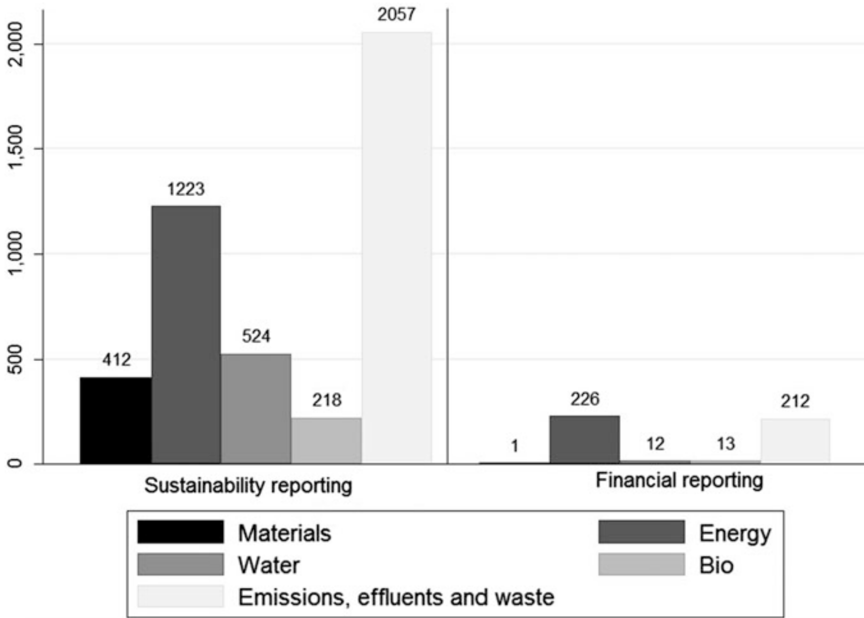


Fig. 17.1 Total amount of disclosure about 11 environmental categories (identified by GRI) in two different accounting periods, i.e., both before and after the application of the 51/2003 European Directive in the Italian context



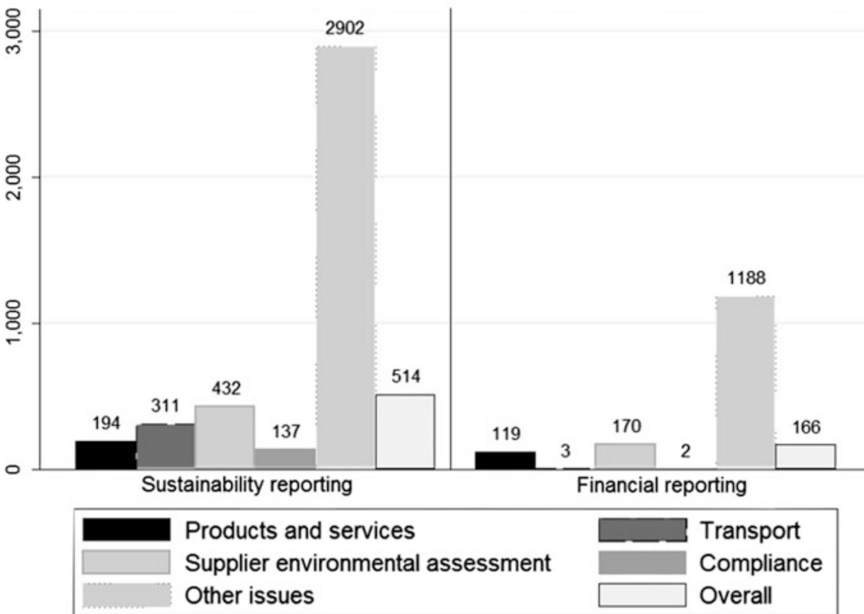


Fig. 17.2 Total amounts of disclosure about 11 environmental categories (identified by GRI) in Italian sustainability and financial reporting

social–environmental reports reserve great disclosure to the category labeled "water." This is not observed in the consolidated annual reports.

The descriptive analysis conducted until now emphasizes the differences in the amount and type of disclosure between financial and sustainability reporting in two different accounting periods. Going into more detail, the analysis focuses on the completeness of environmental disclosure, the willingness to reveal also unfavorable news, and the attempt to use such information also for prospective purposes.

With respect to the completeness of the disclosure (Table 17.4), the analysis ascertains that environmental mention decreases, while environmental description increases in both sustainability and financial reporting in the second accounting period (i.e., after the application of the regulation examined). On the other hand, the environmental evaluation variable is relevant only for social reports where it increases (almost doubles) in the second period.

With respect to the willingness to reveal also unfavorable news (Table 17.5), the analysis ascertains that both financial reporting and sustainability reporting are mainly focused on neutral or favorable information about good environmental actions taken by the entities examined. After Directive 2003/51/EC, there is an increase in the number of sentences dedicated to both bad and favorable environmental information; such an increase is more evident in social reports.

With respect to the attempt to use environmental information also for prospective purposes (Table 17.6), there seems to still be some reticence about the disclosure of environmental future targets, especially in consolidated reports. Financial reporting mainly discloses past environmental information, while social reporting focuses on present information. In any case, we notice an increase in all three types of information (i.e., referring to past, present, and future) in the second accounting period.

The results obtained through the preliminary analysis conducted until now are confirmed by the regression analysis (Table 17.7).

Firstly, we consider as dependent the variables related to the completeness of environmental disclosure (i.e., environmental mention, description, and evaluation). The type of disclosure (i.e., voluntary or mandatory according to the dummy variable called *discltype*) is statistically significant at the 0.05 level and seems to be related to all the three dependent variables. If we consider environmental mention (as dependent variable), the coefficient of the variable called *discltype* is positive, which would indicate that mandatory disclosure (financial reporting) is related to greater environmental mention. If we consider environmental description and evaluation (as dependent variables), the coefficient of the variable called *discltype* is negative (in both cases), which would indicate that voluntary disclosure (social reporting) is related to greater description and evaluation.

Secondly, we consider as dependent the variables related to management willingness to reveal both favorable and unfavorable environmental matters. The type of disclosure (i.e., voluntary or mandatory according to the dummy variable *discltype*) is statistically significant at the 0.05 level and seems to be related to the dependent variable called *env good news*. If we consider management willingness to reveal favorable news, the coefficient of the variable *discltype* is positive, which

Table 17.4 Descriptive analysis of the completeness of environmental disclosure through three different variables (*environmental mention, description, and evaluation*) in both social reports (the variable *discltype* equals 0) and consolidated reports (the variable *discltype* equals 1) prepared for the two accounting periods, i.e., both before (the variable *regulation* equals 0) and after (the variable *regulation* equals 1) the application of the regulation examined

Regulation	Stats	Env mention	Env description	Env evaluation
Sustainability reporting (*discltype* = 0)				
0 (before)	Sum	350	2417	868
	Mean	14.5833	100.7083	36.16667
	Sd	26.8974	86.0523	40.11469
	Min	0	0	0
	Max	114	355	152
1 (after)	Sum	265	3512	1512
	Mean	11.0416	146.3333	63
	Sd	19.1026	129.2428	74.20887
	Min	0	7	0
	Max	73	509	310
Total	Sum	615	5929	2380
	Mean	12.8125	123.5208	49.58333
	Sd	23.1476	111.0377	60.5492
	Min	0	0	0
	Max	114	509	310
Financial reporting (*discltype* = 1)				
0 (before)	Sum	388	499	5
	Mean	16.1666	20.79167	0.2083333
	Sd	32.7715	30.99506	0.6580053
	Min	0	0	0
	Max	157	103	3
1 (after)	Sum	322	896	2
	Mean	13.4166	37.33333	0.0833333
	Sd	16.7693	54.62653	0.2823299
	Min	0	0	0
	Max	50	218	1
Total	Sum	710	1395	7
	Mean	14.79167	29.0625	0.1458333
	Sd	25.78962	44.72441	0.5048523
	Min	0	0	0
	Max	157	218	3

would indicate that more good information about environment is disclosed in the mandatory reports (financial reporting). The size of the coefficient of the variable called *page* emphasizes the low effect that such an independent variable has on the dependent variables.

Table 17.5 Descriptive analysis of the willingness to reveal good and bad news about environmental matters in both social reports (the variable *discltype* equals 0) and consolidated reports (the variable *discltype* equals 1) prepared for the two accounting periods, i.e., both before (the variable *regulation* equals 0) and after (the variable *regulation* equals 1) the application of the examined regulation

Regulation	Stats	Env neutral news	Env bad news	Env good news
Sustainability reporting (*discltype* = 0)				
0 (before)	Sum	3475	18	142
	Mean	144.7917	0.75	5.916667
	Sd	139.2923	1.750776	7.401038
	Min	0	0	0
	Max	602	7	30
1 (after)	Sum	4985	28	276
	Mean	207.7083	1.166667	11.5
	Sd	204.7364	2.68112	14.69398
	Min	8	0	0
	Max	819	11	50
Total	Sum	8460	46	418
	Mean	176.25	.9583333	8.708333
	Sd	176.1193	2.249901	11.85005
	Min	0	0	0
	Max	819	11	50
Financial reporting (*discltype* = 1)				
0 (before)	Sum	658	11	223
	Mean	27.41667	0.4583333	9.291667
	Sd	42.87587	1.444003	13.96106
	Min	0	0	0
	Max	174	6	45
1 (after)	Sum	935	13	272
	Mean	38.95833	0.5416667	11.33333
	Sd	58.2972	1.178767	12.39799
	Min	0	0	0
	Max	218	4	51
Total	Sum	1593	24	495
	Mean	33.1875	0.5	10.3125
	Sd	50.95833	1.304656	13.10215
	Min	0	0	0
	Max	218	6	51

Thirdly (and lastly), we consider as dependent variables related to the type of environmental information disclosed, which can refer to the past (*env past news*), to the present, (*env present news*), or to the future (*env future news*). The type of disclosure (i.e., voluntary or mandatory according to the dummy variable *discltype*) is

Table 17.6 Descriptive analysis about the type of environmental information disclosed which can refer to the past, the present, or the future in both social reports (the variable *discltype* equals 0) and consolidated reports (the variable *discltype* equals 1) prepared for the two accounting periods, i.e., both before (the variable *regulation* equals 0) and after (the variable *regulation* equals 1) the application of the regulation examined

Regulation	Stats	Env past news	Env present news	Env future news
Sustainability reporting (*discltype* = 0)				
0 (before)	Sum	225	3270	140
	Mean	9.375	136.25	5.833333
	Sd	17.41517	134.4785	8.29178
	Min	0	0	0
	Max	79	573	31
1 (after)	Sum	374	4764	151
	Mean	15.58333	198.5	6.291667
	Sd	25.08579	194.1539	10.55618
	Min	0	7	0
	Max	99	773	44
Total	Sum	599	8034	291
	Mean	12.47917	167.375	6.0625
	Sd	21.59195	168.1846	9.393085
	Min	0	0	0
	Max	99	773	44
Financial reporting (*discltype* = 1)				
0 (before)	Sum	559	260	73
	Mean	23.29167	10.83333	3.041667
	Sd	33.31076	20.14225	5.598751
	Min	0	0	0
	Max	121	74	24
1 (after)	Sum	759	390	71
	Mean	31.625	16.25	2.958333
	Sd	42.28867	22.52969	4.657665
	Min	0	0	0
	Max	138	87	19
Total	Sum	1318	650	144
	Mean	27.45833	13.54167	3
	Sd	37.89288	21.31722	5.094845
	Min	0	0	0
	Max	138	87	24

both statistically significant at the 0.05 level and seems to be related to the dependent variable *env past news*. If we consider the disclosure of environmental news about past actions (as a dependent variable), the coefficient of the independent variable *discltype* is positive, which would indicate that more environmental information about past

Table 17.7 Coefficients of the regression models considering as dependent the variables related to the completeness of environmental disclosure (*environmental mention, description, and evaluation*), the variable related to the willingness to reveal favorable environmental matters, and the variable related to the disclosure of environmental news about past actions

Independent variables	Completeness of environmental disclosure			Favorable environmental matters	Past environmental information disclosure
	Env mention	Env description	Env evaluation	Env good news	Env past news
page	0.1413953**	0.6305087**	0.3203091**	0.0796743**	0.1240686*
discltype	14.18629*	−40.02442*	−21.78415*	8.482715**	25.69042**
regulation	−5.284437	21.54689	8.509492	2.607426	5.394296
R^2	0.1097	0.3988	0.4029	0.1544	0.1179
Adj R^2	0.0806	0.3792	0.3834	0.1268	0.0891

Note $*p < 0.05$. $**p < 0.01$

actions is disclosed in the mandatory reports (financial reporting). The coefficient of the variable *page* is statistically significant, but its size emphasizes the low effect that such an independent variable has on the dependent variables.

The analysis conducted about environmental issues has highlighted relevant differences between financial and sustainability reporting in all the matters investigated, i.e., the completeness of environmental disclosure, the willingness to reveal also unfavorable news, and the attempt to use such information also for prospective purposes.

17.3.4.2 Employee Issues

Considering the disclosure of employee matters, the analysis ascertains (Table 17.8) that both the total and the average numbers of sentences dedicated to such issues are greater in sustainability reporting.

After considering the overall employee disclosure according to the distinction between mandatory and voluntary reporting, the time variable is introduced in order to examine such a distinction in the two different accounting periods (Table 17.9), i.e., both before and after application of the Directive 2003/51/EC in the Italian context.

The total number of sentences increases after application of the examined regulation in both consolidated (+3.68%) and social (+28.42%) reports. There is an increase also in the average number of sentences in both the 2010 consolidated and social reports.

Going more into detail, the above-listed employee categories identified by GRI are then used in the present analysis in order to consider the total number of sentences for each employee category in the examined reports. There is a decrease only in the disclosure of "social" (−17.84%) and "communications" (−19.75%) matters after the application of the examined regulation (Fig. 17.3). On the other hand, the major increases regard the following: "diversity and equal opportunity" (+55.06%), "occupational health and safety" (+45.03%), and "labor/management relations" (+35.69%). An interesting difference emerges about the content of sustainability and financial reporting (Fig. 17.4). Both consolidated annual reports and social–environmental reports dedicate great disclosure to "training and education," but only social–environmental reports focus on "development programs."

Table 17.8 Total (sum) and average (mean) amount of employee disclosure in Italian sustainability reporting (the variable *discltype* equals 0) and financial reporting (the variable *discltype* equals 1)

Employee disclosure	discltype	Sum	Mean	Sd	Min	Max
Sustainability reporting	0	8905	185.5208	88.19321	62	445
Financial reporting	1	1918	39.95833	41.4667	0	230
	Total	10823	112.7396	100.2579	0	445

Table 17.9 Total (sum) and average (mean) amount of voluntary employee disclosure (the variable *discltype* equals 0) and mandatory disclosure (the variable *discltype* equals 1) both before (the variable *regulation* equals 0) and after (the variable *regulation* equals 1) the application of the 51/2003 European Directive in the Italian context

Regulation	Sum	Mean	Sd	Min	Max
Social reporting (*discltype* = 0)					
0 (before)	3715	154.7917	71.93897	68	354
1 (after)	5190	216.25	93.53272	62	445
Total	8905	185.5208	88.19321	62	445
Financial reporting (*discltype* = 1)					
0 (before)	941	39.20833	49.59136	0	230
1 (after)	977	40.70833	32.45395	1	115
Total	1918	39.95833	41.4667	0	230

The descriptive analysis conducted until now emphasizes the differences in the amount and type of disclosure between financial reporting and sustainability reporting in two different accounting periods. Going into more detail, the analysis focuses on the completeness of the disclosure about employee issues, the willingness to reveal also unfavorable news, and the attempt to use such information also for prospective purposes.

Firstly, with respect to the completeness of the disclosure (Table 17.10), the analysis ascertains an increase in the number of sentences which mention employee issues in both voluntary and mandatory reports (2010). There is also a significant impact of the examined regulation in the description and evaluation of such matters, but only in the sustainability reporting.

Secondly, about the willingness (Table 17.11) to reveal different types of news (i.e., neutral, bad, and good), both financial reporting and sustainability reporting mainly disclose neutral employee information. The amount of bad news appears to be irrelevant for both types of report.

Lastly, about the attempt to use employee information also for prospective purposes (Table 17.12), there seems to still be some reticence in the disclosure of future targets about employees, especially in consolidated reports. Financial reporting mainly discloses past employee information, while sustainability reporting focuses on present information. In any case, there is an increase in all three types of information (i.e., referring to past, present, and future) in the second accounting period.

The results obtained through the preliminary analysis conducted until now are confirmed by the regression analysis (Table 17.13).

