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Corporate Social Responsibility

Reconciling Aspiration with Application

Edited by

Andrew Kakabadse and Mette Morsing

Corporate Social Responsibility

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Corporate Social Responsibility

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Edited by

Andrew Kakabadse
Cranfield University School of Management

and

Mette Morsing
Copenhagen Business School

In association with the European Academy of Business in Society (EABIS)

Foreword by

Gilbert Lenssen
President, European Academy of Business in Society

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Foreword

In 1994, when capitalism appeared triumphantly emerging from the ideological battles of the twentieth century, Charles Handy warned that 'capitalism must [now] be its own sternest critic' in order to sustain its 'second curve' of evolution (*The Empty Raincoat*, pages 130 and 132). He and other thought-leaders in global affairs predicted that the emergence of a balanced *Corporate Contract* would be vital for a sustainable global free market system. Ever since, the debate on Corporate (Social) Responsibility has burgeoned and recently further intensified.

This book edited by Andrew Kakabadse and Mette Morsing comes very timely as a state-of-the-art work after more than ten years of debate. The importance of managerial theory and practice for constructing an advanced form of capitalism, fit for the twenty-first century, will not be lost on the intelligent reader of this substantial book.

I started this foreword with a reference to Handy because the spirit of this book is of a similar mould: that complexity dominates the outlook of thoughtful observers of affairs of business and society and that understanding and managing paradox is the key mental mindset conducive for responsible action. Those looking for simple answers should probably not read this book.

Whilst the curricula of many of our business schools, modelled on the American enterprise model, continue to instil our future (and current) corporate leaders with a rather cynical mix of agency theory, transaction cost theory and pure neo-classical economics, this book is inspired by the ancient wisdom of St Augustine: that mistaking means for ends is to be turned in on oneself, which is a cardinal sin and a sure ticket to hell. This is highly relevant to business today.

At the heart of this book is the debate on the end and purpose of the firm and the means for achieving these. Purposefully embedded in society, business can be a force for good and a source of hope for the future. Its means of applying efficient resource allocation, optimising value chains, exploiting new knowledge and driving innovation ensure competitiveness, profitability and growth. But these are important and sophisticated means, however, and not ends.

Andrew Kakabadse and Mette Morsing are well placed to conduct a *tour d'horizon* of corporate responsibility from the central perspective of the purpose of the firm. Andrew's background in corporate governance and corporate leadership and Mette's background in organisational development and human resource management provide the essential platforms from which to conduct such a tour.

The tour takes the reader from exploring the thinking behind C(S)R, comparing models and approaches, examining applications in three leading global companies, and prospecting the vanguards of the debate for the future. They have drawn in successfully a wide range of contributions from distinguished representatives from the worlds of academia, business, civil society, consultancy and professional institutions.

I recommend this work to a wider audience in the different worlds where it actually came from: to all enlightened contemporaries in those often still separate worlds of scholarship, management, social and environmental activism and consultancy, so that they might join in one world, our world of the twenty-first century.

Professor Gilbert Lenssen Ph.D. MBA FRSA
President, European Academy of Business in Society

List of Contributors

Laura Albareda, Researcher at the Institute for the Individual, Corporations and Society, ESADE, University Ramon Llull, *Albareda@esade.edu*

Ruth Barratt, Doctoral Candidate, Cranfield University, *Ruth.barratt@asu.edu*

Seb Beloe, Director of Research and Advocacy, SustainAbility, *beloe@sustainability.com*

Eva Boxenbaum, Ph.D., Assistant Professor of Organisational Theory, Copenhagen Business School, *Eb.ioa@cbs.dk*

George Cheney, Professor, Department of Communication, University of Utah, *george.cheney@utah.edu*

John Elkington, Chairman, SustainAbility, *elkington@sustainability.com*

Titus Fossgard-Moser, Ph.D., Sustainable Development Manager, Shell Venezuela, *titus.fossgard-moser@shell.com*

R. Edward Freeman, Olsson Professor of Business Administration, The Darden School University of Virginia, *freemane@darden.virginia.edu*

Andrew Kakabadse, Ph.D., is on the Supervisory Board of EABiS, and is Professor of International Management Development, Cranfield University, *a.p.kakabadse@cranfield.ac.uk*

Nada Kakabadse, Ph.D., Professor in Management and Business Research, University of Northampton, *nada.kakabadse@northampton.ac.uk*

Dr Mike Kennerley, Research Fellow, Cranfield University, *m.kennerley@cranfield.ac.uk*

Jette Steen Knudsen, Ph.D., Director, The Copenhagen Centre for Corporate Responsibility, *jsk@copenhagencentre.org*

Peter Lacy, Executive Director, EABiS, *Peter.lacy@eabis.org*

Thomas Lingard, BA CMA FRSA, Corporate Responsibility Manager, Unilever UK, *thomas.lingard@unilever.com*

Josep M. Lozano, Director, Institute for the Individual, Corporations and Society (IPES), ESADE, *Josepm.lozano@esade.edu*

Christopher Marsden, OBE, Chair, Amnesty International (UK) Business Group, *clmarsden@ntlworld.com*

Lance Moir, Senior Lecturer in Finance and Accounting, Cranfield University, *l.moir@cranfield.ac.uk*

Mette Morsing, Ph.D., Associate Professor, Director of Centre for Corporate Values and Responsibility, Copenhagen Business School, *mm.ikl@cbs.dk*

Dennis Oswald, Assistant Professor of Accounting, London Business School, *doswald@london.edu*

Francesco Perrini, Associate Professor of Management and Innovation, Senior Professor of Corporate Finance and Real Estate Department, Bocconi University, *francesco.perrini@unibocconi.it*

Juliet Roper, Ph.D., Professor and Chairperson, University of Waikato, *jroper@mngt.waikato.ac.nz*

Heike Roscher, Research Assistant and Ph.D. Candidate, ESADE, *heike.roscher@esade.edu*

Cécile Rozuel, Doctoral Researcher, School of Management, University of Surrey, *c.rozuel@surrey.ac.uk*

Charlotte Salazar, Head of Administration, EABiS, *Charlotte.salazar@eabis.org*

Antonio Tencati, Assistant Professor of Business Management, Bocconi University, *antonio.tencati@unibocconi.it*

Steen Thomsen, Ph.D., Professor, Director of the Center for Corporate Governance, Department of International Economics and Management, Copenhagen Business School, *st.int@cbs.dk*

Jodie Thorpe, Senior Advisor, SustainAbility, *thorpe@sustainability.com*

Steen Vallentin, Ph.D., Assistant Professor, Department of Management, Politics and Philosophy, Copenhagen Business School, *sv.lpf@cbs.dk*

S. Ramakrishna Velamuri, Assistant Professor, IESE Business School, *rvelamuri@iese.edu*

Dr Tamyko Ysa, Assistant Professor, Institute of Public Management and Business Policy Department, ESADE, *tamyko.ysa@esade.edu*

Introduction: Corporate Social Responsibility – Reconciling Aspiration with Application

Andrew Kakabadse and Mette Morsing

'Just pious words with little or no action!' was the comment made by a senior consulting partner leading the Human Resources practice for one of the big four international consulting firms, referring to Corporate Social Responsibility (CSR), a topic which he considered to be undeservedly capturing the headlines.

Not that such sceptical perspective is isolated. Numerous commentators in the press, the media and academia have expressed doubts as to the true impact of the corporate responsibility movement.

Are corporate responsibility initiatives built into the budget so that it is possible to trace their actioning through the structure?

At what level in the organisation are the demands for profitability and attention to costs whilst simultaneously pursuing stakeholder sensitive endeavours, reconciled?

How many corporations, irrespective of their intent, are honest about their possible lack of progress in terms of corporate responsibility, whether for reasons of lack of strategic foresight, managerial inattention or the inability to integrate irreconcilable demands?

How many enterprises finally admit to their unrealised corporate responsibilities only because of press, media and watchdog pressure? And is that a viable strategy for corporate responsible action to appear in the future?

Yet, whatever the criticisms, there is little doubt that the involvement of enterprises with issues of social concern will take greater prominence. Therefore, as editors, it is our intention to examine the questions and challenges surrounding the concept and application of the social responsibilities of the enterprise in this unique and original collection of papers. We have designed a book which links and reflects the concurrent debate at business schools, companies, NGOs, consultants and business associations, and therefore we have invited authors from these groups to draw on their experiences and comment upon corporate responsibility from their perspective. Though the authors do not agree on a definition of corporate responsibility, they all share a critical yet constructive concern about its concurrent and future state.

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The other link among these authors is that we have all met – and keep meeting each other – at various workshops and conferences at the European Academy of Business in Society (EABIS), which has provided a fruitful environment for collaboration between business scholars and corporate managers. Although the work so far is primarily dominated by scholars and managers based in Europe, there is an opening towards the rest of world. In the book this opening is reflected by a few authors based in the US and one in New Zealand.

Responding to an invitation for the latest thinking on the corporation and the nature of its responsibilities, numerous papers were received from which seventeen were ultimately selected for publication. The papers have been grouped into four sections: Part I, theories and perspectives; Part II, reporting and regulating; Part III, actions and challenges; and Part IV, questions and perspectives. The opening contribution by Ed Freeman and Ramakrishna Velamuri argues that a concern with CSR is the emergence of a 'separation mentality', positioning apart concerns of business from those of society, community development and ethical application. Their argument is that the separation thesis has become deeply embedded in western society, labelling capitalism as an undesired and exploitative vehicle of wealth creation. The way forward is to adopt a stakeholder philosophy focusing on how communal, in parallel to financial value, can be generated. From 'Don't write off capitalism', and 'Don't write off CSR just yet', is the theme adopted by Chris Marsden, Amnesty International UK (Chapter 2). Recognising that CSR faces considerable criticism from the political perspective which says that, government should intervene more and also that CSR wastes corporate resources, Chris Marsden argues that CSR provides the basis for a system of sustainable market governance. Taken from the perspective of NGOs, the paper evaluates the challenges and potential of corporate responsibility as a vehicle for societal enhancement. It is concluded that the true value of corporate responsibility has not been realised and should be seen as an emerging field of inquiry. The value theme is continued in Chapter 3 with Steen Thomsen who links corporate values, corporate behaviour and corporate governance. CSR and corporate values are viewed as an outcome of the corporate governance mechanisms in operation. With this in mind, the paper identifies a framework for providing explanation of how corporate values are determined by the interplay of key corporate governance levers, namely, models of ownership, board structure and stakeholder involvement. The examination of values, of corporateness and societal responsibilities continues in Chapter 4 through Nada Kakabadse's and Cécile Rozuel's exploration of who is responsible and who should govern environmental development and protection. Conscious of present day environmental degradation, the issue of responsibility is explored from a Liberal, Marxian and Realist perspective. From such analysis, a governance model integrating the three critical viewpoints is provided highlighting the shape of responsible environmental governance for the future.

From a broader overview of the theories and overviews relating to CSR, attention is given in Part II to considerations of reporting, regulating and measuring the implementation and practice of enterprise responsibility initiatives. Lance Moir and Mike Kennerley, in Chapter 5, argue that measurement is becoming more complex due to the need to integrate economic and social performance related criteria sensitive to the goals and concerns of particular levels of management. The paper explores the challenges facing performance measurement, highlighting areas of possible conflict. A framework incorporating economic and social performance measures is offered, concluding that sound governance involves boards of enterprises fully addressing both clusters of hard and soft issues. In their contribution, Moir and Kennerley infer sustainability, a theme that is scrutinised by Antonio Tencati and Francesco Perrini in Chapter 6. Drawing on the SERS (sustainability, evaluation and reporting system) research project, which attempts to aggregate a range of management tools into one comprehensive model for providing an effective performance measurement methodology for assessing corporate sustainability viability, the authors argue that by combining economic value creation with sustainability, shareholder value is an insufficient platform for future organisational and societal design. Broadening shareholder value to that of stakeholder begs the inevitable question of the purpose of government, a theme pursued by Laura Albareda, Tamyko Ysa, Josep Lozano and Heike Roscher, who, in Chapter 7, examine the recent debates concerning the role of government, particularly in the European context. Drawing on research sponsored by the Commission of the European Union (EU), the authors emerge with recommendations concerning the role of government in supporting the promotion of CSR across Europe. The next two chapters of Part II provide case study reporting and regulating application experiences in Denmark. Jette Steen Knudsen reports the results of the Global Reporting Initiative (GRI) pursued with Danish companies. Knudsen's description of the changing business environment is followed by an evaluation of areas of concern in assessing the effect of societal and corporate strategies. The paper concludes by providing an examination of the effectiveness of usage of GRI in Denmark. Still adopting a case approach, Eva Boxenbaum (Chapter 9), draws on institutional theory to suggest that the concept of social construction is a viable but overlooked model of self regulation for CSR purposes.

From a conceptual overview of corporate and socially determined responsibility and analysis of reporting, regulation and performance measurement challenges, Part III of this book then adopts a distinctly practical shape by exploring the challenges and benefits of CSR application through three case studies. Titus Fossgard-Moser (Chapter 10) discusses the recent social performance reviews undertaken in Shell for the years of 2001 and 2003.

Further, Fossgard-Moser offers definitions of social performance within the Shell context, concluding with the key aspects of Shell's Social Programme Management Framework. Mette Morsing and Dennis Oswald follow in Chapter 11 scrutinising CSR application in Novo Nordisk. Particular attention is given to the process of continuous learning for integrating CSR activities with business strategy pursuit. The use of the balanced scorecard and Novo Nordisk's approach to non-financial reporting makes for particularly interesting reading. In similar vein, Thomas Lingard (Chapter 12) demonstrates how Unilever UK is working strategically to embed CSR into the 'culture of the organisation' by encouraging a mindset of CSR from the moment people enter the enterprise through the organisation's corporate recruitment programme. Emphasised is attentiveness to the effect of corporate values on business processes, the benefit to be realised from personal freedom of expression within the workplace and that continuity and consistency of communication are vital to reinforcing commitment to CSR.

As Part I of this book provides opportunity for critical questions of corporate and societal responsibility to be explored, and Parts II and III examine the theory and reality of corporate responsibility pursuit, Part IV closes this unique collection of papers through focus on particular questions concerning CSR development and application for the future. Peter Lacy and Charlotte Salazar in Chapter 13 continue the theme of the corporate and societal enhancement potential of corporate responsibility by arguing that business schools are an under-utilised resource for the promotion of greater understanding amongst managers in integrating economic, environmental and social issues. The Lacy and Salazar theme – educate the managers of the future in order to institutionally ground CSR – is taken further by Mette Morsing and Steen Vallentin (Chapter 14). Gaining top management support in order for CSR initiatives to be successfully implemented, is emphasised. Equally, inconsistent and misplaced commitment can act as an obstacle to realising benefit from CSR initiatives. The paper concludes by emphasising that greater organisational integration of CSR with other business processes is imperative for the effective application of CSR activities. From an internal organisational perspective, the final two papers examine CSR from an 'outside the organisation' viewpoint. Juliet Roper and George Cheney (Chapter 15) examine social entrepreneurship and, in so doing, indicate that the language of business has come to dominate the expression of organisational and public sphere processes. In response, social entrepreneurship is considered as blurring the boundaries between the commercial and the communal and acting as a counter balance to the marketisation of civil society. The theme of nurturing a new corporate and socially responsible language and mindset is pursued by Seb Beloe, John Elkington and Jodie Thorpe (Chapter 16) in their analysis of how business can better interact with government to deliver stakeholder wealth creation solutions. Chapter 16 draws on the CSR and governance thinking to emerge from the United Nations Global Compact report. Through the medium of two case studies, emphasis is given to the role of business leadership in policy design. The final chapter (Chapter 17, Andrew Kakabadse, Nada K. Kakabadse and Ruth Barratt) explores the role and contribution of the Non Executive Director (NED) in championing CSR within the Anglo-American governance system. The unwillingness of corporate boardrooms to accept CSR and how such resistance can be overcome emphasises the need for appropriately positioning CSR within the strategy debate.

Thus, from an overview of theory and contrasting perspectives, to measurement, reporting and governance application, to case study reality-based experience, to operational and strategic considerations for the future; this contribution of seventeen papers acts as a critical reference point.

1 What is the thinking behind corporate responsibility?
2 What considerations should be taken into account in measuring the value and effect of corporate and social responsibility initiatives?
3 What are companies' experiences of CR and CSR?
4 And what should concern us about the future?

In examining these four questions, liberal use has been made of language. We are sure readers will already have noted that the phrases *corporate responsibility* and *corporate social responsibility* are used interchangeably. Some would argue the two are synonymous whilst others argue for difference between them. We, as editors, have made no attempt to inhibit the use of one or the other, nor to provide definition of the two terminologies. We adopt the view that the responsibilities of the corporation and its interrelationship with communities and governments is still a virgin area. The purpose of this book is to congregate a perspective of views and positions from authors based in different national, cultural, and professional contexts. And so we consider it best to allow the reader full access to the range of interpretation our authors offer. Informing and providing understanding of where citizens stand on issues of enterprise and societal responsibilities allows each of us to determine where we, in turn, would wish to position ourselves on the responsibility spectrum. Informing, providing understanding and allowing for self-reflection are the effects that we, as editors, hope this cluster of essays will have on you.

In working towards the realisation of informing, providing understanding and allowing for self-reflection, particular mention must be made of EABIS, whose help and cooperation have made it possible to bring together this collection of papers. EABIS is an organisation with the goal of encouraging collaboration between stakeholders in research, education and training on issues of corporate responsibility. This book is but one example of their admirable efforts to encourage debate of CSR. EABIS's contribution to

CSR inquiry and their sense of collegiality makes it a pleasure for us, the editors, to jointly position this text with them. We therefore see the co-branding of the book with EABIS as a great opportunity to demarcate our joint ambition. Together with EABIS, it is our hope that business, social and political scholars, managers and business school students will enjoy reading the chapters and use them as a point of entry for informed debate in the office, classroom, public meeting or even in circumstances of informal discourse. Just as in our EABIS gatherings, may your debate be informative and stimulating and, in turn, act as a prompt for considered action.

Part I

Theories and Perspectives

1

A New Approach to CSR: Company Stakeholder Responsibility[1]

R. Edward Freeman and S. Ramakrishna Velamuri

1 The problem: has the idea of Corporate Social Responsibility outlived its usefulness?

Assume that the CEO of Firm A is asked the following: 'Well, I know that your company makes products that consumers like, and that those products make their lives better. And I know that suppliers want to do business with your company because they benefit from this business relationship. I also know that employees really want to work for your company, and are satisfied with their remuneration and professional development. And, let's not forget that you're a good citizen in the communities where you are located;[2] among other things, you pay taxes on the profits you make. You compete hard but fairly. You also make an attractive return on capital for shareholders and other financiers. However, are you socially responsible?'

We confess to having absolutely no idea what 'socially responsible' could mean here. If a firm is doing all the things that Firm A does, then it deserves to be applauded and offered as an example for other firms, large and small, to emulate. If it is not doing them as satisfactorily as we think it ought to, then we could perhaps offer to help it do them better, rather than appeal to actions and responsibilities that might lie outside the domain of its day-to-day activities. In summary, by talking of business and social responsibility as if they were two separate things, we might unintentionally be promoting the idea that they involve discrete thought processes and activities. In our opinion, the challenge is to promote a different way of doing business that integrates considerations of business, ethics and society.

Herein lies the problem with Corporate Social Responsibility. Corporate social responsibility reinforces the 'the separation thesis', or the idea that we should separate 'business' from 'ethics or society'. This separation is an idea that reaches very deeply into western culture. It is reinforced by the disciplines of business, by our major theoretical frameworks in management, and by executives and business thinkers themselves. At its worst it

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generates an absolutely destructive idea of capitalism, i.e. that capitalism is about 'anything goes'. After all, the theory says, 'its just business'. Viewed in this way, corporate social responsibility becomes an 'add-on' to ameliorate the supposedly harsh consequences of this view of capitalism.

Let us go back to the example of our Firm A, and examine its decision to hire employees. Has it done something that is 'for the business'? We believe that the answer to that question is a resounding and unqualified 'Yes.' Has it done something that is 'for society'? We believe that the answer to that question is also a resounding and unqualified 'Yes.' So, how do matters of employment count – in the social ledger or the business ledger? A similar argument can be made for customers and communities, and for suppliers and financiers as well. All these individuals and organisations are full-fledged members of society, as well as being stakeholders in Firm A. If they benefit in their dealings with Firm A, then society benefits too, both directly and in a number of indirect ways.

Corporate social responsibility is often about seeming to 'do good works'. And, while there is certainly nothing wrong with doing more good, there can be an implication that companies need to do good works because the underlying structure of business is not good, or morally neutral. We believe that this is a destructive idea, because it fails to recognise the central role business has played in improving the well-being and prosperity of hundreds of millions of people around the world. And, it often causes companies to act in bad faith and get involved in matters where they have little expertise.

This is not Milton Friedman's argument that the only social responsibility is to increase profits; rather it is a practical matter, that giving money to the opera doesn't make up (in any moral sense) for short-changing customers or communities. The focus needs to be on how value is created in the basic business proposition. How does this company make customers, suppliers, communities, employees and financiers better off? Capitalism is a system of social cooperation – a system of how we work together to create value for each other. Seeing it any other way can lead to dangerous social policies, and to the tarnishing of the one institution – business – that still has to play a central role in lifting hundreds of millions of people out of poverty in Asia, Africa and Latin America.

The second problem with corporate social responsibility is that it is focused on 'Corporate' social responsibility. Why is it not called Business Social Responsibility? The focus on 'Corporate' implies that corporations, due to their size and success and perhaps their shareholding pattern, have to shoulder responsibilities that smaller and more closely held businesses do not. Why? It could be argued that large and successful corporations have a greater responsibility to society than small and less successful ones, because they have greater resources to shoulder society's burdens, and 'can' implies 'ought'. However, we believe that talking of responsibilities that are contingent on size and success is highly problematic.

In short, our argument is that if you take a 'creating value for stakeholders' approach to business, and if you acknowledge that ethics and values are as important in these relationships as they are in our other relationships with our fellow human beings, then the idea of 'corporate social responsibility' is just superfluous. There is nothing natural about categories such as 'economic, political, social, etc.' and we want to suggest that such a conceptual scheme – that separates the social responsibilities of a corporation from its business responsibilities – has long outlived its usefulness.

We propose to replace 'corporate social responsibility' with an idea we call 'company stakeholder responsibility'. This is not just semantics, but a new interpretation of the very purpose of CSR. 'Company' signals that all forms of value creation and trade, all businesses, need to be involved. 'Stakeholder' goes back to the very first paragraph of this essay and suggests that the main goal of CSR is to create value for key stakeholders and fulfill our responsibilities to them. And 'Responsibility' implies that we cannot separate business from ethics.[3] We will argue that taking a stakeholder approach to business is ideally suited to integrate business, ethics and societal considerations. Stakeholder theory is about value creation and trade – it is a managerial theory about how business works. It does not subscribe to the separation thesis, so it asks at once business and ethics questions about each stakeholder relationship. The remainder of this paper is structured as follows. Section 2 provides a brief history of the how the stakeholder approach to management developed. Section 3 outlines four successive levels of commitment to the stakeholder approach to CSR – the basic value proposition, sustained stakeholder cooperation, understanding of the broader societal issues, and ethical leadership. These four levels can be considered steps that firms can take as they progressively increase their commitment to the stakeholder approach. In Section 4, we discuss ten principles of the stakeholder mindset that a firm must follow for it to reach the highest level of stakeholder commitment – that of ethical leadership. In Section 5, we summarise the argument.

2 A brief history of the stakeholder idea[4]

A stakeholder approach to business emerged in the mid-1980s. One focal point in this movement was the publication of R. Edward Freeman's *Strategic Management: a Stakeholder Approach* (1984), building on the process work of Russell Ackoff, Eric Trist, Ian Mitroff, Richard Mason and James Emshoff. The impetus behind stakeholder management was to try and build a framework that was responsive to the concerns of managers who were being buffeted by unprecedented levels of environmental turbulence and change. Traditional business frameworks were neither helping managers develop new strategic directions nor were they helping them understand how to create new opportunities in the midst of so much change.

As Freeman observed '[O]ur current theories are inconsistent with both the quantity and kinds of change that are occurring in the business environment of the 1980s … A new conceptual framework is needed' (Freeman, 1984: 5). A stakeholder approach was a response to this challenge. An obvious play on the word 'stockholder', the approach sought to broaden the concept of business beyond its traditional economic roots, by defining stakeholders as 'any group or individual who is affected by or can affect the achievement of an organization's objectives'. The purpose of stakeholder management was to devise a framework to manage strategically the myriad groups that influenced, directly and indirectly, the ability of a firm to achieve its objectives. While the stakeholder framework had roots in a number of academic fields, its heart lay in the clinical studies of management practitioners that were carried out over ten years through the Busch Center, the Wharton Applied Research Center, and the Managerial and Behavioral Science Center, all at the Wharton School, University of Pennsylvania, by a host of researchers.

While the 1980s provided an environment that demonstrated the power of a stakeholder approach, the idea was not entirely new. The use of the term stakeholder grew out of the pioneering work at Stanford Research Institute (now SRI International) in the 1960s. SRI's work, in turn, was heavily influenced by concepts that were developed in the planning department of Lockheed and these ideas were further developed through the work of Igor Ansoff and Robert Stewart. Thus, the stakeholder approach is firmly rooted in the practice of management.

Recently, Giles Slinger has revisited the early history of the idea of stakeholders. Through more extensive interviews, and the examination of a number of historical documents, Slinger rewrites the history as told in Freeman (1984). The essential difference is that the early use of the stakeholder idea was not particularly oriented towards the survival of the firm.[5]

SRI argued that managers needed to understand the concerns of shareholders, employees, customers, suppliers, lenders and society, in order to develop objectives that stakeholders would support. This support was necessary for long term success. Therefore, management should actively explore its relationships with all stakeholders in order to develop business strategies.

The stakeholder approach has been used extensively by business ethicists to explore the ethical consequences on stakeholders of managerial action. Donaldson and Preston (1995)[6] proposed four different ways in which scholars had applied the stakeholder approach to business ethics: as a normative theory, which posits that managers ought to take into consideration the interests of all stakeholders; as a descriptive theory, which limits itself to describing how managers in fact treat stakeholders; as an instrumental theory, which takes the position that managers who take into consideration stakeholders' interests will enjoy better firm performance; and finally, as a managerial theory, that is, as a guide to managerial action. We believe that this fourth managerial perspective on the stakeholder approach has received the least attention in recent times, in spite of having been at the roots of the stakeholder concept at SRI.

According to Freeman and McVea (2001), the stakeholder approach has seven distinguishing characteristics. First, it offers a single strategic framework that allows a manager to deal with changes in the external environment without the need for new strategic paradigms. In this way, it is particularly suited for the dynamic environments that are so prevalent today. Second, the stakeholder approach is a strategic management process rather than a strategic planning process. The focus is less on predicting the future and more on proactively plotting the direction of the firm. Third, a central concern of the stakeholder approach is the achievement of the organisation's objectives through the harnessing of support of all those who are affected by the firm's actions, as well as all those who can affect the progress of the firm. Fourth, the stakeholder approach emphasises the critical role of values-based management, by recognising that a diverse collection of stakeholders will cooperate with the firm over the long term only if they share a core set of values. Fifth, it is at once a prescriptive and a descriptive framework. It advocates a holistic approach to management, integrating economic, social, political and ethical considerations. Sixth, rather than take a stylised view of stakeholders based on very general roles-based groupings (such as shareholders, suppliers, etc.), the stakeholder approach places great importance in acquiring a fine grained understanding of the particular stakeholders of each firm. This deep understanding enables the management to develop tailored solutions for particular stakeholders, as with mass customisation. Finally, it starts off with the premise that a firm can exist and sustain itself only if it offers solutions that balance the interests of multiple stakeholders over time. Taking a stakeholder approach to CSR means we have to focus on integration across stakeholders and on practical managerial solutions that create value for customers, employees, suppliers, communities and financiers.