Let us focus on the total number of sentences dedicated to employee issues (as dependent variable) and the coefficients of the two independent variables (whether they are statistically significant and, if so, the direction of the relationship). Both the type of disclosure and the regulation are statistically significant at the 0.05 level and seem to be related to the dependent variable. The coefficient of the first independent

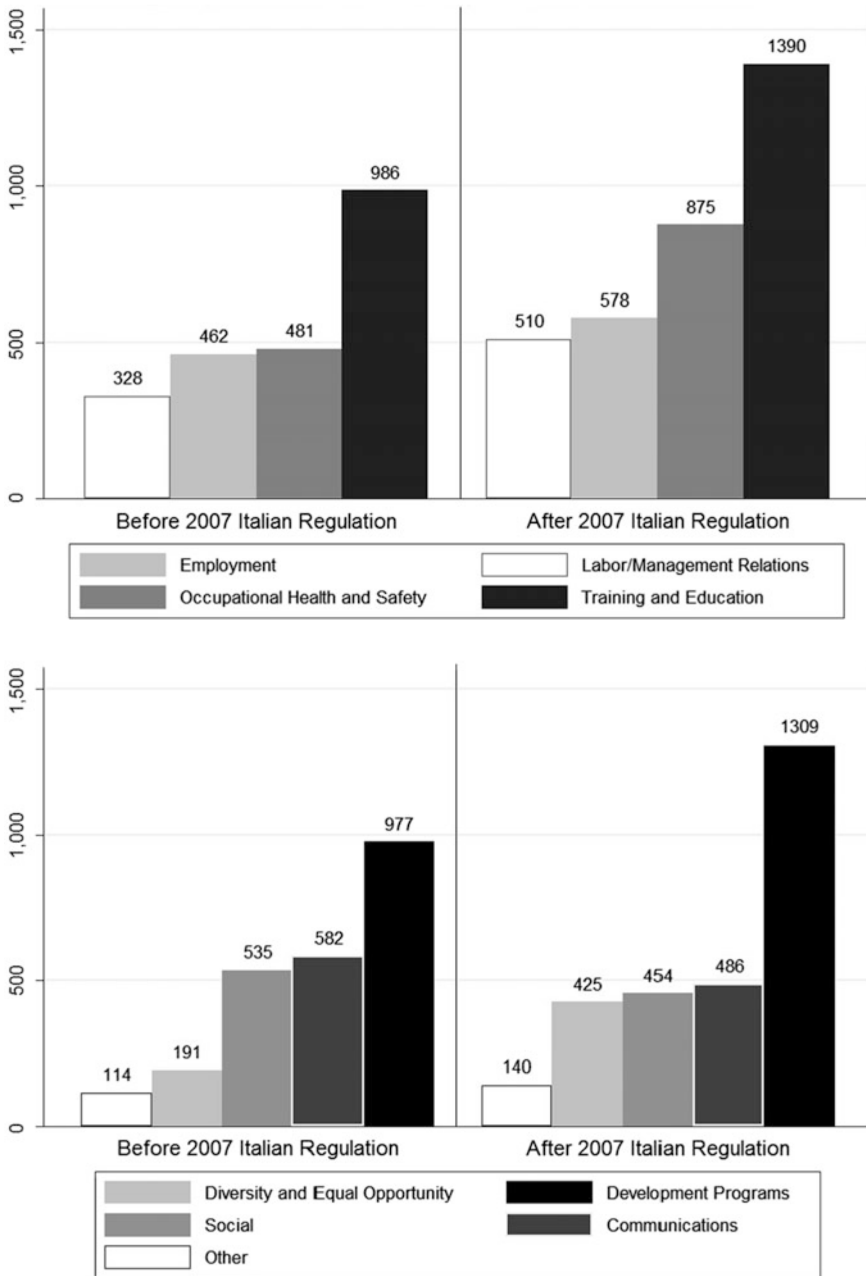


Fig. 17.3 Total amount of disclosure about nine employee categories (identified by GRI) in two different accounting periods, i.e., both before and after the application of the 51/2003 European Directive in the Italian context

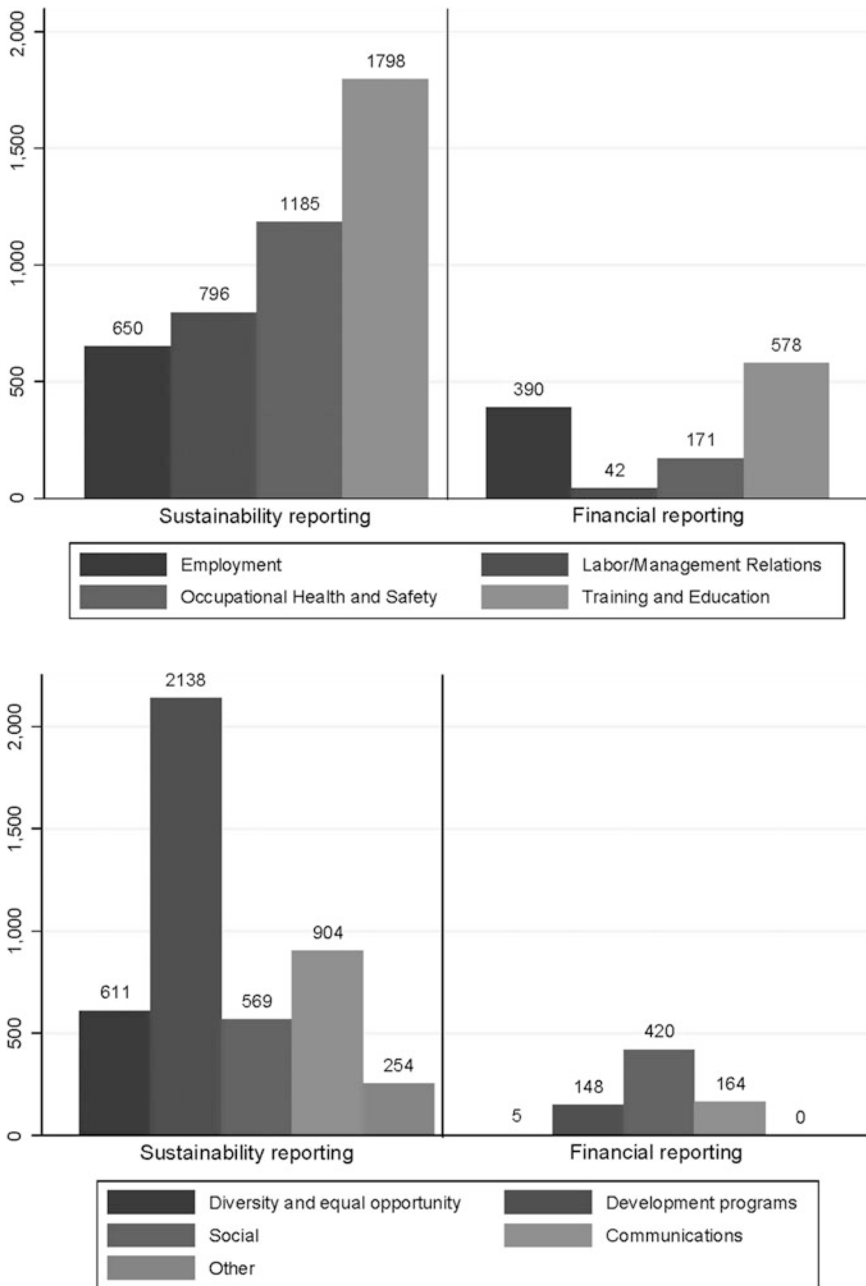


Fig. 17.4 Amount of disclosure about nine employee categories (identified by GRI) in both Italian financial and sustainability reporting

Table 17.10 Descriptive analysis of the completeness of employee disclosure through three different variables (*mention, description, and evaluation*) in both social reports (the variable *discltype* equals 0) and consolidated reports (the variable *discltype* equals 1) in the two different accounting periods, i.e., both before (the variable *regulation* equals 0) and after (the variable *regulation* equals 1) the application of the regulation examined

Regulation	Stats	Employee mention	Employee description	Employee evaluation
Sustainability reporting (*discltype* = 0)				
0 (before)	Sum	252	2525	938
	Mean	10.5	105.2083	39.08333
	Sd	12.65942	47.36168	23.16841
	Min	0	47	11
	Max	54	227	94
1 (after)	Sum	292	3740	1158
	Mean	12.16667	155.8333	48.25
	Sd	13.6626	69.86177	27.31977
	Min	0	41	9
	Max	52	327	118
Total	Sum	544	6265	2096
	Mean	11.33333	130.5208	43.66667
	Sd	13.05689	64.34647	25.48285
	Min	0	41	9
	Max	54	327	118
Financial reporting (*discltype* = 1)				
0 (before)	Sum	362	576	3
	Mean	15.08333	24	0.125
	Sd	16.18619	35.89114	0.337832
	Min	0	0	0
	Max	55	174	1
1 (after)	Sum	421	555	1
	Mean	17.54167	23.125	0.0416667
	Sd	15.21435	23.06383	0.2041241
	Min	1	0	0
	Max	50	79	1
Total	Sum	783	1131	4
	Mean	16.3125	23.5625	0.0833333
	Sd	15.58935	29.84777	0.2793102
	Min	0	0	0
	Max	55	174	1

variable (i.e., the type of disclosure that can be mandatory or voluntary) is negative, which would indicate that greater disclosure about employee issues can be found in social reports. The coefficient of the second independent variable (i.e., before or after the examined regulation) is positive, which would indicate that such a regulation has a greater impact on mandatory disclosure about employee matters.

Table 17.11 Descriptive analysis of the willingness to reveal good and bad news about employee matters in both social reports (the variable *discltype* equals 0) and consolidated reports (the variable *discltype* equals 1) in the two different accounting periods, i.e., both before (the variable *regulation* equals 0) and after (the variable *regulation* equals 1) the application of the regulation examined

Regulation	Stats	Employee neutral news	Employee bad news	Employee good news
Sustainability reporting (*discltype* = 0)				
0 (before)	Sum	3612	30	73
	Mean	150.5	1.25	3.041667
	Sd	72.02355	3.553932	3.168859
	Min	63	0	0
	Max	351	16	10
1 (after)	Sum	5068	20	102
	Mean	211.1667	0.8333333	4.25
	Sd	91.91616	1.606148	4.078043
	Min	60	0	0
	Max	440	7	14
Total	Sum	8680	50	175
	Mean	180.8333	1.041667	3.645833
	Sd	87.25027	2.736346	3.664026
	Min	60	0	0
	Max	440	16	14
Financial reporting (*discltype* = 1)				
0 (before)	Sum	698	6	237
	Mean	29.08333	0.25	9.875
	Sd	37.47801	0.7372098	15.30363
	Min	0	0	0
	Max	182	3	57
1 (after)	Sum	778	16	183
	Mean	32.41667	0.6666667	7.625
	Sd	26.34044	1.970801	8.432919
	Min	0	0	0
	Max	89	7	32
Total	Sum	1476	22	420
	Mean	30.75	0.4583333	8.75
	Sd	32.0893	1.486941	12.27608
	Min	0	0	0
	Max	182	7	57

With respect to the completeness of employee disclosure, considering the number of sentences in which employee matters are mentioned as dependent variable, there is no significant linear relationship with both the independent variables examined here. On the other hand, considering the description of such issues

Table 17.12 Descriptive analysis about the type of employee information disclosed which can refer to the past, the present, or the future in both social reports (the variable *discltype* equals 0) and consolidated reports (the variable *discltype* equals 1) prepared for the two accounting periods, i.e., both before (the variable *regulation* equals 0) and after (the variable *regulation* equals 1) the application of the regulation examined

Regulation	Stats	Employee past news	Employee present news	Employee future news
Sustainability reporting (*discltype* = 0)				
0 (before)	Sum	162	3413	140
	Mean	6.75	142.2083	5.833333
	Sd	6.271052	68.06453	8.625879
	Min	0	56	0
	Max	27	346	29
1 (after)	Sum	240	474 9	201
	Mean	10	197.875	8.375
	Sd	12.26164	88.84981	19.88623
	Min	1	61	0
	Max	58	429	98
Total	Sum	402	8162	341
	Mean	8.375	170.0417	7.104167
	Sd	9.773227	83.19522	15.21791
	Min	0	56	0
	Max	58	429	98
Financial reporting (*discltype* = 1)				
0 (before)	Sum	643	266	32
	Mean	26.79167	11.08333	1.333333
	Sd	31.89927	17.92234	2.443566
	Min	0	0	0
	Max	144	85	11
1 (after)	Sum	685	282	10
	Mean	28.54167	11.75	0.4166667
	Sd	23.71567	11.5203	0.6538625
	Min	0	1	0
	Max	82	41	2
Total	Sum	1328	548	42
	Mean	27.66667	11.41667	0.875
	Sd	27.82035	14.90799	1.829138
	Min	0	0	0
	Max	144	85	11

(as dependent variable), both the 2007 regulation and the type of disclosure are statistically significant at the 0.05 level and seem to be related to the dependent variable. The coefficient of the first independent variable (i.e., the type of disclosure that can be mandatory or voluntary) is negative, which would indicate that greater

Table 17.13 Coefficients of the regression models, considering as dependent the variables related to the completeness of employee disclosure (i.e., *description* and *evaluation*), the variables related to the willingness to reveal *neutral* and *favorable* employee matters, and the variables related to the disclosure of employee news about *past*, *present*, and *future* actions

Independent variables	Completeness of employee disclosure			Willingness to reveal neutral and favorable employee matters		Disclosure of employee news about past, present, and future actions		
	Number of sentences dedicated to employee matters	Employee description	Employee evaluation	Employee good news	Employee neutral information	Employee past news	Employee present information	Employee future information
discltype	−145.56**	−106.9583**	−43.5833**	5.104167**	−150.083**	19.29167**	−158.625**	−6.22916**
regulation	31.47917*	24.875*	4.541667	−0.5208333	32*	2.5	28.16667*	0.8125
R^2	0.5574	0.5663	0.6055	0.0758	0.5969	0.1824	0.6629	0.0791
Adj R^2	0.5479	0.5570	0.5970	0.0559	0.5883	0.1648	0.6557	0.0593

Note $^{*}p < 0.05$. $^{**}p < 0.01$

disclosure about employee issues can be found in social reports. The coefficient of the second independent variable (i.e., before or after the 2007 regulation) is positive, which would indicate that such a regulation has a greater impact on mandatory disclosure about employee matters. Finally, by considering the evaluation (dependent) variable, we notice that only the type of disclosure is statistically significant at the 0.05 level and seems to be negatively related to the dependent variable.

Let us focus on the type of information (i.e., neutral, good, or bad) that is disclosed about employee issues; there is no significant linear relationship when considering the disclosure of employee information that can damage the corporate image. On the other hand, the amount of neutral information (as dependent variable) seems to be related to both the independent variables (i.e., the 2007 regulation and the type of disclosure), which are statistically significant at the 0.05 level. The amount of positive information (as dependent variable) seems to be related only to the type of disclosure (i.e., mandatory or voluntary) in a positive way: more good information about employee issues are disclosed in the mandatory reports.

Lastly, the regression analysis considers as dependent the variables related to the type of employee information disclosed, which can refer to the past, the present, or the future. The 2007 regulation (as independent variable) is statistically significant at the 0.05 level only if related to the disclosure of employee information about present actions (as dependent variable); its coefficient is positive, which would indicate that more information about present actions is disclosed in the mandatory reports. On the other hand, the type of disclosure (i.e., voluntary or mandatory according to the dummy variable *discltype*) is both statistically significant at the 0.05 level and seems to be related to all three dependent variables. The coefficient of the independent variable *discltype* is positive only considering the disclosure of employee information about past actions (as dependent variables); more employee information about past actions is disclosed in the mandatory reports. On the other hand, such a coefficient is negative in the other two cases, which would indicate that more employee information about present and future actions is disclosed in the social reports.

In conclusion, by distinguishing between mandatory and voluntary disclosure, the analysis ascertains that completeness (i.e., evaluation) of employee disclosure and the attempt to use such information also for perspective purposes concern only sustainability reporting. On the other hand, management willingness to reveal favorable aspects of employee matters emerges from the examined consolidated reports.

17.4 Concluding Remarks

The present chapter focused on the differences between financial and sustainability reporting in the disclosure of environmental and employee matters. Thus, the analysis concerned both (mandatory) consolidated annual reports and (voluntary) stand-alone social–environmental reports prepared by Italian-listed corporate

groups for two different accounting periods (both before and after the implementation of Directive 2003/51/EC).

The analysis is especially relevant because efforts by academics and regulators are focused on so-called integrated reporting in order to promote the convergence of financial and sustainability reporting into a “single narrative.” The final results of the present analysis show interesting differences in the disclosure of environmental and employee matters between the consolidated annual reports and stand-alone social–environmental reports examined.

Considering the overall environmental and employee disclosure, voluntary reporting exceeds mandatory reporting. It is also more complete: environmental and employee issues are more descriptive and evaluated in the stand-alone social–environmental reports as compared to in the consolidated annual reports, where they are mainly mentioned. Moreover, financial reporting seems to be quicker to disclose favorable news and information about past actions having an impact on environmental and employee matters. The analysis also revealed some differences of content between financial and sustainability reporting about both environmental issues (e.g., in the GRI category labeled “water”) and employee matters (e.g., in the GRI category labeled “development programs”).

On the research side, this study makes a contribution to the debate concerning “integrated reporting.” It also contributes to the financial reporting debate by presenting the impact of a specific regulation on both mandatory and voluntary disclosure practices adopted by Italian entities. At the same time, it offers company managers and accountants precious information about the most widespread communication practices for reporting environmental and employee matters. From the operative perspective, our evidence can help regulators and standard setters to better discipline management commentary reporting with reference to environmental and social issues.

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Chapter 18
Corporate Social Responsibility, Investor Sentiment, and Stock Returns

Emrah Keleş and Ayten Çetin

Abstract In this study, we show that corporate social responsibility (CSR) increases volatility, since it creates noise in financial markets. Some outstanding studies related to the impact of investor sentiment state that companies with higher volatility exercise lower returns following high sentiment periods. Using environmental, social, and governance (ESG) research data, we sort a large number of US firms into high, medium, and low groups along with their social and environmental scores. We then predict the return of the high average minus the low average with investor sentiment, which has the tendency to act based on cognitive biases rather than the information at hand. Investor sentiment is proxied by direct sentiment surveys and the Baker and Wurgler (2006) composite sentiment index. We find that companies with higher environment-focused CSR activities have lower subsequent returns following high sentiment periods. We capture this evidence also for social performance with the composite sentiment index. The study introduces new insight to corporate social responsibility literature and extends return predictability literature. It also contributes a behavioral view to CSR–company performance relations.

Keywords Corporate social responsibility · ESG · Investor sentiment · Company performance · Stock returns

JEL Codes G02 · C58 · C59

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18.1 Introduction

The importance of environmental, social, and governance (ESG) issues has risen dramatically over the last decades. Along with this, companies take more non-financial decisions into consideration for their investment decisions. Some scholars emphasize the move from economic to social values (Battilana et al. 2009).