In the section that follows, we outline four levels of commitment to Company Stakeholder Responsibility.

3 Four levels of commitment to the stakeholder approach[7]

Level 1: basic value proposition

At this most basic level, the entrepreneur or manager needs to understand how the firm can make the customer better off, while at the same time offering an attractive value proposition to employees, suppliers, communities and financiers. It is important to note that it is not possible to sustain making customers better off, without at the same time making the other stakeholders better off. For example, Naturhouse, a Spanish dietary supplements retail chain, has grown at an annual rate of between 40 and 50 per cent for seven years in a row from 1997–2004, in a mature and highly competitive market. It took the company five long years, from 1992–1997, to develop and refine a new business model with strong value propositions to its stakeholders. Once the company had finally come up with a model that offered its suppliers a decent price, its franchisees an attractive return on investment and effort, and its customers a unique combination of products and nutritional advisory services, it was able to grow at an explosive rate. What this example highlights is so obvious that we too often take it for granted: a business model that simultaneously satisfies the different stakeholders is a prerequisite for any company to start doing business profitably. Business failure and mediocre performance are often attributable to the firm's inability to articulate strong enough value propositions simultaneously to all its stakeholders.

Level 2: sustained stakeholder cooperation

Once the most basic level of stakeholder awareness has been achieved, the entrepreneur or manager must understand that the continued survival and profitability of the company depend on effectively sustaining the cooperation amongst the stakeholders over time. The competitive, macroeconomic, regulatory and political environments are so dynamic that they make it necessary for the initial stakeholder arrangements to be revised on a constant basis. Each revision will invariably upset the delicate balance struck in the value propositions of the company to the different stakeholder groups. For example, the entry of a new competitor from a low cost country such as China might mean the company has to reduce its price to its customers. This reduction might well involve a short term reduction in the prices paid to suppliers, a reduction in the wages of employees relative to output, or a reduction in the return to financiers. It is important for the manager to have a deep understanding of how these trade-offs affect each stakeholder, the limits to the sacrifice a given stakeholder will accept, and how these current sacrifices can be compensated in the future. Indeed, management according to the stakeholder approach is the effective balancing over time of multiple stakeholder interests.

Level 3: an understanding of broader societal issues

According to Haaland-Matlary (2005), the manager today is asked to be aware of and responsive to more and more international issues, without the moral compass of the nation state or religion to guide her any more. The insecurity caused by the increase in terrorism further compounds matters. Often, companies are caught flat-footed in the face of unexpected developments.

> [I]t was only after the fact in Nigeria that Shell took a major interest in human rights ... [W]hen Amnesty International accused Telenor, a

> Norwegian telecommunications company, of racist policies in Malaysia, the company's management froze and responded more than a week late. Even though Amnesty International's case was poor, the damage was done. (Haaland-Matlary, 2005)

What this means is that managers can no longer decline to take positions on issues that apparently are not purely business related. Shell paid a heavy price through loss of reputation by its refusal to use its considerable leverage with the Nigerian government to try to halt the execution of political activist Ken Saro-Wiwa. A proactive attitude is necessary towards all stakeholder groups, both primary, i.e. those that have direct business dealings with the company, and secondary, such as NGOs and political activists who can affect the operations of the company.

Level 4: ethical leadership

Recent research points to a strong connection between ethical values and positive firm outcomes such as sustained profitable growth and high innovativeness. The Good Work Project, started in 1995 by three teams of investigators led by Howard Gardner, Mihaly Czikszentmihalyi and William Damon, examined the relationship between ethics and performance. This project involved intensive, face-to-face interviews with professionals in a variety of domains – 'journalism, genetics, business, jazz music, theater, philanthropy, and higher education' (Gardner, H., M. Czikszentmihalyi, and W. Damon, 2000, 'The Good Work Project: a Description', Unpublished Document). Based on forty interviews with business leaders in the US, Damon (2002) concludes:

> We found that a strong sense of moral purpose not only promotes a business career but also provides a telling advantage in the quest to build a thriving enterprise. In fact, a sense of moral purpose stands at the center of all successful business innovations. Far from being a constraining force that merely keeps people honest and out of trouble, morality creates a fertile source of business motivation, inspiration, and innovation. (Damon, 2002)

Damon (2002) proposes the three faces of morality: restrictive, philanthropic and generative. Restrictive morality mainly consists of controlling behaviours that can be destructive, such as cheating, lying, or committing sexual harassment; it provides us with guidance of what not to do. Philanthropic morality promotes contributions to worthy social causes. Damon points out that this form of morality is triggered after the individual or organisation has achieved success and profits. It is often practised out of enlightened self-interest. The third type of morality is of the generative kind, which is based on a:

> proactive promotion of positive moral initiatives, as opposed to embracing ethical postures as a way to avoid ethical breaches. A positive moral initiative may be as simple as the urge to serve customers better by bringing them a superior or less-expensive product, or as complex as making the news available to everyone on earth 24 hours a day. But whether the impetus is large or small, a sense of moral purpose beats at the heart of every great business success, because it's that pulse that creates and sustains the innovation that achieves success.
>
> Generative morality arises from a deep inner belief that sparks imagination and gives birth to a new business concept. It also fosters the sense of commitment that sustains the concept during inevitable periods of doubt, stress, and temporary reversals. It provides a reason to go to the mat for an idea, a steel foundation for the persistence needed to implement any innovation. And it's the key to giving your company the moral advantage. (Damon, 2002)

We believe that this form of proactive ethical leadership is possible only if there exists a deep understanding of the interests, priorities and concerns of the stakeholders.

We believe that there are some general principles which make up a 'mindset' or 'worldview' that is necessary to understand and practise all four levels of Company Stakeholder Responsibility.

4 Ten principles of company stakeholder responsibility

(1) We see stakeholder interests as going together over time. The very idea of managing for stakeholders is that the process of value creation is a joint process. Let us take the case of a typical CEO of a large international company. We'll make the CEO an amalgam of a number of real CEOs, and call him Bob Collingwood, and his company Woodland International.[8] Collingwood's company's products and services must create value for customers, first and foremost, so that they are willing to pay for them. Suppliers must be willing to do business with Woodland International, so that products and services can be created in the first place, and if the suppliers are committed to making Woodland even more effective and productive, then both will be winners. Woodland must offer employees jobs (wages and benefits) that are acceptable, and if Bob and his colleagues can get employees to share the purpose of Woodland, to come to work engaged and ready to create value, then all will be winners. Woodland needs to be a good citizen in the communities in which it operates, if for no other reason than in a relatively free and open society citizens can use the political process to force Woodland to be a better citizen. If on the other hand, Woodland acts as a responsible citizen it may well generate very positive goodwill, and be able to operate more freely. Finally, Wood-

land needs to show returns to its shareholders, meet obligations to debt holders, banks and others. Profits don't conflict with other stakeholders, rather they are the scorecard which tells us how well we are managing the whole set of stakeholder relationships. Bob and his colleagues must keep these stakeholder interests in balance, hopefully mutually reinforcing each other.

(2) We see stakeholders as real people with names and faces and children. They are complex. Of course people are complex, and that should go without saying. However, much of the popular thinking about business people assumes just the opposite. We often make assumptions that business people are only in it for their own narrowly defined self-interest. One main assumption of the traditional shareholder-centred view is that shareholders only care about returns, and therefore their agents, managers, should only care about returns. Most human beings are more complicated. Most of us do what we do because we are self-interested and interested in others. Business works in part because of our urge to create things with others and for others. Working on a team, or creating a new product or delivery mechanism that makes customers lives better or happier or more pleasurable all can be contributing factors to why we go to work each day. And, this is not to deny the economic incentive of getting a pay cheque. The assumption of narrow self-interest is extremely limiting, and can be self-reinforcing – people can begin to act in a narrow self-interested way if they believe that is what is expected of them, as some of the scandals such as Enron have shown. We need to be open to a more complex psychology – one any parent finds familiar as they have shepherded the growth and development of their children. We have encountered story after story where managers 'discovered' that their 'adversaries' were a lot more like them than they had originally thought. In short they discovered that these 'adversaries' shared a great deal of their own humanity: a lesson which we should all remember.

(3) We seek solutions to issues that satisfy multiple stakeholders simultaneously. Bob Collingwood's problem is that his world is fragmented. Issues and problems come at him and his team from lots of places, in lots of forms. He could spend his entire job just talking to customers, or employees. He needs to find a way to develop programmes, policies, strategies, even products and services that satisfy multiple stakeholders simultaneously. Now the first step in that process is to actually recognise that he needs to look for simultaneous solutions. For instance, suppose that he is under pressure to make a particular service more affordable to low-income citizens. Under the traditional shareholder-centred view, he might see this as an illegitimate 'tax on shareholders'. Such a view would not lead to much innovation and to a constant friction with critics and regulators. He might take this criticism as a call for innovation and productivity, so that if

he can figure something out, he can develop a new market (lower-income customers), satisfy some critics, and become a good citizen in the community. The difference in mindsets is fairly substantial, and so will be the search for a solution.

(4) We engage in intensive communication and dialogue with stakeholders – not just those who are friendly. Obviously we need intensive dialogue through multiple methods with customers, suppliers, employees and shareholders, but communities, critics and other secondary stakeholders count as well. Critics are especially important dialogue members. Critics are trying to give Collingwood and his team another point of view about Woodland International. One way to see critics is to view them as representing unmet market needs, since the critic wants the company to act differently. It is the job of the executives to see if there is some underlying business model, so that this unmet need can be turned into an entrepreneurial opportunity creating wins for all stakeholders. Not every critic can be satisfied, not every critic has a legitimate point of view, and not every need can be met. But, too often, executives don't meet with their critics enough to determine whether or not there is an opportunity to create value. Dialogue is the foundation of a free society, and the foundation of capitalism itself. Despite fictional stories about 'spot market transactions where every player just knows the prices', real business is built on a foundation of solid, honest and open communication. Indeed, most management meetings we have been a part of for the last twenty-five years have all, at some point, reinforced the need for 'better communication'. There is no difference in adopting a managing for stakeholders view – it is just more difficult and even more intense.

(5) We commit to a philosophy of voluntarism – to manage stakeholder relationships ourselves, rather than leaving it to government. When executives and pundits are committed to the traditional shareholder view, there is a temptation to look at the myriad stakeholder pressures and play 'Blame the Stakeholder'. But, the real problem here is our mindset. In short 'we have met the enemy, and he is us'. The challenge for us is to reorient our thinking and our managerial processes to be responsive to stakeholders. We believe that such a stakeholder mindset must be based on the idea of voluntarism. Voluntarism means that an organisation must, of its own will, undertake to satisfy its key stakeholders. A situation where a solution to a stakeholder problem is imposed by a government agency or the courts must be seen as a managerial failure. Similarly, a situation where Firm A satisfies the needs of consumer advocates, government agency, etc. better than Firm B, must be seen as a competitive loss by Firm B. The driving force of an organisation becomes, under a voluntarism mindset, to create as much for stakeholders as possible.

(6) We generalise the marketing approach. We need to 'overspend' on understanding stakeholder needs, using marketing techniques to segment stakeholders to provide a better understanding of their individual needs and using marketing research tools to understand the multi-attribute nature of most stakeholder groups.

We might define 'overspending' as paying extra attention, beyond that warranted by considerations of efficiency, to those groups who are critical for the long term success of the firm. Overspending on stakeholders without whose support the company would fail can make sense in a number of instances. For instance, many fast moving consumer goods (FMCG) companies overspend on customers, interviewing several thousand a year. Traditionally telecom companies overspent on the attention they paid to the regulatory process, which was for a long time their major source of revenue. Oil companies should, likewise, consider adopting a conscious policy of overspending on OPEC and government and stakeholders who can convey a positive image to the public. Chemical companies have recently begun to overspend on environmentalists, trying to clean up their image as 'dirty companies' and 'spoilers of the environment'. 'Overspending' is not necessarily measured in monetary terms. 'Spending' may be in terms of more time or more energy or whatever the relevant resource required by a given stakeholder group.

(7) Everything that we do serves our stakeholders. We never trade off the interests of one versus the other continuously over time. Just as many successful companies think in terms of 'how to serve the customer' or 'how to serve the employees', it is possible to generalise this philosophy to 'how to serve our stakeholders'. The 'reason for being' for most organisations is that they serve some need in their external environment. When an organisation loses its sense of purpose and mission, when it focuses itself internally on the needs of its managers, it is in danger of becoming irrelevant. Someone else (if competition is possible) will serve the environmental need better. The more we can begin to think in terms of how to better serve stakeholders, the more likely we will be to survive and prosper over time. A managing for stakeholders approach asks the company to clearly articulate how its basic business proposition makes its stakeholders better off.

(8) We negotiate with primary and secondary stakeholders. The basic idea behind the stakeholder approach is that if a group or individual can affect a company or be affected by a company then there needs to be some interaction and some strategic thinking. Many executives get caught up in whether or not a particular stakeholder group, especially critics, is 'legitimate' or not. And, while this is an important issue for some purposes, the stakeholder mindset encourages executives to meet, interact and negotiate with both 'legitimate' stakeholders, and those whose legitimacy may be questioned from an overall point of view.

In very practical terms, groups which have some power must be taken into account, regardless of whether or not in a 'pure capitalism' system, they should be there at all. In our relatively free and open society, the consequences of not negotiating with a broad range of stakeholders is that they use the political process to 'negotiate' indirectly by pressuring government to enact a set of rules that is not likely to be optimal to company interests. You can think of this idea as 'managerial legitimacy', i.e., if a group has some power to affect the company then it is legitimate to spend managerial time worrying about that group. Often, because these interactions start off with stereotypes of both business and critic behaviour, careful attention to process can turn the relationship into one positive for both sides.

(9) We constantly monitor and redesign processes to make them better serve our stakeholders. A hallmark of the stakeholder mindset is that in today's world no one 'gets it right' all the time. Whatever your interactions and strategies are with stakeholders, they can always be improved. The classic case for such improvement comes from thinking about the environment. By paying attention to the environment and environmentalists, companies from McDonalds to 3M have radically redefined their production processes to turn waste streams into new products, realise millions of dollars in cost savings, and gain a reputation as companies that are environmentally friendly and willing to work with environmental groups.

(10) We act with purpose that fulfills our commitment to stakeholders. We act with aspiration towards fulfilling our dreams and theirs. We believe that the key idea which holds this stakeholder mindset together is the idea that businesses can have a purpose. And, there are few limits on the kinds of purpose that can drive a business. Wal-Mart may stand for 'everyday low price'. Merck can stand for 'alleviating human suffering'. The point is that if an entrepreneur or an executive can find a purpose that speaks to the hearts and minds of key stakeholders, it is more likely that there will be sustained success.

Purpose is complex. Running a purposeful business is even more complicated. Once we give up the traditional shareholder view as the only possible purpose for a business, the field is wide open. Perhaps 'maximising shareholder value' is a good purpose for a business, but surely it is not the only one. Purpose is inspirational. The Grameen Bank wants to eliminate poverty. Fannie Mae wants to make housing affordable to every income level in society. Tastings, a restaurant in Virginia, wants to bring the taste of really good food and wine to lots of people in the community. All of these organisations have to generate profits, or else they cannot pursue their purposes. And, they cannot generate profits or fulfill purpose without intense engagement with their stakeholders.

5 A new CSR: Company Stakeholder Responsibility

We have argued that Corporate Social Responsibility has outlived its usefulness, because it is flawed in two respects. First, it promotes the 'separation thesis', the idea that business issues and social issues can be dealt with separately. This flaw promotes the potentially destructive idea that the underlying structure of business is either not good or is morally neutral. We have proposed a stakeholder approach that takes into consideration the intertwined nature of economic, political, social and ethical issues. It is centered in the practice of management, and provides the manager with a pragmatic framework for action. The second flaw with Corporate Social Responsibility is its focus on corporations. We do not see why social responsibility only applies to corporations, rather than to all organisational forms. The stakeholder approach that we have proposed applies as much to an entrepreneurial start-up and to a mid-sized closely held firm as it does to a corporation with diffuse ownership.

Based on the stakeholder approach we have outlined, we have proposed a new CSR – Company Stakeholder Responsibility – as a new capability for organisations to develop. We have outlined four levels of commitment to this new CSR, and we have suggested ten principles that can help executives and business thinkers begin to apply this approach. (Boxes 1.1 and 1.2 are a summary of Company Stakeholder Responsibility.)

Box 1.1: Four levels of commitment to Company Stakeholder Responsibility

The Basic Value Proposition

How do we make our stakeholders better off?
What do we stand for?

Principles for Sustained Stakeholder Cooperation

What are our principles or values on which we base our everyday engagement with stakeholders?

Broader Societal Issues

Do we understand how our basic value proposition and principles fit or contradict key trends and opinions in society?

Ethical Leadership

What are the values and principles that inform my leadership?
What is my sense of purpose? What do I stand for as a leader?

Box 1.2: Ten principles for Company Stakeholder Responsibility

(1) We see stakeholder interests as going together over time.
(2) We see stakeholders as real people with names and faces and children. They are complex.
(3) We seek solutions to issues that satisfy multiple stakeholders simultaneously.
(4) We engage in intensive communication and dialogue with stakeholders, not just those who are 'friendly'.
(5) We commit to a philosophy of voluntarism – to manage stakeholder relationships ourselves, rather than leaving it to government.
(6) We generalise the marketing approach.
(7) Everything that we do serves our stakeholders. We never trade off the interests of one versus the other continuously over time.
(8) We negotiate with primary and secondary stakeholders.
(9) We constantly monitor and redesign processes so that we can better serve our stakeholders.
(10) We act with purpose that fulfills our commitment to stakeholders. We act with aspiration toward our dreams and theirs.

Notes

1. The ideas in this paper have been developed with a number of co-authors over the years in several places. In particular see Wicks, Freeman and Parmar (2005); Freeman and McVea (2001); Freeman and Martin, et al. (2005); and Freeman and Phillips, et al. (2005). We are grateful to a number of people for helpful conversations, in particular Professors Gianfranco Rusconi, Dr Valeria Fazio, Dr Mette Morsing, doctoral students at the Copenhagen Business School doctoral consortium on Corporate Responsibility, numerous participants in the EABIS conference in Gent, Professors Jeff Harrison, Robert Phillips and Andrew Wicks.
2. We admit that there are many ways of being a good corporate citizen.
3. Note that we are using 'ethics' in its broadest sense to encompass obligations to employees, and other stakeholders. This is sometimes referred to as an 'American' usage, whereby the 'European' usage is much narrower. CSR is our broad term here, and we think it is more specific and more useful than distinguishing 'ethical' from 'social'. We are grateful to Dr Valeria Fazio for many conversations on this issue.
4. For a fuller discussion of the history of the stakeholder idea see Freeman (2005, in press).
5. Slinger's argument can be found in his doctoral dissertation, 'Stakeholding and Takeovers: Three Essays', University of Cambridge, 2001. An abridged version is in 'Spanning the Gap: The Theoretical Principles Connecting Stakeholder Policies to Business Performance', Centre for Business Research, Department of Applied Economics, Working Paper, University of Cambridge, 1998.
6. An important paper on the stakeholder approach in the business ethics literature is Donaldson, T. and Preston, L. E. 1995. 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications'. *Academy of Management Review*: 20(1), 65–91.

7. The first three levels of commitment are explored in greater detail in Wicks, Freeman, and Parmar (2005). The origins of these ideas can be found in part in Freeman (1984) in the idea of 'enterprise strategy'. We are grateful to our co-authors for permission to develop these ideas in the context of Company Stakeholder Responsibility.
8. Some readers may recognise Bob Collingwood as the harried hero of Freeman (1984). In reality he is a composite of the thousands of executives who have been kind enough to have conversations with us about the ideas here.

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2

In Defence of Corporate Responsibility

Chris Marsden

Once a fringe idea, corporate social responsibility (CSR) is now part of the business mainstream. Most major companies have CSR policies and leading CEOs regularly acknowledge their wider responsibilities to society and the environment. Lacking precise definition, CSR has thrived as a general 'motherhood' concept but has suffered because it encompasses such a wide range of business activity from supporting good causes and investment in community projects to employment practices and environmental and human rights impact management. CSR has always attracted its fair share of critics. Detractors have dismissed it as corporate philanthropy[1] by another name or worse, as meaningless froth. Now, two more serious criticisms of CSR have emerged from separate ends of the political spectrum. This is not about philanthropy or giving something back to society as some kind of conscience-easer for taking so much out. It is levelled at the heart of the purpose of business and what companies, particularly large companies,[2] are responsible for. It is about whether companies should take account of social and environmental concerns beyond those that clearly affect a company's operating capabilities.

In his book and subsequent film, *The Corporation*, Joel Bakan alleges that CSR is a smokescreen, enabling companies to hide their bad practices and strengthen their ability to resist regulation by government.[3] Separately, *The Economist* has argued that CSR is a waste of resources, distracting companies from their core roles of producing goods and services, and making profits.[4] These criticisms are misguided but they have intellectual foundations and require rebuttal. Both overplay the role that governments can and will play in regulating how companies behave, and underestimate the positive contribution that NGOs can make in shaping the social environment in which businesses operate. They also exploit the confusion which surrounds the meaning of CSR. By attacking, with some justification, some aspects of CSR and its abuse, they threaten to undermine the fundamental notion of corporate responsibility (CR),[5] which was never a fringe idea; it simply was not seen to encompass the range of issues which have to be

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confronted today. Unlike CSR, which too often seems to describe widely varying lists of activities, CR is a way of doing business which takes into account all of a company's impacts on society.

Bakan says that CSR presents a potentially dangerous sop enabling companies to appear to be addressing their social and environmental 'externalities' and thereby distracting pressure for government intervention and proper regulation. He argues that robust nongovernmental institutions and community activism, though vital contributors, can never be a substitute for government regulation. 'Many among the corporate elite and their defenders would likely sing "Hallelujah" the day activists against corporate abuse abandoned government. That is, after all, what many business leaders want: replacement of government regulation of corporations with market forces, perhaps shaped by the oversight of nongovernmental organisations (with no legal powers) and the demands of conscientious consumers and shareholders (with minimal effects).'[6]

The Economist argues that free enterprise capitalism provides huge value for society and for this to take place most efficiently companies need to focus on what they do best, competing for market share and maximising returns for shareholders, undistracted by environmental and social agendas which are the proper concern of governments. 'Through the action of [Adam] Smith's invisible hand, the private search for profit does advance the public interest. There is no need for thought-leaders in CSR armed with initiatives and compacts to bring this about. It is an error to suppose that profit-seeking, as such, fails to advance the public good, and that special efforts to give something back to society are needed to redeem it.'

In a narrow sense, they are both right. Bakan justly accuses many companies of hiding under a pretence of social responsibility. *The Economist's* argument that the public interest regarding the production and distribution of goods and services is likely to be served best by market players pursuing their self-interest in a competitive market place has been well rehearsed ever since Adam Smith invented the concept of the 'invisible hand'. Nevertheless economic theory (e.g. the unreality of assumptions underpinning competition theory) and experience of market failure show that public welfare cannot be left entirely to the product of individuals and groups pursuing self-interest. *The Economist* quite correctly argues 'As a general rule, correcting market failure is best left to government. Business cannot be trusted to get it right. Settling such questions (as global warming) exceeds the competence and proper remit of private enterprise.' 'The proper guardians of the public interest are governments, which are accountable to all citizens. It is the job of elected politicians to set goals for regulators, to deal with externalities, to mediate among different interests, to attend to the demands of social justice, to provide public goods and collect the taxes to pay for them, to establish collective priorities where that is necessary and appropriate, and to organise resources accordingly. The proper business of business is business.'[7]

Where they are both wrong, however, is in their implicit assumptions that the exercising of corporate responsibility has no positive effects and that positive effects can only be achieved though government action. The gaping hole in both Bakan's call for more government regulation and *The Economist's* assertion as to the proper role of government in regulating the marketplace is not that this should not ideally happen – of course it should – but that it is very unlikely to, certainly to the necessary degree, in the foreseeable future. The governance paradigm has changed, although many with vested interests in the old system do not, or do not want to, recognise it. The cosy idea that companies can be left to pursue the narrow interests of their shareholders because the interests of other groups are either factored into the company's business model or looked after by a strong, representative government and fair legal system simply no longer holds up.

There may be countries in the 'First World' where this state of affairs more or less still exists. Certainly there are many people who assume that it does still exist. But even in these countries, the ability of governments to regulate and tax their larger companies, particularly multinational companies, is increasingly inadequate. Reasons include the need to prioritise global competitiveness, the increasing complexities of company technologies and organisational and financial structures with which government officials struggle to keep up, and the difficulties of applying domestic law to international activities.

Beyond the relatively well-regulated 'First World' economies, regulation and the rule of law varies from weak to non-existent. This needs to be seen at two levels.

Firstly, in the vast majority of countries, companies face very little regulation. This is because even diligent governments struggle to regulate for the public interest effectively, while many others either do not try very hard or are plain corrupt. Large companies, whether domestic, private or state owned, or multinational, are often faced with huge environmental and social issues, with which governments are either not coping or wilfully disregarding. Should they just wring their corporate hands, say that these are matters for the government and blithely ignore them? If they do, are they not in some way complicit in the environmental or social harm that is being done, either directly or indirectly associated with their activities?

Secondly, increasingly, markets and the companies operating in them are global. National boundaries are increasingly irrelevant to movements of information, capital, goods and even people. Many of the leading environmental and social issues are also global in nature and need global strategies to address them. As with such issues at the national level, ideally it should be governments and the law that deal with them. But there is no effective system of global government or cooperation of national governments globally and only some embryonic concepts of international law. Therefore, should not multinational companies, which often have global logistic, technical and financial capabilities, which exceed many national governments, play an active part in addressing the issues?

The fact is multinational companies are major players in these spheres. They are not democratic, they are inclined to 'greenwash',[8] to being two-faced, and even in Bakan's terms 'pathological'. They have huge potential to contribute positively towards these issues, way beyond the value of their product or services and the employment they provide, as well as huge potential to do harm. If we cannot regulate and hold these companies to account through the law to ensure business is done in a way that these social and environmental issues are properly factored into market decision making, then other ways must be found. This is where corporate responsibility comes in. The crucial roles of civil society groups and responsible governments are to press with all carrots and sticks that can be found for the increasing internalisation of CR into core business practices.

The questions, therefore, should not be about whether companies accepting a wider set of environmental and social responsibilities (full CR) is the right way to address market failure. Rather, they are:

1 Can CR make a positive contribution to public welfare (beyond the value of a company's product or service and the incomes it generates)?
2 Does CR distract companies from creating the full value of their product or service?
3 Is CR a point of departure towards or a hindrance to the evolution of a better market governance system?

If CR can make a positive difference, then surely it should be encouraged. If making that positive difference somehow detracts from a company's ability to deliver its product or service efficiently, then that needs to be properly understood and managed. If encouraging CR is seen as a potential hindrance to the evolution of a better governance system, then that danger needs to be openly recognised, debated and countered.

This begs a fourth question:

4 What can leading companies, their business associations, civil society organisations and governments do to make the importance of CR better understood and better implemented?

These four questions are addressed below.

1 Making a positive difference

For all the understandable accusations of corporate 'greenwash' and in relation to the UN Global Compact, 'bluewash',[9] it is hard to deny that a significant number of leading multinational companies have improved their environmental and social performance. This may still be far below what many would regard as acceptable and many more companies may still have hardly begun the CR awakening process, but it is progress. It is hard to be definite about the extent of this contribution and this would certainly be a fertile area for more detailed research. This conclusion is reinforced by Margolis and Walsh in their paper 'Misery loves Companies; rethinking social initiatives by business',[10] which argues for a shift of academic research emphasis from the frustrating and perhaps futile attempt to prove a causal link between corporate social performance and economic performance to 'questions about what it is firms are actually doing in response to social misery and what effects corporate actions have, not only on the bottom line but also on society'. Margolis and Walsh pose the following research questions:

- Do companies really make a concrete difference in curing social ills when they act as though they can do so?
- How can the assumed truth that companies can be effective agents, not just of economic efficiency but of social repair, be realised?
- How can the concrete differences be achieved?
- What are the conditions under which, and the processes through which, the intended beneficiaries and institutions central to a healthy society indeed benefit from these corporate actions?

While the lengthy process of academic research adapts to this important proposal, the following examples at least seem to indicate hopeful, if still inadequate progress.

FSC and MSC

Both the Forestry and Marine Stewardship Councils (FSC and MSC) represent small but significant attempts at sustainability governance by agreements between companies and NGOs. B&Q, a leading UK hardware chainstore, uses the FSC standards for its hardwood products. The company states 'All virgin wood bought by B&Q will come from forests of known location where the supplier has given us sufficient reassurance that the forest is well managed and independently certified as such. Certification must include the ability to trace the wood from the forest to the final processor with certified "chain of custody".'[11] FSC news January 2005 states 'The largest DIY retailer in the United Kingdom (UK), B&Q has signed a deal with the certification body SmartWood, a programme of the Rainforest Alliance, to certify its key stores to the Forest Stewardship Council (FSC) chain of custody standards.

B&Q is targeting business customers such as Government and local authority purchasing departments as well as general trade customers who are increasingly demanding timber and manufactured wooden products from well managed forests.'[12]

The more recently started Marine Stewardship Council in its 2004 report[13] gives a number of examples of well known companies adopting its standard, for example: 'Leading UK retailer Waitrose has developed its first own brand MSC product … wild Alaska smoked salmon … Waitrose held training sessions on the MSC for all its fish-counter staff ahead of launching the product, demonstrating their strong commitment to the programme.' The *Daily Telegraph* in March 2004 reported that 'The MSC's little blue logo is gradually becoming the fishing world's equivalent of the Soil Association's mark. It's a sign of sustainability that the accredited fishery has, in contrast to many others, a future.'

Novartis

Novartis, the Swiss based pharmaceutical company, reports:

> In May 2001, Novartis committed to a unique public–private collaboration agreement with the World Health Organization (WHO) in the fight against malaria. Novartis agreed to make Coartem®, currently the only oral fixed dose artemisinin-based combination therapy (ACT), available on a 'not-for-profit' basis for distribution to public sector agencies of malaria-endemic developing countries. Through grants provided by the Global Fund For AIDS, Malaria and Tuberculosis, Novartis has equally undertaken to supply Coartem, under the aegis of WHO, to public sector agencies. The partnership aims at establishing sustainable supply chains for distribution via support programs covering stock management/forecasting and operational research; improving treatment regimens in malaria-endemic countries via support of health care education and community awareness of treatment policies and use of Coartem; and monitoring systems for new malaria drugs in the developing world. Beyond providing the treatment, Novartis supports a capacity building program in Zambia. This program aims at ensuring optimal levels of patient access to the drug and includes conducting operational research, raising community awareness and educating healthcare workers.[14]

Novo Nordisk

Another healthcare company, Novo Nordisk, as part of its 'Sustainable Supply Chain Management' has developed a 'Supplier Evaluation Programme'. The programme was initiated as part of Novo Nordisk's commitment to environmental and social responsibility. The Company claims to be

> actively seeking to promote social responsibility and a good environmental performance across our business operations. We believe that people should be treated fairly and that the impact on the environment should be minimised. We do this not only to manage our risk effectively but also because we think it is the right thing to do. As a truly responsible business, we should be able to account for all our activities. If our

> suppliers are found to be environmentally and socially negligent, it reflects badly on us. We therefore expect our suppliers to comply with both local legislation and international standards on environmental management and human rights … In 2003 we asked our suppliers' opinions on the evaluation programme. An independent study was carried out by an external party (NOP Healthcare) on behalf of Novo Nordisk … A large majority of suppliers agreed that they had a good dialogue with the contact person at Novo Nordisk … More than half (56%) of our suppliers believed that Novo Nordisk's programme had a positive impact on their internal operations.[15]

As Simon Zadek explains in his recent *Harvard Business Review* article[16] the Company is also leading the way in dialogue with other key stakeholders.

> Danish pharmaceutical company Novo Nordisk has created a practical tool to track societal learning on some of its core business issues – animal testing, genetically modified organisms, and access to drugs. The drugmaker's approach can be adapted and used by any company facing any number of issues. In the early stages, issues tend to be vague and their potential significance well below conventional thresholds used by the financial community to determine materiality. These issues are often first identified through a company's interactions with nontraditional sources of knowledge, such as social activists. As one senior business manager explains, when he deals with nongovernmental organizations, 'I see the future of our markets, our products, and this business.'

Gap and Reebok

Gap Inc., the US clothing multinational, asserts[17] that 'improving garment factory conditions is a central element to our overall commitment to social responsibility'. The company has drawn up a 'Code of Vendor Conduct' and reports that in 2003, 8,500 visits to garment factories were made and provides details of the levels of code violation in different regions and what is being done about them.

Another well known brand in the clothing and footwear industry, Reebok, has developed an impressive worker communication system, which provides workers with a secure way of expressing concerns in a manner which enables the company's management to focus on specific issues as they arise. The company has openly accepted the principles of freedom of association and collective bargaining and is actively pursuing this in difficult places like Indonesia and China. The *Boston Globe* in January 2005 reported that Reebok is supporting a new organisation called the Fair Factories Clearinghouse. It will help develop and distribute a piece of software that was originally built by the Company's technology group to track the working conditions at factories where Reebok's shoes and apparel are made.

Shell

A number of companies are leading the drive to counter the prevalence of bribery and facilitation payments in so many countries in the world. Among these, the oil company Shell has established a very clear 'no bribes' policy. The Company has produced management primers on bribery, corruption and related dilemmas. Most of its national operations have procedures to prevent facilitation payments by staff, contractors and suppliers. Proven incidents of bribery are reported (8 in 2003) and offenders disciplined.[18]

BP

Finally, another oil company, BP, has recently helped to advance the role played by such companies in the protection of human rights. Although the Company has a strong policy commitment on human rights, based on the Universal Declaration, it found itself inadvertently in danger of potentially denying human rights to the indigenous communities living along the path of the Baku–Tbilisi–Ceyhan ('BTC') oil and gas pipeline project, for which BP is the lead contractor. A detailed report by Amnesty International 'Human Rights on the Line',[19] demonstrated that the Project Agreements could have a 'chilling effect' on the host governments' willingness to enforce their human rights, labour rights and environmental obligations pursuant to international treaties. Amnesty warned that the land acquisition could have the effect of resettling the 30,000 people who would be forced to give up their land rights to make way for the pipeline; there could be inadequate enforcement of health and safety legislation to protect workers and local people; and there could be a serious risk to the human rights of any individuals who protest against the pipeline. Amnesty expressed particular concern that the Host Government Agreements (HGAs) would create a disincentive for the host countries to protect human rights because the governments have agreed to pay compensation to the BTC consortium if pipeline construction or operation is disturbed pursuant to the HGA clause indicating that host countries are liable for any disruption to the economic equilibrium of the project. Having participated in a public meeting to launch the report and after due consideration of the arguments BP accepted Amnesty's conclusions. After lengthy negotiations between lawyers representing the two organisations a compromise settlement was reached in which a Deed Poll (a legally binding contract designed to protect the rights of the three host governments to promote and regulate human rights and environmental issues) was drafted and then signed by the BTC Project. Subsequent to this agreement, BP and Amnesty have had discussions with the IFC, which provided loans to the BTC project. It is to be hoped that these and future talks will pave the way for the IFC to create guidelines for the HGAs of similar projects in the future to contain adequate provision for human rights protection.

There would seem to be enough probability here that large companies can make a positive difference to justify taking the precautionary principle and act on that assumption. This is surely more than a mere smokescreen, designed to distract governments from taking proper regulatory control, which is the thrust of Joel Bakan's argument. To quote the Margolis and Walsh paper again:

> We suggest adopting a pragmatic stance toward questions about the firm's role in society, one articulated most clearly by William James: 'Grant an idea or belief to be true,' it [pragmatism] says, 'what concrete difference will its being true make in anyone's actual life? How will the truth be realized? What experiences will be different from those that would obtain if the belief were false? What, in short, is the truth's cash-value in experiential terms?' The first step of James's pragmatic approach is to assume that an idea is true. In this case, we need to begin with the idea that organisations can play an effective role in ameliorating social misery. From that beginning, pragmatism then instructs us to look at the consequences of acting on this belief. Do companies really make a concrete difference in curing social ills when they act as though they can do so?[20]

2 CR a distraction from the real business of business?

The objection to companies devoting resources to external social concerns, a principal argument of *The Economist*, which goes back at least to Friedman's insistence that 'the business of business is business',[21] is that it diverts management from its proper and most value creating role, not just value for shareholders but also for society as a whole. There can be no doubt that taking account of the environmental and social impacts of a company, both negative and potentially positive, adds to the accounting costs, requires greater management expertise and time and adds complexity through the loss of having just one bottom line objective and success measure. In that sense proper attention to CR by companies might cause certain products to be more expensive or produced in lower quantities. But that is what should happen anyway if the regulatory environment did what Bakan and *The Economist* argue that it should, namely ensure that environmental and social costs inflicted by companies were either paid for through taxes or prevented by law. So the main point must be not that these 'external' costs are 'internalised' but that it is too difficult and beyond the competence of business managers to handle these issues and therefore undermines the effective functioning of the company.

This may be so. But should business be allowed to be that simple; protected from understanding and managing all aspects of its value creation and destruction? There may be painful transition processes but should not companies be expected to adapt to these higher expectations of performance? It can be done, as shown below.

The transformation of BP's exploration business

During the 1980s and early '90s, BP developed and produced most of its oil and gas from fields it had discovered in the North Sea and Alaska. This was done with brilliant technology and considerable, if inadequate in the views of some, attention to the environment. As these fields began to be depleted, most of the Company's new oil and gas discoveries were made in places with very different problems, like Colombia, Angola and Papua, Indonesia. At first, BP relied on staff with experience of the North Sea and Alaska to develop its production sites in the Casanare region of Colombia. These were mainly highly skilled engineers, driven by production targets and used to delivering on time. They had not come across social issues before. If there was a security problem, put up barbed wire fences and get the army in to protect you. If the locals are unhappy, hire a team to build a school, improve the water supply or support new business ventures. Problem solved? Not so. The Colombian army had another agenda, its war against 'terrorists', and BP got sucked in by association to the human rights abuses in which the army was implicated. BP's social projects, while admirable in themselves, were so totally separated from company personnel and the oil development work, that no real links were made and no mutual understanding with the local community developed.

Following reputation-damaging media reports and much internal management debate, BP has evolved a strategy to deal with this new reality of doing business in places with major social problems, often associated with conflict. It has been a leading participant in the Voluntary Principles on Security and Human Rights,[22] it has developed guidelines, training, management and reporting systems on these issues, including engaging with difficult governments. It is also working on much stronger stakeholder engagement, particularly with local communities, and is much more transparent about what it is doing in its public reporting processes. The Company still faces many problems and makes many mistakes[23] but it is a clear example of how management can adapt successfully to having to take account of wider issues than the immediate bottom line. And there is no suggestion that these activities are a distraction from the company's profit-making business. On the contrary they are a necessary, if often frustrating and difficult part of doing business and the better BP gets at these things the more successful the company will be.

To be fair to *The Economist* articles, they do include the assertion that 'managers ought to behave ethically as they pursue proper business of maximising owner value – and that puts real constraints on their actions'. The article quotes from Elaine Sternberg's book *Just Business*[24] saying that owner value excludes 'lying, cheating, stealing, killing, coercion, physical violence and most illegality'. Instead honesty, fairness and ordinary decency are called for. Splendid, but as Sir Geoffrey Chandler points out in his letter responding to *The Economist* articles[25]

> [the] challenge is the prevailing public distrust of companies arising from the perception that profit precedes principle, rather than being based upon it. Nothing could better illustrate the validity of this perception than the recent twentieth anniversary of the Bhopal disaster – one of the worst examples of safety being compromised and adequate compensation denied in the interest of corporate profit. ... Certainly a company whose practices are based on 'ordinary decency' will thrive, but this attractively naïve concept is unlikely to be helpful to those who actually have to manage in the many countries today characterised by unrepresentative government, corruption, discrimination, violence and human rights violations.

Managers may be the agents of the owners and obligated to do their best to provide them with value but they are also guardians of ethical values and assurance that value is created honestly and without undue cost in terms of adverse environmental and social impact. All responsible large companies, especially multinational companies operating across national borders and differing cultures and value systems need to support their managers with carefully thought-out value statements, policies, codes of behaviour, training, support, monitoring and reporting systems.

3 Is CR a point of departure towards or a hindrance to the evolution of a better market governance system?

The main problem is not so much that behaving responsibly is a distraction from single-minded pursuit of profitability but that the responsible company's competitors may not play by the same rules. This is what business people call the problem of 'the level playing field'. Ideally this should be provided by government. Whether ultimately this will come in the form of a global convergence towards one system of government and society based on a concept of 'market democracy' underpinned by international law or a complex mixture of co-existing country-based governing structures, or some other scenario, it hard to foresee. But government-provided level playing fields are unlikely to happen anytime soon. They may never happen. So anything that can be done in the meantime to make things even a little bit better by working on and with organisations that can make a real difference on the ground must be worthwhile. Encouraging the positive application of CR, the development of voluntary codes of practice, norms and reporting systems, could gradually enable the evolution of a better governance system as expectations develop into 'soft law', which in turn evolves into 'harder' law. CR can hardly be accused of hindering the evolution of a better market governance system, when there is no evidence of such evolution taking place without CR taking a leading role. The challenge is how to make playing fields less sloped in favour of the bad guys in an under or inconsistently regulated marketplace, while at the same time working towards the ideal of effective and enforceable regulation. It is a challenge for those in a position to influence company behaviour, in particular the companies themselves, their business associations, civil society organisations or NGOs and national governments.

4 What can leading companies, their business associations, civil society organisations and governments do to make the importance of CR better understood and better implemented?

There is a clear need for more transparency and better accountability systems. One way, of course, is to invest in information systems, which let all the key players know what everyone else is doing, so that decisions by investors, customers, suppliers and current and potential employees are made in a more informed manner. The methods used by the rapidly growing socially responsible investment (SRI) movement are helping to lead the way. The FTSE4GOOD index[26] is one example. This very public indication of whether or not leading FTSE companies have complied with some minimum environmental and human rights standards has perhaps done more than any other single initiative in the UK, at least, to raise the profile of these issues in corporate boardrooms and shareholder groups. The recent introduction of tougher human rights conditions led to the withdrawal of some companies from the index, which can only have done some good. Another initiative is the Business & Human Rights Resource Centre,[27] which runs the leading Internet site providing information on what companies are doing both to enhance and constrain human rights. The work depends on an international network of experts plus a small central team, making full use of the latest communication technology to draw attention to reports and breaking news from many sources, for instance from NGOs, academics, journalists and companies themselves. Its purpose is to make available information in an easily accessible way, for others to take action as they think fit.

In principle it should be in the interests of 'good' companies to make sure that 'bad' companies do not get away with cost-saving poor CR performance. It is frustrating for many trying to make progress on these issues that so often those companies which declare themselves to be among the good guys, while leading the way on voluntary initiatives, are the first to resist any moves towards more formal codes of behaviour or regulation designed to bring more companies into compliance with minimum standards (i.e. levelling at least the foundations of the field). In the recent debate over the UN Norms on Human Rights a number of companies which to a large extent already apply most of the basic content of the Norms, nevertheless allowed associations of which they are members, like the International Chamber of Commerce, to campaign strongly against the formal adoption of the Norms by the UN Sub Commission on Human Rights. Others, of course, for instance members of the Business Leaders' Initiative on Human Rights (BLIHR),[28] have taken a much more constructive approach by 'road testing' the Norms, in other words examining how applying the Norms in practice impacts their operations and, in March 2006, intending to report their findings. Leading companies clearly do need to come off the fence and take active leadership roles in formulating the necessary rules of the game and influencing the associations to which they belong to do likewise.

The role of NGOs is just as problematic. In a world where representative government is at best weakened in its ability to look after the common interest and at worst unrepresentative and corrupt, NGOs act, with varying degrees of legitimacy, as representatives of particular interests, such as the environment or human rights. Acting as watchdogs and whistle-blowers, they have become a form of countervailing power to that wielded by large companies, although with considerably less financial resources and often less formal rights in existing law. Within this countervailing force there is considerable difference of opinion as to whether to pursue undiluted oppositional tactics to what companies are doing or whether to engage in constructive dialogue and even partnership. Indeed more radical groups, like London Rising Tide[29] openly criticise the likes of WWF and Greenpeace for taking part in joint conferences with leading oil and mining companies for selling out to big business and contributing to the plague of 'greenwash'. It is interesting to note that only ten years ago it was Greenpeace which first recognised the emerging power of civil society to pressurise companies independently of government action, in its high profile action against Shell and the sinking of its Brent Spar oil storage unit in the North Atlantic. Since then the campaigning environmental organisation, like several other leading NGOs, has grown as a 'political' institution and has been drawn into more of a problem-solving role alongside its whistle-blowing one. It has come to take a more pragmatic view that for all their failings, companies have a huge role to play in solving the world's major problems. They have to be part of the solutions not just a cause of the problems, and they need all the help they can be given. How that help is given, how it is paid for, how NGOs retain their integrity, independence and ability to take oppositional action as required, are current hot issues.

Nevertheless, NGOs do have a major role to play in articulating the expectations on corporate behaviour of civil society and campaigning, through engagement and/or oppositional tactics as necessary, for their realisation. For example, whatever happens to the UN Norms on Business and Human Rights in the long drawn out UN governance process, it is imperative that Amnesty International and other human rights NGOs continue to press companies to adopt them as the basis for their human rights performance. They are the new level of expectations that society is placing on companies. There is every reason to believe that this will make a difference to people whose human rights are under threat in many different ways in countries where these companies are operating. NGOs should resist calls to switch their focus back to just national governments. They need to work on both companies and governments. While it is important that they are not hoodwinked by 'greenwash', there is no reason for constructive NGOs to draw back on efforts to encourage worthwhile if still small advances as described in the cases above, as long as they can be genuinely seen to be a positive step towards larger and longer lasting solutions. Meanwhile, the London Rising Tides of this world have every right to campaign as they do and have an important point to make but they would do better if they also articulated a realistic vision of how to create the 'more compassionate system than capitalism' that they want.

It is very much part of the role of NGOs to try to influence governments on how they can, in turn, influence companies to take on responsibilities for environmental and social issues. Most NGO staff and volunteers instinctively want to pressurise governments to regulate company behaviour, for instance to bring in compulsory social reporting and make companies liable to prosecution for complicity in human rights abuses in Third World countries. While these campaigns should continue because they are necessary parts of any long term solution to making all companies take these issues seriously, there are many less politically difficult things that governments can be persuaded to do in the shorter term. Their position on processes like the UN Norms and the OECD guidelines for multinational companies can be influenced by well organised lobbying, not least by persuading leading companies to add their voices for constructive change. Governments can be persuaded to give public praise to top performing companies and reward their leaders with recognition and invitations to prestigious networking events, which are very highly prized in the business world. Perhaps most significantly, in every country governments are large customers of many of the companies NGOs are concerned about. There are huge opportunities to influence government purchasing decisions and contract clauses to reflect company environmental and social performance as well as its price competitiveness. Finally many companies trading abroad do so with the help of Government Export Credit Guarantees. These conditions can also be influenced.

Conclusion

This paper set out to refute both Bakan's argument that CSR is largely a smokescreen designed to distract governments from their proper role in regulating for market failure and *The Economist's* argument that CSR distracts companies from their main profit-making activities and, therefore, reduces the value they create for society. Both argue that the issues CSR seeks to address are the proper concern of governments. Through a number of examples, it was shown that companies, which understand and put into practice their corporate responsibility (CR, see note 5) can make a positive contribution to public welfare through the manner in which they operate, beyond the value of their product or service and the incomes they generate. From a short term profit-making point of view, managing this contribution may be a distraction and it does not come without cost. Nor should it be, however, as social and environmental costs should be factored into the costs of production. Ethically it is certainly the right thing to do and often, as in the case of oil and gas exploration, it is a crucial part of earning a 'licence to operate'. In the wider sense it is part of the way in which companies can begin to earn the trust of society that they do not put profit before principle.

A pressing problem is how to create a more effective regulatory environment to 'level the playing field' by making the market take account of social and environmental costs and benefits. It was argued that CR could not justifiably be seen as a hindrance to the effective evolution of a proper market governance system. On the contrary it is a crucial part of the only realistic game in town and could become a building block in the evolution of 'soft' into 'hard' law. The final section of this paper suggested a number of ways in which CR could be encouraged and made more effective, chiefly by investing in better information systems from which greater transparency and accountability could be achieved.

Clearly, no sensible person would recommend a governance system which depends totally on the interplay of market forces, corporate self-governance and pressure from NGOs. It does sound rather like Joel Bakan's undesirable corporate 'Hallelujah' scenario, described above. Corporations do need more effective governance than this and the common interest does need protecting by those with the authority and competence to do so. Nevertheless, while the 'Hallelujah' scenario, in part at least, is the current reality we need to do all we can to make it work as well as possible. It is not good enough arguing that environmental and social agendas are the proper concern of governments, when governments are manifestly failing to address these agendas adequately. The interplay of NGOs and companies in promoting corporate responsibility does not replace the need for effective government, but it does fill in some of the gaps and encourage governments to understand what they should be doing.

Notes and references

1. Corporate philanthropy as pure philanthropy is justly criticised because it amounts to directors giving away the shareholders money (often for their own personal reasons) instead of giving it back to the shareholders to decide what they want to do with it. If, as is often the case, such payments are strategic invest-

ment in community relations or image building, then they are not strictly philanthropy. Community investment is part, but only a small part, of a company's overall impact on social and environmental issues and, therefore, its social responsibility.

2. Large companies individually have greater potential to affect the environment and social issues, to have command over resources, to control information, gain uncompetitive market share and exert undue influence.
3. *The Corporation – the pathological pursuit of profit and power*, Joel Bakan, 2004, Free Press, p. 151.
4. *The Economist* survey of Social responsibility, January 22, 2005.
5. Corporate Social Responsibility, especially its initials CSR, has become the widely used shorthand term to cover any or all of a list of activities from corporate philanthropy (see note 1 above) to the responsible management of a company's external impacts on society. The concept is wide open to misinterpretation and abuse. The term corporate responsibility (CR) is preferred here and will be used for the remainder of this paper as it denotes a way of doing business which takes account of a company's full range of responsibilities to all its stakeholders, not just its social ones and especially not just its 'philanthropic' ones.
6. Bakan, *The Corporation*.
7. *The Economist*, January 22, 2005.
8. 'Greenwash'or 'Bluewash': a company talking up its CR policy and programme, including membership of a voluntary association and signature to agreed principles or guidelines (in the case of bluewash to the UN Global Compact), while doing very little in practice.
9. See note 8.
10. 'Misery loves companies – rethinking social initiatives by business', J.D. Margolis and J.P. Walsh, *Administrative Science Quarterly*, 48 (2003) p. 268–305.
11. B&Q timber buying policy (revised August 2000), see www.diy.com
12. See www.fsc.org
13. See www.msc.org
14. See www.novartis.com
15. See www.NovoNordisk.com
16. 'The Path to Corporate Responsibility,' Simon Zadek, *Harvard Business Review*, Vol. 82, No. 12, December 2004.
17. See www.Gap.com
18. See www.shell.com
19. *Human Rights on the Line, The Baku–Tblisi–Ceyhan Pipeline Project*, Amnesty International UK, May 2003.
20. See note 10.
21. 'The Social Responsibility of Business is to Increase its Profits', Milton Friedman, *New York Times Magazine*, September 13, 1970.
22. See www.voluntaryprinciples.org
23. See 'The houses that gas built' by Shawn Donnan, *Financial Times Magazine*, March 26, 2005.
24. *Just Business*, Elaine Sternberg, Oxford University Press, 2000.
25. 'The Good Company', Sir Geoffrey Chandler, *The Economist*, Letters, 3 Feb. 2005.
26. See www.ftse.com/ftse4good/index
27. See www.business-humanrights.org
28. See www.blihr.org BLIHR companies 'road testing' the Norms include ABB, Barclays, Hewlett Packard, MTV Europe, National Grid Transco, Novartis, Novo Nordisk, Statoil and The Body Shop International.
29. See london@risingtide.org.uk

3

Corporate Governance and Corporate Social Responsibility

Steen Thomsen

Introduction

Both Corporate Governance (CG) and Corporate Social Responsibility (CSR) have become important topics in recent years, but there is some confusion as to the relationship between the two concepts.

Some would argue that corporate governance is a special case of corporate social responsibility, since CG is mainly concerned with the relationship between investors and managers, while CSR is more generally concerned with corporate relations to all stakeholders. This view may be supported by Shleifer and Vishny´s (1997) narrow definition of corporate governance as '*the mechanisms by which investors assure a return on their investment*'. However, the most generally accepted definition of corporate governance as '*the control and direction of companies*' (The Cadbury Committee, 1992) is clearly not a subset of CSR, but a different concept altogether.

This paper argues that corporate social responsibility is a way to characterise corporate values and/or corporate behaviour, while corporate governance is concerned with the institutional conditions for these values. In other words, CSR and corporate values more generally are the result of a given set of corporate governance mechanisms. Based on previous work (Thomsen, 2004) the paper proposes a theoretical framework to explain corporate values as an outcome of corporate governance defined in a broad sense as ownership, board and stakeholder structure.

This approach may be contrasted with the traditional view which appears to be that corporate values are based on the (high) ethical standards of managers and other employees. This may be true or not, but it is not a satisfactory answer since it instantly begets the question of why these managers rather than others with different ethical standards are employed in the organisation. Clearly, the decision to hire and fire managers or other employees is not made at random. Employment decisions and thereby values are not exogenously given. Moreover, it seems likely that managers and employees are influenced by the social context in which they operate,

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for example by their economic incentives, other members of the management team, the board, capital market pressures or pressures from customers and other markets.