While corporate social responsibility (CSR) has no unique definition, it refers to any management of public policies and social issues (Windsor 2006). The increasing interest in CSR and ESG is leading to a wide range of research dealing with the relationship between CSR and corporate financial performance (CFP). In these studies, different proxies are used to measure CFP. The large number of measures results in different findings of significance and/or signs of impact. Most studies are based on the capital asset pricing model (CAPM) framework. Classical theories assume that rational investors dominate financial markets and remove the effects of irrational ones, which enables wealth accumulation and prices that revert to their fundamental levels. However, according to behavioral scholars real-world arbitrage is limited because it is risky and costly (Shleifer and Vishny 1997), and investors are affected by sentiment (De Long et al. 1990). Hence, irrational, so-called noise traders cause prices to deviate from their fundamental values.

Investor sentiment is defined as a tendency to act based on cognitive biases rather than the information at hand. Sentiment effects attract many scholars and are, therefore, used to predict stock returns. One of the important findings of sentiment studies on the aggregate level is that market returns are lower following high sentiment periods. This negative effect of sentiment is captured for companies that are difficult to value and arbitrage (Lemmon and Portniaguina 2006; Baker and Wurgler 2006). When sentiment is high, subsequent returns of small, young, highly volatile, unprofitable, non-dividend-paying, extreme growth, and distressed stocks become lower (Baker and Wurgler 2006).

Although it is increasingly important, there are few CSR studies which take sentiment into consideration. In his theoretical paper, Orlitzky (2013) discusses that CSR has an impact on financial markets for two reasons. First, due to the mixed impact of CSR on CFP, it is not easy to capture the systematic effect of CSR on fundamentals. Another reason is that there is information asymmetry about CSR commitment between executives and other stakeholders. For either reason, the difficulty in evaluating CSR causes noise in markets. In financial markets, more noise trading leads to excess market volatility references.

In this study, we test whether corporate social responsibility (CSR) creates noise in financial markets and, therefore, increases volatility. We use environmental, social, and governance (ESG) research data as a CSR measure. After sorting a large number of US companies into high, medium, and low groups with their social and environmental scores, we predict the return of the high average minus the low average. As investor sentiment proxies, we use direct sentiment surveys and the Baker and Wurgler (2006) composite sentiment index after controlling specific company characteristics, Fama–French factors, and financial and macroeconomic

indicators. As a result, we find that companies with higher environment-focused CSR activities have lower subsequent returns following high sentiment periods. We find similar evidence for social performance by using the Michigan University Sentiment Index.

This study contributes to the literature in several ways. First, it introduces new insight to corporate social responsibility literature by incorporating sentiment. Second, it extends return predictability literature with CSR implications. It also contributes a behavioral view to the CSR–company performance relation.

The rest of the paper is organized as follows. In the next part, we document a literature survey focusing on CSR–CSP and sentiment–return relations and develop a hypothesis. In the third part, we explain data and descriptive statistics. Portfolio formulation and model construction take place in detail. We analyze the sentiment effects for CSR-focused portfolios and discuss the findings in this part; we conclude the paper in the fourth part with further directions.

18.2 Literature Survey and Theoretical Background

18.2.1 Relationship Between CSR and CFP

A company/an investor may be involved in CSR activities or has motives to invest in CSR-oriented stocks for many reasons. The most common motives are "economic" and "ethical" (Lougee and Wallace 2008). Complying with shareholder theory, economic motive of a company is related to its short-term objective. According to shareholder theory, companies are driven to maximize profits and increase shareholder wealth. Friedman (1970) supported this theory by saying "*there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.*" Therefore, shareholders are likely to give more importance to short-term profits (why just short-term?). However, stakeholder theory suggests that management has to satisfy several groups, who have some interest or "stake" in a company and can influence its outcome (Ziegler et al. 2009). This theory assumes that values are part of doing business (Freeman 1994). Besides economic motive, Donaldson and Preston (1995) add a moral/ethical part to CSR. Stakeholders care about long-term benefits much more, and companies can choose to invest in CSR as a means of "doing the right thing," as in Donaldson's (1990) stewardship theory. From this perspective, ethically purposed CSR activities are associated with stakeholder theory.

The relationship between CSR and CFP has been investigated for a long time. Although there is more positive evidence, one cannot conclude that CSR has a positive impact on CFP. However, companies benefit from CSR programs or activities in some ways. CSR activities strengthen corporate reputation

(Fombrun and Shanley 1990; Williams and Barrett 2000; Mahon 2002) and decrease transaction and agency costs (Jones 1995; Barnett 2007). These activities can also diminish business risk (Orlitzky and Benjamin 2001; Godfrey 2005). Strong CSR programs decrease the likelihood of scandals or accidents, helping to protect a company or limit damage (Lougee and Wallace 2008). Companies can also have the chance to practice better management (D'Amato et al. 2009). They may use CSR a tool to differ from competitors in compliance with their purpose of increase accounting and market performances. The Body Shop is a good example of a company successfully using CSR for brand differentiation (Lougee and Wallace 2008). Furthermore, CSR enables better internal policies (D'Amato et al. 2009). For example, reputation attracts more applicants, the more qualified of which can be recruited (Turban and Cable 2003). Recruiting to adopt CSR policies in a company is also becoming more common (Lougee and Wallace 2008).

Negative effects of CSR are based in its costly nature (Windsor 2001). In the case of environmental or social activities that exceed their benefits due to energy savings, recycling, or waste reduction, the assumption of shareholder wealth maximization can deviate. While CSR benefits are uncertain or not expected in the near future, CSR activities use a large amount of financial resources and, therefore, lead to reduced profits, decreased values, or competitive disadvantages (McWilliams and Siegel 2001; Mackey et al. 2007; Von Arx and Ziegler 2008).

The ambiguity of evidence for CSR–CFP can also be observed in literature survey studies for this relationship in aggregate. For instance, Orlitzsky et al. (2003) review 52 individual studies, finding that CSR activities translate into better financial performance for various industries and periods. More interestingly, they report CSR affects financial performance via reputation more than it increases internal performance. Lougee and Wallace (2008) examine the CSR trend and relationship between CSR and CFP over a 15-year period from 1992 to 2006. They conclude that the higher the companies invest in CSR the higher returns on asset (ROA) ratio they have. Similarly, Friede et al. (2015) find evidence of non-negative relationship between CSR (environment, social, and governance criteria) and CFP in 90% of the 2200 related studies they reviewed. On the other hand, Griffin and Mahon (1997) analyze 51 articles for 25-year period about the relationship between CSR and CFP by using multiple sources of CSR data and corporate financial performance proxies.[1] They conclude that the use of different measures determines the results. Margolis and Walsh (2001) give an extensive summary of CSR studies. They found that most studies (42 of 80) document a positive impact of social performance on financial performance. They also discuss the mainly positive impact (68%) of financial performance over CSR and conclude that companies in a financially good situation (with respect to accounting, market, and other

[1]For CSR data the authors consider the Fortune reputation survey, the Kinder, Lydenberg, and Domini (KLD) index, the Toxics Release Inventory (TRI), and corporate philanthropy, whereas they choose accounting measures like retun on equity, return on asset, the natural logarithm of total assets, the asset age and 5-year return on sales as financial performance indicators.

performance) can have social expenditure. These studies suggest some reasons as to why no clear CSR–CFP relationship exists. Among them, three are the most salient:

(i) The large range of variables affecting this relationship (Hillman and Keim 2001; Mackey et al. 2007).
(ii) Endogeneity problems, i.e., reverse causality between CSR and CFP (Griffin and Mahon 1997; Orlitzsky et al. 2003).
(iii) Misspecification and measurement errors and problems in research design (McWilliams and Siegel 2000).

18.2.2 Inefficient Financial Markets

Regardless of their findings, these studies are mainly based on the efficient market hypothesis (EMH) or more broadly the capital asset pricing model (CAPM). In the CAPM approach the prices of stocks fully reflect all available information; markets are efficient (Fama 1970) and in efficient markets, rational investors, namely arbitrageurs, dominate the financial markets and eliminate the effects of irrationals that enable wealth accumulation. Even in the short time prices change; they go back to their fundamental levels in the long run, which is the discounted sum of future cash flows.

Mackey et al. (2007) assert that regardless of maximizing the preset value of a company's future cash flow, CSR is likely to maximize the market value of the socially responsible company. However, according to Orlitzky (2013) this conclusion about the economic consequences of CSR is based on following assumption:

(i) CSR actions that have impact on other market participants must be valid and meaningful.
(ii) Financial markets should be at least semi-strongly efficient.

Due to the nonlinear and highly complex relationship between CSR and CFP (Brammer and Millington 2008), evidence for the relationship between variable definition of CSR[2] and CFP is mixed. This creates noise in financial markets. Another source of noise stems from false CSR signals arising from the economic notion known as information asymmetry. Information asymmetry involves two parties where one (managers of socially responsible companies) has more information than the other (actual and potential investors of a socially responsible company),[3] causing a disparity between outsiders' and insiders' evaluation of CSR information. When CSR information is subject to distortion and/or is not rationally assessed, CSR actions increase noise in capital markets (Orlitzky 2013).

[2]For example, whether CSR is in favor of lowering risk largely depends on how it is defined (Orlitzky 2013).

[3]Strickly speaking, it is the condition that seller has more information than buyer (Akerlof 1970).

Because they contain non-financial characteristics, CSR reports may lead to psychological bias in stock prices and hence cause dispersion in the behavior of investors. This dispersion reduces the common judgement among investors.

Contrary to mainstream finance, behavioral finance is interested in deviation from strict rationality assumption. Researchers in this field of finance assert that mispricing not only stems from earning opportunities but also from psychological foundations (Barberis et al. 1998; Daniel et al. 1998). Behavioral finance is based on mainly two constructions: real-world arbitrage is limited because it is risky and costly (Shleifer and Vishny 1997) and investors are affected by sentiment (De Long et al. 1990). Contrary to arbitrageurs, irrational investors, namely noise traders, form their beliefs with some psychological biases, whereas they make their preferences in accordance with prospect theory (Kahneman and Tversky 1979). These cognitively based beliefs about future cash flows that are not explained with information at hand are commonly known as investor sentiment (Baker and Wurgler 2007). Sentiment effects attract many scholars for that reason. Predictability tests are ideal for measuring these effects. If sentiment causes over-valuation, according to these tests, sentiment-sensitive stocks would make lower returns when sentiment changes (Baker and Wurgler 2007).

The level of CSR activity in a company or a country as a whole may depend on shareholders' expectations, which are influenced by social values and culture. While US companies behave responsibly in an economic, social, and ethical manner, their European counterparts are pushed by institutional enforcements (Maignan and Ralston 2002). In some countries such as the UK, France, or Germany, these enforcements are maintained by government regulations. In the UK, pension funds investors have to disclose the level they consider environmental, social, and ethical issues in their investments; in France, there is a social and environmental data reporting obligation for public companies, and in Germany, tax advantages for some investments drive the CSR demand (Orlitzky 2013).

18.2.3 The CSR–Sentiment Relationship

In financial markets, investors can consider noise for speculative purposes[4] (Laffont 1985) or unconsciously, that is, when they fail to separate noise from information (Black 1986). Regardless of the reason, noise increases in equity markets over time (Orlitzky 2013). Orlitzky (2013) argues that CSR creates noise for the above reasons, and more noise in equity markets causes many investors to consider a higher level of noise for their investment decisions. Hence, more noise trading leads to excess market volatility.

[4]Baker and Wurgler (2006) define investor sentiment as the propensity to speculate.

Unclear separation between noise and information and accumulated noise in markets also reduce investors' judgement. This reduction also means an increase in common judgement errors, which is investor sentiment.

Naughton et al. (2014) explain cumulative abnormal returns around CSR press releases with investor sentiment. They proxy sentiment by using the difference between the log of the average market-to-book ratios of firms with high CSR spending and firms with low CSR spending. They argue that companies respond to sentiment-driven investors when committing resources to CSR projects.

18.2.4 Return Predictability and the Effect of Sentiment

Because predictability tests are suitable for finding the effect of sentiment, we use predictability regressions to show the relationship between level of CSR activities and sentiment changes. There is strong evidence that sentiment is a significant predictor of stock returns. An important finding of sentiment studies in aggregate levels is that the market has lower returns following high sentiment periods. This negative effect of sentiment is captured for companies that are difficult to value and arbitrage (Lemmon and Portniaguina 2006; Baker and Wurgler 2006). Strong evidence shows that when sentiment is high, subsequent returns of small, young, highly volatile, unprofitable, non-dividend-paying, extreme growth, and distressed stocks are lower (Baker and Wurgler 2006). When sentiment is low, the opposite is true. If CSR leads to volatility of all stocks, as in Orlitzky (2013), we expect higher sentiment periods to be followed by lower subsequent returns of higher CSR-related portfolios. We hypothesize our suggestions below:

"Stocks with higher CSR activities get lower subsequent returns following higher previous period sentiment compared to stocks with lower CSR activities."

To test the hypothesis, we examine the predictability of stock returns in 1-year horizon. First, we sort stocks based on their level of CSR activity, then form three portfolios, namely high, medium, and low ones. Second, we seek predictability patterns in the average returns of the portfolios upon the sentiment level of the previous period.

18.3 Data and Methodology

18.3.1 Data and Variables

In this study, we use environmental, social, and governance (ESG) research data from the ASSET4 database of Datastream. We obtain CSR data from the ASSET4

database of Thomson Reuters.[5] Information related to the environment and the social part of this are presented in CSR reports, sustainability reports, Web sites, and annual reports, while corporate governance information is obtained from annual reports, corporate governance reports, and proxy filings (Wang et al. 2013). We use ESG data of Asset4 for 994 US stocks in the Russell 1000 Index starting with 2002. Because ASSET4 provides data starting from 2002 and data for the last 2 years is missing, our sample data covers the period of 2002–2014. We neglect governance and financial data and focus on social and environmental scores such as Naughton et al. (2014). These scores are the products of a large number of criteria where every individual criterion is scored. Then, we sort these stocks into high, medium, and low groups with their social and environmental scores. Finally, following Baker and Wurgler (2006), we employ return of the high average minus the low average as a dependent variable.

Our independent variable is investor sentiment. For sentiment measures, we use the University of Michigan Consumer Sentiment Index (CSI) and the Conference Board Consumer Confidence Index (CI) as direct sentiment proxies. Both indexes are derived from surveys that involve a set of questions about current and expected future economic conditions (Dominitz and ve Manski 2003). On the other hand, the Baker and Wurgler (2006) composite sentiment index derived from market ratios is our indirect sentiment proxy. Since CSR data is available for 2002–2014, we obtain sentiment data from surveys for the same period. However, BW data is limited up to 2010. Sentiment measures are described in more detail in Appendix 1.2.

Table 18.1 shows the variables, the database we gathered, and some descriptive statistics. Environmental and social scores of companies differ in a wide range. While the lowest social score is 3.64 and the highest is 98.88, these scores are 8.30, and 97.28, respectively, for environment data. Although mean values for sentiment surveys are similar, and nearly 88 for each one, the gap between minimum and maximum is higher in CI. This difference may stem from CI questions, which focus on the shorter term. On the other hand, since BW is derived from principle component analysis, it takes numbers from positive to negative.

We present the relationship of three sentiment proxies in Fig. 18.1. According to Fig. 18.1, one can conclude that while three sentiment proxies change in the same direction, CSI and CI show a high correlation with 0.88 and are low with BW (0.11 with CSI and −0.07 with CI).

We obtained the factors RMRF, SMB, HML, and MOM for the US stock market directly from the Kenneth R. French data library. As controlling variables, the factors RMRF, SMB, HML, and MOM come from Kenneth French's library.

[5]ASSET4 is an originally Swiss private company founded in 2003, which was acquired by Thomson Reuters in 2009. It gathers quantitative and qualitative ESG data on 3100 global companies (as of Q2 2010) and scores them on four pillars: environmental, social, corporate governance, and economic. In turn, the pillar scores that were derived from 18 categories of more than 250 key performance indicators constitute an overall company score showing the company's strength related to ESG principles (http://thomsonreuters.com/content/dam/openweb/documents/pdf/tr-com-financial/report/starmine-quant-research-note-on-asset4-data.pdf).

Table 18.1 Descriptive statistics

Variable	Definition	Mean	Max	Min	Observation	Database
RET	Logarithmic difference of stock prices	0.06	2.93	−5.02	13,110	Datastream
ENV	CSR environmental performance overall score	41.95	97.28	8.30	9210	ASSET4
SOC	CSR social performance overall score	45.25	98.88	3.64	9210	ASSET4
RET^{ENV}	Average return of the high environmental-score minus the average return of the low score	−0.01	0.08	−0.07	14,908	Constructed
RET^{SOC}	Average return of the high social score minus the average return of the low score	−0.01	0.05	−0.08	14,908	Constructed
CSI	Consumer Sentiment Index	81.84	95.20	63.70	14,908	The University of Michigan
CI	Consumer index	81.22	105.89	45.44	14,908	The Conference Board
BW	Baker and Wurgler (2006) composite sentiment index	−0.16	0.27	−0.59	8946	Jeffrey Wurgler Library
RMRF	Excess return on the market	6.96	35.19	−38.34	14,908	Kenneth French Library
SMB	The average return on the three small portfolios minus the average return on the three big portfolios	2.84	27.76	−8.23	14,908	Kenneth French Library
HML	The average return on the two value portfolios minus the average return on the two growth portfolios	1.12	14.44	−12.31	14,908	Kenneth French Library
MOM	The average return on the two high prior return portfolios minus the average return on the two low prior return portfolios	−1.09	25.65	−82.91	14,908	Kenneth French Library

The variable RMRF is the excess return of the value-weighted market over the risk-free rate; MOM is the return on high-momentum stocks minus the return on low-momentum stocks, where momentum is measured over months [−12, −2]. As described by Fama and French (1993), whereas SMB is the return on portfolios of small minus big ME stocks, HML is constructed to isolate the difference between high and low BE/ME portfolios.