In this chapter I first outline the general framework and then comment on three specific mechanisms: ownership structure, board structure and stakeholder structure. I then draw some general conclusions for the theory and practice of corporate social responsibility.

The determinants of corporate values

If the firm as such is nothing but a legal fiction, its values must ultimately be derived from the preferences or values of its stakeholders. More specifically, I propose that corporate values are created when companies internalise the values of salient stakeholders, of which owners and managers appear to be the most important. Stakeholders can influence a company directly through market transactions and contracts without imposing their values on the company, but transaction costs and information problems set a limit to use of contractual mechanisms. Under incomplete contracting non-market governance mechanisms must be used instead (Zingales, 2001). I propose that internalisation of stakeholder preferences takes place in a hypothetical three-stage process: 1) allocation of ownership rights, 2) board composition, 3) the influence of important stakeholders.

First, in stage 1, *the ownership decision* allocates ownership rights across the relevant parties, i.e. the company's present and potential stakeholders. This is a matching problem in which owners with specific characteristics are matched with firms, which have their own specific characteristics. Owner characteristics include access to information, capital and knowledge. Strictly speaking all firm characteristics are attributable to the relevant stakeholders, but it simplifies the discussion considerably to talk about firm characteristics. Important firm characteristics include size, technology, activities, information characteristics, etc. For given firm characteristics, the economic theory of corporate ownership (Hart, 1995; Hansmann, 1996) predicts that ownership will be allocated to minimise transaction costs. Owners internalise their market transactions with the firm and efficient ownership minimises the total costs which firms have in transacting with the relevant stakeholder groups. In principle any stakeholder or group of stakeholders can at any time make a bid to the incumbent owners to acquire ownership. The outcome will determine the identities of the owners. Under incomplete contracts, this choice has material consequences for the values and behaviour of the firm (Hart, 1995a; Hansmann, 1996).

In stage 2, *the board composition* decision allocates board seats over the set of potential board members, which include the stakeholder representatives as well as professional managers and board members. Boards are normally elected by the owners, but in some countries other stakeholders (employees, governments) also appoint board members. Owners delegate many decision rights concerning corporate values to the board. In companies that separate ownership and control this implies that managers play a pivotal role in creating or changing corporate value systems and that the composition of the board is a key determinant of this process. Legally, board members share a joint responsibility to all shareholders (and creditors), but organisational theorists (Jones and Goldberg, 1982; Evan and Freeman, 1993; Luoma and Goodstein, 1999) have argued that board members may also serve as agents for specific stakeholders, a dual role, which may sometimes conflict with their fiduciary duty. For example employee representatives, which are mandatory in countries like Germany (Charkham 1994), may take a special interest in labour conditions.

In stage 3, *the board enters into implicit contracts* with key stakeholders (Rosen, 1994). As mentioned, companies can obviously be influenced by means of formal contracts and market transactions, but these relations may be modelled as constraints subject to which the corporate objective function is maximised. This paper therefore focuses on the role of implicit contracts based on reputation (Fombrun and Shanley, 1990; Kay, 1995) and corporate culture (Kreps, 1990). One argument is that such 'soft' variables need more specific attention than standard budget considerations to have an impact on corporate decision making at all.

The entire process takes place in a specific legal/institutional/cultural context. This regime may have a direct effect on corporate values because national cultures differ which will influence the values of executives and stakeholders (Charkham, 1994; Licht, 2001). Variations in the legal system and the protection of minority investors may also influence corporate values indirectly, for example the attention which companies pay to shareholder value (La Porta et al., 1998, 1999a, 1999b). The institutional setting may have an indirect influence on corporate values through ownership structure, which differs significantly across nations (e.g. Roe, 1994; Prowse, 1995; Pedersen and Thomsen, 1997; La Porta et al., 1998, 1999a, 1999b). Values will also be influenced by board structure (Charkham, 1994; Baums et al., 1994), for example the ratio of executive to non-executive directors or whether employees are represented or not. However, this paper will focus on determinants of corporate values within a given institutional framework and only occasionally refer to international differences in corporate governance.

The sequential emphasis on first ownership, then board structure and then stakeholder structure is not accidental. Formally, corporate values are determined by the owners at the annual general meeting or the decision to set values is delegated indirectly to the board. Ownership is therefore logically prior to other factors, which influence corporate values. The decision of whether or not to acquire ownership of the firm implies that residual control rights are allocated to certain owners and not to others. Owners may then delegate responsibility to the management board (which they effectively do in large public corporations). They or their management agents may then decide to include relevant stakeholder representatives on the board, or they may decide not to. And finally the board may decide to form and honour implicit contracts with the stakeholders. Or it may decide not to. The outcome will depend on the preferences of the relevant decision makers as well as their decision mandate, which is determined in the previous stage.

Ownership

One solution to contracting problems between a firm and a stakeholder or a group of stakeholders is to internalise the stakeholder–firm relationships through ownership (Hart, 1995a; Williamson, 1996; Hansmann, 1996). Standard examples of this include vertical integration between up- and downstream firms (Williamson, 1975), manager-owned firms (Thomsen and Pedersen, 1998), supplier and customer cooperatives (Hansmann, 1996), government ownership (e.g. Shepherd, 1989; Laffont and Tirole, 1993; Hart, Shleifer and Vishny, 1997), employee ownership and partnerships (Hansmann, 1996). The widespread use of investor-ownership can also be explained as a solution to contracting problems. Suppliers of capital can rely on debt contracts but for specific investments with little or no value in alternative use (and therefore also no value as collateral), this may be inappropriate. To get the owners to accept a less favourable risky return based on a share of residual earnings they need the residual rights of control as a safeguard against expropriation by company managers (Shleifer and Vishny, 1997; La Porta et al., 1998; Hansmann, 1996).

Contrary to the standard stereotype of the publicly held corporation the ownership literature therefore emphasises that ownership identities do in fact vary a great deal across firms, industries and nations, and that this variance has important implications for firm behaviour and performance (Hart, 1995a; Hansmann, 1996). Clearly, ownership structure is a potential source of variance in corporate values.

However, ownership shares are not generally distributed across the various stakeholder groups in accordance with their stakes in the company. First, not all stakeholders have sufficient surplus capital or risk willingness to invest in ownership. This is a standard impediment to employee ownership. Secondly, not all of them have the information to be efficient owners. This is an obstacle to government ownership and sometimes also for financial investors. And third, the cost of collective decision making for owners with highly diverse resource endowments, preferences and information could be prohibitive. All else equal this implies that companies with homogenous owners will be more efficient, for example if they belong to the same family or the same community (relatives, farmer-members of a cooperative, institutional investors).

Inefficient allocations of ownership may occur if economic selection mechanisms are slow (Hill and Jones, 1992), and in some cases ownership structures may be perpetuated by government regulation or inertia (Roe, 1991, 1994; Hansmann, 1996). In other words there is a rationale for values that are related to those critical stakeholders. As emphasised by Hill and Jones (1992), managers effectively come to act as agents for all critical stakeholders – owners and non-owners alike – whose relationship with the firm is not efficiently coordinated by spot market contracting. In many cases incorporating their interests in the corporate objective function will be both privately and as socially optimal although it is unlikely that a social optimum will be reached in this way alone (Arrow, 1973).

The board

A second mechanism shaping corporate value systems is board composition – i.e. the composition of the top management team. In companies that separate ownership and control the responsibility for defining and changing corporate values is often effectively left to the management. Relationships with critical stakeholders may be internalised by having them represented on the board as non-executive members (Jones and Goldberg, 1982; Evan and Freeman, 1993; Luoma and Goodstein, 1999). Board members may effectively represent different ownership groups (for example founding families, large blockholders or institutional investors as well as owner-managers). In some countries employees or governments are entitled to board representation. But owners may also voluntarily choose to appoint members with links to stakeholders groups (e.g. the financial community or research institutions) that are believed to be important to firm growth or survival.

This view of boards corresponds to the resource dependency function, one of the three generic board roles identified by Johnson et al. (1996). In contrast, agency theory clearly emphasises the two other board roles identified by Jones et al. (1996) – control and service. The service role is warranted by a division of labour between owners and managers (including non-executive directors). The control role (decision control) emerges whenever ownership and control are separated in order to make sure that managers do in fact act in the interests of the owner. In fact, the control role is the agency-theoretic rationale for the existence of boards (Fama and Jensen, 1983a: 311).

The standard assumption is that the board should aim to maximise shareholder value. But while owner interests may be clearly expressed by shareholder value maximisation in textbook-like corporations with dispersed ownership, actual owner interest may be less homogenous. First, large investors (like pension funds) may be concerned with ethical and political concerns as well as stock returns (Woidtke, 2002) and so may small shareholders. Secondly (as argued in the previous section), large owners like founding families or other corporations may be concerned about their non-ownership business relationships with the firm (Thomsen and Pedersen, 2000). Third, founders and their families may have their own idiosyncratic ideas about the company's mission (Morck et al., 1988). These issues have been shown to be important even in large listed companies and they may be even more important in private corporations. Finally, the board will need to take non-owner stakeholder considerations into account, even if shareholder value remains the overall goal. And again one way to do this is to include representatives from the relevant constituencies.

However, the gains from improved stakeholder relations have to be weighed against potentially increasing costs of collective decision making related to managing conflicts of interest and larger board size (Hermalin and Weisbach, 2000). Social choice theory indicates that the decisions which emerge from heterogeneous membership are not always rational (Arrow, 1951; Mitchell, 1984; Hansmann, 1988: 278–9). An alternative solution is to invite decision experts who are believed to understand the needs of the critical stakeholders to sit on the board, but it is not clear to what extent such representation will work as a safeguard for stakeholder interests.

Significant responsibility concerning the formulating of corporate values will therefore usually be delegated to the executive directors. Luoma and Goodstein (1999) find that only 14 per cent of the board members in their sample can be categorised as stakeholder representatives, enough perhaps to give voice to some stakeholder interests, but not enough to seriously influence corporate decision making. As indicated in agency theory, this delegation may be efficient, since managers have better access to information about business conditions, stakeholder pressures, etc. (Hermalin and Weisbach, 2000). But it does create obvious incentive problems from an agency viewpoint. Since complete contracting is impossible, corporate governance will not completely eliminate agency problems, profit will at most be maximised net of agency costs, and firm behaviour will necessarily involve some trade-off between the values of owners and managers. In other words, the corporate objective function will de facto give some weight to company size, growth, firm specific risk and/or other factors of interest to managers (Cyert and March, 1963; Marris, 1963; Marris & Mueller, 1980).

Finally, even if managers do aim to maximise shareholder value, it is not clear how this overall goal should be implemented, particularly since there is considerable stochastic variation in stock prices, accounting profits and other outcome based measures of performance. As a result shareholder value maximisation may be implemented by corporate values that are more directly controlled by managers (Holmström, 1979). Holmström (1979) argues that the priority given to these performance measures will reflect their relative 'informativeness'. Performance measures that have a greater impact on economic value creation or are more correlated with managerial performance (effort) will get higher priority. The priority given to a specific objective will increase in the signal-to-noise ratio so that measures which are well correlated with the underlying variables will be preferred to measures which are subject to a great deal of stochastic variation. For example, product innovation is more important to long-term stock performance in certain industries than in others, but innovation may be very difficult for company managers to control and for outsiders to measure, and consequently well-defined measures like R&D expenditure or patents may be used instead. The priority given to an objective will depend on the marginal information contributed by the specific performance measure. Measures that are highly correlated with other performance measures (i.e. add less new information) will *ceteris paribus* get lower priority.

Implicit contracts with stakeholders

A third way for companies to internalise stakeholder concerns is to increase their creditability and trustworthiness through implicit contracts based on reputation (Fombrun and Shanley, 1990; Kay, 1995) and corporate culture (Kreps, 1990) or socialisation (Scott and Lane, 2000).

Reputation may be built by consistent behaviour over a long period of time and facilitated by communication (Fombrun, 1996). Following Kreps (1990), a reputation for honesty is a valuable asset which will be lost if the company is not truthful, which implies an economic incentive to honesty. Commitments to employee satisfaction, customer value and creditor protection may also be valuable, self-sustainable assets. Arrow (1973), Sen (1993) and others have argued that ethical codes may improve economic efficiency when other social institutions fail to achieve optimal results, in particular the classic market failures when the firm has access to unique information (Arrow, 1973). Arrow (1969) proposes that non-market institutions may in fact arise in response to market failures.

Intuitively, the emphasis placed on different stakeholder values should reflect their relative bargaining power (Bernheim and Whinston, 1986; Mitchell et al., 1997; Scott and Lane, 2000), which should again reflect their impact on the overall value creation in the firm. For example, in labour intensive industries where human capital is important relative to machinery and equipment, more emphasis might be placed on employee satisfaction.

However, because of the nature of the agency problem it is not sufficient to state in broad terms that the firm should take the welfare of some (or all) stakeholder groups into account. Measurement and implementation issues need to be addressed, and incomplete contract theory implies serious problems in this respect. If stakeholder concerns were explicit and verifiable they could easily be included in a formal contract, but because of transaction costs this is not always possible (Hart, 1995a). Precisely because stakeholder claims are not easily articulated or verifiable, even implicit contracts may be difficult to enforce. For example, managers may pay lip service to business ethics, stakeholder concerns and environmental issues, but it may be difficult to establish whether they give these objective sufficient weight in actual decisions. Likewise, in the absence of reliable measures and criteria, it will always be possible for outsiders to claim that managers have not done 'enough' to meet these concerns.

As a result implicit contracts are often implemented by way of proxies or 'signals' that are believed to be correlated with the underlying goals just like performance measures contribute to the solution of shareholder–manager problems (Holmström, 1979). Examples include policies such as lifetime employment, quality guarantees, relationship management programmes as well as survey measures of employee and customer satisfaction or corporate image ratings, customer and employee retention rates, quality certifications and standards for environmental sustainability. And again the priority given to these performance measures will reflect their perceived informativeness as well as the importance of the underlying goals. The informativeness criterion implies that performance measures that are more volatile, more subject to measurement error and less subject to management control will also, all else equal, be given less weight in the corporate objective function. Holmström's view is based on statistical decision theory, but a similar conclusion is reached by Scott and Lane (2000) based in social psychology.

Socialisation is another way in which stakeholder concerns may conceivably be internalised, not only in corporate values, but also even in the minds and identity of the managers. Scott and Lane (2000) argue that managers' identities are affected by representing the organisation in its relationships with stakeholders so that they come to act consistently with the presented self-image (p. 47). Stewardship theory (Davies et al., 1997) holds that managers will identify with organisational values and prefer cooperative behaviour, which could facilitate implicit contracting with external stakeholders.

Conclusion

The theoretical framework outlined in the previous sections has several important implications for the theory and practice of corporate social responsibility.

1 Discussion and good intentions will have no effect on actual corporate social responsibility, if they do not have solid foundations in ownership, board or stakeholder structure.

2 Companies with dispersed ownership – governed by share market signals – cannot credibly commit to corporate social responsibility, since implicit contracts with stakeholders can and will be unilaterally renegotiated as soon as the prevailing shareholder coalition changes (empirically speaking, often several times a year).
3 In contrast, more stable long-term owners provide a better basis for CSR. For example, family-owned companies can credibly commit to CSR. In the same way the preferences of some institutional investors for 'ethical investment' provides a base for CSR, if and only if these preferences translate into stable ownership shares and voting behaviour at annual general meetings.
4 Companies commit most succinctly to CSR by the composition of the board of directors, whose competencies, experience, personal and ethical characteristics translate directly into company behaviour.
5 The government or other stakeholders may influence the corporations to become more socially responsible by mandatory rules which place representatives – e.g. employee-elected members or government representatives – on company boards which is common practice in many continental European companies.
6 More generally, companies will respond to stakeholder and media pressure through CSR. Increased CSR may therefore be implemented by greater media coverage and stronger bargaining positions of relevant stakeholder groups – which may be influenced *inter alia* by public policy.
7 The more general question of whether greater CSR will increase overall social welfare has not been addressed in this paper. It is clear that some level of CSR is already incorporated in corporate values through existing ownership, board and stakeholder configurations. Is more CSR called for? Or less? It is not difficult to think of counter-intuitive examples of how perceived CSR may lower the dynamic efficiency of the business sector or thus decrease long-run social welfare. For example, a desire to save jobs may impede or block innovation and entrepreneurship which would have yielded large benefits to future generations.

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4

Environment: Who is Responsible and How to Govern it?

Nada K. Kakabadse, Cécile Rozuel and Andrew Kakabadse[1]

Introduction

Human beings often believe they occupy a particular position in the hierarchy of nature, at the top of the scale. This held belief has a critical implication for the way humans perceive their surroundings. Actually, we often tend to believe that the world we are living in is extensively global and borderless and is our sole and apparent property. The world we are living in is referred to as 'the environment' or the natural world, as affected by human activity.

Increasingly, evidence supports the idea that for years and particularly over the past century, human activity has largely and often negatively affected the natural world. The phenomena labelled environmental degradation and pollution, which raised greater concern by the 1960s, illustrate how humans do affect the environment. Yet, humans do not seem to realise, as Purser (1997: 367) points out, building further on the work of Lovelock (1996), that the 'obvious fact is that the earth can survive without the presence of humans; we need the earth more than the earth needs us'. Lovelock's (1996) Gaia theory explains how the earth's 'biota' is tightly coupled with its environment and how it acts (and has acted since life on earth) as a single, self-regulating living system in such a way as to maintain the conditions that are suitable for life. The system includes the near-surface rocks and atmosphere and as such regulates the chemistry of the oceans, composition of the atmosphere and surface temperature. Hence increased environmental damage will lead to the disappearance of the familiar world of today within the life span of many people now alive (Lovelock, 1996). Beyond the philosophical debate between 'techno-centrists', who hold that humans manipulate nature and 'ecocentrists', who hold that the earth nurtures humans' existence (Elliott, 1999: 18), two main elements should be taken into account in our relationship to nature. First, if the earth can indeed survive without the presence of humans, it cannot by itself 'cure' the harm caused by human activity. That is the environment, to some extent, is dependent on humans' willingness to act in a more environmentally friendly way. Second, and related to the former issue, humans not only harm the environment, but consequently harm themselves and challenge their future, if not their present (Purser, 1997). As Nobel Prize laureate Amartya Sen explains, 'It is not about humans preserving the natural world, but rather preserving themselves. The precariousness of nature is our own fragility' (PNUE, 2002 – translated by author). Indeed, environmental changes are suspected to have an impact on health, housing and infrastructures, economy, society and culture, within the perspective of an increasing vulnerability (PNUE, 2002). Addressing these issues, Garner (1996: 6) argues that the 'present practices will have long-term consequences affecting the fundamental interest of future generations' and that 'more important is the increasingly international character of environmental decision-making'. What makes environmental issues complex to address is that they are by definition global issues, whilst the effects of human activity are felt neither uniformly nor immediately (Elliott, 1999). Thus whilst everyone should be concerned with environmental issues, not everyone can have the means or ability to do so. Yet, environmental damages are mostly irreversible (Thomas and Belt, 1997).

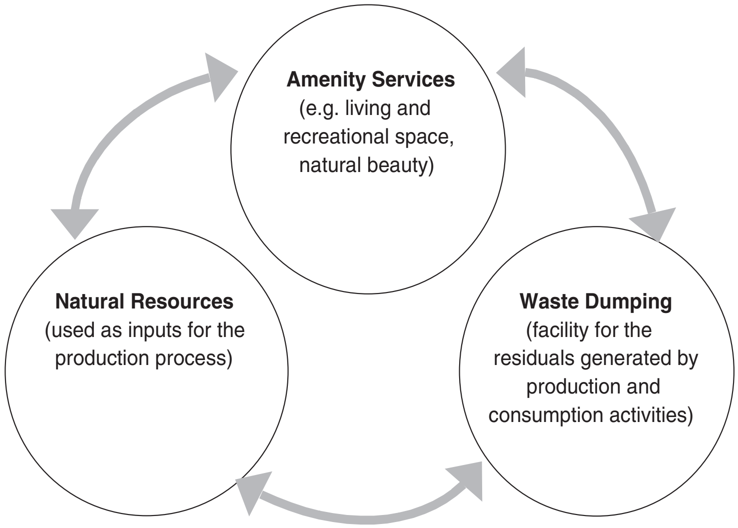
To be able to address the issue of environmental degradation in a comprehensive and objective manner, we first need to understand our relationship to our environment. That is we need to understand and articulate what we expect from it, what we have already done to it, and to explore the mechanisms by which we damage the natural world as well as the factors that may exacerbate that phenomenon. Second, we need to explain why environmental damages have happened and establish who bears a responsibility for such consequences. Third, we need to define the most appropriate and potentially successful solutions to the problem. Last and most importantly, we need to make serious and wholehearted commitment to implementing these solutions. This paper explores these three issues of environmental degradation and is thus respectively structured. The paper closes with a proposal of an integrated model of governance that is required for sustainable growth.

The human relationship with the environment

Wall and Rees (2001: 166) identify three main roles that the environment plays with regard to human activities that are not mutually independent (Figure 4.1). Environment provides humanity with amenity services (e.g. living and recreational space, natural beauty), with natural resources used as inputs for the production process (also referred to as production function); and with waste dumping facility for the residuals generated by production and consumption activities (also referred to as absorption function).

Drawing on this framework, they argue that the 'capacity of the economy to produce still more products is constrained or limited by the availability of natural resources' (Wall and Rees, 2001: 167). Elliott (1999: 34) also argues

Figure 4.1: Environmental roles



Source: Compiled from Wall and Rees (2001)

'whilst absolute resource scarcities have not generally materialised, economic development in the past has been closely correlated with mounting rates of resource extraction'. However, not all scholars share the viewpoint that the world has a finite amount of resources that humans exploit intensively. Bhattacharya (1995: 64), for example, argues that 'the world is not running out of non-renewable resources'. Bhattacharya (1995) and Poulson (1994) adopt a market-based approach economic philosophy that holds that the greater the scarcity of resources, the higher the prices and the greater the improvements in efficiency and technological innovation. Yet, Chukwuma (1996) insists that even strong believers in technology as our saviour must be aware of the finite amounts of global resources. Believing that the world is infinitely resourceful in any case does alleviate the fact that the environment at present has been and continues to be substantially damaged (WWFN, 2003). More specifically, the key environmental functions of production and absorption are closely intertwined in a process of resource renewal, but both are increasingly impeded and degraded by human activities (PNUE, 2002).

Types of environmental pollution

Yearley (1996) identifies three main types of pollution: land pollution, exemplified by humans burying things in it or operating hazardously on it; water pollution, especially via river pollution in both urban and rural areas; and air pollution, where the main culprits, among many others, are fuels burnt for energy, more particularly the so-called greenhouse gases.

Yearley (1996) also addresses other significant but more specific types of pollution, such as nuclear (radiation) pollution, chemical pollution, polluted foodstuffs and genetic pollution, as infamously illustrated in Europe by the 'mad cow disease' crisis or the passionate and yet-unsolved debate on GMO. Although he admits that it is difficult to define accurately what elements are to be considered as pollutants, Yearley (1996) also explores other interrelated global environmental problems, namely resource depletion, over-population and loss of biodiversity. Others (Chukwuma, 1996; Garner, 1996; Jegasothy, 1999; PNUE, 2002) have also highlighted the underlining interrelationship between all forms of pollution, as well as between environmental degradation and socio-economic, socio-cultural, technological and demographic factors. However, there are typically four types of measures of environmental change, which are water pollution (i.e. access to safe water supplies), industrial pollution (i.e. emissions of sulphur dioxide), depletion of environmental resources (i.e. deforestation), and greenhouse gas emissions (i.e. carbon dioxide) (Perrings and Ansuategi, 2000).

The evidence scientists have gathered of environmental degradation is pretty scary whilst the consequences for the earth and us are only partly understood. For example, some 20 per cent of tropical forests was lost from 1960 to 1990; 85 per cent of endangered species are threatened by their habitat loss as consequence to the removal of original forests at a rate ten times higher than any possible level of regrowth; the equivalent of fifty football playgrounds are deforested each minute; global pesticides use results in 3.5 to 5 million acute poisonings a year; some 20 per cent of the world's susceptible drylands are affected by soil degradation, consequently threatening the livelihoods of one billion people; some 23 per cent of all diseases are attributed to environmental causes; at some times of the year, the Ganges, Niles, Colorado and Yellow Rivers run dry before reaching the sea; the ozone hole area was estimated to be 23 million square kilometres in 1999, a phenomenon first measured by the end-1970s; since 1965, the additional heat trapped in the atmosphere due to greenhouse gases has more than doubled, being equal to 2.1974 watts per square metre in 1998 (DFID, 2000; 2001; WWFN, 2003; Coupry, 2004). More recently, a report commissioned by the US Pentagon found that climate change could well become the main threat to life on earth in the next twenty years. Global warming, especially through fossil fuel burning, is expected to cause enduring problems of species extinction, population migration, food and water supplies and conflicts inherent to a state of resource scarcity. The report, kept secret by the US defence officers and revealed by the British newspaper *The Observer*, ultimately targets the current environmental position of the US government, which denies the existence of significant climate change despite increasing evidence from comprehensive studies on the consequences, sometimes already irreversible, of global warming on species extinction and land exhaustion (Brown, 2004; Liverman, 2004; Townsend and Harris, 2004; *The Observer*, 2004).

Mechanisms by which humans damage the natural world

Environmental degradation must be understood as a key factor increasing the vulnerability of human beings. Vulnerability results from both social and physical (including environmental) threats, but the ability of human beings to resist or react to such threats depends on both natural and social characteristics of a given region and the resources available to soften the impacts of natural disasters – including wealth, technology, education, information, infrastructures, access to resources and management skills (PNUE, 2002). Therefore, vulnerability is not directly related to national wealth, but rather determined by a various set of economic, social and institutional factors that may be directly related to level of income per capita (Adger, 2001). To that extent, everyone is likely to be exposed to social and physical threats at some time, both rich and poor nations.

With our survival at stake, it becomes extremely urgent to seriously examine the mechanisms linked directly or indirectly with environmental degradation (Garner, 1996), especially because the greater the gap between the pace of environmental degradation and that of our social response, the more limited the development options of future generations and the greater the replacement cost of exhausted resources (Kasperson et al., 1999 in PNUE, 2002). Indeed, since vulnerability is the outcome of a set of processes, it is critical to understand the chain of cause and effect between natural disasters and their consequences on human beings, in order to further investigate the possible points for intervention (Clark et al., 1998 in PNUE, 2002). At the forefront of the debate is the relationship between growth and environmental damage. The argument is about whether economic development is compatible with environmental protection. As Shafik (1994: 757) explains, at one extreme has been the view that the 'greater economic activity inevitably leads to environmental degradation and ultimately to possible economic and ecological collapse'. Whilst at the other extreme is the view that those 'environmental problems worth solving will be addressed more or less automatically as a consequence of economic growth' (Shafik, 1994: 757). The issue of development is particularly sensitive because it involves a reflection on the discrepancies between developed and developing countries, the North and the South, the rich and the poor (Garner, 1996: 125; OECD, 2000; Kakabadse and Kakabadse, 2001).

Factors that exacerbate environmental degradation

Examination of the empirical evidence reveals that developed countries do share a good deal of responsibility for the current state of environmental degradation. For example, it is widely acknowledged that while OECD countries account for about 25 per cent of the world population, they are responsible for about 50 per cent of global greenhouse gas emissions, and for 70 per cent of global CO_2 emissions, for 80 per cent of the world's resource use, and for using 100 times more electricity than the poorest nations (Elliott, 1998; Iwami, 2001; Waller-Hunter, 2001; WWFN, 2003).