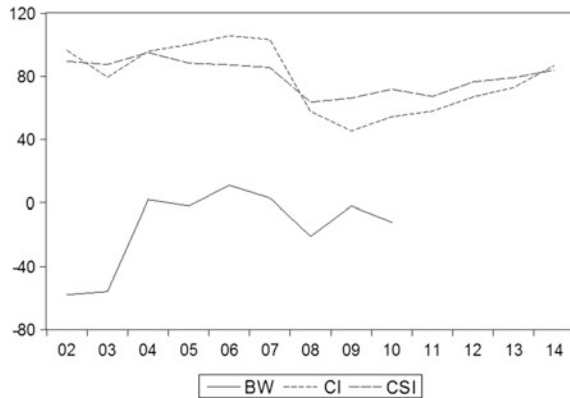

Fig. 18.1 Correlation between sentiment proxies

18.3.2 Predictability Regressions

As the first step, based on stocks' CSR environmental and social scores, we construct three portfolios, namely high, medium, and low. The differences between the return of the high-sored portfolio and that of the low-scored portfolio are defined as CSR premium. Second, we regress CSR premium on sentiment measures by controlling the Fama–French factors and the momentum factor, which are other predictors of stock returns. Finally, our regressions are constructed as below:

1. $\text{RET}_t^{ENV} = \beta_0 + \beta_1 \text{SENT}_{t-1}^{CSI} + \beta_2 \text{RMRF}_t + \beta_3 \text{SMB}_t + \beta_4 \text{HML}_t + \beta_5 \text{MOM}_t + \varepsilon_t$
2. $\text{RET}_t^{SOC} = \beta_0 + \beta_1 \text{SENT}_{t-1}^{CSI} + \beta_2 \text{RMRF}_t + \beta_3 \text{SMB}_t + \beta_4 \text{HML}_t + \beta_5 \text{MOM}_t + \varepsilon_t$
3. $\text{RET}_t^{ENV} = \beta_0 + \beta_1 \text{SENT}_{t-1}^{CSI} + \beta_2 \text{RMRF}_t + \beta_3 \text{SMB}_t + \beta_4 \text{HML}_t + \beta_5 \text{MOM}_t + \varepsilon_t$
4. $\text{RET}_t^{SOC} = \beta_0 + \beta_1 \text{SENT}_{t-1}^{CSI} + \beta_2 \text{RMRF}_t + \beta_3 \text{SMB}_t + \beta_4 \text{HML}_t + \beta_5 \text{MOM}_t + \varepsilon_t$
5. $\text{RET}_t^{ENV} = \beta_0 + \beta_1 \text{SENT}_{t-1}^{CSI} + \beta_2 \text{RMRF}_t + \beta_3 \text{SMB}_t + \beta_4 \text{HML}_t + \beta_5 \text{MOM}_t + \varepsilon_t$
6. $\text{RET}_t^{SOC} = \beta_0 + \beta_1 \text{SENT}_{t-1}^{CSI} + \beta_2 \text{RMRF}_t + \beta_3 \text{SMB}_t + \beta_4 \text{HML}_t + \beta_5 \text{MOM}_t + \varepsilon_t$

We expect a negative relation between investor sentiments of the previous period and our dependent variables, the average returns of stocks in the high environmental performance scored portfolio minus the average returns of the stocks in the low environmental performance scored portfolio. In other words, we test whether stocks with higher CSR activities get lower subsequent returns following a previously higher period sentiment relative to stocks with lower CSR activities.

Table 18.2 shows the results of the pooled panel regressions based on CSR performances. We show related tests in Appendix 1.3. We perform six regressions for three sentiment proxies. The 1st, 3rd, and 5th columns provide results for environmental performances. The 2nd, 4th, and 6th columns show the results for social performances. We find a negative relation between sentiment and next

Table 18.2 Regression results

	Dependent variable: CSR premium					
	(1)	(2)	(3)	(4)	(5)	(6)
CSI	−0.135**	−0.027				
	(0.069)	(0.132)				
CI			−0.061*	0.032		
			(0.033)	(0.067)		
BW					−0.013	0.119***
					(0.046)	(0.037)
RMRF	−0.079	−0.067	−0.093*	−0.082	−0.168***	−0.227***
	(0.056)	(0.073)	(0.054)	(0.075)	(0.033)	(0.035)
SMB	0.259***	0.160**	0.231***	0.187**	0.193*	0.432***
	(0.053)	(0.070)	(0.064)	(0.079)	(0.107)	(0.083)
HML	−0.074	−0.198	−0.089	−0.257	−0.229***	−0.401***
	(0.115)	(0.218)	(0.096)	(0.231)	(0.034)	(0.068)
MOM	0.050	−0.035	0.047	−0.049	−0.001	−0.120***
	(0.032)	(0.038)	(0.032)	(0.038)	(0.022)	(0.033)
Constant	9.844*	1.678	4.059*	−2.820	−0.199	0.728
	(5.026)	(9.835)	(2.385)	(4.766)	(0.173)	(0.666)
Observations	12,922	12,922	12,922	12,922	8946	8946
Adjusted $R2$	0.61	0.28	0.55	0.29	0.91	0.70
Ind. effect	No	No	No	No	No	No

Dependent variables, environmental and social premiums, and raw values of the Baker and Wurgler (2006) composite sentiment index, BW, are multiplied by 100. Driscoll and Kraay (1998) heteroskedasticity autocorrelation spatial correlation (HACSC) robust standard errors are showed in parentheses. *p < 0.1; **p < 0.05; ***p < 0.01

period's return based on environmental CSR performance for direct sentiment measures. We also find the same evidence for BW sentiment measure for social CSR performance. We report higher coefficients for CSI than for CI, which means returns of higher CSR scored companies are affected much more by previous CSI increases than by CI increases. Another important result is that sentiment predicts nearly 21–33% more variation of subsequent returns of stocks of which environmental performances are higher compared to stocks with a high social performance score. As we discussed earlier, in periods when investors behave more according to their beliefs than facts, stocks are expected to become more volatile due to CSR activities. According to the results, returns of companies with a high environmental score are affected more by investor sentiment in the previous period than returns of companies with a high social score.

As direct sentiment proxy, BW explains the predictability of returns for stocks with a high social performance in the sixth model, and this model shows better fit than the others. However, this may arise from the shorter time series (2002–2010) relative to those of the first four models (2002–2014).

Among control variables, SMB predicts returns for socially responsible firms (both environmentally and socially high-scored) in six models. We also find evidence that market risk premium (RMRF) and company risk measure (HML) have negative effect on stock returns for last two models. Although signs for RMRF and HML are as expected, we document neither correct sign nor predictive pattern (in majority) for MOM.

18.4 Conclusion

This study provides some importance evidence in support of the idea that CSR creates noise. Increased noise in markets leads to a reduced level of investors' common judgement and, hence, contributes to volatility. Following the strong evidence in the predictability literature that more volatile stocks have lower subsequent returns corresponding to higher sentiment in the previous period, we find that following high sentiment periods, socially responsible firms obtain lower returns, especially with their consideration of environmental issues. Second, sentiment explains the greater variation in returns of environment-friendly stocks than in the returns of stocks that pay much attention to the social areas of CSR.

As further research, the cross-sectional differences can be extended. In addition, since common judgement errors, so-called investor sentiment might be expected to be higher with monitoring and oversight, stocks from such countries can be attractive for studies seeking the CSR–sentiment relation. Furthermore, evidence from other markets, such as bonds or mutual funds, are left as other potential research areas. Although this study documents some evidence for large US companies for which information asymmetry is low due to the high level of monitoring and oversight, studies involving companies located in less monitored countries may present stronger support. A comparison between such countries is also likely to be salient.

Appendix 1

1.1 ASSET4 Database

The ASSET4 database is shown in Table 18.3.

Table 18.3 ASSET4 pillars and categories

Pillar	Category	Description
Environmental performance	Resource reduction	Resource reduction: The resource reduction category measures a company's management commitment and effectiveness toward achieving an efficient use of natural resources in the production process. It reflects a company's capacity to reduce the use of materials, energy or water, and to find more eco-efficient solutions by improving supply chain management
	Emission reduction	The emission reduction category measures a company's management commitment and effectiveness toward reducing environmental emission in the production and operational processes. It reflects a company's capacity to reduce air emissions (greenhouse gases, F-gases, ozone-depleting substances, NOx and SOx, etc.), waste, hazardous waste, water discharges, spills or its impacts on biodiversity and to partner with environmental organizations to reduce the environmental impact of the company in the local or broader community
	Product innovation	The product innovation category measures a company's management commitment and effectiveness toward supporting the research and development of eco-efficient products or services. It reflects a company's capacity to reduce the environmental costs and burdens for its customers, and thereby creating new market opportunities through new environmental technologies and processes or eco-designed, dematerialized products with extended durability
Social performance	Employment quality	The workforce/employment quality category measures a company's management commitment and effectiveness toward providing high-quality employment benefits and job conditions. It reflects a company's capacity to increase its workforce loyalty and productivity by distributing rewarding and fair employment benefits, and by focusing on long-term employment growth and stability by promoting from within, avoiding lay-offs, and maintaining relations with trade unions
	Health and safety	The workforce/health and safety category measures a company's management commitment and effectiveness toward providing a healthy and safe workplace. It reflects a company's capacity to increase its workforce loyalty and productivity by integrating into its day-to-day operations a concern for the physical and mental health, well-being and stress level of all employees
	Training and development	The workforce/training and development category measures a company's management commitment and effectiveness toward providing training and development (education) for its workforce. It reflects a

(continued)

Table 18.3 (continued)

Pillar	Category	Description
		company's capacity to increase its intellectual capital, workforce loyalty and productivity by developing the workforce's skills, competences, employability, and careers in an entrepreneurial environment
	Diversity and opportunity	The workforce/diversity and opportunity category measures a company's management commitment and effectiveness toward maintaining diversity and equal opportunities in its workforce. It reflects a company's capacity to increase its workforce loyalty and productivity by promoting an effective life–work balance, a family friendly environment, and equal opportunities regardless of gender, age, ethnicity, religion, or sexual orientation
	Human rights	The society/human rights category measures a company's management commitment and effectiveness toward respecting the fundamental human rights conventions. It reflects a company's capacity to maintain its license to operate by guaranteeing the freedom of association and excluding child, forced, or compulsory labor
	Community	The society/community category measures a company's management commitment and effectiveness toward maintaining the company's reputation within the general community (local, national, and global). It reflects a company's capacity to maintain its license to operate by being a good citizen (donations of cash, goods, or staff time, etc.), protecting public health (avoidance of industrial accidents, etc.), and respecting business ethics (avoiding bribery and corruption, etc.)
	Customer/product responsibility	The customer/product responsibility category measures a company's management commitment and effectiveness toward creating value-added products and services upholding the customer's security. It reflects a company's capacity to maintain its license to operate by producing quality goods and services integrating the customer's health and safety, and preserving its integrity and privacy also through accurate product information and labeling

1.2 Sentiment Surveys

Consumer confidence or sentiment surveys are often used as sentiment proxies. Lemmon and Ni (2008) consider the consumer confidence index as retailer investor sentiment since it bases the perception about households' current and expected

financial situation on a survey. US-based studies cite The University of Michigan Consumer Sentiment Index and The Conference Board Consumer Confidence Index because they are important measures indicating the strength of the US economy via consumers. These indexes are constructed by surveys comprised of the answers of many households regarding their financial situations, expectations for the US economy, and propensity of basic goods' consumption (Lemmon and Portniaguina 2006, p. 1500). The surveys are shown in Table 18.4.

Table 18.4 Direct sentiment surveys

	The University of Michigan Consumer Sentiment Survey	The Conference Board Consumer Survey
1	We are interested in how people are getting along financially these days. Would you say that you (and your family living there) are better off or worse off financially than you were a year ago? [better/same/worse]	How would you rate present general business conditions in your area? [good/normal/bad]
2	Now looking ahead—do you think that a year from now you (and your family living there) will be better off financially or worse off, or just about the same as now? [better/same/worse]	What would you say about available jobs in your area right now? [plentiful/not so many/hard to get]
3	Now turning to business conditions in the country as a whole—do you think that during the next twelve months we'll have good times financially or bad times, or what? [good times/uncertain/bad times]	Six months from now, do you think business conditions in your area will be [better/same/worse]?
4	Looking ahead, which would you say is more likely—that in the country as a whole we'll have continuous good times during the next five years or so, or that we will have periods of widespread unemployment or depression or what? [good times/uncertain/bad times]	Six months from now, do you think there will be [more/same/fewer] jobs available in your area?
5	About the big things people buy for their homes—such as furniture, a refrigerator, stove, television and things like that. Generally speaking, do you think now is a good or bad time for people to buy major household items? [good time to buy/uncertain, depends/bad time to buy]	How would you guess your total family income to be six months from now? [higher/same/lower]

1.3 Baker and Wurgler (2006) Composite Sentiment Index

Baker and Wurgler (2006) estimate the first principle component of six measure described in the table below. They construct an index to proxy sentiment involving level of closed-end fund discounts, number of initial public offerings (IPOs), and equity share in new issues while considering lagged values of NYSE turnover, dividend premium and first-day returns on IPOs. Then, the authors regress raw values of six proxies on macroeconomic variables and use residuals to obtain the pure sentiment component. However, for a comparison with direct sentiment measures, we first use index as the sentiment proxy, which explains sentiment effect as independent from common business cycle component. The components are shown in Table 18.5.

1.4 Panel Regression Tests

We perform some tests for model choice, serial correlation, cross-sectional dependence, and heteroscedasticity. Then, we use Driscoll and Kraay's (1998) standard errors, which are robust to heteroscedasticity, autocorrelation, cross-sectional dependence, and cluster (Table 18.6).

Table 18.5 Components of the Baker and Wurgler (2006) composite sentiment index

Measure	Proxy	Timing	Sign
Turnover (liquidity)	Natural log of the raw turnover ratio, detrended by the 5-year moving average	Lagged	+
Dividend premium	Log difference of the average market-to-book ratios of payers and nonpayers	Lagged	–
The closed-end fund discount	Average of [(Net asset values (NAV) of closed-end stock fund shares)—(Market prices of closed-end stock fund shares)]	Raw	–
First-day returns on IPOs	Average first-day returns on IPOs	Lagged	+
Number of IPOs	Number of IPOs	Raw	+
Equity share in new issues	Gross equity issuance/ (Gross equity + gross long-term debt issuance)	Raw	+

Table 18.6 Panel regression tests

Test	1	2	3	4	5	6	
F test for individual effects	$F = -4.9371e-14$ p-value = 1	$F = 1.4702e-1$ p-value = 1	$F = 0$ p-value = 1	$F = -1.4893e-14$ p-value = 1	$F = 1.1689e-1$ p-value = 1	$F = -8.7378e-15$ p-value = 1	No significant individual effect
Breusch-Godfrey/Wooldridge test for serial correlation	chisq = 12,918 p-value < 2.2e−16	chisq = 12,920 p-value < 2.2e−16	chisq = 12,917 p-value < 2.2e−16	chisq = 12,916 p-value < 2.2e−16	chisq = 8945.8 p-value < 2.2e−16	chisq = 8941.1 p-value < 2.2e−16	Serial correlation
Breusch–Pagan Heteroscedasticity test	BP = 2845.4 p-value < 2.2e−16	BP = 2441.8 p-value < 2.2e−16	BP = 3445.9 p-value < 2.2e−16	BP = 3243.3 p-value < 2.2e−16	BP = 3994.9 p-value < 2.2e−16	BP = 4027.7 p-value < 2.2e−16	Heteroscedasticity
Pesaran CD test for cross-sectional dependence	$z = 2532.9$ p-value < 2.2e−16	$z = 2532.9$ p-value < 2.2e−16	$z = 2532.9$ p-value < 2.2e−16	$z = 2532.9$ p-value < 2.2e−16	$z = 2107.5$ p-value < 2.2e−16	$z = 2107.5$ p-value < 2.2e−16	Cross-sectional dependence

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Chapter 19
An Industry Perspective on Regulation and Reporting

Julian Lustig-Gonzalez and Laura Harcourt

Abstract Following a brief history of the role of socially responsible investment and its effects on both global business and the environment, a series of criteria for determining appropriate assets is collected from three companies. These criteria may be considered a starting basis for a standardized selection process, in order to better regulate and report on the industry.

Keywords Sustainable portfolios · Industry guidelines · CSR investing

19.1 Introduction

The need for the regulation and reporting of environmental, social, and governance metrics has never been so pressing. It is clear from numerous examples of corporations around the world exerting their influence that regulation is necessary. Unimpeded corporate actions not only affect the market, but also foster negative social impact, an example of which can be clearly seen in the Dakota Access Pipeline protests of 2016. Meanwhile, evidence of poor governance has resulted in tumultuous markets and a severe global recession. All of these actions occur against a backdrop of the many cataclysmic effects of climate change, both day-to-day and impending.

In the absence of a standardized system of regulation and reporting, many socially responsible asset managers have developed internal systems. Despite a lack of regulation, there are commonalities in the criteria investment companies use to select assets for their SRI portfolios. This chapter will act as a resource for asset managers and their clients.

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The concept of investing according to one's values or for the benefit of society is not new or innovative. Even some religious texts contain references and guidelines for investing ethically. Lead by primarily religious investors, the concept of value-based or socially responsible investing primarily revolved around divesting from sin stocks. As the name suggests, sin stocks are companies that profit from sectors of the economy universally found to be distasteful: gambling, tobacco, weapons manufacturers, and so on. During the political climate of the 1960s, many social concerns and inequalities were brought to the forefront and influenced how likely concerned investors were to put their money into companies that had repressive or ethically questionable business practices. Historical pressure on sin stocks and rapidly evolving investment strategies utilizing ethical, rather than purely financial criteria came to a head in the 1980s and can be traced to a single movement in South Africa to dismantle the system of apartheid, which allowed discrimination against individuals on the basis of race. Churches, universities, cities, states, and groups of concerned investors modified their investment strategies to pressure the Government of South Africa to end apartheid. The influence of this joint venture in the social change that South Africa has undergone since the 1980s cannot be denied.

At this time, environmental concerns were being held by the public at large, largely promulgated by high-profile disasters such as the *Exxon Valdez* and, more recently, the BP oil spill.

It was just past midnight on March 24, 1989—Good Friday—when the *Exxon Valdez*, bound for Long Beach, California, struck an underwater reef off the coast of Alaska. Over the next several days, up to 38 millions gallons of crude oil flooded into the waters of Prince William Sound, marking one of the most devastating instances of human-caused environmental disasters in recent history. Exxon, after weathering a flood of litigations, blamed the Coast Guard for the spill and eventually paid out $63 billion in a quiet settlement to the group of seafood companies known as the Seattle Seven and just over $500 million in punitive damages.

The spill and subsequent litigation drew public and court attention to the regulations surrounding oil tankers, resulting in the Oil Pollution Act of 1990 and new regulations for tankers coming from Alaska.

Eleven years later, just before midnight on April 20, 2010, high-pressure methane gas from the Macondo Well in Mississippi Canyon Block 252 in the Gulf of Mexico rose into the drilling rig of the Deepwater Horizon drilling unit and ignited. The resulting explosion killed eleven workers, injured seventeen others, and spilled crude oil into the Gulf at the rate of approximately 8000 barrels per day.

After a number of lawsuits, BP settled with the US Government to the tune of $18.7 billion, while costs of cleanup are over $54 billion. Millions of pounds of oil and oily material have been cleaned from the Louisiana beaches since the explosion and spill, and long-term effects on the Gulf's environment are still being recorded and studied.

19.2 Comparison

To gain insight into the self-regulatory models used by socially responsible firms, three different investment management companies with internal criteria to determine appropriate sustainable, responsible, and impact funds were analyzed. Despite a lack of mandated regulation for ESG metrics, these three independent companies have developed internal processes for establishing an SRI portfolio. When compared, we can clearly see many commonalities and some interesting variations. The attributes of each company are detailed in the table below.

19.3 Criteria

The criteria by which assets were assessed for inclusion into an SRI portfolio were varied but certain commonalities were shared across the board.

19.4 Sourcing Data

The first and most challenging step shared by all of these firms was sourcing the data. It is common knowledge in the investment community that an informational advantage can lead to higher returns and it is no different within the world of ESG investing. Each company began their stringent data collection processes in a similar fashion.

The first step is a comprehensive search for the candidate asset's presence in news and articles. This is coupled with a controversy search to assure that the company was not embroiled in any current or past incidences which could affect future performance.

If the search yields nothing of concern, an assessment of the company's internal structure is undertaken. During this assessment, the firm will consider the candidate's business model, leadership, and extent and type of their community involvement and outreach. Many firms will also reach out to the candidate assets directly in an attempt to get them to disclose information that is not usually publicly available.

Once data is collected, the firm must focus on only the information relevant to their investment thesis. Once compiled and analyzed, this research can aid asset managers in determining whether the candidate company is appropriate for inclusion into the portfolio.

19.5 Exclusionary Screens

Exclusionary screens are utilized to remove any assets which meet the firm's avoidance criteria. For example, Company A used exclusionary screens for any company which receives more than 3% of their revenue from certain morally ambiguous sectors of the economy such as gambling, tobacco, or firearms. These ethically ambiguous or harmful assets are known as "sin stocks."

19.6 Community, Employee, and Environmental Impact

Because the consideration of "sin stocks" is so subjective, it is difficult to build a universal metric around the use of them. Therefore, many companies utilize qualitative criteria to determine the compatibility of an asset by examining their asset's relationship with the communities they affect, their employees, and the environment. Failing to take a holistic approach to assessing an assets management of their relationships could result in assuming unnecessary risk.

A company that assumes responsibility for and actively tries to mitigate harmful/high-risk business practices to the ecosystems they impact all while generating returns for shareholders is a naturally more attractive investment. There are countless examples of companies trying to be obfuscate their impact on the environment ultimately to little avail as the spread of information technology has created the need for more transparency, not less.

When a company's employees are marginalized and discontented, they often publicize their frustration through social media, independent journalism, and self-published blogs. Companies who ignore the risk of poor publicity are flirting with disaster. Not that long ago Nike became synonymous with sweatshops and dangerous working conditions, which in turn, tainted their brand for many investors.

19.7 Business Practices

Another commonality between these different firms was an in-depth analysis of the business practices of each asset. There are many possible factors which may affect the firm's decision: How does management values its organizational assets? Mismanagement and a culture of complacency can lead to fundamental organizational assets to be underutilized, low performing, or unprofitably chaotic.

How does the candidate asset treat its human capital? A disconnect between the value that an employee creates for the company and the way they are treated an be a red flag for value investors and create concern for investors looking to mitigate the potential risks of strikes, bad PR, or inability to retain qualified employees.

What does the candidate view as its responsibility to shareholders, stakeholders, and customers? Companies that actively try to avoid facing hard truths are only postponing future losses. When companies are engaged with their communities, they listen to and act on the feedback they receive. This raises the overall health of the company by keeping them dynamic and actively mitigating risks before they become problematic. The fact that many companies do not operate in this way creates consternation for investors looking for responsible stewardship of a company.

Most markedly, each firm required that an asset illustrates diversity in board members. Research that has shown that diversity in the boardroom correlates to an improvement in organizational performance. Companies in the top quartile for racial and ethnic diversity are 35% more likely to have financial returns above their respective national industry medians.

19.8 Regulatory Initiatives and Reporting

When asked about regulatory initiatives such as the UN's Principles for Responsible Investing (PRI) and the Global Reporting Initiative (GRI), all the test firms interviewed felt that these initiatives were progress toward a standardized system of regulation and reporting. However, none of the test firms are influenced by the PRI nor GRI during their selection process. Several firms find regulatory bodies such as the PRI and GRI useful for validation of information collected through their own proprietary research.

19.9 Regulation of Criteria

Information gathered along the above metrics not only establishes whether the candidate company meets the firm's criteria, but can help to determine whether management has identified industry risks and how they plan to address them. What is their long-term strategy, Are they addressing future risks? What are the motivations for addressing these risks? Is it the bare minimum for compliance? Or is it from an internal drive for the company to move ahead of these risks? All of this data comes together to help the investment manager better price the candidate asset and assess it from a holistic approach.

Shareholder advocacy allows investors to hold these types of discussions and prepare companies for risks they are not currently addressing. They can set targets and benchmarks to address the risks. An increase in share price is not necessarily

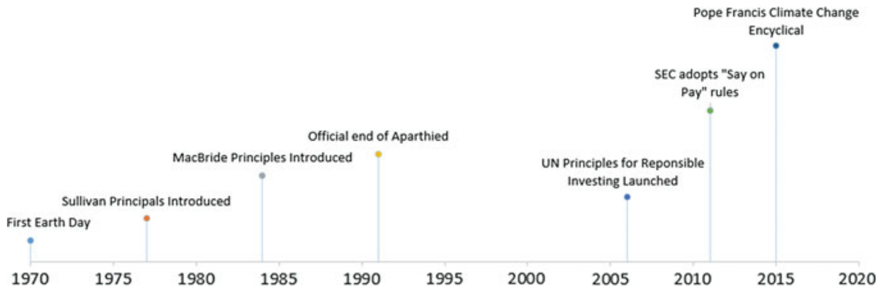

Fig. 19.1 Timeline of milestones in the regulatory environment for socially responsible investors

Table 19.1 Profiles of companies interviewed

Company A	Asset manager Privately held >100 employees 25 > 50 billion AUM Manages mutual funds institutional accounts
Company B	Investment manager Privately held <1000 employees <100 billion AUM Manages equities, fixed income, private equity, and hedge fund portfolios
Company C	Investment manager Privately held <100 employees >25 billion AUM Manages equities, fixed income, multi-asset, and global investment products

linked to these conversations, but from a holistic approach, it is likely improving the overall health of an organization. This in turn provides better returns to the clients of the investment management firm.

By helping to redefine what information to expect as companies begin to self-report and what metrics should be tracked by regulators, socially responsible investment firms are helping to raise the industry's level of overall responsibility. The availability of ESG metrics to investors will help ensure that firms are mitigating all risks, not just to themselves but also to the ecosystem and environment where they thrive. You cannot remove ESG components from the investments that are made. Responsible investing requires a holistic approach to ensure that all risks are being evaluated and addressed. It is only a matter time until ESG metrics become an industry standard requirement for fulfilling fiduciary responsibility (Fig. 19.1 and Tables 19.1 and 19.2).

Table 19.2 Current ecosystem of regulatory initiatives and influencers

Principles for Responsible Investment (PRI)	An international partnership of investors which defines six voluntary and aspirational investment principles for incorporating ESG issues into investment practice
Carbon Disclosure Project (CDP)	A UK-based NGO working with companies and cities to disclose their greenhouse gas emissions and environmental impact
Global Reporting Initiative (GRI)	An international independent organization that helps businesses, governments, and other organizations understand and communicate the impact of business on critical sustainability issues such as climate change, human rights, corruption
International Integrated Reporting Council (IIRC)	A global coalition of regulators, investors, companies, standard setters, the accounting profession, and NGOs, promoting communication about value creation as the next step in the evolution of corporate reporting
Global Impact Investing Rating System (GIIRS)	A project of the nonprofit B Lab, assessing the social and environmental impact of companies and funds
Sustainable Stock Exchanges (SSE)	A peer-to-peer learning platform for exploring how exchanges, in collaboration with investors, regulators, and companies, can enhance corporate transparency—and ultimately performance—on ESG issues and encourage sustainable investment
Ceres	A nonprofit organization advocating for sustainability leadership, comprising a network of investors, companies, and public interest groups. Ceres' focus is the acceleration and expansion of the adoption of sustainable business practices and solutions to build a healthy global economy
Financial Stability Board (FSB)	Comprised of G20 members and chaired by Mark Carney, the FSB has established an industry-led task force to report disclosure standards for companies on climate-related issues
Sustainability Accounting Standards Board (SASB)	An independent nonprofit developing sustainability accounting standards that help US public corporations disclose material, decision-useful information to investors

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Chapter 20
CSR Disclosure Practices in the Zambia Mining Industry

Obby Phiri and Elisavet Mantzari

Abstract The main objective of this chapter is to examine the corporate social responsibility (CSR) disclosure practices and the related motivation for (or lack thereof) CSR disclosures in the Zambian mining industry. Key CSR disclosures are examined to identify the trends in disclosure. Semi-structured interviews were also conducted with the mining managers to explore the underlying motives for such disclosures (non-disclosures) and the prospects that exist for future development. We find that there is very limited CSR disclosure by mining companies in Zambia, while CSR reporting is directed mainly towards 'public image building' and motivated by project financing purposes for those companies with a 'western' parent company. We argue that the lack of demand for such reporting from the Zambian citizenry has partly contributed to the low disclosures. Some international voluntary reporting guidelines have been adopted by 'western' parent mining companies, while reputation risk management remains a key concern for these companies. The study contributes to understanding the underlying motives for CSR disclosures in a developing country context.

Keywords Corporate social responsibility · Disclosures · Mining companies · Multinational subsidiaries · Zambia

20.1 Introduction

This chapter examines the corporate social responsibility (CSR) reporting of major copper mining companies in Zambia. CSR reporting represents an important process for organisations to communicate the social and environmental effects of their economic actions to particular interest groups within society and to society at large

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(Gray et al. 1996). It is the provision of financial and non-financial information relating to the organisation's interaction with its physical and social environment (Hackston and Milne 1996) forming an important aspect of corporate accountability. CSR reporting is predicated on the assumption that companies do have wider responsibilities than simply to make money for their shareholders and explicitly recognises that companies have some form of social responsibility apart from, or at least in addition to, their economic responsibilities. CSR reporting thus rests on a broader conception of the accountability practices of an organisation and incorporates all forms of possible accounting and not just the economic (Gray 2002). Accountability in this sense does not simply mean a corporation's willingness to accept responsibility but also its liability to provide an account for its actions.

The number of companies reporting on their social and environmental aspects has been increasing over the years (Cooper and Owen 2007) together with criticisms associated with such reporting. CSR reporting, for instance, has been criticised for being used as a management strategy for marketing, managing corporate risk and building corporate reputation (Kotler and Lee 2005). This managerialism of CSR has amounted to little more than a 'smokescreen', directing attention away from core issues, such as pollution and environmental degradation, tax avoidance/evasion, discrimination, threats to the health and safety of employees, and social dislocation and unrest in local communication (Bakan 2004; Frederick 2006; Korten 2001). The increase in CSR disclosures has also been seen as a direct result of the social demands and expectations placed on the companies (Banerjee 2007) resulting in a growing allocation of CSR-related management positions to the organisational charts of major companies. As a result, CSR has become a rationalised, routinised and institutionalised practice and has continued to be largely shaped by the economic rationale towards managing corporate risk and reputation. Corporations have used CSR reporting in order to proclaim how wonderful they are in meeting their social and environmental obligations, selectively reporting on good things about their activities while neglecting important matters (Unerman et al. 2007).

The mining industry poses significant effects on the economic, social and environmental dimensions of many countries, especially those that are overly dependent on the sector as is the case with Zambia. The mining companies have received increasing criticism from international organisations, national governments, consumers, employees, local communities, non-governmental organizations (NGOs) and the wider public as a result of the negative effects that the industry has on the environment and the society. The mining companies are now faced with challenges to improve their environmental and social performances, to ensure integration of the concept of sustainable development and to deliver on their corporate social and environmental responsibilities (Yakovleva 2008).

In this study, we examine how mining companies in Zambia's copper mining industry discharge this accountability. CSR reporting is seen as a way of demonstrating social and environmental accountability; thus, our first objective is to examine the CSR disclosures practices of the mining companies. In addition to

examining the CSR disclosures, we are also interested in understanding the underlying motivation for the associated level of CSR disclosures. This forms our second objective aimed at understanding why mining companies disclose (or not disclose) CSR information. This is important in order to appreciate how CSR reporting might be improved in a developing country context. The analysis of the CSR disclosures is made in reference to the prominent disclosure categories identified in the literature and the international voluntary reporting guidelines, such as the Global Reporting Initiative (GRI) (Waddock 2007) and the Equator Principles (EPs) (Wright and Rwabizambuga 2006). The CSR disclosures made by large-scale copper mining companies from 2004 to 2011 are examined. The investigation of the underlying motivation for such disclosures is made through analysing nine interviews with mining managers from the seven main copper mining companies operating in Zambia between October and December 2011. The next section highlights the relevance of CSR to the mining sector, followed by an overview of the Zambian copper mining industry. Section 20.4 reviews some CSR reporting trends identified in the literature, while Sect. 20.5 discusses the theoretical assumptions and the research approach of the study. In Sect. 20.6, the findings are presented and discussed, followed by the last section of the conclusions.

20.2 Relevance of CSR to the Mining Industry

The nature of the mining industry's operations predisposes it to unique CSR challenges which other industries might not have. Indeed, many of the environmental disasters or human rights incidents that have contributed to the growing public concern about CSR over the last 50 years took place in the extractive industry (Hamann 2003). The damage caused to the natural environment is usually significant and irreversible, while the negative social and environmental impacts are more severe compared to other industries (Mutti et al. 2012). Thus, the mining companies have to consider CSR as an important business issue because of the negative public opinions about the sector over companies' environmental and social performance (Rae and Rouse 2001).

Despite recent development initiatives related to the mining industry and efforts to establish sustainability of the companies' operations, the mining companies continue to pose a detrimental social, economic and environmental impact on the host countries, including tax evasion (Christian Aid 2015; Counter Balance 2010), environmental degradation, negative impact on human health, labour and human rights abuses (Das and Rose 2014; Lindahl 2014).

As a result of these detrimental effects on the host countries (which are mostly mineral-dependent developing countries), the industry has been consistently targeted by different pressure groups at both local and international levels, often challenging the legitimacy of the industry (Christian Aid 2015; Human Rights Watch 2011). The mining companies, mostly multinational companies (MNCs), are under pressure and scrutiny from several societal forces which have been formed in

response to the concerns about the negative effects of their operations, especially in developing countries. Thus, for the mining companies, maintaining a 'license to operate' poses a constant challenge as they face resistance from the numerous social organisations to expand mining operations. In addition, the mining companies often operate in remote areas, which are economically underdeveloped and lack provision of social welfare services. In such areas, CSR becomes especially important as the governments may not provide such services.

20.2.1 Response of Mining Industry to Social Pressure

Mining companies have responded to social pressure through CSR reporting and sustainable mining initiatives (Dashwood 2014). The companies have been actively innovating in the field of CSR in order to address the sustainability challenges of their operations in a more proactive manner (Mutti et al. 2012). Mining companies were among the first companies to publish stand-alone sustainability reports and adopt the voluntary codes of conduct in environmental management (Jenkins and Yakovleva 2006). The mining companies have been fostering the concept of sustainable mining presenting themselves as constructive contributors to development through nurturing positive relations with their host governments and mitigating antagonism with local communities through community developmental projects (Kirsch 2010). At the local level, sustainable mining implies mining companies engaging in socio-economic activities, such as education, health and training, while on the environmental sphere, this involves demonstrating commitment to the efficient use of natural resources, preventing land degradation and reducing pollution (Hendrix 2006). The sustainable approach to mining is seen as an important factor in the sustainable development of many countries.

However, the sustainable approaches to mining have been criticised for addressing mostly the priorities and concerns of (largely western) parent companies' stakeholders. The CSR practices and reporting (where present) are not reflective of the local demands or expectations, especially in developing countries (Idemudia 2011). Thus, the local challenges and opportunities have not been captured by mining companies leading to CSR practices and reporting that are irrelevant to the priorities of local societies (Christensen and Murphy 2004). In some cases, the CSR practices of mining companies have been argued to indirectly divert attention away from the real local political, economic and social problems (Frynas 2005).

Sustainable mining initiatives, which are vulnerable to commodity market price fluctuations and are frequently interrupted by local grievances, have been criticised for being short-term, capital-intensive, and dependent on a specialist and mobile workforce (Kirsch 2010). Sustainable mining is viewed by some as 'a slogan of little practical value to the policy makers' (Hendrix 2006, p. 52), or an oxymoronic concept where the promise of sustainability is an attempt to hide the symptoms of social, economic and environmental devastation (Frynas 2005; Gilberthorpe and Banks 2012).