Another meaningful illustration, the amount of water it would take per day to support 4.7 billion people at the UN daily minimum is 2.5 billion gallons, which is the same amount of water used per day to irrigate the world's golf courses (World Watch, 2004). Besides, the 'knowledge society' that developed and developing countries aim to achieve engenders high levels of consumption and accumulation of electronic and computer equipments, as such products become dated after 4 to 5 years of age. Recycling these equipments, which often contain hazardous materials, constitutes another significant challenge and responsibility for western countries (Bouvais, 2002; Campagnolle, 2004).

The World Wild Fund for Nature (WWFN) in its 2002 *Living Planet Report* calculates the Ecological Footprint (EF), which measures the consumption of renewable natural resources by a human population, and compares it with the estimated biologically productive capacity of the land and sea available to the given population. The Report explains that relative to the earth's population, the average EF should be 1.9 hectares per person, which is the maximum earth's biological capacity to renew in a sustainable way the resources that a person consumes. However, in 1999, the EF of the world's average consumer was 2.3 hectares, and it was estimated that the EF of an average African or Asian consumer was less than 1.4 hectares per person, for the western European an average EF of 5 hectares whilst for the North American the average EF was 9.6 (WWFN, 2003). Can then any one deny that developed countries do have a special moral responsibility in addressing the issue of the environment? This responsibility is not only because they are the major contributors to pollution but also because they have the economic and political means to do so (Waller-Hunter, 2001).

Some would argue that there is a change in the pattern of responsibility for environmental degradation, as the share of developing countries is increasing in terms of global air and water pollution, deforestation and consecutive desertification, as well as soil degradation (Elliott, 1999: 59; DFID, 2000: 17). Indeed, non-industrialised countries tend to favour economic imperatives at the expense of environmental concerns, and governments welcome 'dirty industries' as a source of job creation and economic development despite their long-term adverse effects on health and the environment (Chukwuma, 1996). Thus, it is particularly critical to understand the reasons behind that phenomenon given the weight developing countries have in terms of population and natural resources. Yet it is particularly challenging because it implies examining the mechanisms between poverty, growth and environmental degradation.

Poverty and environmental damage

Although there appears to be an agreement amongst some scholars as to the existence of a 'vicious circle' of poverty and environmental damage (Jegasothy, 1999; Stiglitz, 2002: 224), it is not easy or simple to draw these relationships because to a certain extent, this circle is reinforced by the process of industrialisation and economic development, notwithstanding the effect of globalisation. It is generally acknowledged that poor people are more vulnerable to environmental degradation, because their existence mainly depends on activities directly linked to the use of natural resources (OECD, 2000; 2001). Poor people do strive for survival. Thus, being both the 'victims and unwilling agents' of environmental degradation, they highly value the environment, but their poverty often restricts their ability to manage natural resources in a sustainable way (Shafik, 1994: 758; Elliott, 1999: 43). Less developed economies still mainly rely on agriculture, fishery and activities relating to natural resources, which make their people highly dependent on the quality of the environment for their livelihoods (DFID, 2000: 13). Indeed, almost 75 per cent of the world's poorest people (approximately 3 billion) depend on agriculture, forestry or fisheries to secure their work and household income. For example, over 60 per cent of world's canned tuna and 30 per cent of the *sashimi* come from Pacific fisheries, of which local fisheries catch approximately 200,000 tonnes (10 per cent of the total check). The rest (i.e. 1.8 million tons) is checked by the foreign fishing fleet that pays small licence fees to access the Pacific fishing ground, leading to more than quadrupled increases in fishing over the last thirty years with potential threat of over-fishing (Kennedy, 2004). Moreover, the fourteen Pacific Island Countries (PIC) received less than 4 per cent ($79.3) through the licence fees from the fishing industry's $2 billion a year earnings (Kennedy, 2004). Similarly, US subsidies to its cotton farmers exemplify the harm rich countries' subsidies inflict on the poor. US subsidies of US$3 billion a year to 25,000 (mainly rich) cotton farmers leads to overproduction of cotton that pushes down the world market price and impoverishes the millions in poor countries (e.g. Brazil or African countries) who rely on cotton for their livelihood (*The Economist*, 2004).

A fast growing population in those circumstances is likely to worsen the problem. Although population growth can be a significant stimulus in the early stages of development, it may well become a burden for the environment as a result of overexploitation, driving to resource depletion, deterioration of land, water and biodiversity (Chukwuma, 1996; Jegasothy, 1999). Increasing levels of poverty in rural areas then encourage people to leave for cities, where fast-growing urbanisation along with increasing unemployment and insufficient public facilities lead to increased poverty, health and sanitation problems, criminality and social unrest and distress. There is a growing empirical evidence that there is reinforcement between poverty and environmental degradation in developing countries (Jegasothy, 1999; OECD, 2001). Yet, to what extent and at what price is economic growth likely to break the vicious circle of poverty? Or will it further reinforce it through increased environmental damage, and ultimately increased poverty?

Since the early 1990s, when economists first reported a systematic relationship between income changes and environmental quality – this relationship is known as the Environmental Kuznets Curve (EKC), named after Simon Kuznets's 1955 relation between income inequality and per capita income – the EKC has become a standard tool for environmental policy debate and is often used as an illustration of how as an economy grows, pollutants' discharges to the environment also increase rapidly, then decelerate and eventually decline (Grossman and Krueger 1991; Bhattacharya, 1995; Yandle et al., 2002). Thus from this perspective environmental degradation would be seen as a transitory phase, a necessary harm for future development, and in some cases growth would even be beneficial to the environment (Perrings and Ansuategi, 2000). However, the validity of such an assumption has not been proven yet, and the review of findings to this date only asserts the existence of an EKC for local air pollutants (Perrings and Ansuategi, 2000; Gupta, 2002). Even, if the relationship between income per capita and environmental quality is proven to hold, it would be still necessary to consider other factors which affect environmental conditions, such as political, social and industrial factors amongst other things (Iwami, 2001). Four main relationships have been conjectured in relation to the potential existence of an EKC (Perrings and Ansuategi, 2000): first, income-related changes in the sectoral composition of economies (that is the changes due to industrialisation, particularly amongst SMEs); second, income-related changes in technology; third, a link between income and the demand for environmental quality (admitting that environmental quality is per nature a luxury good); and fourth, the impact of environmental constraints to growth (that is if environmental constraints are binding, there is no choice but to be environmentally concerned, and since as income rises, constraints increase as aggregate levels of pollution and degradation increase due to greater consumption, then the greater the economic growth, the more intense the environmental concern). From a different perspective, Shafik (1994: 764) argues that 'while there is no inevitable pattern of environmental transformation with respect to economic growth at an aggregate level, there are clear relationships between specific environmental indicators and per capita incomes'.

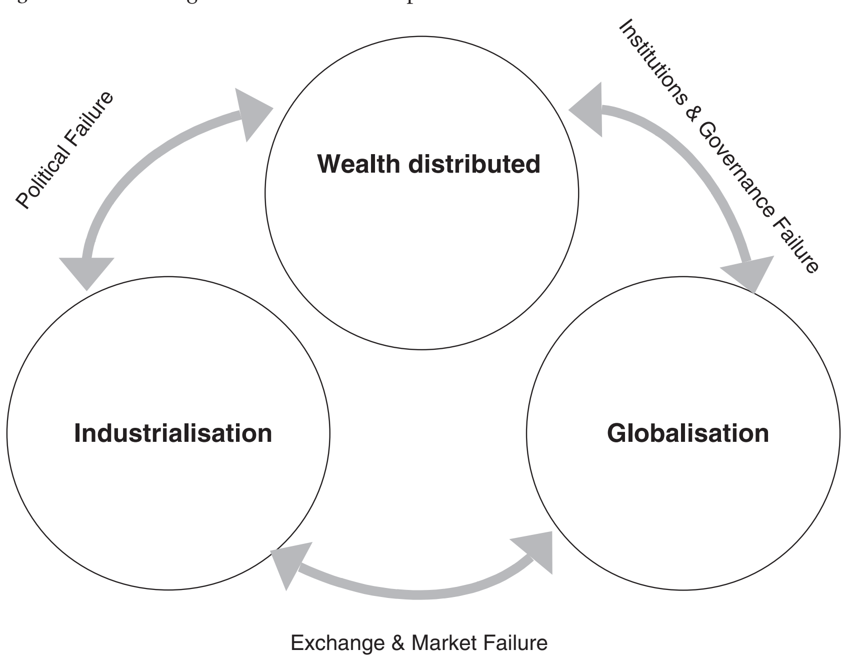
Growth and environmental protection

Admitting that environmental degradation is the direct consequence of the developing countries' dual economies, there are three main arguments that support the idea that economic growth is necessary for environmental protection (Iwami, 2001). First, economic growth is necessary to provide financial resources to build up infrastructures for environmental improvements. Second, fair prospects of future growth in a country also encourage further investments in the region, which may trigger technology transfers.

Third, growth in income per capita is the prerequisite to break the vicious circle of poverty and environmental degradation. In the same vein Tweeten and Zulauf (2002) argue that increased income levels slow down population growth and as such relieve some pressure on the environment, and later on enable a shift in consumption patterns to less environmentally-damaging goods and services which, combined with education and research, eventually lead to environmental preservation policies.

Whilst this argument in principle holds some validity, its application is challenged by the reality of political and economic behaviour. Notwithstanding that it is possible to 'grow out' of some environmental problems, nothing is automatic in that process (Shafik, 1994: 759). Rather, several disruptions have eventually impeded the process of economic growth as the support mechanism for environmental protection (Figure 4.2). First, it is up to politics to decide how wealth will be distributed, and if not managed properly, wealth creation can become a major threat to the environment (Thomas and Belt, 1997). Second, industrialisation, at the core of traditional development frameworks, is identified as the trigger for the overall process of environmental degradation, through the extensive use of chem-

Figure 4.2: Challenges to environmental protection



Source: Compiled by authors

icals and radioactive materials, the increase of industrial waste dumped in nature, as well as the expanding consumption rates, especially in energy (Garner, 1996; Iwami, 2001). Moreover, export-led industrialisation policies, which aimed at exploiting intensively the natural land resources of developing countries, in parallel with urbanisation and overpopulation, which increase the pressure on the natural resources available, eventually are factors threatening the natural equilibrium of the earth (Iwami, 2001). Third, and eventually the cause of most adversities, globalisation, enhanced by ever-increasing world trade flows, greater economic liberalisation and consequently greater external debt burden supported by developing countries, makes it harder for national governments and people to claim their 'sovereignty' (Elliott, 1999). Nations are much more interconnected, which means, amongst other things, that pollution, if unequally distributed, nonetheless has been experienced by even the most remote community (Yearley, 1996: 28).

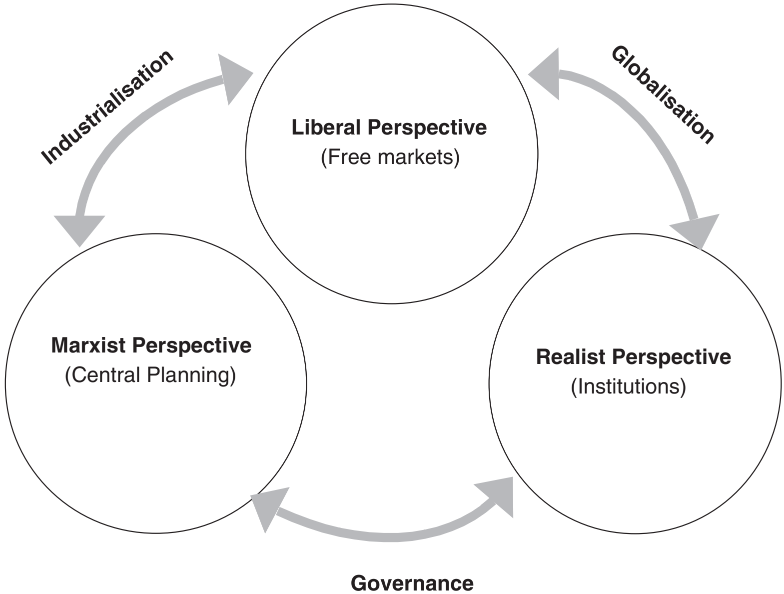
Although environmental degradation is a global problem, the share of power and means of action is not globally balanced (Garner, 1996: 111; Elliott, 1999: 57). Besides, if the threat is certainly a global concern, it does not necessarily mean that it has to be managed only at a global level (Roy and Tisdell, 1998; Adger, 2001; Ryan, 2003). Over the past decades, the patterns of the world economy have been designed according to the dominant neo-liberal perspective, as illustrated by the policies recommended by the World Bank and the International Monetary Fund (IMF) that developing countries should pursue development through the Structural Adjustment Programmes (SAPs) (Elliott, 1999: 31). The outcomes of the implementation of such packages are illustrated by further ineptness and higher poverty (Gupta, 2002).

Environmental damage: who bears responsibility?

Political economic scholarship possesses a tradition that spans more than two centuries and throughout this history and still today, there have co-existed distinctively different views on the essence of political economy. Thus there are multitudes of views on how environmental degradation occurs and who bears responsibility, depending on the philosophical position one holds. Gilpin (1987: 25) identifies three broad philosophies of political economy that provide insights to the posted questions, namely Liberalism, Marxism and Realism (Figure 4.3).

Although each perspective holds a fundamentally different view as to the patterns of economic integration they also share common ideas on how to achieve it. For example, liberal and Marxist positions utilise strategies of industrialisation, whilst liberal and realist positions promote ideas of globalisation (Figure 4.3). Each position will be first explored individually.

Figure 4.3: Political economy perspectives



Source: Based on Gilpin (1987)

Liberal philosophy

Developed economies, and in particular Anglo-American and international institutions such as the World Bank, IMF, or the World Trade Organisation (WTO) have mainly been inspired by the Liberalist philosophy, leading to the promotion of world trade liberalisation, free markets and economic growth based on the exploitation of comparative advantages (Stiglitz, 2002: 18). In a Liberalist perspective, free markets are the key to the optimal resources allocation and to equilibrate supply and demand through the mechanism of the 'invisible hand' (Gilpin, 1987: 27). The exchange (or market) is based on freedom under the rule of law, which is embedded in the spontaneous economic order (Hayek, 1979). As such, the market is anonymous in its nature and individuals are totally free to engage in any economic activities with anyone as long as those activities are not prohibited by law (Hayek, 1979). Prices are signals that express the relative scarcity or abundance of a good, and as such coordinate an effective resource allocation. Considering that exchange does not require any particular social structure or specific organisations, governments should not intervene, except in the case of market failures or the procurement of a so-called public good (Gilpin, 1987: 29). The policies recommended through SAPs, conditioning the grants of loans to developing countries, were perfect illustrations of a free-market ideology: cuts in government expenditures and public sector employment; elimination of food subsidies, which implies an increase in agricultural prices; privatisations and higher interest rates, are some of the instruments used to extend the 'western' model of the world economy (Elliott, 1999: 32; Stiglitz, 2002: 18). As the result of those policies, the less developed countries often specialise in the extensive production of agricultural goods, which are mostly dedicated export, which in turn, eventually exhausts the natural resources they have and thus obliges them to borrow further from international lenders in order to import food, to finance the economic and institutional reforms imposed by the SAPs and to pay back the previous loans and interests, since the sale of national production does not provide enough capital to curb the dependency of the 'have-nots' towards the 'haves' (Chukwuma, 1996; Ockrent, 2001).

In the Liberal political economy perspective, the environment can be considered as a commodity, which implies that it can be submitted to the rules of free markets. This is exemplified by the option exercised by developed countries to dispose of their hazardous waste, which includes toxic, inflammable, explosive and nuclear materials (Elliott, 1999: 63). Apparently illegal trade of hazardous waste is taking place worldwide, harming even more already damaged poor countries, and doing so with the silent support of supranational institutions, as illustrated by the infamous internal memo from the World Bank's Chief Economist, Lawrence Summers, who in 1992 wrote that the World Bank should perhaps think of 'encouraging more migration of the dirty industries to the least developed countries' for three main reasons, one being for instance that 'under-populated countries in Africa are vastly under-polluted' (Yearley, 1996: 75).

Developing countries are by far the losers in the developmental game of the western model for several reasons. Developing countries do not have the political influence to impose environmental standards for developed countries (Yearley, 1996; Elliott, 1998). They also often do not accept standards proposed by developed countries and/or supranational organisations, as their non-democratic governments pursue their own interest and foster corruption (PNUE, 2002). Sometimes, they also refuse to play the fool in an unfair negotiation process with developed countries, arguing (rightly) that higher global environmental standards are likely to impede their economic development and boost the transfer of polluting industries and hazardous waste from North to South (Yearley, 1996; Elliott, 1998). Developing countries also desperately need capital, in order to finance development programmes, build up infrastructures and pay back the loans and the interests they have accumulated for years, through the encouragement of international monetary institutions (Garner, 1996: 126; Yearley, 1996: 74).

Developed countries indeed compensate receiving countries or their ruling elite, for accepting their waste. The compensation amounts paid are likely to be extremely significant for developing countries, however these are still a low cost and often a more environmentally hazardous solution to a costly problem created by multinational companies based in the developed world. Elliott (1999: 64) poignantly summarises this issue arguing that 'the amounts paid to the receiver of hazardous materials are negligible, however, compared with the savings made on storage and disposal in the country of origin'. Moreover, developing countries are even less equipped, informed and knowledgeable than industrialised nations to deal with hazardous waste, which results in even more environmental damage (Elliott, 1999: 65).

Consequently, many scholars explain the current state of environmental degradation as a market failure, implying that market-based solutions are inappropriate to tackle environmental issues (Iwami, 2001), for at least two reasons. First, the very nature of environmental pollution is complex and as such it is difficult to fully apprehend the market-based principle of the 'polluter pays' which is neither easy to implement nor easy to monitor, notwithstanding the implications of global social responsibility amongst developed polluting countries (Elliott, 1999: 60). In fact from the liberal political economy perspective, pollution is analysed as an externality. That is, the benefits of pollution, which is the production of goods for sale, are mainly for the producer whilst the costs of pollution are supported by society as a whole (DFID, 2000: 20). Therefore, as long as the costs of pollution can be externalised, there is little incentive for adopting more environmentally-friendly patterns of production and consumption, and for developing appropriate technology that will reduce environmental degradation (Shafik, 1994). Moreover, the greater the uncertainty of the potential benefits and the greater the perception that a certain degree of pollution can be accommodated, the less likely consumers are willing to pay an extra cost, economic or social, for improving the global environment (Garner, 1996: 9; Thomas and Belt, 1997). Building on the Kyoto protocol experience, Adger (2001) explains that in a voluntary cost–benefit approach, the likelihood of ratification of a multilateral treaty is greater when it is expected that each participant will benefit from a favourable outcome, which means that costs of abatement of polluting activities must be perceived as small, and costs of non-participation (i.e. more pollution and degradation) must be perceived as high. Apparently, this has not been the case yet.

Thus, implicitly resulting from the idea of market failure, the environment should be considered as a public good, which implies that governments should intervene and design a regulatory framework that focuses on rebalancing pollution costs and benefits between social actors, and ultimately reducing overall costs (DFID, 2000: 20; Stiglitz, 2002: 224). If environment is a global public good, it is then per se non-excludable and non-rival in consumption. However, Nielsen (2003) specifies that the marginal benefits from consuming the environmental public goods are certainly positive but not identical for everyone, so that some countries are more affected by environmental changes than others. Therefore, some intervention of a strong institutional body is required to manage equitably the effects of environmental changes, something the global market cannot do. Indeed, the Liberalist view fails to take into account that if trade liberalisation is not per se an obstacle to environmental protection, then it requires effective environmental policies, and adequate and enforceable legislation that aim to reduce environment vulnerability (Thomas and Belt, 1997; DFID, 2000: 37). Hence, multinationals paying little or no tax as they are able to exploit tax loopholes and tax accounting rules and practices, are exemplified by Cisco and Colgate-Palmolive who had received tax breaks sometimes exceeding their reported net income (Henry et al., 2002). Increasing 'corporatisation' of international institutions is a critical issue to examine in light of defined expectations for global governance (Gupta, 2002).

However, free markets are not the only culprits for global environmental degradation. Indeed, both the Realist and the Marxist philosophies fail to elaborate propositions that satisfactorily explain and address environmental damage.

Marxist philosophies

From the Marxian perspective the process of capitalism has led to the exploitation of men and natural resources alike. If the process continues until its inevitable collapse then 'emancipation means being freed from both social and "natural" oppression' (Eckersley, 1992: 81). Thus some argue that Marx's own position relative to nature is that man ought to conquer his environment, for this is the means of 'human self-aggrandizement' (Eckersley, 1992: 80). Therefore in the planned economies, instead of market being used for the efficient allocation of resources through price mechanism, a central planner sets output levels and techniques for production in all sectors. Considering that the input and output structure of all sectors are coordinated from the outset the system requires central authority equipped with strong power that enables the initial collection of goods and service for reallocation (Polanyi, 1957). Price represents the exchange conditions necessary for the repeated reproduction of the system itself. However, as history shows, the problem that central planners face is one of 'knowledge', which is dispersed amongst individuals or that remains unarticulated and merely embodied in the various skills and specialised economic agents, which in turn leads to ineffective utilisation of the resources or planning failure. In addition, in the planned economy, reproducibility of both economic and non-economic (e.g. political, cultural, religious) institutions becomes of primary importance whilst the scarcity of resources gets relegated to a consideration of more or less secondary importance (Sahlins, 1972). Thus the reproducibility of the system depends on the reproducibility of institutions. Notwithstanding, some scholars have tried to address the environmental issues through a Marxist perspective, creating two distinct positions, the 'Orthodox' eco-Marxism and 'Humanist' eco-Marxism or neo-Marxist perspective.

The 'Orthodox' eco-Marxism argues that humans should seek to protect the non-human world to the extent to which doing so is of some instrumental value for the former, and that the overall environmental degradation originates from the dynamic of private capital accumulation. Hence, the empirical evidence of capitalism's inefficiency to manage resources in a sustainable manner. Orthodox eco-Marxists argue that 'the private and socially inequitable mastery of nature under capitalism should be replaced by the public and socially equitable mastery of nature under communism' (Eckersley, 1992: 85).

However, the experience of planned economies of the former Soviet Union demonstrates that public resources management is by no means an effective response to pollution and the like. Drawing upon the Czech Republic experience, Earnhart (2001) identifies the very limited public participation to environmental decision-making and monitoring as the major reason for environmental degradation during the communist period. Because of rigid bureaucracy, lack of transparency and political control on people's freedom of speech and action, economic interests by far were favoured over environmental concerns, a phenomenon more frequently observed under communism than during the transitional democratic period (Earnhart, 2001). DiLorenzo (1993: 14) also observes that 'where property is communally or governmentally owned and treated as a free resource, resources will inevitably be overused with little regard for future consequences'. Therefore, the failure of communist regimes to adequately manage natural resources comes from the absence of effective property rights. Other experiences of planned economy have indeed underlined the critical importance of appropriate property rights in initiating sustainable development, for ownership rights make people more independent and rights to use common resources make them more sensitive to environmental preservation (Roy and Tisdell, 1998). When it is unlikely that one will be held accountable for one's actions, and when the state itself is not accountable for its actions, as occurred in the former communist countries, there is little chance that people will behave in a socially responsible way (DiLorenzo, 1993; Thomas and Belt, 1997).

The neo-Marxist trend that attempts to address environmental issues is referred to as 'Humanist' eco-Marxism, and argues, against Marx's underlying anthropocentric philosophy, that nature should be perceived as 'humanity's inorganic body' (Eckersley, 1992: 88). As such, a socialist stewardship would emancipate both humans and non-humans from capitalism, so that humans will be able to take care of their own body, hence caring about nature but still as an instrument serving humanity's universality. Moreover, in non-market societies or organisations (e.g. families, NGOs), economic processes are not independent of non-economical process, but are closely linked with them. That is, human economies are 'embedded not only in economic institutions but also in the religious, political and cultural institutions of society' and as such provide structural stability and integrity to non-market economic process exemplified by the reciprocity system of economic integration (Polanyi, 1957: 14). Being more environmentally concerned, this view has little in common with Marx's core ideas, unless it accepts the perspective of an anthropocentric world, which would lead to the eventual subjugation of the non-human to humans (Eckersley, 1992: 90).

Either Liberal or Marxist-based propositions have proved to be inefficient in addressing environmental damage, although the Realist view does not really perform better.

Realist philosophy

Realist philosophy holds that the environment, as any resources, is to be managed by the state for the greatest good of the nation as the expression of the ultimate right of each nation to sovereignty (Elliott, 1999: 66). However, the global nature of pollution makes this issue a global problem that cannot be successfully addressed individually but rather through effective international cooperation (Elliott, 1998). As such the Realist perspective also fails to provide a satisfying solution to environmental degradation, because the interdependence of the world's resources irrespective of national borders are in fundamental conflict with the sovereign nature of some 170 nation-states (Garner, 1996: 115). Furthermore, there is increasing evidence of a governance-failure, referring to the inadequacy of institutions to create commitment from individual economies for environmental improvements. For instance, subsidies to energy consumption have had a clear negative effect on the environment (Iwami, 2001), whilst corruption, lack of concern, unclear indicators and poor monitoring are elements reinforcing environmental damage (DFID, 2000: 21).

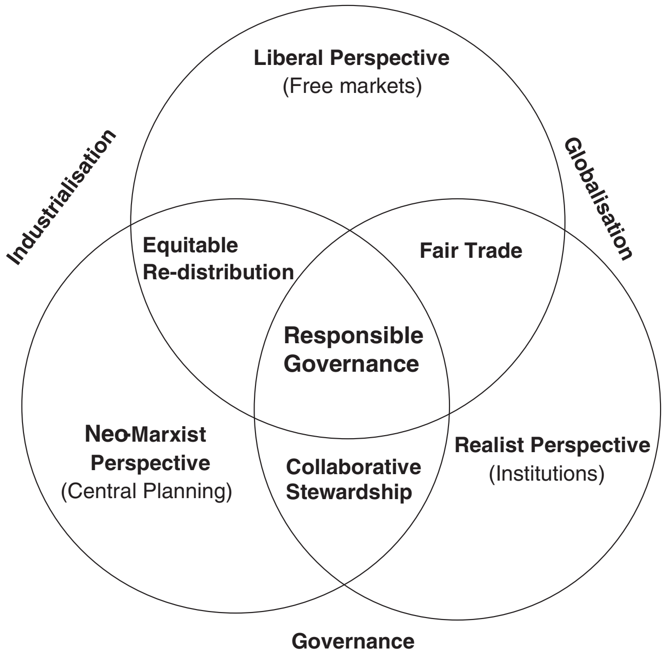
Elliott (1998: 97–8) identifies two main positions in defining the nature of the 'governance failure'. One position holds that current international practices are no longer adequate to deal with trans-boundary environmental issues. The other holds that governance failure is fundamentally due to an incongruence between the nature of the global environmental problems and the type of solutions a nation-state based geopolitical system can come up with. Thus, on the one hand sovereignty is seriously challenged by the intrinsic borderless characteristic of environmental problems, which eventually impedes nation-states in fulfilling their social contract to provide security for the citizens; and on the other hand, the lengthy process of negotiations, the non-authoritative and lowest-common denominator characteristic of most agreements, and the natural reluctance of nation-states to submit part of their sovereign power to international institutions seriously challenge the possibility to design a collective and comprehensive framework of environmental legislation, enforcement and monitoring (Garner, 1996: 117; Elliott, 1998; Marshall, 2002). However, some argue that the realist perspective 'exaggerates the difficulties and underestimates the achievements of international co-operation' (Garner, 1996: 115).