20.3 The Zambian Copper Mining Industry

Commercial copper mining in Zambia, a former British colony that gained independence in 1964, can be traced back to 1928. Since the discovery of one of the world's largest copper and cobalt ores on the Copperbelt Province, the mining industry has been the major contributor to national development. After the country's independence, the mining sector was nationalised and put under the management of the national parastatal company, Zambia Consolidated Copper Mines (ZCCM). During the era of a nationalised mining industry, the government was able to direct the profits towards developmental programmes (such as building hospitals, schools, roads and other infrastructure) and provided subsidies to state-owned manufacturing companies. Thus, the ZCCM was used as a vehicle for national development, extending its responsibilities beyond mining.

Following the oil crises and falling copper prices in the 1970s to 1990s, the economy collapsed at an unprecedented rate with per capita income declining by 50% leaving the country the 25th poorest in the world (Ferguson 1999). The state had to seek loans as it could no longer support the social infrastructure it had created from the copper revenues. The country's increasing debt resulted in the imposition of liberalisation structural adjustment policies by financial donors in the 1990s (Fraser and Lungu 2007). These liberalisation policies were led by the 'kleptocratic' government of the late Chiluba but were also the result of conditionalities imposed by donors, the International Monetary Fund (IMF) and the World Bank (Fraser 2008). Donor support was provided based on certain conditions, including privatisation programmes and the adoption of World Bank and IMF policies. As Adanhounme (2011) argues, the structural adjustment programmes (SAPs) were a significant part of the liberalisation solutions seen as a panacea for African post-colonial economies.

Under the guidance of the World Bank, the Zambian government started the privatisation of the state-owned ZCCM in 1997. This gave rise to the emergence of seven companies which were eventually bought by seven multinational mining companies. Since 1997, when privatisation began, there have been changes in the ownership structure of the privatised mining sector as some investors pulled out of Zambia with ownership occasionally being transferred to the government and then sold to other (mainly Chinese) mining corporations[1] (KPMG 2013). As a result, the number of mines owned by Chinese corporations has increased though their total proportion of copper production is still relatively low at less than 10%.[2] The major mining companies, including their ownership structure, are shown in Table 20.1.

[1]For instance, Anglo-American, Anglo-Vaal, Binani and Enya Holding had invested in the mining sector in Zambia. These investors decided to later sell off their ownership in the mines citing different reasons, such as unfavourable copper prices.

[2]The last acquisition was in July 2011 of Metorex of South Africa (the parent company of Chibuluma Mines) by Jinchuan Group, a Chinese mining group.

Table 20.1 Major mining operations in Zambia

Name of mine	Output per cent* (%)	Ownership	Country of origin	Commodities mines
Kansanshi Mining Plc	35.07	First Quantum Minerals Ltd (80%); ZCCM Investment Holding Plc (20%)	Canada	Copper, gold
Lumwana Mining Plc	21.92	Barrick Gold Corporation (100%)	Canada	Copper, cobalt, gold
Konkola Copper Mines	20.73	Vedanta Resources Plc (79%); ZCCM Investment Holdings Plc (21%)	UK and India	Copper, cobalt
Mopani Copper Mines	14.75	Glencore Xstrata Plc (73%); First Quantum Minerals Ltd (17%); ZCCM Investments Holdings Plc (10%)	Switzerland; Canada	Copper, cobalt
NFC Africa Mining Plc	3.29	China Non-ferrous Mining Corp Ltd (85%); ZCCM Investments Holdings Plc (15%)	China	Copper, cobalt
Chibuluma Mines Plc	2.66	Jinchuan (85%); ZCCM Investments Holdings Plc (15%)	China	Copper, cobalt
CNMC Luanshya Copper Mines	1.58	China Non-ferrous Mining Corp Ltd (80%); ZCCM Investments Holdings Plc (20%)	China	Copper, cobalt

*This is based on 2010 copper production figures (*Source* MMMD 2010)

Liberalisation policies have continued in a more moderate form since the 2000s with the state continuing to play a greater role in development. Other large-scale mining operations have started[3] besides the former ZCCM companies, and copper production has subsequently increased after a significant drop in the 1990s (see Fig. 20.1). In all the mining operations, except Lumwana Mines Plc, the government retains ownership of between 10 and 20% through the ZCCM Investment Holding Plc.[4]

The mining sector remains the driving force for Zambia's economic development. The sector, for instance, accounted for 86% of foreign direct investment, 80% of exports, over 25% of government revenue and contributed to 1.7% to direct employment in 2012 (ICMM 2013). Further, the mining taxes' contribution to total government revenue has increased from 16% in 2008 to 32% representing a 2.8 and

[3]The two largest copper producers, Kansanshi Mines and Lumwana Mines, were not part of ZCCM.

[4]The extent of the influence of government through this ownership and regulatory tools is a subject for further research.

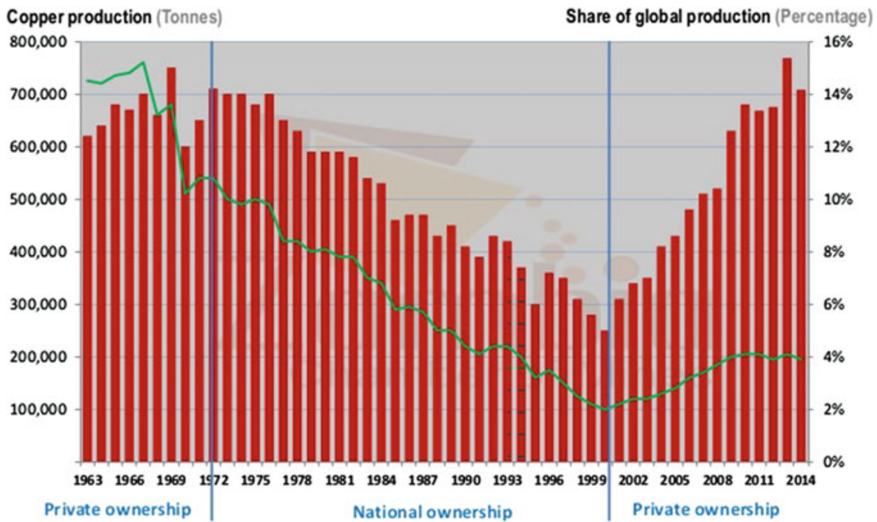

Fig. 20.1 Zambian copper production 1963–2014. *Source* International Council on Mining and Metals (2013); Zambia Chamber of Mines (2014)

6% of gross domestic product, respectively (ZRA 2013). However, these sectoral contributions are still low when compared to the late 1960s and early 1970s when copper mining accounted for more than 80% of foreign exchange earnings, over 50% of government revenue and at least 20% of total formal sector employment (CSO 2004). The country's mineral dependence, despite several diversification programmes, has remained very high at over 83%[5] (Haglund 2011b).

While the mining sector's performance has been improving[6] after privatisation, the social and economic well-being of the country has relatively not improved with over 60.5% of the population still living in poverty and Zambia is ranked the 13th poorest country in the world (World Bank 2016). Thus, one of the key challenges for Zambia is how to equitably benefit from the increased production and revenues from the mining sector in order to develop. The country's economy remains vulnerable to volatile world copper prices as the sector contributes more than 80% to foreign exchange income.

Even though there have been notable benefits resulting from the increased investment in the sector, there have also been deleterious outcomes which have raised concerns about the social and environmental responsibilities of the mining companies. The benefits of privatisation from the entrance of MNCs in the industry include the increased investment which has reinvigorated the industry and resulted

[5]According to the Haglund (2011b), Zambia ranked second from Botswana in mineral dependence in 2010 among the all non-fuel, mineral-dependent countries. The country recorded an increase from 79.4% in 1996 to 64% in 2005 and 83.6% in 2010 in mineral dependence.

[6]Improvement in terms of production levels and contribution to government revenue.

in increased production level (ICMM 2013). Mining employment levels and government revenue contribution have been rising. However, the overall quality of employment and the proportionate contribution to total formal employment remain low (Fraser and Lungu 2007; ICMM 2013). Relative to the increased copper production, the proportion of the industry's contribution to government revenue has remained also low (ZRA 2013).

Mining activities have negative environmental effects, and concerns have been raised regarding whether the mining companies are responsible enough to prevent or limit pollution considering the limitations of the government regulatory agencies. There has also been an observed deterioration of social infrastructure, such as housing, health, water and sanitation in the mine townships which had previously been under ZCCM (Lungu and Mulenga 2005). The limited benefits resulting from the increased mining investment have largely been attributed to the lopsided development agreements that these MNCs entered into with the Zambian government (Christian Aid 2011; Lungu 2008).

The growing diversity of investors in the sector (see Table 20.1) implies that CSR practices and/or reporting will not be uniform across the sector. In addition, since mining ownership can easily change, the systemic drive for short-term profitability implies that consideration of the strategic importance of CSR might be largely ignored (Sikka 2010) resulting in CSR practices aimed at addressing short-term 'stakeholder' pressures (Perez-Batres et al. 2012).

This study examines the CSR reporting practices of the seven large-scale mining companies. The focus is on large-scale mining companies as previous studies have shown a link between the size of companies and the level of social disclosure with larger companies more likely to disclose than small and medium-sized companies (Patten 2005). Therefore, if any form of CSR reporting is happening anywhere in the Zambian mining sector, it should be observable in the main mining companies shown in Table 20.1.

20.4 CSR Reporting Trends and Developments

CSR reporting, in broad terms, comprises the organisation's relationships with its stakeholders.[7] It is seen as the 'process of communicating the social and environmental effects of organisations' economic actions to particular interest groups within society and to society at large' (Gray et al. 1996, p. 3). Thus, CSR reporting rests on a broader conception of the accountability[8] practices of an organisation and

[7]Gray et al. (1987, p. 85) identified the principle stakeholders for corporate social reporting purposes as the local communities, employees and consumers. Others include shareholders, suppliers, government and various pressure groups.

[8]Accountability is synonymous with duty and obligation, and thus with responsibility. However, both terms—responsibility and accountability—may suggest different meanings depending on the intention of those who use the terms, while dealing with corporate power (Bendell 2004). To use

incorporates all forms of possible accounting not just the economic (Gray 2002). Through CSR reporting, companies are thus discharging their social (and environmental) accountability. This accountability is concerned with the relationship between groups, individuals, organisations and the rights to information that such relationships entail.

CSR reporting can be seen within the broader aspect of democracy (Gray et al. 1996). The purpose of CSR (practice and reporting) is to promote a more open, transparent and democratic society (Gray 2002). The resultant transparency and accountability, arising from an increased flow of information to society, are central components of a democratic society[9] (ibid.). The increased accountability, particularly of powerful institutions and organisations, to society ensures that society is informed about the operations of business and also gets the chance to act on the information (if it wishes) (Gray et al. 1997; Swift 2001) promoting a democratic evolution. In this sense, CSR reporting is based on the democratic right of society to get information from corporations. Gray et al. (1996) argued that through providing information to society by a corporation, a re-democratisation process can be started which is necessary to return power to people from that corporation. CSR reporting, viewed in this way, has the potential to bring power back to the community (nationals) and thus address the apparent imbalance of power relations between society and business (Gray 1992).

Many CSR scholars have often been confronted with the question of what CSR reporting should encompass (e.g., Adams and Harte 1998; Carroll 1979; Crane et al. 2004; Windsor 2006). In recent years, an increasing body of CSR reporting literature has included a wider range of issues, such as employment issues or employee-related disclosures (Grosser and Moon 2008), community involvement disclosures (Chapple and Moon 2005; Panapanaan et al. 2003), environmental disclosures (Deegan and Gordon 1996; Gray 2002; Hawkins 2006) and (increasingly) economic or responsibility to government disclosures (Christian Aid 2008; Sikka 2010). The section below discusses these CSR disclosure trends.

(Footnote 8 continued)

the term ‘responsibility’ is regarded by some as not challenging the power of corporations but to allow corporations to work voluntarily on their responsibility, while to use the term ‘corporate accountability’ is regarded by some as challenging corporate power and working to give society more power in determining the behaviours of corporations (Bendell 2004). More specifically, accountability goes beyond a voluntary approach to suggest or establish mechanisms of controlling large corporations to ensure more socially responsible action.

[9]Gray et al. (1996) argued the whole issue of corporate social reporting within a broader explanation of democracy. They identified three forms of democracy: representative, state and participative. Advocating participatory democracy, Gray et al. (1996) claim that information should flow from those who control resources to those from whom resources are acquired.

20.4.1 Employment Issues

Employment disclosures involve the provision of information by companies that affect employment and employees. This form of disclosure includes reporting on matters such as employee numbers and remuneration, equal opportunities, employee share ownership and employment of the disabled. It can also cover disclosures on health and safety, employee consultation, training and trade union information.

In this integrated global economy, the expansion of multinational companies and the increasing significance of outsourcing through the supply chain has led to growing attention being paid to the responsibilities companies owe to employees in workplaces (Crane et al. 2008). In addition, there is an increasing concern especially in the case of developing countries, that occupational health and safety regulations may often be subordinated to government attempts to provide a competitive investment environment for attracting and retaining capital (Vogel 2005). As a result, companies have come under constant pressure[10] to implement employee welfare management programmes and address workplace issues, such as paying decent wages, removing discrimination and promoting health and safety in the workplace[11] (Royle 2005). The companies' disclosures of a range of workplace issues, including health and safety, employee relations and working conditions, remuneration and benefits, recruiting practices, training education and professional development, equal opportunities and non-discrimination (Yakovleva 2008), can be seen as a response to this pressure.

20.4.2 Environmental Disclosures

Environmental disclosures concentrate on providing information about the organisation's effect on the physical environment. These disclosures relate to environmental policies, impacts, processes and audits, environmental-related expenditures, the environmental benefits of products, pollution control, protection of natural resources and details on sustainable operations.[12]

[10]Pressure has been exerted especially from NGOs and trade unions. The trade unions have constantly urged companies to take account of employee rights, human rights, and health and safety at work (Baptiste 2008).

[11]While CSR practices have the potential to improve employee welfare (Jones et al. 2007), the corporate drive to increase profits, on the hand, may involve exploitation of the workforce and abuse of human rights. Studies have shown evidence of increasing employee concerns about long working hours, increasing levels of labour turnover, employee discrimination, abuses of human right, absenteeism, 'burnout' and injuries in the workplace (Jones et al. 2007; Yakovleva 2008).

[12]This could include information related to energy conservation, energy efficiency and details on sustainability.

Environmental issues, for many years, have been a major concern in the CSR literature (Deegan and Gordon 1996; Gray 2002; Hawkins 2006). The United Nations (2013) noted that different forms of environmental degradation have inflicted serious damage on the socio-economic development of many countries, particularly developing countries (like Zambia) where the livelihoods of many people are dependent on natural resources.

Major companies, in response to increasing demand for environmental responsibility, have produced codes of conduct and have claimed to be implementing strategies for protecting the environment (Hoffman 2000). Companies are also increasingly, though selectively, disclosing a considerable amount of information about their environmental policies and strategies in order to inform the public and various stakeholders about their activities (Deegan et al. 2000). However, Banerjee (1998) argues that responding to public concerns about environmental protection is one way in which companies can maintain a good public image which is fundamental for corporate profitability.

20.4.3 Community Involvement Disclosure

Community involvement disclosure includes any disclosures of information relating to community involvement and public welfare, sponsorship and advertising, as well as charitable donations of cash, products or employee services to support established community activities, events, organisations, education and the arts. According to Gray et al. (1996), the broad nature of the category effectively means that most conventional forms of CSR, outside the employee or human resources and environment categories, tend to fall under this heading. This has tended to be the least developed area of CSR practice with few clear trends emerging and little consensus on what should be reported and how it should be reported (Gray et al. 1996). Muthuri et al. (2009) noted that corporate responsibility to the community is contextual depending on the local social, political, legal and economic environment. In developing countries, particularly in Africa, for instance, Visser et al. (2006) observed that companies have been the key providers of health care, education and infrastructures, often playing the paternalistic role of the state.

Thus, many companies have initiated community projects in the vicinity of their sites in order to offset the negative impact of their activities and to give something back to the local community (Corporate Watch 2006). This effort is amidst increasing tensions between companies (especially MNCs) and the local communities in which they operate which has raised questions about the role of businesses in local communities (Campbell 2004). However, Achda (2006) argued that the motivation of companies to donate to communities is not often based on principles of moral or social responsibility, but is instead motivated by image building, tax planning, security and profits. Calvano (2007) contends that companies often use corporate philanthropy to ‘buy-off’ or silence communities which oppose their activities.

20.4.4 Responsibility to the Government and Society

This disclosure relates to the economic contribution of the companies to government and society. It covers economic information such as paying the appropriate tax revenues owed to governments and the promotion of local business development (through local training and procurement), particularly in developing countries.

Tax revenues, in principle, form an important economic contribution of corporations to non-shareholders and non-employees (Yakovleva 2008) and are key to nation states' social service provision. However, Sikka (2010) argued that little explicit weight is attached by scholars to the important role that businesses can play in fostering economic development in society. Desai and Dharmalapa (2006), however, contend that the difficulty of incorporating taxation into the social responsibility agenda has stemmed from the presumed tension between the goal of shareholder wealth maximisation and meeting other stakeholder needs. Although taxes can make significant contribution to improving the quality of life of citizens, particularly the poor, corporations view taxes as merely another way of reducing their costs and hence their social obligation to society. Further, developing countries are particularly vulnerable to the tax avoidance and tax evasion schemes of multinational corporations because of institutional inadequacies (Christian Aid 2008).