The 1972 Stockholm Conference probably marked a watershed as the emergence of an international concern on environmental issues, and since then institutions have been created, initiatives have been launched and conferences have taken place; however the general outcome has been disappointing (Elliott, 1998). Some question the very existence of a global interest behind pure policy rhetoric, considering that many developing countries are doubtful on the good intentions of developed countries to address global environmental issues, and are therefore reluctant to sign treaties they perceive mainly targeting 'western' pollution and widening the gap between the rich and the poor (Yearley, 1996: 80; Gupta, 2002). Although possible solutions can be comprehensively assessed and designed in order to meet the specific needs of the country or region with a purpose of sustainability, their implementation and the environmental issue becomes mainly a matter of political willingness (Elliott, 1999; DFID, 2000; 2001). Up to now, there has been little prospect for significant progress in the realist perspective (Elliott, 1998). However, the increasing elaboration of policies (including CSR at the international level) represents a type of multi-layered government where power shifts to international organisations and multi-national corporations – adding another layer of governance (Held et al., 1999). Nonetheless, the current status of international environmental institutions, which are fragmented and geographically distant with small budgets and little support, illustrate the ineffectiveness of global governance of the environment to this date (Marshall, 2002).

Towards a possible solution

Considering that human economic societies are so complex that they cannot be reduced to a single mode of coordination, be it market, planning or reciprocity, neither of three political economy philosophies (Liberalism, Marxism and Realism) can adequately serve as a unitary model upon which any real economic society should be constructed. Moreover, all three philosophies hold assumptions that humans are 'rational' *homo œconomicus*. However, human economic societies are neither simple nor pure systems but complex and intricate ones, composed simultaneously of more or less of all three philosophies (Polanyi, 1957; Hodgson, 1988). How and

Figure 4.4: An integrative model of sustainable development



Source: Compiled by the authors

to what extent these three philosophies mix or co-exist in a particular economic society informs the characteristics of that society.

Hence, comprehending environmental degradation requires analysing and addressing the issue through each of the three paradigms. All three have a great deal to offer provided the mix of advantages parameters is exercised (Figure 4.4). That is in a global economy there is a need for some market regulation that allows poor nations but not rich ones to protect their infant industries and subject multinationals and other companies that trade between the nations to mandatory fair trade laws. Moreover, a pluralistic and collaborative stewardship of resources (i.e. democratisation of governance structure) is necessary, as well as equitable redistribution of resources, as the main issue is how resources are controlled and how that control is determined.

Economic growth is necessary to alleviate dire poverty and ultimately enable developing countries to manage more efficiently their natural resources, but its pattern should not be dictated by developed economies, either directly or indirectly through the imposed recommendations of supranational entities such as the World Bank, the IMF and WTO. Furthermore, there is a need for a clear regulatory system, which effectively holds polluters accountable for their actions, which is likely to imply institutional reforms and greater transparency in policy-making. Since global issues cannot be addressed locally, nation-states must give up some of their sovereignty, as long as every player abides by the rules; that is, even the biggest developed countries, who are also the biggest polluters, are to accept being players and not rule-makers. This is a tremendous challenge to the existing global governance framework, where the USA can go back on their involvement in the 1997 Kyoto agreement with impunity, and in fact increase their emission of greenhouse gases by 10 per cent between 1990 and 2000 while they had promised to reduce it by 7 per cent (compared with the 1990) level by 2012 (Smée, 2004).

What each political-economy philosophy has to offer has been examined recently with a view to developing a more adequate global environmental governance framework and reform the relatively inefficient UN model (Marshall, 2002; Pallemaerts, 2003). There are many options to design the future institution (or institutions) for global environmental governance, from a hierarchical integrated model included as a high-level body in the UN structure, to an advisory body to the UN Secretary General, to coordination through principles, clustering or networks; from a Global Environmental Organisation to an International Environmental Organisation to a World Environmental Organisation (Gupta, 2002; Marshall, 2002). None of the models proposed can fully satisfy simultaneously the three political philosophies examined in this paper.

However, it should be possible, drawing on the examination of each model and the implications of each paradigm, to determine priorities and imperatives in order to achieve rapidly the set-up of a fair and adapted governance system. This should occupy a high level in the hierarchy of international institutions, and should avoid the risks of bureaucratic inertia and resource wasting due to excessive fragmentation; it should be fully involved in the management of the globalisation process to counterbalance effectively the increasing pressure of financial market institutions; it should provide a clear and sound platform for discussion recognised by all stakeholders from both North and South; countries should truly support it and grant it some of their sovereignty to make it a strong executive organisation whose policy-making process is transparent and collaborative (Roy and Tisdell, 1998; Gupta, 2002; Marshall, 2002; Pallemaerts, 2003).

Therefore, although the most powerful governments and corporations still resist necessary changes, the greatest hope probably lies in the growing political influence of civil society actors, mainly Non-Governmental Organisations (NGOs) supporting local communities that are involved in environmental protection. Indeed, future plans for action towards sustainable development cannot but be collaborative, not least because those whose lives are affected by the policies and their effects need to understand the purpose and design of the policies. This is exemplified by *Fundación Natur*, a non-governmental organisation that officially started in 1979, and that has now assumed a position of leadership in Ecuador and the international community on issues relating to environmental education and development policies. NGOs participate in global environmental awareness, hence indirectly influence the international environmental agenda, and have the ability to develop networks aimed at forming, informing and monitoring projects (DFID, 2000: 27). The difficulty is to take a global perspective which does not elude local concerns and contexts, and to act local whilst not overshadowing global impacts and priorities.

Partnerships are often perceived as a potentially successful solution to enhance collaboration amongst stakeholders, but they too require willingness and fair play from all parties, and an agreed monitoring and performance measuring process which is yet to be designed (Ryan, 2003). However, there is a growing number of communities that are adopting reciprocity as a pattern for economic integration as exemplified by LETS (local exchange trading system) and NAM membership (new associations movement) whose aim is to create a non-capitalist market society, which shows that there are many alternatives that society can choose to pursue (Kakabadse and Kakabadse, 2003). The aim of reciprocal mechanisms of coordination through local community currency is to mediate exchanges between goods and to:

- establish reciprocal exchange based on trust;
- mediate inflation, unemployment and autonomous growth of community through circulation of local currency within a specific region;
- prevent credit creation, speculation and monster accumulation of capital (i.e. the idea of a Clearing Union of a kind which would automatically discharge trade deficits and prevent the accumulation of debt, was strongly supported by Keynes, 1942);
- prove zero or negative interest in order to estimate the trading of goods and services;
- provide structure to evaluate non-market services such as welfare, care for the environment;
- provide frameworks for horizontal linkage between non-government and other not-for-profit organisations in relation to labour, consumption, welfare and environment; and
- build trust, stimulate and enrich communities (Nishibe, 2001: 3).

Successful initiatives led on a local scale bring evidence that willingness to participate in global improvement is a huge step forward. For instance, the Ecoprofit programme implemented in Graz, Austria, in the mid-1990s, targets small and medium-sized enterprises and aims to integrate environmental goals into production management in order to achieve cleaner production processes. With a hundred firms from thirty-eight different sectors involved in the programme, significant results have been obtained in Graz, formerly known as the 'Smog capital': between 1995 and 2000, participating firms have globally saved €21 millions, consumption of solvents has dropped by 72 per cent, waste production has fallen by 54 per cent, water use has decreased by 30 per cent and electricity use rate by 8 per cent (Touboul, 2004). Such examples stir up the interest of neighbour countries, but remain too few to expect a real change in environmental behaviour patterns in the short to medium-term.

Given the probability of the under-estimated environmental costs of past and current behaviours, and although it is cheaper to control pollution at its source than to finance pollution-tackling programmes, a complete reversal of environmental damage is indeed unlikely. However, if sustainable development is to take place, governments need to adopt a proactive approach to environmental degradation, protecting natural resources before damages occur (Chukwuma, 1996; Thomas and Belt, 1997). Sustainability implies qualitative development, and a moral dedication to improving everyone's life towards a greater well-being with no distinction of any kind (Chukwuma, 1996). Sustainability also implies that the entire ecosystem must be included in qualitative development, for we are both part of and responsible for our natural environment.

Surely, the effort must come from all the stakeholders, as UN Secretary General Kofi Annan (2003) states: 'International and non-governmental organisations, the private sector and each and every individual have a role to play in changing entrenched outlooks and ending destructive patterns of behaviour.' In that perspective, wide public information and awareness campaigns need to be implemented, because mass media have the ability to educate people towards the adoption of less materialistic and more environmentally respectful behaviours and beliefs (Chukwuma, 1996). Through the promotion of democracy and respect of human rights, through consumption patterns and political lobbying, we still have a chance to decide on our future. The futures are for us to choose!

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Part II

Reporting and Regulating

5

What to Measure in the Twenty-first Century?

Lance Moir and Mike Kennerley

One of the main governance issues that boards have to face is what to measure and, in particular, how to set appropriate performance goals for operating managers. If governance is about the 'the relationship among various participants in determining the direction and performance of corporations' (Monks and Minow, 2004), then we need to address who the participants are, how to choose a direction and what constitutes performance. It is precisely this inter-relationship which causes the problem. For many managers the achievement of a single objective – maximisation of shareholder wealth – to a single actor, the shareholder provided enough complexity. Indeed many (e.g. Jensen, 2001) argue that this is all it should be. However, there are other participants – customers, employees, governments who also make claims on the firm and its resources and who also seek 'performance'. In a traditional shareholder value model, the key decision tool would be based around net present value and ultimate measures of 'value'. This focus has led boards to think about financial measures such as earnings per share and share price growth. Yet recent financial scandals reflect unethical behaviours whilst societal pressures have also led to risks which can impact on firm value. In a more complex setting, the interplay between firm value and societal value changes the traditional approach. For the senior management of a firm the problem then is how to determine performance in such as way as to satisfy these multiple stakeholders (Freeman, 1984) whilst still meeting the economic objectives. This chapter will examine some of the performance measures that address these potential conflicts and proposes a conceptual framework in order to address forms of measurement that take account both the economic and the social and argues that boards need to think about governance in a way that can address both issues.

The financial perspective

The financial value of a firm is regularly determined as the discounted value of future cash flows (Brealey and Myers, 2003), where the discount

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rate represents the blended cost of capital, adjusted for the risk of the firm. Rappaport (1986) argued that, in order to maximise shareholder value, managers could focus on the impact of seven key value drivers. These are:

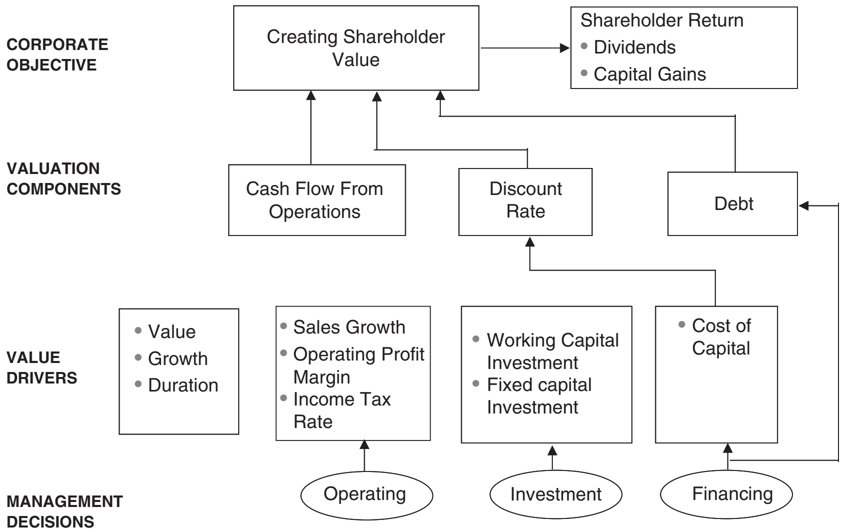
- Sales growth
- Operating profit margin
- Cash tax rate
- Level of working capital investment
- Level of fixed capital investment
- Cost of capital
- Value growth duration or competitive advantage period.

Rappaport then also took ideas around competitive strategy, notably from Michael Porter's (1985) models of five forces and of value chain to show how different competitive strategies would lead to a need to focus on different value drivers. Thus where a firm is subject to cost pressures, the issues of sales growth (in order to drive down marginal costs) and margin are the key drivers. An essential argument of Rappaport is that firms only create shareholder value when they generate returns in excess of their cost of capital. The link to strategy is such that firms can only create value if they have some form of sustainable competitive advantage. This approach to firm management has been popularised in the form of the varieties of value based management ('VBM'), frequently proposed by a number of consulting firms. The key factor behind much VBM is that the sole or principle objective of the firm is to maximise shareholder wealth. However, this approach has also been challenged by a number of commentators (Arnold, 2000), some of whom observe that the maximisation of shareholder wealth leads to maximising all stakeholder claims. We do not take a position on the virtues, or lack thereof, of this and other market-based approaches, but we observe that this is the nature of modern corporate management. We therefore need to find a way in which managers can balance competing claims, whilst continuing to function in the market-based economy. Rappaport represented these drivers as shown in Figure 5.1.

Alternative strategic models might lead to different value drivers. Thus the resource based view of the firm and the resource dependency views (Pfeffer and Salancik, 1978) might point to a need to focus on key stakeholders – for example, employees in the IT industry. But, in a similar way, a focus on the key strategic issues can also be linked back to shareholder value.

Therefore, if we can link the social issues of a firm to one of these value drivers, then we can demonstrate the impact that a firm's social issues can have on firm value, possibly linked with strategic choices. If we put to one side, the drivers of tax rate and the levels of capital investment, we argue that most social issues have an impact on one of the other four drivers. We now consider each in turn.

Figure 5.1: The shareholder value network



Source: Rappaport (1986)

Sales growth

An example of this driver might be that firms that act responsibly attract customers who would prefer to purchase from such firms when compared with others. This link is not demonstrated in all cases as actual purchases but this does show an approach.

Operating margin

Firms with better relationships with employees will experience lower turnover and thus reduce costs, although this behaviour might also lead to higher expectations from employees and thus higher wages. Similarly better relations with suppliers will enable better negotiation in order to improve service and reduce costs.

The key issue from the issues of sales and margin (in effect, profit) is that firms need to see a *link* between the actions they take and the (financial) bottom line.

Cost of capital

Firms that are regarded as responsible, possibly also by inclusion in ethical indices, will be seen as less risky and thus their shareholders will apply a lower discount rate. Such firms might also be able to achieve higher levels of debt capacity and so will similarly be able to reduce their cost of capital (Brealey and Myers, 2003). In traditional financial theory, these issues should not matter as shareholders could diversify away such specific risk – however Rappaport (Rappaport, 1986) also points out that shareholders might actually work from a lower cost of capital.

Competitive advantage period

This is potentially the most valuable, but most elusive driver. Much of the issue of responsibility of firms links back to 'reputation'. The idea here is that responsible firms should be able both to make higher sales *for longer*, but also secure better access to scarce resources. Trust becomes a key issue in competitive strategy. Jones (Jones, 1995) in his development of instrumental stakeholder theory emphasises the trust element: 'The firm will gain competitive advantage if it is able to develop relationships with its stakeholders based on mutual trust and cooperation.' Thus, if we can link the separate benefits which arise from the disparate aspects of the business in the society literature to one of the seven value drivers, then we could also calculate the value to the shareholder of such an activity and thus the theoretical impact on the share price. Such a tool would have a dramatic impact on managers who seek to act in a responsible manner, but lack the financial language both to argue for resources for social projects and to communicate such strategies to shareholders. It would also have the effect of identifying which social initiatives destroy shareholder value and which would thus be at risk from this analysis. Therefore a key need is to codify the results from the business in the society literature around these seven value drivers so that we can show the links between particular issues (say employee satisfaction or diversity) and manifested share price.

Willard (2002) in a similar manner identifies seven business benefits that firms can achieve from sustainability (a term which he uses inter-changeably with responsibility). He shows how the net present value of such benefits can be calculated. His approach shows specific instances of the general approach set out above. The seven benefits he lists are:

- Easier hiring of the best talent
- Higher retention of top talent
- Increasing employee productivity
- Reduced expenses in manufacturing
- Reduced expenses at commercial sites
- Increased revenue/market share
- Reduced risk, easier financing.

Board performance targets

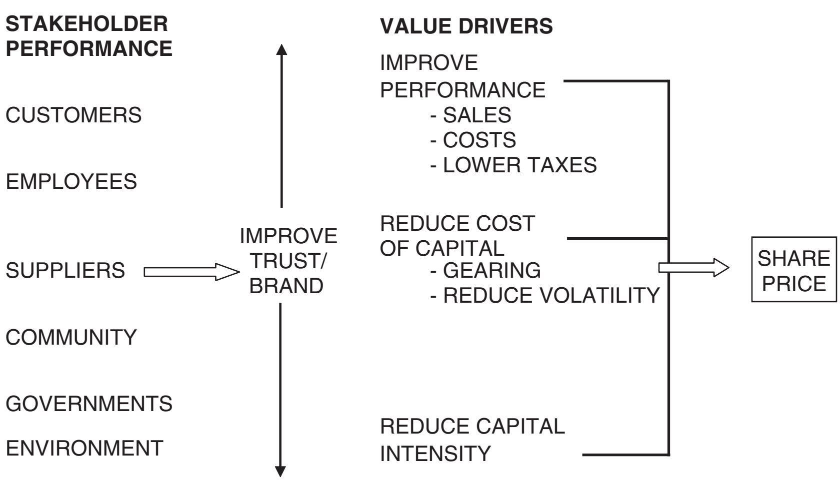
Metrics used at boards have traditionally been focused on financial results and typically near term results. These have been further embedded by the setting of management incentives linked to such measures as earnings per share, a single period entirely financial measure. The ritualistic presentation of results to the investment community in these limited terms during the 1990s created a culture of governance around short-term, share-price driven issues. In response to some of the problems that follow from a narrow focus we have seen the attempt to manipulate results, which has in turn led to the many governance reviews of Cadbury, Greenbury, Higgs and Sarbanes-Oxley.

Yet share price, in the financial sense also includes future results and this is why the period of competitive advantage is a crucial value driver. We can sense the financial markets thinking about investment once more and the sustainability of returns. For example, the *Financial Times* reported in September 2004 investor concerns that Unilever plc would cut spend on advertising in order to deliver single year results.

Within these governance reviews, one that attempted to focus boards on the long-term in the United Kingdom was the Turnbull review. This requires boards to assess the major risks (and this means business risks, not just financial risks) to the firm. This focus will be further enhanced with the expanded Operating and Financial Review required from UK listed firms from 2005. This review will need to consider the risks from the social and environmental areas to the firm. It is in this multi-faceted, complex world that boards need to reconsider the performance metrics they use. In particular they will need to consider how social and environmental performance links into financial performance.

We argue however that boards should consider these issues as interrelated and not as separate issues. In particular boards need to extend their scanning to include factors of stakeholder satisfaction and then identify

Figure 5.2: Linking stakeholders to share price



how these impact one or more of the value drivers which, in turn, drive share price. Of course, in addition, to these aspects we expect normal effective operational management, including good investor communications. No amount of good environmental scanning and moral management can make up for poor basic operational management. We illustrate these linkages in Figure 5.2.

Measuring stakeholder performance

Over the last decade the way in which organisations measure and manage their performance has been the focus of enormous attention amongst academics and practitioners alike. Many models, processes and frameworks have been proposed which aim to help managers improve the way they measure the performance of their organisation. These models, processes and frameworks have a common objective, to align activities at different levels of the organisation with the ultimate objectives that the organisation is trying to achieve.

In line with the above discussion, it is increasingly being recognised in the literature on the subject of performance measurement and management that a broader set of stakeholders than just shareholders need to be satisfied if an organisation is to achieve sustainable success. Furthermore, even where the financial/shareholder objective dominates it is recognised that the drivers of financial or shareholder performance are non-financial in nature and as a result it is essential that these non-financial drivers of performance are measured and managed in order to deliver the organisation's ultimate objectives.

Whilst taking a broader stakeholder view of performance and incorporating non-financial measures improves understanding of the objectives of an organisation and how they can be achieved, they clearly add considerable complexity to the task of measurement and management. If we are to develop a meaningful performance measurement/management framework which will help decision making we need to provide an understanding of how activities and operations at all levels affect the achievement of overall objectives and provide tools that enable managers to focus attention in the right areas and manage tradeoffs between stakeholder requirements and between conflicting priorities.

The Balanced Scorecard is the most popular measurement framework and has become common terminology among executives; however since its introduction the concept has evolved. With each of Kaplan and Norton's books on the subject (in 1996, 2000 and 2004), less emphasis has been placed on the exact balance of measures and more on the need to explicitly link desired performance outcomes to the drivers that enable achievement of those outcomes. Having balance in the number of measures is no longer considered strictly necessary (Schneiderman, 2001). As long as we understand how they contribute to the ultimate objective we will not be taking our eye off the ball.

Kaplan and Norton propose the use of strategy maps (sometimes referred to as success maps) to understand how the drivers of performance affect the top-level objectives. Strategy or success maps explicitly link performance outcomes to the drivers of those outcomes, explicitly showing how non-financial, internal, leading, short-term measures such as Employee Development or Employee Satisfaction affect financial, external, lagging, long-term measures such as Return on Capital Employed or Profit Growth. The success or strategy map provides a model of the performance of the organisation which tells the story of the organisation's strategy. When Schneiderman talks about a 'good scorecard' it is a strategy or success map to which he refers regardless of whether the Balanced Scorecard, Performance Prism or other measurement framework has been used to develop it.

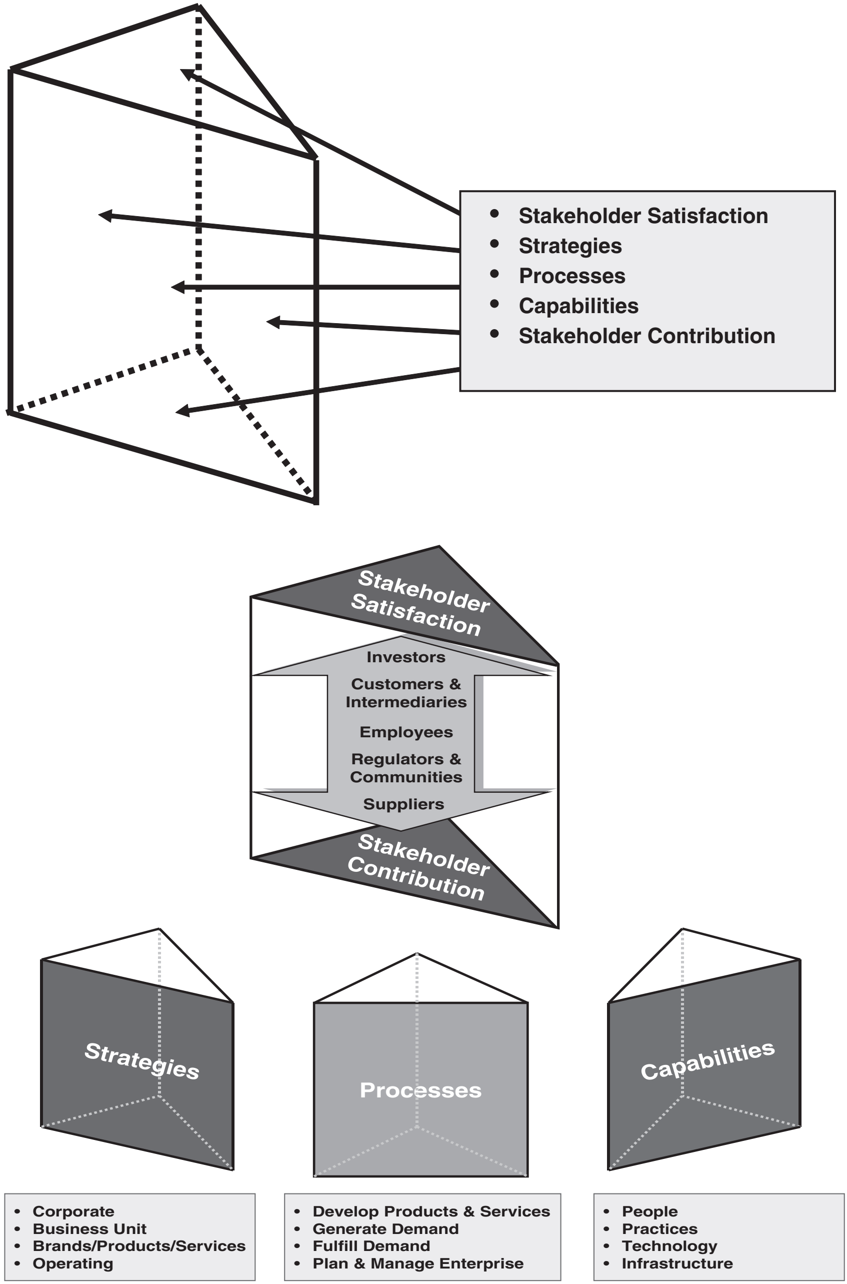
Designing performance measurement systems is all about deciding which measures to select, and just as importantly, which measures to ignore. Therefore developing the right performance measures is all about selecting the key objectives that the organisation needs to improve and designing appropriate measures to track this improvement.

When management teams do this together it clarifies their thinking on what is important. Having a debate refines their views and makes explicit the mental models each holds in their heads about how they believe the organisation works. Our experience shows that this process in itself is highly beneficial. It can help the top team to clarify and agree strategy even if the measurement process doesn't progress further.

The success map should show all the key objectives the organisation is trying to achieve over the coming period. They are linked showing the main cause and effect relationships between the objectives. This is an extremely good communication tool both within the management team and for communicating the objectives by demonstrating how the actions of employees throughout the organisation contribute to its overall objectives.

It is commonly stated that one of the main benefits of performance measurement, and the Balanced Scorecard in particular, is that is translates strategy into action, and that measures should be derived from strategy. This is such a conceptually appealing notion that nobody stops to question it. In reality, strategies are reactions to opportunities or threats in the organisation's operating environment. Understanding – through quantification – the operating environment must, therefore, be the starting point. Knowledge of stakeholders' changing wants and needs and how well the organisation is satisfying them is both the output of prior strategies and the basis of new strategies. The starting point for deciding what to measure shouldn't be 'What is the organisation's strategy?' but instead, 'Who are the organisation's key stakeholders and what do they want and need?' Therefore, stakeholder satisfaction is the first viewpoint on performance encapsulated in the

Figure 5.3: The facets of the performance prism



Performance Prism (Neely, Adams C, and Kennerley, 2002) a stakeholder focused approach to developing an organisations performance measures and success map. Figure 5.3 shows the Performance Prism.

This facet is deliberately broader than the balanced scorecard view of stakeholders, which encompasses only shareholders and customers. No mention is made in the balanced scorecard of employees. No mention is made of suppliers, alliance partners or intermediaries. And no mention is made of regulators, the local community or pressure groups. Yet all of these parties can have a substantial impact on the performance and success of an organisation. In contrast, this first facet of the Performance Prism explicitly demands that organisations consider who their key stakeholders are and what it is that they want and need.