20.5 Collection of Evidence and Theoretical Approach

There are a number of ways through which a company can make CSR disclosures, such as annual reports, separate social and environmental reports, company brochures, press circulars and the Internet (Zeghal and Ahmed 1990). The analysis of CSR disclosures in this study started with the annual reports. The CSR disclosures of the large-scale mining companies are examined over the period from 2004 to 2011. Even though annual reports are the most important and regular medium through which companies make their disclosures (Adams et al. 1998) and the majority of CSR studies have used annual reports (see, e.g., Campbell 2000; Deegan and Rankin 1997; Gray et al. 1995), studying social and environmental disclosures contained solely in the annual report might capture an incomplete picture of CSR disclosures (Unerman 2000). Therefore, our analysis was extended to alternative mediums of CSR disclosures and includes separate stand-alone social and environmental reports, company websites, social and environmental management plans and policies, community brochures or bulletins were publicly available. Table 20.2 shows the annual reports that were examined, while Table 20.3 shows the other CSR disclosures media that were accessed.

As can be observed from Table 20.3, the alternative mediums of CSR disclosures such as Internet and separate, stand-alone, social and environmental reports are rarely employed in Zambia. Therefore, we extended our focus and examined

Table 20.2 Annual reports accessed and analysed

Company	2004	2005	2006	2007	2008	2009	2010	2011	Auditors
Konkola Copper Mines			Yes	Yes	Yes	Yes	Yes	Yes	Deloitte
Mopani Copper Mines	Yes	Yes	Yes	Yes	Yes	Yes			Deloitte
Kansanshi Mining Plc			Yes	Yes	Yes	Yes	Yes	Yes	PWC
Chibuluma Mines Plc	Yes	Yes	Yes	Yes	Yes				Deloitte
Luanshya Copper Mines/NFC Africa Mining Plc	–	–	–	–	–	Yes	Yes	Yes	Deloitte
Lumwana Mining Plc		Yes	–	–	–	–	Yes	Yes	PWC

Table 20.3 Other CSR disclosure media

Mining company	Website	Separate CSR report	Community bulletins
Konkola Copper Mines	Yes	No	Yes
Mopani Copper Mines	No	No	No
Kansanshi Mining Plc	No[a]	Yes[b]	Yes
Chibuluma Mines Plc	No[d]	No	No
Luanshya Copper Mines	No	No	No
NFC Africa Mining Plc	No	No	No
Lumwana Mining Plc	No[d]	No[e]	No

[a]The CSR disclosures were done in the group company CSR report (not locally in Zambia), where Kansanshi Mining Plc CSR activities were predominately disclosed

[b]The Zambia annual reports of the company provide very limited information. The parent company does some sustainability reporting within the annual report where Chibuluma Mines operations are mentioned

[c]Barrick acquired the company in July 2011. The CSR analysis covers the period from this acquisition date. Prior reports, except 2005, were not accessible when company was in its development stage. The disclosures have been made at the parent company level, not locally in Zambia. In addition, the specific reference to Lumwana activities is limited in the report, albeit the period was too short since acquisition for reporting

[d]There is specific reference to the Equator Principles (2007). Other referenced charters and sets of principles include the Extractive Industries Transparency Initiatives (2008) and the International Labour Organisation's Declaration of Fundamental Principles and Rights at Work (2008)

[e]Metorex Plc stated that 'while Environmental Impact Assessments ("EIAs") and Environmental Management Plans ("EMPs") are a legal requirement in the countries of operation, the documents for projects are prepared to comply with the EP and the International Finance Corporation's Performance Standards. This is done in the event of existing and potential project funding from EP signatory banks, as well as the use of such international standards as best practice' (Metorex 2011). This is not applicable to the period after the acquisition by Jinchuan Group, and the subsequent conversion of the company into a private limited company

parent company websites to check for specific reference to their subsidiaries' CSR disclosures.

In order to address the first research objective aimed at gaining insight into the CSR reporting practices of the mining companies, a qualitative analysis of these documents and archival records (documentary analysis) was conducted. A number of categories of CSR disclosures were developed (see Appendix20.1)[13] based on the academic literature, voluntary reporting guidelines and the understanding of the historical, socio-economic and political context of Zambia in order to provide some structure to the scattered CSR disclosures in the documents. Reference is also made to the interactive and reflexive process developed by Bebbington (1999)[14] in the CSR disclosures analysis.

In order to investigate the underlying motivation for CSR disclosures by the mining companies, semi-structured interviews with mining managers were also conducted. In total, 11 interviews were conducted by one of the authors over a three-month period, from October to December 2011. The duration of interviews varied from 45 to 90 min, and the interviews were voice-recorded and transcribed in their entirety. The transcripts, together with any relevant notes taken during the interviews, were then analysed thematically (Auerbach and Silverstein 2003). Each interview was numbered, and the quotations in the analysis below are presented verbatim in the format of '*interview number, page from relevant text*'. We have anonymised the identity of the interviewees. The quotations used present the 'thick description' (Denzin 1994, p. 505) as they appeared to represent a particular theme. The analysis of the transcribed data, thus, was directed at the search for underlying themes and sub-themes in addressing our research objective. We, however, remain sufficiently flexible so as to profit from any 'opportunistic' dimensions that may arise in the research (Buchanan et al. 1988). In addition, while recognising that most common recurring themes from the data could easily be determined (using matrices), we were careful to avoid presenting a 'smoothed set of generalisations that may not apply to a single interview' (Miles and Huberman 1994, p. 435).

We adopt a stakeholder accountability approach in analysing the companies' CSR disclosures and interviews. We are attuned to the accountability framework that requires corporations to demonstrate their accountability to the stakeholders as being one part to the process (Stewart 1984). The effective utilisation of such information is the second part. Further, the stakeholders need to be empowered in

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[13]In developing the CSR disclosure categories, refinements were made to the initial set of CSR disclosure categories after an examination of the CSR documents as some crucial issues considered important from the context of Zambia became eminent. Such categories were included to ensure that if there is an absence of disclosure related to these categories, it can be identified (Choudhury 1988). The final CSR disclosure categories set developed came to 21 categories as shown in Appendix 20.1.

[14]Bebbington (1999) argued for the use of qualitative content analysis which moves beyond the measurement of the volume of disclosure (under quantitative content analysis) to examine the qualitative aspects of disclosure such as context of disclosures and also their meaning and implications. Adams and Harte (1998) assert that there is need to explore the 'context' in which the disclosures take place.

order to be able to hold the corporations to account (Cooper and Owen 2007). This accountability requires not only the provision of such information but also that which facilitates action (Bailey et al. 2000). CSR disclosures by companies have the potential to enhance stakeholder accountability through empowerment by facilitating action on their part (Cooper and Owen 2007). Thus, understanding the CSR disclosures and underlying motivations should have value in facilitating action and contribute to CSR initiatives that promote empowerment. In fostering corporate accountability, we do acknowledge also that there are power differentials that lie at the heart of any accountability and associated accounting relationship (Roberts and Scapens 1985).

20.6 Findings and Discussion

Our findings from the examination of the CSR disclosures practices are discussed in Sect. 6.1, while the analysis of the interviews is discussed in Sect. 6.2.

20.6.1 CSR Disclosure Practices

The Zambian mining company that has disclosed the most—mainly through their company website—compared to the other mining companies, is Konkola Copper Mines (Konkola). The other two companies, Kansanshi Mining (Kansanshi) and Lumwana Copper Mines (Lumwana), did not report at the subsidiary level, but had some reasonable CSR disclosures of their operations at their parent company level. Nonetheless, we found that the CSR disclosures at the parent company level of Kansanshi are more comprehensive as compared to Lumwana,[15] which in itself is more than that done by Metorex Plc of their operations at Chibuluma Mines (Chibuluma). There was hardly any publicly available and recognisable CSR disclosures for Mopani Copper Mines (Mopani) and Luanshya/NFC Africa Copper Mines (NFC Africa).

Of the seven companies examined, only two of them make reference to the (voluntary) CSR guidelines or standards. Kansanshi (FQM) makes reference to the EPs, while Lumwana (Barrick) refers to the Global Reporting Initiatives (GRI-G3). Metorex, on the other hand, made specific reference to the Equator Principles in instances when it sought project funding:

> …the documents for projects are prepared to comply with the Equator Principles (EPs) and the International Finance Corporation's Performance Standards. This is done in the event of

[15]The CSR reporting is not very specific to Lumwana mining by Barrick. One argument is that this was a new acquisition by Barrick (acquired in July 2011).

existing and potential project funding from EP signatory banks, as well as the use of such international standards as best practice (Metorex 2011).

Thus, as the motivation for adopting these Equator Principles was for project financing, we do not envisage the continued adoption of such principles following the takeover of Metorex by the Chinese company, Jinchuan Group, which resulted in the conversion of the company to a private limited company and subsequent delisting on the Johannesburg Stock Exchange (JSE).

It was further observed that the mining companies that had CSR embedded in their mission statement had a specific policy on it. Apart from Mopani and NFC Africa, there was either a CSR committee at board level (for instance, Kansanshi) or a separate CSR section/department (for instance, Konkola). However, the board level responsibility at Kansanshi, Lumwana and Chibuluma was at their parent company level, which arguably does not represent commitment at the local or national level.

Companies have, at a minimum, a legal responsibility (Carroll 1999). For the mining industry, this includes maintaining adequate health, safety and environmental standards. All the mining companies examined (except Luanshya/NFC Africa[16]) have their own specific health and safety systems which are designed to meet the minimum Zambian legal standards. Konkola, Mopani and Kansanshi's health and safety systems all claim to comply with the OHSAS 18001[17] standard. Compliance with this standard automatically entails meeting the Zambian minimum legal requirement, as a pegging to an international standard, which goes beyond the local standards, gives a favourable image to the mining companies.

Of the six mining companies examined, only three (Konkola, Chibuluma and Lumwana) made specific reference to gender equality or equal opportunities for female employees/candidates. The mining industry has largely been dominated by male employees. Moreover, none of the mining companies disclosed a statement of recognition of employees' right to belong to any trade union or encouraged employees to join workers' unions in order to have their views represented. With regard to human resource development, all mining companies (except Chibuluma) have mentioned the existence of staff development programmes, albeit at different disclosure levels.

Considering the high levels of poverty in Zambia, companies ought to show commitment, whether direct or indirect, to its eradication. Expectedly, all mining companies, except Mopani and Chibuluma, have some direct programmes focussed on poverty alleviation, for instance, the 'enhanced sustainable livelihood' programme supported by Konkola. In line with the poverty alleviation agenda, Konkola and Kansanshi utilise rural and agriculture development as a tool to

[16]No information was available.

[17]This is an internationally recognised standard on Occupational Health and Safety Assessment Series (OHSAS) which states requirements for an occupational health and safety (OH&S) management system, to enable an organization to control its OH&S risks and improve its performance (British Assessment Bureau 2013).

enhance the local communities' livelihood. Kansanshi, for instance, has been funding the conservation farming scheme which supported 550 rural farmers in 2011. Besides poverty, one of the negative social impact of mining operations has been HIV/AIDS which has robbed the sector of valuable manpower (MSD 2010). There was commitment through activities or programmes directed at addressing HIV/AIDS among the employees and the local community by all mining companies.

With respect to business commitment to fighting corruption and the promotion of ethical business practices, only three companies (Konkola, Kansanshi and Lumwana) mentioned or specifically stated their commitment to the fight against corruption. This commitment, for instance by Konkola, was through a company code of ethics covering bribery and corruption. Appendix 20.2 attempts to summarise the disclosure findings and provides some related examples.

20.6.2 Motivation for CSR Disclosure (Non-disclosure)

This section reveals the key themes from the analysis of the interview evidence, along with reflections from prior studies. Mining managers interviewed recognised the importance for mining companies to be socially responsible in Zambia. However, CSR in terms of both practice and reporting was not understood as a proactive undertaking which associates CSR as being a 'response' to societal demands (Wood 2010). In this regard, the mining managers view their social responsibility as responding to community needs, as explained by one mining manager:

> […] we don't want to be seen as abusive in the society, we don't want to be seen as a company that cuts corners when no one is looking because eventually these things catch up with you. So, it's best as a good corporate citizen that we respond to the burden and responsibility that society imposes upon us. (M8, p. 4)

Further, CSR engagement is motivated by the perceived synergistic nature of CSR (Byrch et al. 2015; Van Marrewijk 2003) through creating benefits to the local communities (and the nation at large), while undertaking profitable mining operations. The mining companies view their involvement in CSR activities as creating a 'win-win' situation as they generate benefits for the people. This explains the involvement of mining companies in some community activities, sometimes, with the involvement of local NGOs. The mining companies engage in activities, such as running hospitals and clinics, supporting community schools and football clubs, most of which are responsibilities that were taken over at privatisation from ZCCM. One mining manager, for example, commented:

> […] the people here have high expectations of us…and we want to give back to the local population, the local inhabitants […] whatever we can manage. You cannot work if the community around you is hostile, you have to work in a community where everybody is happy. They should see that they are benefiting from the investment. So we play a very big role and corporate social responsibility is very critical for everybody; it's a win-win situation. (M4, p. 3)

However, some mining managers, mostly from the Chinese companies, implied that their level of engagement in CSR activities is driven by their profitability levels. CSR, in this case, is profit-driven and represents an outcome of profitable operations. Thus, mining companies should not forget their main reason for being in operations, which is to maximise their shareholders' wealth (Sikka 2010), at the expense of CSR. The strategic economic considerations are seen as compromising the ethical or caring considerations of the mining companies. One Chinese company manager commented:

> […] it's good to be socially responsible, otherwise it will be inhuman not to be […] but not at the expense of forgetting why the company is in existence. (M3, p. 5)

This was reiterated by another Chinese company manager who argued that:

> We are an investor and have got specific targets and objectives. We are not a charitable organisation but are here to make a profit. (M4, p. 15)

In general, we find that there is less justification or motivation for engaging in CSR by the mining companies and thus the need for national guidelines on CSR engagement by mining companies. The mining companies that report CSR initiatives and practices are effectively only reflecting the ethos of the parent company in most cases. One mining manager, for example, commented:

> […] there is nothing compelling us [to engage in CSR]. It's only that we have developed this culture that we feel so indebted to our community to pay back and this is derived from how our parent company operates […], so really it would be good in Zambia to have some policies that actually compel companies to do CSR, (it is) for the good of this country. We need some laws or something to compel the company, not just saying you should do CSR. (M2-1, 10)

Due to the growing diversity of investors and the rapid expansion of the sector in the post-privatisation period, the fairly homogeneous business policies and practices of the pre-privatisation era (of ZCCM) have ceased. The new investors have different institutional backgrounds which effectively shape their organisational routine. These organisational routines (processes, strategies, technologies and norms) are seen to persist long after a company has entered a new market (Haglund 2011a) as adaptation or change is associated with transaction costs (Nelson and Winter 2002). Thus, for mining companies whose parent companies do not emphasise CSR engagement or have a CSR policy, their level of CSR involvement would be low.

We also find that project financing requirements is the key motivating factor for CSR disclosures among the mining companies which had a western parent company (see also Sect. 6.1). The adoption and implementation of some of the international voluntary reporting guidelines, such as the Equator Principles, was largely directed at meeting the financing requirements. One mining manager justified, for example, that the adoption of voluntary reporting guidelines was motivated by financing incentives and stakeholder demands: '*this is how we derive our financing and what stakeholders demand from us to do*' (M11, p. 2). The financing of mining projects through international capital markets has increasingly included provisions for minimum company standards for environmental and social performance vis-à-vis local stakeholders (Haglund 2009). The firms that are not willing to comply with these standards increasingly face supply constraints on accessing funding from international capital markets.

The mining companies that have parent companies listed on the international stock exchanges are increasingly faced with the challenge to report on their sustainability (or environmental and social) performance in addition to their financial and operational performance (Ernst and Young 2012). In order to do this, they need to have in place systems that capture such performance. Thus, the capital market requirements provide some form of mechanism that shapes the corporate behaviours and practices which trickles down to subsidiary level. One mining manager, for instance, commented:

> Ourselves, we do not only rely on compliance to the government laws. We have to follow international standards, ISO 14000, OHSAS 18000, […] we have external auditors. So, our reporting system compliance is not really worrying about the Zambia Environmental Management Agency (ZEMA). It's about compliance to international standard which we have to abide by. So, that is why we have our own internal system which we have to ensure that it's compliant with our own set of rules and by doing so, it actually helps reduce the workload of ZEMA and Mines Safety Department (MSD) because we are able to have that focus of trying to be compliant to international standards. (M2-2, p. 7)

Reputational risk management is a key consideration for these companies as the capital market is sensitive to negative publicity regarding mining operations (Gedicks and Brown 2015). The multinational companies have to manage this reputation risk, hence their engagement in public relations activities which get publicised as CSR programmes. One mining manager, for example, emphasised that because the company is listed on international stock exchanges, '*we are subject to negative publicity or complaints from the community. So we would like to operate at a very high level of standard*' (M1, p. 14). The negative publicity can easily permeate the international media and needs to be contained. Following from the need to manage their reputation, we find that responsibility for CSR activities in most of the mining companies resides with the 'public relations managers' (or community relations managers) with the resultant CSR practices (and reporting) being philanthropic, unsustainable and directed at public relations.

While the 'western parent' mining companies have key concerns over access to financing and engage in some form of CSR adopting the 'western' voluntary reporting guidelines, this is not a major issue for Chinese-owned mining companies. There is no subtleness in terms of their motivation for undertaking any CSR-related activities. For instance, one company specifically states that it supports '*community projects that will enhance its public image*' (NFC Africa 2009). Arguably, any CSR-related activity is expected to be motivated for reasons related to enhancing public image. Thus, Chinese companies do not have incentives to adopt the 'western' voluntary guidelines. One manager from a Chinese-owned mining company, for example, stated that:

> […] well, there are those (guidelines), but there must be incentives for us to actually embrace those policies, otherwise we will operate normally. We are an investor mind you. (M4, p. 15)

Access to financing is not a key consideration for the Chinese-owned mining companies to engage in CSR. Frost and Ho (2005) observed that at a time when most multinational companies operating in Africa are private, large Chinese investors in strategic sectors, such as energy, mining and construction, are frequently state-owned. Concerns over access to financing, a key driver for mining companies with a western orientation to implement the voluntary guidelines, is lower among the Chinese companies as they can rely on China's state-controlled banks for financial support regardless of their economic performance (Gill and Reilly 2007). Thus, in contrast to the 'western' (stock exchange) listed multinational companies where shareholder oversight is afforded through corporate governance arrangements which include significant commitment to financial and non-financial information disclosure, the Chinese investors have a state-led corporate governance, monitoring and oversight arrangement.

We also find that one of the major reasons for non-disclosure or limited level of disclosure was the low (if any) demand for such information from within the local citizenry. Firstly, there is no requirement to produce the information, and secondly, no stakeholder group or citizenry has demand for such information. This means that mining companies are likely to meet only the ethos or requirements of the parent companies. Companies are usually prone to respond to stakeholder demands (Banerjee 2007), and where these demands do not exist, little or no progress might be expected. The low demand for CSR disclosures might also be a reflection of the educational level of the nation[18] and the level of activism of stakeholders, such as civil society, who have played a major role in developed countries.

[18]Zambia has an average total adult literacy rate of 61.4% (UNICEF 2016).

20.7 Conclusions

This study sought to examine the CSR disclosure practices of major copper mining companies operating in Zambia and the underlying motivations for such disclosure (non-disclosure) practices. Our study found that the extent of CSR reporting within the country is very limited. The annual reports do not usually provide any CSR-related information, while the alternative CSR disclosure media, for instance, company websites and discreet CSR reports, are also very few in Zambia. CSR does not form an integral part of the business strategy of most Zambian mining companies. CSR practices and disclosures reflect mainly the parent company's ethos and aim at meeting legal requirements. Interestingly, while CSR reporting in Zambia is scarce, the 'western' parent companies have been reporting on their Zambian company's CSR activities in their home countries. This partly reflects the increased demand for CSR reporting by investors in such developed economies (Ernst and Young 2012). It was further revealed that the underlying motivation for adoption of 'western' voluntary CSR guidelines by the mining companies was for project financing purposes. Thus, in cases where there is no demand for project financing, no recognisable reporting has been provided. In addition, we found that reputation risk management and the concern to portray a good public image were among the main concerns for CSR-related engagement.

One of the main reasons attributed to the limited CSR disclosures within the country was the lack of demand for such information. There is no specific government requirement for such disclosures, and also, the expected external pressure from some stakeholder groups, especially the civil society or non-governmental organizations, was minimal. This is a reflection of the relative power of such stakeholder groups and also the level of education within the country.

Given these findings, there is a need for government to take a more proactive and strategic stance on the CSR agenda (Lepoutre et al. 2004). CSR needs to be explored, not only as self-government (voluntary and non-enforceable) or as an alternative form of government (substitute for government), but also as self-regulation which is facilitated by government, coordinated in partnerships with government, and mandated either directly or indirectly by government (Gond et al. 2011). There are (new) opportunities that arise for government to deploy CSR for governance purposes and to regulate corporate behaviours through CSR (Moon 2002).

The composition of the mining industry ownership is increasingly diverse, and the resultant CSR practices will vary depending on the forces that influence it. Therefore, governments should get involved in spearheading the CSR agenda that will be relevant and reflective of the context of the country. There is a danger of CSR being 'camouflaged' (Adanhounme 2011) and unreflective of the local peculiarity, if it remains a directive of the parent company. There is a further danger

of continued lack of CSR engagement, especially where the parent company does not prioritise the CSR agenda, as in the case of the Chinese state-owned mining operations. Thus, as ownership structure will continue to influence the level of CSR disclosures (Adam 2002), there is need for government involvement in creating a national framework or guideline which should form the minimum expected from mining companies. The lack of national policy on CSR makes the country more prone to further exploitation and abuse, such as labour abuses and environmental degradation. The proactive engagement of government in the CSR agenda is required as CSR has the potential to contribute to sustainable development (Dashwood 2014).

There is also a need to empower some of the key stakeholder groups, such as the civil society organisations, potentially resulting in an increased demand for corporate accountability. The civil society organisations within Zambia could benefit from an international network that could enhance their advocacy or watchdog role in exposing corporate behaviour to public scrutiny (Dahan et al. 2010). Improved capacity, with a corresponding increased public awareness, should also enhance accountability. Getting the mining companies to account for their social and environmental effects of their mining operations is an important step in the accountability and democratisation process. When such information is readily available, stakeholders could then demand necessary institutional reforms in order to promote development.

While we do recognise the intrinsic nature of the industry as posing challenges in promoting sustainable practices, we hold that there are still opportunities for the sector to contribute positively to the sustainable development of mineral-dependent countries. Further, there is need to explore the opportunities that lie within the reforms introduced by the sector in order to identify the potential contribution to socio-economic development of host countries. We support the view that mining could be the basis for a sustainable future. However, this requires 'real' accountability and transparency in mining operations and revenue generations. Thus, viewed in the context of sustainable development, mining should involve a transparent process which ensures that appropriate revenues generated by exploitation of non-renewable resources are invested to safeguard the long-term development of sustainable livelihoods of affected communities (Yakovleva 2008). Engaging in CSR is one way that the industry could promote an open, transparent and democratic society (Gray 2002). The mining industry should strengthen its commitment to sustainable development and identify alternative strategies, change governance models in areas of stakeholder engagement; supply chain management; pollution prevention and risk management; post-closure remediation and sustainable livelihoods and cooperative linkages between projects via mutual dependence (Mutti et al. 2012). Therefore, initiatives that promote accountability in the sector and sustainable mining practices should be encouraged as these enhance the potential for the sector to contribute to sustainable development.

Improved CSR reporting that is anchored on corporate accountability, especially in developing countries where there are inefficient government systems, is imperative. We support Belal (2008) argument that CSR has the potential of promoting

equality, social justice, transparency and accountability by holding companies accountable. The improvements needed in CSR disclosures, we propose, could start by examining the current reporting practices and understanding the underlying motivation for such disclosures (or non-disclosures).

Appendix 20.1

CSR disclosure categories	
1	CSR guidelines/standards
2	Mission/vision statement
3	Company policy for social, ethical and environmental matters
4	Board level responsibility or CSR committee
5	Health and safety
6	Gender equality or equal opportunities
7	Industrial relations
8	Human resource development
9	Poverty alleviation
10	Malaria, HIV/AIDS programme
11	Rural and agricultural development
12	Local business development
13	Corruption
14	Observation of various national ceremonies
15	Contribution to the Zambia Revenue Authority
16	Technological factors
17	Attitude towards environmental matters
18	Environmental breaches and fines
19	Recognition of relevant stakeholder
20	Support of recreational facilities
21	Support for retired or ex-mine employees

Table 20.4 Analysis of CSR disclosure in the Zambia mining industry

	Disclosure category	Konkola	Mopani	Kansanshi[a]	Chibuluma[b]	Luanshya/NFC Africa Mining	Lumwana[c]
1	CSR guidelines/standards	–	–	Yes[d]	–[e]	–	Yes[f]
2	Mission/vision statement	Yes[g]	–	Yes[h]	–	–	Yes
3	Company policy for social, ethical and environmental matters	Yes	–	Yes[i]	–	–	Yes
4	Board level responsibility or CSR committee	Yes	No[j]	Yes[k]	Yes[l]	No[m]	Yes[n]
5	Health and safety	RAMPK[0]—OHSAS 18001:1999	Mopani 5 Star—OHSAS 18001:1999[p]	Yes—OHSAS 18001: 2007[q]	IsoMetrix[r]	–[s]	Yes
6	Gender equality or equal opportunities	Yes[t]	–	–	Yes[u]	–	Yes
7	Industrial relations	–	–	–	–	–	–
8	Human resource development	Yes	Yes[v]	Yes	–	Yes	Yes
9	Poverty alleviation	Yes—alternative livelihood	–	Yes[w]	–	Yes[x]	Yes[y]
10	HIV/AIDS programme	Yes	Yes	Yes[z]	Yes[aa]	Yes[ab]	Yes
11	Rural and agricultural development	Yes—Self Help Groups	–	Yes[ac]	–	–	–[ad]
12	Local business development	No	–	Yes[ae]	Yes[af]	Yes[ag]	Yes
13	Corruption	Yes[ah]	–	Yes	–	–	Yes
14	Donations and other charitable causes	Yes[ai]	Yes[aj]	Yes	Yes[ak]	Yes[al]	–[am]
15	Contribution to the Zambia Revenue Authority	Yes—windfall tax liability[an]	Yes—windfall tax liability[ao]	Yes[ap]	Yes[aq]	Yes[ar]	Yes[as]

(continued)

Table 20.4 (continued)

	Disclosure category	Konkola	Mopani	Kansanshi[a]	Chibuluma[b]	Luanshya/NFC Africa Mining	Lumwana[c]
16	Technological advancement	New smelter—cut emissions[at]	Yes—upgrade to smelting process[au]	Yes	–	–	Yes
17	Attitude towards environmental matters	Policy, provisions	No policy-EMP[av], provisions[aw]	Policy, board commitment	Policy, board committee	–	Policy, board commitment
18	Infrastructure development	Yes[ax]	Yes[ay]	Yes[az]	Yes[ba]	Yes[bb]	Yes
19	Recognition of relevant stakeholder	Yes	–	Yes	Yes[bc]	–[bd]	Yes
20	Support of recreational facilities	Yes	–	–	Yes[be]	Yes	–
21	Support for retired or ex-mine employees	–	–	Yes	Yes	Yes	Yes

[a]The CSR disclosures were done in the group company CSR report (not locally in Zambia), where Kansanshi Mining Plc CSR activities were predominately disclosed

[b]The Zambia annual reports of the company provide very limited information. The parent company does some sustainability reporting within the annual report where Chibuluma Mines operations are mentioned

[c]Barrick acquired the company in July 2011. The CSR analysis covers the period from this acquisition date. Prior reports, except 2005, were not accessible when company was in its development stage. The disclosures have been made at the parent company level, not locally in Zambia. In addition, the specific reference to Lumwana activities is limited in the report, albeit the period was too short since acquisition for reporting

[d]There is specific reference to the Equator Principles (2007). Other referenced charters and sets of principles include the Extractive Industries Transparency Initiatives (2008) and the International Labour Organisation's Declaration of Fundamental Principles and Rights at Work (2008)

[e]Metorex Plc stated that 'while Environmental Impact Assessments ("EIAs") and Environmental Management Plans ("EMPs") are a legal requirement in the countries of operation, the documents for projects are prepared to comply with the EP and the International Finance Corporation's Performance Standards. This is done in the event of existing and potential project funding from EP signatory banks, as well as the use of such international standards as best practice' (Metorex 2011). This is not applicable to the period after the acquisition by Jinchuan Group, and the subsequent conversion of the company into a private limited company

[f]Barrick reports according to the Global Reporting Initiative's (GRI) Sustainability Reporting Guidelines, using GRI-G3, the third version of the guidelines. Reference is also made to the UN Global Compact (UNGC) and the International Council on Mining & Metals (ICMM) Sustainable Development Principles

[g]Enhance stakeholder value underpinned by strong sustainable development practices

Table 20.4 (continued)

[h]Kansanshi has a mission statement that incorporates sustainability or CSR, 'through economic viability, the company enhances social development and mitigates negative environmental impact'
[i]Company's CSR focusses on five main areas namely governance and risk management, economics, environment, social and labour
[j]CSR issues are handled by the Corporate Affairs Manager
[k]There is a committee responsible for CSR, delegated by the Board, the 'Environmental, Health & Safety and Corporate Social Responsibility Committee ("EHS&CSR Committee")'
[l]Metorex has a SHEC board subcommittee
[m]CSR activities are placed under the Public Relations Manager, aimed at spreading and promoting a favourable image
[n]At parent company level, the company has a corporate responsibility committee
[o]The RAMPK programme conforms to all the requirements of the OHSAS 18001:1999 specifications
[p]The 'Mopani 5 Star Safety System' conforms to all the requirements of OHSAS 18001:1999 specifications
[q]The company's safety management systems are based on the BSI OHSAS 18001 2007 Standard and subject to continuous review and development so that they are both practical and straightforward to implement in order to achieve the objective of reducing risk and zero fatalities
[r]Chibuluma introduced its integrated Safety, Health, Environment and Community (SHEC) management system, the 'IsoMetrix' in 2011
[r]Information on the health and safety system at company not known
[t]KCM promotes equal opportunity employment for men and women (Vedanta is an equal opportunity employer. In order to maintain a healthy gender ratio, the employment of professionally qualified lady candidates into management positions shall be encouraged)
[u]Female recruitment promoted at the mine
[v]Graduate recruitment programme and workers training to improve workers' skills and supervision leadership (Annual report 2009)
[w]Alternative livelihood programmes, conservation farming and resettlement support programme
[x]Some community-related activities could be classified as such
[y]Spent USDO.285m in community investment in 2012
[z]Kansanshi has had HIV/AIDS programmes called 'One Man Can' (2010), then 'One Woman Can' (2012) and 'One Couple Can'(2013) which followed in sequence. It also has a workplace VCT sensitisation programme
[aa]The company, in partnership with Zambia Health and Communication Trust (ZHECT), encourages voluntary counselling and testing among its employees
[ab]No specific HIV/AIIDS programmes. However, company runs a hospital and three clinics
[ac]Conservation Farming Scheme supporting 280 rural farmers in 2011 to 550 famers in 2012. Vegetable gardening and poultry rearing
[ad]There is no specific mention of Lumwana's programme on rural and agricultural development
[ae]This is done through 'business development workshops', 'contractor training', engaging local level contractors and partnering with local chamber of commerce and research consultants
[af]Local contractors and suppliers supported
[ag]The claims to have spent ZMK18,900m (USD3.6m in 2011) as part of its business development contribution
[ah]KCM has a code of ethics covers bribery and corruption practices

Table 20.4 (continued)

[ai]These amounted to USD65,605 in 2011 and USD33,203 in 2010

[aj]These amounted to USD0.15m in 2009 and USD0.43 in 2008. Mopani supports two hospitals, seven clinics and four schools

[ak]Donations to schools and national events

[al]The company makes some donations to the community in various forms. The donations expenditure was ZMK46m (USD8870) in 2011

[am]No donations were made in 2012

[an]During the year ended 31 March 2011, KCM and government of Zambia agreed for the final settlement of windfall tax liability of USD27m after the demand by ZRA for its settlement on 17 May 2010. Interestingly, windfall tax did not meet the definition of 'income tax', hence charged to cost of sales. No income tax was paid for the years 2011 and 2010 as the company still has unutilised tax losses. It paid USD0.254m and USD1.292m in 2009 and 2008, respectively (USD2.285m and USD0.712m in 2007 and 2006, respectively)

[ao]Mopani provided for a windfall tax liability of USD65.293m in 2008. This was not remitted to Zambia Revenue Authority because the directors were of the opinion that the tax was in breach of the development agreement. In addition, Mopani accumulated tax losses amounting to USD471.8m in 2009 (USD459.912m), which are subject to agreement with ZRA. These losses can be carried forward for a maximum period of ten years from the year in which they are incurred for set off against future profits from the same source. No mineral royalty tax was paid in 2008 and 2009. No income tax has been paid for the period 2006, 2007, 2008 and 2009. With the accumulated tax loss of USD471.8m, no tax could be receivable for the next foreseeable future. Mineral royalty payments were USD19.83m, USD4.762m, USD3.771m and USD1.625m for 2008, 2007, 2006 and 2005, respectively. The company was exempt from paying mineral royalty tax for the first 5 years of its operations up to 31 March 2005

[ap]The company made tax payments of USD247.85m and USD77.79m in 2010 and 2009, respectively. In 2012, the company contributed 8.59% of gross national income to the total economy

[aq]Chibuluma made payments (excluding PAYE) amounting to ZMK135.14bn (USD28.33m) in 2010. The company had accumulated tax losses of USD42.619m as at 30 June 2005. The mineral royalty due in 2005 was USD59,000 only, and no income tax was paid (USD2,000 only in 2004)

[ar]The company made payments to ZRA for mineral royalties of ZMK1.260,000 (USD242.98) and no income tax in 2011

[as]Paid USD46.97m in royalties and taxes in 2012

[at]A new state-of-the-art flash smelter was commissioned in 2008 incorporating technology from Outotec, Finland. The smelter processes ore from Konkola, Nchanga and other third party concentrate and has a capacity of 311,000t pa. The smelter has benchmark environmental performance as it captures 99.6% of sulphur emissions

[au]Mopani used the loan from the European Investment Bank to upgrade the Mufulira smelting process

[av]Company is still implementing the Environmental Management Plans

[aw]Provisions made for environmental restoration costs on an annual basis. The original provision was determined by external consultants prior to privatisation of ZCCM. The balance sheet at the date of acquisition included a provision for environmental and restoration costs at the end of the mine's life. The provision was increased for 2009 by USD3.3m (USD3.2m in 2008) in line with the Environmental Assessment Report prepared by Scott Wilson Piesold and audited by African Mining Consultants

Table 20.4 (continued)

[ax]KCM owns and operates two modern hospitals and seven clinics to provide health care to employees and the community. KCM owns and operates two trust schools in Chingola and the Konkola that provide quality universal primary and secondary education to over 1800 children of both mine employees and outsiders

[ay]Mopani undertook to rehabilitate the Chibuluma-Mindolo bypass road in August 2011. The project cost was USD10m

[az]Constructions such as the Sustainable Suburban Development, Solwezi Airport, Urban Clinic Maternal and Child Health wing, construction of the Kalumbila Housing Project, etc

[ba]Contributed to infrastructure development, for instance in 2011, in construction of classrooms, repair of school buildings, pothole mending/levelling

[bb]The company states that it will 'concentrate on infrastructure development because it is the only sure way of leaving a lasting impression and structures that the residents can always refer to and live with'. The infrastructure development in 2011 was ZMK2,002million (USD385,682)

[bc]The company developed a Resettlement Action Plan for settlers within the Chibuluma South Mining license

[bd]All efforts are directed at image building

[be]Company supports soccer and rugby clubs

Appendix 20.2

See Table 20.4.

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