The second facet concentrates on Strategies. Only when we know what our stakeholders want and need is it possible to start to explore the issue of what strategies should be put in place to ensure the wants and needs of the stakeholders are satisfied. Therefore, the second facet of the Prism asks – 'What are the strategies we require to ensure the wants and needs of our stakeholders are satisfied?'

The third facet of the Performance Prism – the Processes facet – asks the question 'What are the processes we have to put in place in order to enable our strategies to be delivered?'. Here we are talking about processes in the sense of the generic business processes that underpin the common operations of most organisations. For each of these (normally cross-functional) processes, it should be possible to identify specific measures that allow management to address critical questions that they need to be able to answer. For example, it might be necessary for an operations executive to ask 'Are the organisation's fulfil demand processes working efficiently and effectively?' and 'If not, how will I know which sub-components of it are the cause of its inefficiency or ineffectiveness?' And so on through the other key processes and their sub-sets.

The fourth facet of the Performance Prism, the Capabilities facet, is perhaps the least widely understood. Capabilities are a relatively new but important management concept. They are the combination of people, practices, technologies and infrastructure that together enable execution of the organisation's business processes (both now and in the future). They are the fundamental building blocks of the organisation's ability to compete. Without the right people, practices, technologies and infrastructure in place, it is impossible to execute or improve the processes. The key question associated with this facet then becomes 'What are the capabilities we require in order to operate and develop our key processes?' As soon as this question has been answered, then it becomes possible to identify measures that allow the organisation to assess whether it has the required capabilities in place now, or has plans to implement them, and whether they are being sufficiently nurtured and protected.

The fifth and final facet of the Performance Prism is the Stakeholder Contribution facet. This facet has been included as a separate component since it recognises the fact that not only do organisations have to deliver value to their stakeholders, but also that organisations enter into a relationship with their stakeholders which should involve the stakeholders contributing to the organisation. Take employees, for example. Employees want from an organisation a safe, secure place to work. They want a decent salary and compensation package. They want recognition and fair treatment. They might also want an opportunity to influence the organisation. But, *in return*, the organisation itself wants its employees to contribute to the business. It wants them to offer ideas and suggestions, to develop skills and expertise, to advocate, to turn up for work and to remain loyal to the business – training replacement staff costs money. This symbiotic relationship between the organisation and the stakeholder is true for all classes of stakeholder – whether we are talking about investors, customers, employees, suppliers, alliances, or the local community. Each has its own quid pro quo. All other measurement frameworks we have researched fail to recognise the reciprocal relationship between the stakeholder and the organisation. It is a critical and unique feature of the Performance Prism.

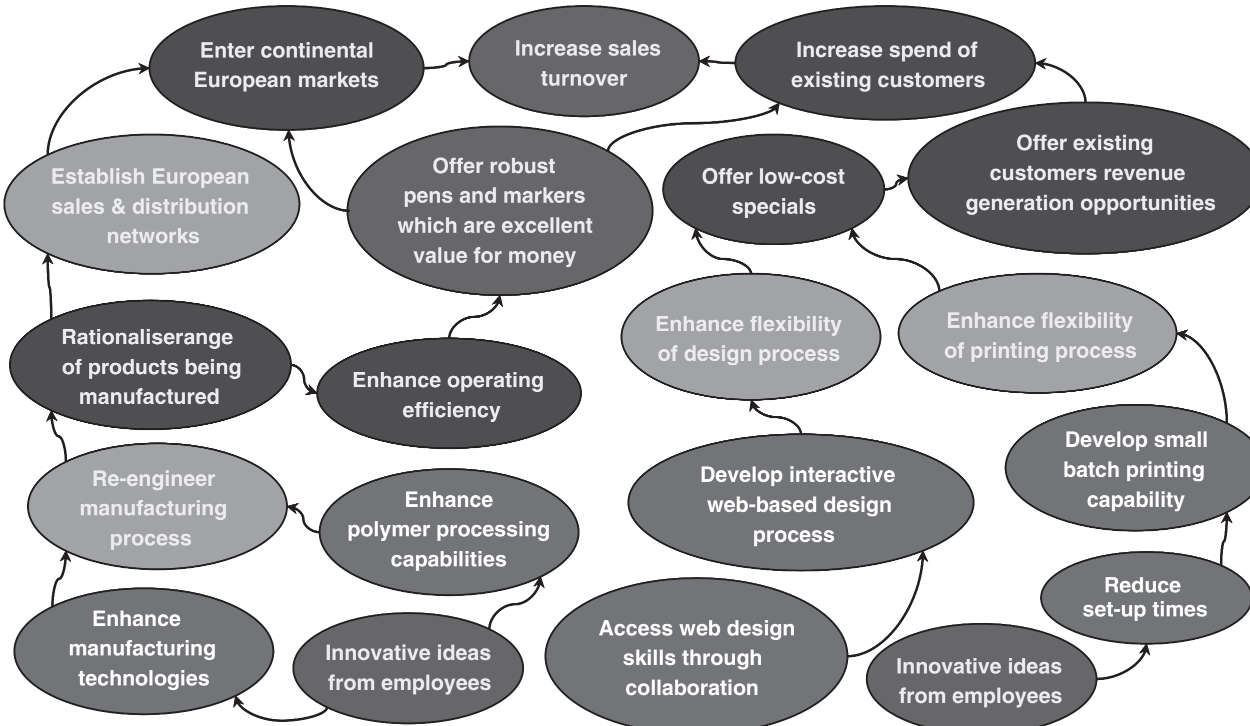
In summary the Performance Prism approach helps build a stakeholder focused measurement system by answering a number of key questions:

- Stakeholder satisfaction. Who are our key stakeholders and what do they want and need?
- Stakeholder contribution. What do we want and need from our stakeholders on a reciprocal basis?
- Strategies. What strategies do we need to put in place to satisfy these twin sets of wants and needs?
- Processes. What processes do we need to put in place to enable us to execute our strategies?
- Capabilities. What capabilities do we need to put in place to allow us to operate and improve these processes?

It should be noted that the Performance Prism is not a prescriptive measurement framework. Instead, the Performance Prism is a framework – a tool – which can be used by management teams to influence their thinking about what the key questions are that they want to address when seeking to design their performance measures and measurement systems, and so manage their business. You get what you measure.

By using this approach organisations can explicitly link the processes that they undertake to the wants and needs of their stakeholders. At this level it is possible to make decision about priorities and objectives for individual activities and processes, and understand how actions at that level will affect stakeholders and their satisfaction.

Figure 5.4: Example of a success map for Writing Inc.



One key issue which needs to be addressed is that not all stakeholders are of equal importance to the success of a given firm. For example, customers are much more important to retailers and employees are more significant for knowledge management firms, such as the computer industry. The working through from success maps to value drivers should allow firms to identify the relative importance of stakeholders to a given firm. However, a full scan of stakeholders will always be necessary.

Figure 5.4 provides an extract from the success map of a pen manufacturer which illustrates how the wants and needs of selected stakeholders, i.e. investors (increased sales turnover) and customers (robust pens and markers which are value for money) are explicitly linked to the drivers that will enable the delivery of these wants and needs. These drivers include the contribution of other stakeholders such as employees which the organisation must work to encourage.

Conclusion

Performance measurement is becoming more complex and yet operational managers need guidance. We argue that boards need to look beyond short term financial metrics to understand what performance means to multiple stakeholders and what this performance means for strategic choices. From this understanding, different performance metrics can be put in place for different business units. Goals in the future will be more than just sales and profit targets – but in the twenty-first century with greater scrutiny and, hopefully, greater accountability, we will be able to reduce the impact of short-term financial game playing both at main boards and by individual managers.

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6

The Sustainability Perspective: a New Governance Model

Antonio Tencati and Francesco Perrini

1 Value creation, stakeholder view and sustainability

A company – that can be defined as an economic and social institution, which aims to produce goods and services (Pivato and Gilardoni, 1997: 387) – pursues the creation of wealth, namely, value. In order to achieve this purpose, the firm cannot ignore the context in which it operates. In fact, a network of relationships connects the company to a great number of interrelated individuals and constituencies, called stakeholders (Ulrich and Krieg, 1973; Freeman, 1984; Donaldson and Preston, 1995; Clarkson, 1995). These relationships influence the way a company is governed and, in turn, are influenced by the company's behaviour.

More in depth, Post, Preston and Sachs (2002: 9) emphasise that 'the capacity of a firm to generate sustainable wealth over time, and hence its long-term value, is determined by its relationships with critical stakeholders' and 'any stakeholder relationship may be the most critical one at a particular time or on a particular issue' (Post, Preston and Sachs, 2002: 8). With regard to this point, convincing examples are provided by the protesting and boycotting campaigns carried out by non-governmental organisations (NGOs) against various companies (e.g. Nestlé, General Motors, Levi Strauss and Co., Gap, Shell, Nike, Reebok, McDonald's, Monsanto, Danone, Triumph, Del Monte, Starbucks, Coca Cola, the Big Pharmas, Microsoft) operating in different industries and countries (Vanderbilt, 1998; Klein, 2000; Hertz, 2001; Bandura, Caprara and Zsolnai, 2002). These firms changed their strategic choices under the pressure of specific stakeholder groups and the lack of an early recognition of their requirements brought in some cases harmful consequences for the company reputation and the business development.

If the entire set of stakeholder relationships becomes strategic for the long-term success and survival of a company, shareholder value cannot be considered a sufficient objective and a sufficient measure in order to assess the quality of business management. The concept of extended enterprise

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based on a relational view of the firm focused on stakeholder linkages (Post, Preston and Sachs, 2002) calls for rethinking the nature, purposes and behaviour of companies.

More specifically, a firm can develop over time if it is able to build and maintain sustainable and durable relationships with all the members of its stakeholder network. Therefore, in our point of view, a company creates value when it adopts a managerial approach, which is sustainability-oriented.

According to the definition provided by AccountAbility in 1999, 'sustainability is the capability of an organization to continue its activities indefinitely, having taken due account of their impact on natural, social and human capitals' (AccountAbility, 1999: 94). A *sustainability-oriented company*, that pursues the sustainability objective, is one, which develops over time by taking into consideration the economic, social and environmental dimensions of its processes and performance affecting the quality of stakeholder relationships. In this kind of firm economic and competitive success, social legitimacy and efficient use of natural resources are intertwined according to a synergetic and circular view of the company's aims. In this perspective, value creation processes are broad and shared and ensure that a company will develop and survive in the long run by fulfilling, in different ways, the requirements of its stakeholders which provide the resources the firm needs to manage its operations. For this reason it is possible to make a shift in the generally adopted notion of value (wealth) and introduce the concept of *stakeholder value* (Figge and Schaltegger, 2000).

Therefore, sustainability and the related stakeholder view of the firm are at the basis of a new governance model which informs a company's activities and its relations. In the traditional and still dominant paradigm, management choices were guided by interests of only a part, i.e. shareholders and investors in general. Nowadays and more and more in the future, sustainability, i.e. the quality of stakeholder relationships, must be the guiding principle for the managerial decision-making process and the pillar of a more correct and suitable corporate strategy.

This is not only a normative approach. Many examples, in Italy too, show that it is possible to achieve positive financial and competitive performance through a strong attention to the social relationships and an effective environmental management. For example, social capital is at the basis of the long-term success of many Italian districts (e.g. in the ceramic tile industry: Porter, 1990: 210–25; Jarboe, 2001: 8–9) and organisation, such as Ferrari (Lipparini, 2002: 163–200) or Coop (see Box 6.1), the first retailing group in Italy, or many local public utilities companies (see Box 6.2), play a meaningful role for the development of local communities through important processes of wealth creation and distribution.

Box 6.1: The role of Coop in Italian society

Coop is the largest Italian retail chain, with more than a 17% market share in the grocery market. It is owned by 5,300,000 members, grouped in around 175 territorial consumers' cooperative societies. The retail network is constituted by 1,280 points of sale, accounting 1,320,000 square metres and around 50,000 employees. The 2003 turnover was more than 11,000 million Euros. This dominance on the market is supported and strengthened by Coop efforts towards sustainability along its entire stakeholder network.

In particular, Coop has built and maintains a distinctive positioning on the market thanks to its true and genuine commitment to sustainability. For this purpose, the cooperative organisation has developed a broad set of initiatives:

- since 1991 Coop has released an annual social report on its relationships with the most important stakeholder groups (members, consumers, employees, civil society, cooperative movement). This *Social Balance* is focused on the programmes carried out and the wealth distributed. This report is considered a fundamental tool in supporting the social/societal strategy of the group;
- since December 1998 Coop Italy, the national consortium which realises purchasing, marketing and quality control activities for territorial cooperatives, has been certified according to Social Accountability 8000, the ethical sourcing standard. Coop Italy was the first European company to obtain SA 8000 certification. It first adopted SA 8000 internally and subsequently involved all the suppliers of Coop labelled products (about 300 all over the world) in the project focused on the protection of workers' rights. Also thanks to the Coop's intervention Italy has the greatest number of SA 8000 certified facilities in the world (167 out of 572 global certifications, as of 31 December 2004);
- Coop distributes Fair Trade products, organic foods, Eco-labelled products, Forest Stewardship Council (FSC) labelled goods in order to supply the most complete and sustainable range of products on the Italian market;
- since the late Nineties Coop has developed a broad campaign, called Advantages for the Community, aimed at fulfilling specific social needs of the local communities in the fields of education, training, welfare policies. This community programme is based on partnerships among territorial cooperatives, public institutions and NGOs.

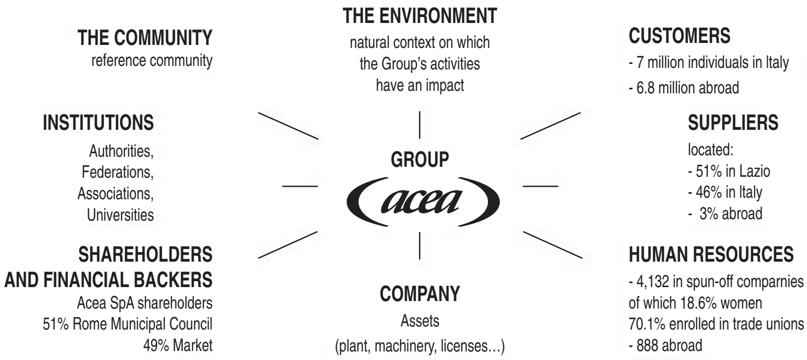
Source: http://www.e-coop.it; Meglioli, 2001.

Interesting and critical managerial implications derive from this sustainability perspective. In fact, sustainability especially means:

- strategic importance of intangible assets;
- cooperation (co-responsibility) among companies, public administration and stakeholder groups;
- the need for real stakeholder engagement processes;
- new performance evaluation and reporting systems, focused not only on corporate internal indicators, but also on the level of satisfaction of the stakeholder groups affected by company decisions and actions.

Box 6.2: Acea's processes of wealth creation and distribution

Acea (Azienda Comunale Energia e Ambiente) was incorporated in 1909 as a municipal company serving the municipality of Rome and was subsequently transformed into a joint-stock company in 1998 and then listed on the Milan stock exchange and partially privatised in 1999. Today the Acea Group operates also at international level in the energy and integrated water services sectors. Throughout its evolution it has maintained and strengthened its identity as a company rooted in the community (in particular, the city of Rome), aware of social needs and of the importance of protecting the natural environment. Acea adopts a multi-stakeholder approach: the stakeholder groups identified are presented in the following Figure.



Source: Acea, 2004: 37

Value of production rose 13.36%, from 1,336 million Euros in 2002 to around 1,515 million Euros in 2003. In the same year the Acea Group generated value added amounting to more than 642 million Euros, up with respect to 2002. The value added created has been distributed as follows:

- 37.8% to human resources;
- 11.2% to institutions;
- 17.7% to shareholders and financial backers;
- 33.0% to the company;
- 0.3% to the community.

The value added is 42% of value of production. Costs related to suppliers, amounting to 950 million Euros, represent 62.7% of value of production, in which costs devoted to the environmental management (around 23.2 million Euros, 1.5% of value of production) are also comprised. Acea's suppliers are mainly located in the Rome area (50%).

Source: Acea, 2004, available at http://www.aceaspa.it

2 Strategic importance of intangible assets

In the twenty-first century world, civil society plays a growing role, consumer models in the most advanced economies evolve towards goods and services which have a strong intangible and symbolic component, public concern and awareness of critical issues, such as environmental emergencies (air pollution, energy consumption, water supply, climate changes, etc.), the protection of employees' rights throughout the supply chain, the role of companies in the communities to which they belong, rules of corporate governance and so on, are widespread and increasing.

As previously underlined, in this world the capability of an organisation to continue its activities and operations over time depends on its stakeholder relationships. Therefore, the main value-drivers for a company are the intangible assets, directly affecting the quality of these relationships. Intangibles refer to information capital (or intellectual capital) and include know-how, brands, trust, reputation, etc. (Vicari, 1995; Pozza, 1999; Ghoshal and Bartlett, 1999; Lev, 2001; Castaldo, 2002). The intangibles can be divided into two categories (Vicari, Bertoli and Busacca, 2000):

- knowledge resources that comprise knowledge, capabilities, skills available in the organisation or in its stakeholder network;
- trust resources that include trust, reputation, image, brand-equity and the overall license to operate, i.e. the social consensus necessary for corporate survival.

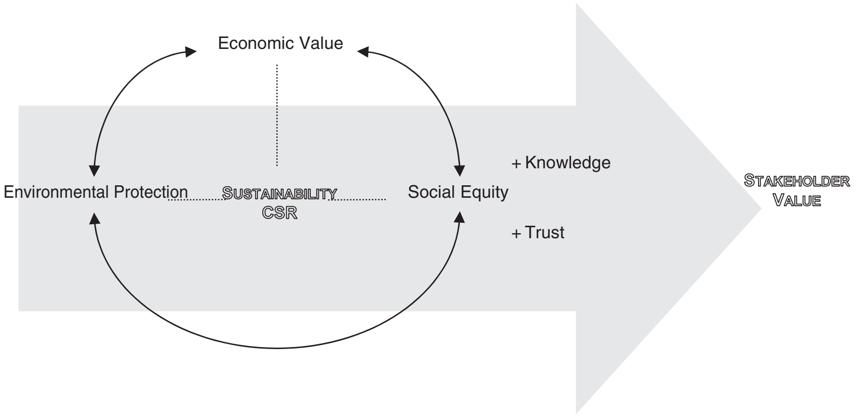
Knowledge could have a great impact on the 'development and maintenance of favorable and productive stakeholder relations' (Post, Preston and Sachs, 2002: 25). A high level of knowledge resources could enable a company to better understand the different stakeholder needs, define innovative solutions in order to meet stakeholder expectations and make sustainable value creation processes. Moreover, if the success of a company depends on the quality of the stakeholder relationships, then the perceptions of the different stakeholder groups become crucial as well, because they have a great influence on the sustainability of the linkages. Therefore, trust is a fundamental element in order to read and understand the dynamics characterising the network of relationships that connects a firm to a great number of interrelated individuals and constituencies.

Thanks to its activities and choices a company creates and enhances (or destroys and reduces) its intangibles. By pursuing, in integrated way, economic, social and environmental objectives a sustainability-oriented company increases its intangible assets of knowledge and trust, which support the processes of value creation. In fact, this kind of company is committed to following an innovative path, which involves all aspects of the firm and its stakeholder network. This allows, on the one hand, to improve management operations (through, for example, cooperative sourcing policies or eco-efficient investments) and, on the other, to make the company's value proposition much more attractive and involving for the entire stakeholder network (through, for example, social- or eco-labelled products or direct interventions in the local community).

Therefore, this type of firm, careful of the expectations coming from the different stakeholder groups and capable of meeting the specific requirements expressed by the various constituencies, develops a well-defined corporate social responsibility (CSR). According to the Commission of the European Communities (2001d and 2002c), 'CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.' Thus, CSR contributes to the sustainability of business in society (European Multi Stakeholder Forum on Corporate Social Responsibility, 2004: 5) by strengthening the linkages with stakeholders thanks to high corporate social and environmental performance (determined by innovative solutions supported by knowledge resources), which impacts the level of trust that individuals and constituencies have in a company and its products. Much stronger is the social commitment demonstrated by the company, much broader is its 'license to operate' (that means increasing of trust resources). Thus, the sustainability-oriented company is also a responsive one (see Figure 6.1).

The stakeholder value created by a sustainability-oriented and responsive company makes it possible to reward, in specific and appropriate ways, the different stakeholders who contribute resources. Sustainability therefore becomes the strategic objective not only of socio-economic systems but also of companies, which aim to pursue long-term economic develop-

Figure 6.1: Corporate goals, intangibles and value creation in a sustainability-oriented and responsive company



ment, consistent with promoting social cohesion and protecting the environment (Commission of the European Communities, 2004: 5). In this way, a firm manages with success and improves the quality of its stakeholder relationships.

3 Cooperation

Sustainability needs innovative solutions: instead of the traditional approaches based on competition and zero- or even negative sum games it is crucial to foster cooperation and collaborative networks also designed according to biological system-based models (Kelly, 1994). 'One of the most compelling ways to help firms succeed is by increasing the power of the linkages and networks they are part' (Commission on the Private Sector & Development, 2004: 30).

Shared responsibility among public authorities, enterprises and the general public is at the basis of the European strategies for protecting the environment since the early Nineties (European Community, 1993): voluntary programmes, such as EMAS (Eco-Management and Audit Scheme) and Eco-label aimed at promoting environmental innovation with regard to processes and products respectively, were launched by the European Community in that period and are based on this collaborative approach (Commission of the European Communities, 2001a).

In some industrial areas and districts (e.g. in the ceramic tile district of Modena/Reggio Emilia in northern Italy: Assopiastrelle and Snam, 1998; Comitato Promotore, 2002) new relationships among local players have been developed during the last decades in order to reduce the overall impact on the environment through material and energy recovery policies and shared managerial improvements according to an industrial ecology perspective: 'in an industrial ecosystem … the consumption of energy and materials is optimized, waste generation is minimized, and the effluents of one process … serve as the raw material for another process. The industrial ecosystem would function as an analogue of biological ecosystem' (Frosch and Gallopoulos, 1989: 94).

A co-responsibility approach is fundamental to face social problems too. Public–private sector agreements and partnerships should be promoted to support social cohesion and the development of local communities and fight unemployment/underemployment and social exclusion (The Copenhagen Centre, 1998). Various initiatives are implemented, in a collaborative way, by companies, public authorities and NGOs in Europe, for example in the fields of minorities' integration and improvement of employees' work–life balance (The Copenhagen Centre, CSR Europe and International Business Leaders Forum, 2003: 31–33).

More in general, creating effective partnerships among public institutions, enterprises and civil society is the most important instrument to pursue economic growth, poverty eradication and sustainable development, implement Agenda 21 and achieve the internationally agreed development goals (World Summit on Sustainable Development, 2002a, Principle 18; World Summit on Sustainable Development, 2002b: 42–54).

A very interesting example of a partnership based on a system innovation involving public authorities, companies and citizens is provided in Italy by the Conai's experience. Conai (Consorzio Nazionale Imballaggi, i.e. the national compliance scheme for packaging recovery) was instituted in 1997, started operating in 1998 and, through an important process of building durable relationships between local authorities and companies, managed to achieve a well developed recycling/recovering industry, already in line with the new Directive on packaging and packaging waste, adopted by the European Parliament and the Council on 11 February 2004 (Pogutz and Tencati, 2003; Conai, 2004).

4 Effective stakeholder engagement

A collaborative and cooperative approach aimed at supporting sustainability-oriented efforts requires real stakeholder engagement processes. In this enlarged view of the governance model, stakeholders become an essential part of the extended organisation and their role is crucial for a successful strategic management.

With regard to this point, an important case history regards mining companies in Latin America: in that area they are changing their traditional behaviour and are starting to involve in depth communities, NGOs and public authorities in order to define a shared vision of the development and overcome the previous conflicts, which characterised the relationships between international enterprises and local players (Pélouas, 2004).

The current processes of implementation of many local Agendas 21 provide other very good examples of this new view of stakeholder participation in decision-making activities. In fact, local authorities, public institutions, enterprises, NGOs and citizens are involved in a shared framework in order to define, plan and implement new patterns of development affecting a specific territorial area (Sancassiani, 2004). This means that the concepts of sustainability and stakeholder engagement do not work only in the corporate environment but call for an extended implementation in order to identify new governance solutions more suitable for responding to the current complex social needs.

5 New perfomance evaluation and reporting systems

From a view of the firm based on the concepts of stakeholders, sustainability and CSR it is possible to derive the complementary concept of *social accountability,* meaning that the company is held accountable for its actions and its outcomes. Therefore, a sustainability-oriented company must define appropriate systems to measure and control its own behaviour in order to assess whether it is responding to stakeholder concerns effectively and to communicate and demonstrate the results achieved. In particular, these new evaluation and reporting systems should have the purpose of broadening, integrating and improving the traditional financial/economic approaches to the corporate performance measurement, taking into due account the stakeholder concerns and requirements.

During the last decades many social and environmental standards and management solutions were developed: more than a hundred proposals were defined (ISO Advisory Group on Corporate Social Responsibility, 2003). This multiplicity, complexity and the absence of a clear reference framework generate undesired effects among companies and their own stakeholders (Italian Ministry of Labor and Social Affairs, 2003):

- confusion for companies and lack of management and organisational innovation;
- confusion and lack of clarity for the companies' stakeholders.

Thus, there is strong need for a fit and clear framework for a corporate sustainability performance evaluation and reporting system. This methodology should 'go beyond previous work on the "triple bottom line" and "balanced scorecard" ' (Post, Preston and Sachs, 2002: 25) in order to take into account in an explicit and complete way the different relationships which companies develop with their stakeholders.

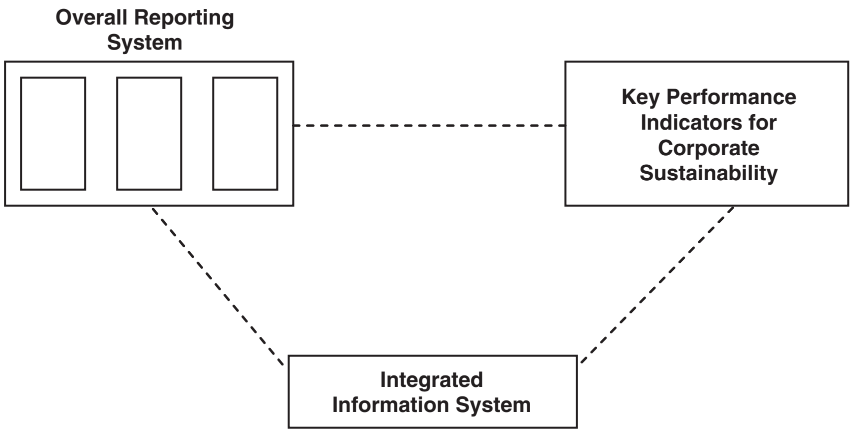
With reference to the balanced scorecard, Paine (2003: 120) points out that some non-financial variables are important on their own terms and not only as means to financial ends and underlines that they may be critical success factors: 'Therefore, managers must care about them for the same reason they care about financial performance–because they are intrinsically important and part of what is expected of leading companies today ... This expanded conception of corporate performance is implicit in the calls for corporate accountability that have become commonplace in recent decades.' With regard to the triple bottom line (TBL), according to Elkington (2004: 16), who coined the concept in 1994, 'the TBL agenda as most people would currently understand it is only the beginning. A much more comprehensive approach will be needed that involves a wide range of stakeholders.' And the Global Reporting Initiative (2002: 9) adds, 'like any simplification of a complex challenge, this definition has its limitations ... Defining sustainability in terms of three separate elements (economic, environmental, and social) can sometimes lead to thinking about each element in isolation rather than in an integrated manner.'

Therefore, it is crucial to work on managerial tools capable of monitoring and tracking from a qualitative and quantitative viewpoint the overall corporate performance according to a stakeholder framework. Furthermore, not only the corporate internal, but also the external performance should be measured. This means that the degree of trust, the stakeholder satisfaction, generated by the overall (economic, social and environmental) strategy developed and implemented by a company, should be carefully evaluated (Zadek, Pruzan and Evans, 1997).

An interesting proposal on this topic – the *Sustainability Evaluation and Reporting System, SERS* – has been defined by SPACE (the Research Centre of Bocconi University on Risk, Security, Occupational Health and Safety, Environment and Crisis Management). This integrated approach derives from theoretical analyses and empirical experiences carried on in almost fifteen years of research activities in the fields of management of sustainability and social, environmental and sustainability performance evaluation and reporting and thanks to the collaboration with companies and institutions (SPACE, 1993; Gilardoni, Pogutz and Tencati, 1995; Pogutz and Tencati, 1997; Tencati, 1999; Tencati, 2002a; Perrini and Tencati, 2003; Tencati, Perrini and Pogutz, 2004; Tencati, 2005).

The SERS proposal aims to aggregate different management tools (e.g. social reporting, environmental reporting, and key performance indicators) into a comprehensive model. The goal is to build an efficient and effective methodology for an overall assessment of corporate sustainability in order to foster and support new accounting and reporting efforts in companies (with a particular focus on SMEs), contribute to the integration between financial and non-financial performance measures, improve the quality of decision-making processes and of the overall business management and strengthen the corporate accountability and responsiveness towards the different stakeholder groups.

Figure 6.2: The Sustainability Evaluation and Reporting System (SERS): the SPACE framework



SERS is composed of three elements (see Figure 6.2):

- the *Overall Reporting System* (or the *Sustainability Reporting System*) which comprises:
  - the Annual Report;
  - the Social Report;
  - the Environmental Report;
  - a Set of Integrated Performance Indicators;
- the Integrated Information System;
- the Key Performance Indicators for Corporate Sustainability.

The SERS' three elements are organised as follows:

- the *Overall Reporting System* is composed of the annual report, that includes the profit and loss account, the balance sheet and the statement of cash flows; the social report, that includes the ethical policy, the value-added statement and the analysis of stakeholder relationships; the environmental report, that includes energy and materials accounting and environmental (monetary) accounting. The Sustainability Reporting System allows a company to check and report the annual overall corporate performance. It is a fundamental tool in meeting the information needs coming from different stakeholder groups and affecting the concept of corporate social accountability. Thus, in order to achieve a more complete view of the business behaviour, a company should also define and present a set of *integrated performance indicators, i.e. cross-cutting indicators* (Global Reporting Initiative, 2002: 45). In general, cross-cutting indicators relate physical and technical quantities to financial ones (e.g. an indicator could relate the total amount of waste generated during the year to the value added);
- the *Integrated Information System* is the core of performance evaluation and reporting processes. Based on the new ICT solutions, such as the Enterprise Resource Planning (ERP) systems, this element enables an organisation to collect, process and share physical/technical and financial data. Programmes to introduce environmental and social accounting systems for the purpose of integrating the existing financial and cost accounting methodologies have to start from this level;
- the *Key Performance Indicators for Corporate Sustainability* are specific indicators developed in relationship with the corporate information requirements. The aim is to provide a tool to continually monitor an organisation's performance trends. Number and types of measures should be defined on the basis of real corporate needs. In this way the *Key Performance Indicators* (KPIs) represent a *Dashboard of Sustainability* (International Institute for Sustainable Development, 2001) suitable for supporting management decision-making processes. Sets of indicators proposed by many organisation, such as the Global Reporting Initiative (2002), the World Business Council for Sustainable Development (2000

and 2003), Eurostat (2001a and 2001b) and the European Environment Agency (2002 and 2003), can be used in drawing up an organisation's specific measurements, but they should not limit corporate choice: every firm should build their own, specific set of indicators capable of providing the necessary information in order to support business management in an effective way. Indicators can focus on the financial, operating, marketing, environmental, social, cross-cutting aspects of business management. Key Performance Indicators are also used in the Overall Reporting System and in order to define them the company should carry on stakeholder engagement activities.

These Key Performance Indicators are the crucial element of the SERS methodology. A small or medium company could not have sufficient time and resources to define a long and complicated Sustainability Reporting System. But this kind of firm certainly needs a map for an ongoing assessment of its performance and of the related quality (degree of sustainability) of the relationships with its stakeholders. This map is really provided by a set of KPIs. And this consistent and clear dashboard of sustainability could also be used as a fundamental tool to communicate the information required by the different stakeholder groups. Therefore, this set of indicators must be the result of a process of stakeholder engagement, involving the different constituencies in the KPIs definition. And, in line with the adopted stakeholder view of the firm and the sustainability concept, the key performance indicators should be organised according to a stakeholder framework (see Box 6.3).

Box 6.3: The Italian CSR–SC Project

One of the most important initiatives carried on during the last years in Italy in the field of CSR-related initiatives has been the project called Corporate Social Responsibility–Social Commitment (CSR–SC), launched by the Italian Ministry of Labour and Social Affairs in June 2002. Bocconi University was involved by the Italian Government as a technical partner to support the Ministry' team in the definition of the CSR–SC project. The main aims that the CSR–SC Project pursues are as follows:

- promoting a CSR culture among companies;
- defining a simple and modular tool that firms can adopt on voluntary basis in order to identify socially responsible behaviour;
- proposing a list of relevant performance indicators to measure the social performance of companies;
- guaranteeing citizens that the reporting of corporate social commitment by companies is true and not misleading.

Common elements of the proposal presented during the Third European Conference on Corporate Social Responsibility held in Venice on 14 November 2003 are the following:

- a voluntary approach;
- corporate self-assessment:
- no traditional certification mechanisms;
- a set of performance indicators.

In particular, a set of performance indicators and a system of guidelines are provided in order to support companies in the self-assessment of their own social performance and in its reporting through an innovative tool called Social Statement. The Ministry of Labour and Social Affairs' proposal organises the indicators according to a three-level framework (Global Reporting Initiative, 2002: 36–37):

- Categories: stakeholder groups which are specifically affected by clusters of indicators;
- Aspects: thematic areas monitored by groups of performance indicators related to a given category of stakeholders;
- Indicators: measurements that supply information related to a given aspect. They can be used to check and demonstrate organisational performance. The information can be qualitative, quantitative (physical and technical) or economic-monetary.

The stakeholder categories identified are as follows:

- Human Resources;
- Members/Shareholders, Financial Community;
- Clients;
- Suppliers;
- Financial Partners;
- Government, Local Authorities and Public Administration;
- Community;
- Environment.

Source: Tencati, Perrini and Pogutz, 2004.

This type of structure allows a company to focus on the relationships and the related performance, which firms, and especially SMEs, develop through their activities and behaviour.

6 Conclusions

According to Elkington, there is a 'growing recognition that sustainable development will require profound changes in the governance of corporations and in the whole process of globalization, putting a renewed focus on government and civil society' (Elkington, 2004: 7). And Zsolnai adds: 'If we want to sustain capitalism we have to create a less violent, more caring form of it' (Zsolnai, 2002: 7).

The current patterns of production and consumption are unsustainable from economic, social and environmental viewpoints. To change the course we need a deep transformation in the governance models, starting from the company level.

With regard to this point, we must recognise that the quality of stakeholder relationships is crucial for the long-term development of the firm. The capacity of a firm to generate and distribute sustainable wealth over time is linked to strong and synergetic relationships with its stakeholders. In this perspective, an enterprise must look beyond mere financial performance and fully include the social and environmental aspects of its activities. Therefore, sustainability becomes the ultimate corporate purpose in a stakeholder perspective. Sustainability, namely, the capacity to continue operating over a long period of time, is the result of an integrated vision. It requires changes in the nature, purposes, behaviour and organisation of a company:

- the success of managerial efforts must not be measured according to a shareholder perspective, but should adopt a more holistic and comprehensive stakeholder value approach;
- if stakeholder relations are at the basis of the capability of a company to continue its operations over time, then intangible assets in terms of knowledge and trust resources, directly affecting the quality of these linkages, are the main value-drivers for a firm;
- every company is not a monad, but a vital part of a network: system thinking and innovation and new cooperative approaches are needed instead of zero-sum behaviour. Therefore, radical and involving processes of stakeholder engagement should be supported by companies in order to improve and strengthen their intangibles and their license to operate;
- stakeholder engagement implies accountability and accountability implies new corporate performance evaluation and reporting systems. One of the keys for a successful strategic management is the availability of tools capable of monitoring and tracking from a qualitative and quantitative viewpoint the overall corporate performance and, in particular, the state, i.e. the sustainability of the different stakeholder relationships. Therefore, there is an urgent need for new systems of measuring the corporate outcomes according to a stakeholder framework.

Every of these steps means a deep challenge to current, prevailing trends: however, a growing number of players (companies, citizens, public authorities) are recognising that sustainability and responsibility are the pillars of our long-term wealth and are already working to achieve these goals, demonstrating that new economic, social, environmental, institutional and cultural patterns are possible and needed.

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7
The Role of Governments in Fostering CSR

Laura Albareda, Tamyko Ysa, Josep M. Lozano and Heike Roscher
ESADE,[1] University Ramon Llull

The purpose of this paper[2] is to analyse differences in the approaches of European government policies in the light of their ideals, and four different models of government action are put forward. Our proposal's theoretical coherence stems from the fact that CSR is not a new and isolated item for inclusion on the political agenda. On the contrary, it forms part of the current debate on the role of companies in society, clearly shaping the current challenges to the welfare state and its governance, and the socio-economic development of each country. This initial hypothesis has been given a relational reading that emphasises the strategy of dialogue and collaboration between company, government and the organs of civil society.

Today, CSR is already present on the political agendas of most European and other governments. An important social challenge facing all these governments is to provide a response to the new role of companies in economic development, with the social and environmental problems this entails. Furthermore, the European Commission expects these national policies on CSR to tie in with both community policies and international codes and standards. Many European governments have started to develop and design actions and policies on and around CSR. In general, they have preferred not to introduce compulsory CSR policies as such. They have chosen instead to work towards the furthering and facilitating of CSR, developing common standards and information practices on the subject, together with spaces for dialogue and partnership. The role of governments and public administrations in this process is both fundamental and irreplaceable. As Aaronson and Reeves (2002) have recalled, these policies can contribute to greater clarity and awareness when examining the large number of voluntary approaches taken by the corporate sector over recent years.

Fundamental in the European context are the European Commission's Green Book 'Promoting a European framework for corporate social responsibility' and its later Communication 'Corporate social responsibility: a business contribution to sustainable development',[3] which have become points of reference in any approach to this issue.[4] The European Com-

A. Kakabadse et al. (eds.), *Corporate Social Responsibility*

mission defines CSR as 'the voluntary integration of social and environmental considerations into business operations and in the interaction with their stakeholders' (European Commission, 2001). The Commission concentrates on two aspects of this integration: what it involves, and how it is to be effected. On the first question, it emphasises that companies must assume social and environmental commitments in their actions. On the second, they opt for the voluntary approach. Debates on CSR make it increasingly clear that, in a globalised world, we are seeing the appearance not only of competing versions of products and services, but also of models for companies and their management, and even for countries.

The concept of CSR is linked to problems raised by economic globalisation and its effect on challenges among which are: crisis and change in the welfare state (Midttun, 2004); new forms of governance (Moon, 2002, 2004); society, corporate and government relationships (Gribben et al., 2001); new corporate imperatives and new social demands (Zadek, 2001).[5] This approach postulates that the social governance of our interdependent world requires a series of developments. It requires a new vision of how companies contribute to society, a new relationship between political and corporate actors, and the ability to reach a shared diagnosis and perspective on the main challenges to our companies that will enable us to contextualise that vision and that relationship.

As Rome has pointed out (2005), every country's approach to CSR encapsulates a series of different elements: political and institutional structure; political style and processes; social structure; emphasis on voluntary approach or acceptance of state guidelines and control; local and national views of the role of companies; the role and posture of NGOs and civil associations in society; the kind of educational system and the values it transmits; what is expected of their leaders; and historical traditions. All this means that companies and countries must be increasingly aware of the need to formulate their own approach to CSR. CSR does not now simply affect relationships between company and society. It has become a way of rethinking the role of companies in society that takes governance and sustainability as its core values.

To represent thinking on what governments can do to drive CSR as a dilemma on the pros and cons of legislation is to take an essentially impoverished and sterile line. Legislation is only one element among many, and in many cases not even the most useful or important. What is required is an overall political framework. We should be asking what needs to be done to promote and encourage increasingly responsible and sustainable companies and organisations. Does a discourse on CSR based on political institutions make sense? We believe it does. Particularly if we take as reference for any discussion the two key words appearing in the subtitles of the European Commission documents: promoting (from the perspective of political institutions), and contribution (by the corporate sector). This

Figure 7.1: Initiatives in CSR

		Government	
		Absence of strategy	Encouragement of CSR
Company	Absence of strategy	Lack of initiatives	One-way public initiatives on control
	Development of frameworks for CSR	Individual corporate initiatives	Shared vision, public initiatives to facilitate and combine resources (dialogues, partnership and networks)

directly links a commitment to CSR with a commitment to corporate excellence, quality, continuous improvement, innovation, differentiation, competitiveness and internationalisation. This is an issue on which neither companies nor governments alone can hope to succeed. On the contrary, success will only come from a growing capacity to bring their individual institutional expertise to bear in a joint approach to the development of CSR (see Figure 7.1).

The governance of our complex societies will be impossible if we cannot turn the sense of responsibility of their many actors into a sense of co-responsibility. This is where recognition of the political dimension of CSR development comes in. For the issue of CSR and the role of the company in society does not ask companies to stop being companies, or to take on functions to which they are not suited (or for which they have no legal remit). It simply asks them to be fully and wholly companies, but companies for the twenty-first century.

Diversity of public sector roles on CSR

Related to the roles of government in developing CSR, are the approaches of Fox et al. (2002), published by the World Bank. The authors postulate four possible roles for the public sector: *mandating, facilitating, partnering* and *endorsing*. Figure 7.2 gives us an overall vision based on a combination of initiatives and roles.

Other later documents (Lepoutre et al., 2004) also present a review of the roles of governments in the CSR debate. Their analysis reviews strategic roles to be played by government managing institutional uncertainty

Figure 7.2: Public sector roles

		Public sector activities		
Public sector roles	Mandating	'Command and control' legislation	Regulators and inspectorates	Legal and fiscal penalties and rewards
	Facilitating	'Enabling' legislation	Creating incentives	Capacity building
		Funding support	Raising awareness	Stimulating markets
	Partnering	Combining resources	Stakeholder engagement	Dialogue
	Endorsing	Political support		Publicity and praise

Source: Fox, Ward, and Howard (2002)

(activate, orchestrate and modulate) and present common tools of public action managing strategic uncertainty (public information campaigns, organisational reporting, labelling, contracts, agreements and incentives). And Nidasio (2004) focuses on comparing the framework models for reportings developed by four European governments: Italy, Belgium, the Netherlands and France. Theories on CSR frequently now include a global overview of its contribution to governance.[6]

European government actions on CSR: a comparative analysis

Our research aimed to carry out a comparative analysis on public sector activities adopted by European governments in the application and promotion of CSR at the national level. We therefore analysed programmes and policies by EU-15 governments. Our conclusion is that there are several different models for approaching CSR in public policies. Each country takes the line on CSR in social or environmental issues that best suits its welfare state, based on existing relationships between company, government and society.

Our reading assumes that planning and implementing public policies on CSR now goes beyond the traditional relationship of government action (public administrations) with the private sector (companies). It includes all the social actors: public sector, private sector, society, and most importantly the intersections between these, in relational collaboratives. For a broader and less dualist view on the issue, we worked from a relational model proposed by Mendoza (1991, 1996). Mendoza's analytical model focuses particularly on the interrelation, collaboration and partnership between the different actors: companies, governments and society.

Thus, we analysed three different levels of government action on CSR, with each level incorporating the earlier one. Our initial analysis dealt with the *issues and instruments* used by governments in their initiatives for promoting CSR. This involved researching each country and building a database on the issues, policies and instruments applied by governments in promoting CSR. The second level consisted of looking at *stakeholders and contexts*. This perspective considered the relationships between actors involved, and any interrelationships and co-responsibilities created. It required a study of the environment, cultural context and socio-economic tradition of the country in which the government frame for CSR had evolved. Thirdly, for a more systematic and dynamic analysis, we also covered *strategic and relational aspects*, the models for the conception and development of the CSR discourse and the design of public policies.

The application of the relational model to public policies on CSR gave us an overview of government action, taking into account both actors involved and their contexts:

- Profiles and models for action adopted by the governments.
- Public programmes and policies.
- Discourses compiled by governments on the CSR concept, including the dissemination, means and organisations used.
- Incorporation of CSR into the organisational structure.

This allows us to examine how CSR policy was assimilated into government structures and public policies.[7]

This information was grouped by country and incorporated in a specific report by each country analysed.[8] If we cross the available information on the profile of each country with the relational model applied to public policies on CSR, we are able to build up the map of public policies and the corresponding programmes for development of CSR. Under this perspective the thematic and instrumental approaches are fully integrated in an strategic-relational approach. We then asked ourselves whether any of these elements define models for action.

Models for public policies on CSR in Europe

Applying this relational and strategic approach let us use these profiles to analyse government initiatives. Our analysis concludes with the identification among the EU-15 countries of four models for government action in the development of public policies promoting CSR.[9] As a result, a denomination is suggested that offers a key to interpret each model, indicating its dominant, but not exclusive, perspective.

The partnership model

We use the title 'partnership' to refer to the form of designing and implementing public policies on CSR in the Nordic and Scandinavian countries (Denmark, Sweden and Finland), to which we have added the Netherlands.[10] These countries have considerable experience in environmental management, which now also incorporates the CSR component. They also enjoy a tradition that historically favours social negotiation, in which relationships between government and company are seen as positive, and which includes aspects of cooperation. The Nordic model, linked to a long tradition of preference for cooperative agreements and consensus between different types of organisation, is largely characterised by the use of partnership as a tool, and by the creation of a shared area of welfare. In essence, the impetus here towards the adoption of public–private partnerships could be seen as the heir of Scandinavian political culture, in which research work always highlights cooperation, consensus and participation (Greve, 2003).

Under the political tradition of most Nordic countries over the last century, social problems form part of the basic competences of governments and, as such, are considered amongst the basic issues that their policies must resolve (Rosdahl, 2001). With such values underpinning their political-social philosophy, these countries have during the course of the twentieth century developed an extensive and comprehensive welfare state. Within this framework, since the 1950s their social policies have been directed towards improving social provision and services. Furthermore, during the final decade of the twentieth century, these governments began to acknowledge the importance of economic actors, above all of companies, in combating and resolving social problems. It is therefore safe to say that for governments identifying with this model, the movement towards CSR mainly involves a change in attitude by their social actors (companies, trade unions and social organisations), assuming co-responsibility in the building of a more inclusive society, and a dynamic and integrated employment market. For these governments, all actors are jointly committed to building new policies and actions on CSR that will favour the growth of a fairer society.

Apart from this, for many companies already involved in the social context, being socially responsible is simply inherent to their way of doing business. Social initiatives are often implemented informally or implicitly, as a response to local expectations and demand (Morsing, 2005). National contexts define a framework where public and private actors are directly involved in the process of creating public policies and establishing partnership for social responsibility. Partnership is seen as an innovative and sometimes even a key tool for resolving difficult social problems (Hardis, 2003). Local governments, responsible for channelling the formation of such partnership, are also heavily involved, thus furthering the idea of social co-responsibility between administrations, companies and social organisations. Encouraging partnerships has thus become central to public policies endorsing CSR in these countries. In fact, in the Danish context, intersectoral local partnerships practically incorporate the concept of CSR (Nidasio, 2004). Finland, Sweden and the Netherlands all gave national responses to the Green Book.

One of the policies common to all these countries is an insistence that companies provide adequate CSR information, respecting principles of transparency on social issues. It is consumers themselves who place most emphasis on socially responsible production. In the Netherlands, for example, labels are used to avoid confusion. Another differential factor in this model is that their authorities assume that they must lead by example. For instance, particularly in public tenders, every effort is made to promote the use of goods or services produced in a socially responsible manner. In short, public policies on CSR are seen as part of the normal frame for social and employment practices. There is a very considerable commitment by local governments who act as the channels for the formation of partnerships, favouring the concept of social co-responsibility between administrations, company and social organisations.

The business in the community model

In this model we have included the English-speaking countries: the United Kingdom and Ireland. The 'business in the community' concept refers to the way these governments and companies interpret the role of the company in society, in particular as regards social challenges and its role in community development. The British government has been one of the most innovative in the development of a political CSR framework. It links CSR with the main challenges in societal governance faced by developed countries (DTI, 2001, 2003a, 2003b).

CSR first saw the light in the United Kingdom and Ireland during the final decades of the twentieth century, as a response to a deficit in social governance when the economies of all industrialised countries suffered an economic crisis, closing companies and causing serious problems of social exclusion (Moon, 2004). Both societies had to deal with severe problems of social exclusion and growing poverty in both urban and rural settings, coupled with environmental degradation. The crisis also affected the welfare state, as could be seen in the decline of the social services offered by public administrations. These governments began to look for innovative solutions to these problems in the involvement of all social actors, above all companies. They began to create corporate networks and public–private partnership projects to strengthen CSR. Firms were soon involved in social projects that invested in the community.

The concept of 'business in the community' arose from the idea that companies have a fundamental role in the economic development of the community in which they are located, and in combating social exclusion and poverty. In the United Kingdom and Ireland, it is now commonplace for governments and companies to use concepts like 'investment in the community', 'involvement in the community', 'regeneration strategies for less favoured areas' and 'commitment to the community' to define their contribution to social and community development.

The idea of corporate responsibility was first seen in the contribution of companies to sustainable development through new public social governance policies (Moon, 2004). In terms of corporate management, government posture is one of voluntary involvement in CSR. Companies bring CSR initiatives into commercial practices and corporate management on a voluntary basis, quite apart from any legal requirements. However, particularly in the United Kingdom, the government adopts what is known as 'soft intervention' to drive and endorse corporate action in CSR areas.

In both the United Kingdom and Ireland, government action is conceived as developing, facilitating and providing incentives for CSR, as well as encouraging public–private partnership. In their role as facilitators, they seek mechanisms that provide incentives, whether through so-called 'soft regulation' to encourage corporate CSR actions, or through tax measures. Another important idea in these countries as regards CSR is the building of partnership projects for the public and private sectors, either together or with the third sector. This allows a joint assault on problems linked to social exclusion, poverty, lack of social services and quality of life in economically less favoured areas. Companies collaborate in partnership projects with local governments in staff training, company creation and investment in less fortunate urban or rural areas.

To sum up, under this model government actions on CSR focus on providing support to the private sector, facilitating economic and sustainable development and economic regeneration, with the support and collaboration of the private sector. These countries deal with social problems like unemployment and social exclusion through CSR policies involving their companies, a response to a crisis of governance, and in which governments try to create spaces for corporate action. Finally, governments base their application of CSR measures on 'soft regulation'.

The sustainability and citizenship model

The *sustainability and citizenship model* tackles CSR from a focused perspective, above all through companies considered as 'good citizens'. The countries explored in this model of CSR – Germany, France, Austria, Belgium and Luxembourg – usually have experience in sustainable development policies, and their governments began moving towards CSR after the publication of the European Commission Green Book. This experience, essentially based on the 1990s, views CSR initiatives as part of long-term sustainability.

The concept of 'corporate citizenship' holds that companies must not only be good citizens through transparency of activities and compliance with tax obligations, but must go further. It also refers to the company's obligation to maintain a direct link with its local environment and to contribute to resolving social problems by partnership with other actors in society. One of the main characteristics of the 'sustainability and citizenship' model is the value it confers on the socially responsible behaviour of companies which undoubtedly contributes to social change. Essentially, the key notion behind this concept is for companies to function as genuine social agents, corporate citizenship being the strategy adopted to support their actions in this sphere. In this model, government action mainly takes the form of encouraging CSR and creating incentives to help companies assume their social responsibility. However, the approach of these governments to CSR may be voluntary, as is the case in Germany, Austria, Belgium and Luxembourg, or may have a greater regulatory component as is the case in France.[11]

The countries forming part of this 'sustainability and citizenship' model generally enjoy relatively sound welfare states that in the 1990s had to withstand the impact of world economic crisis, an increase in social costs and the consequences of population ageing. The concept of 'social market economy' also responds to the same principle, combining as it does economic and personal freedom with social justice, and so including components of social responsibility. Debate on CSR therefore often comes from within companies themselves. They may join forces and create platforms to share experiences to be able to speak with a single voice.

Among the countries included under this model, France deserves special attention. In France, CSR is well established in activities backed by the French government related to sustainable development. So much so that at times such activities appear to be directed by the government, causing a more regulatory approach, in line with the apparently more centralist orientation of the French state.

The Agora model

We use the title *Agora* to refer to the way of implementing and applying public policies on CSR in the Mediterranean countries, including Italy, Spain, Portugal and Greece. These countries have only recently expressed an interest in the issue, largely following the publication of the Green Book and Communication. In 2001 none of their governments took part in EC debates on the Green Book. However from 2002 onwards most began to include CSR initiatives on their political agendas. Although some are still at an emergent stage, others like Italy have already begun to consolidate their CSR project. We have given this model the title of *Agora* because in Mediterranean countries, political application of CSR arose from a series of discussion processes. Governments attempted to engage companies, corporate bodies, universities, social organisations and trade unions with political representatives in working groups debating the actions they were trying to initiate. This method works by seeking a consensus on government action that includes all social voices and viewpoints.

The creation of commissions or working groups using a 'multistakeholder' focus to discuss the concept of CSR and seek consensual solutions on the role the government should play characterises this process in the Mediterranean countries.[12] In short, the *Agora* model allows space for discussion with a certain public dimension. Unlike the EC's European Multistakeholder Forum on CSR, these working groups or commissions are created by governments during initial stages of government action, even before frameworks for action have been defined. The countries in this model generally have less developed welfare states than those in the north of Europe, particularly as regards social services. But like other European countries, they too have suffered the consequences of economic crisis and increased unemployment and social exclusion.

The origin of the CSR discourse in Mediterranean countries must be sought first in the EC and in general in various international initiatives. These include the OECD's guidelines for multinational companies, the Global Compact and sustainability indexes. In parallel, CSR actions were beginning to be endorsed by large multinational companies. In all these

Figure 7.3: Models of government action in the development of public policies for endorsing CSR in the EU-15

Model	Characteristics	Countries
Partnership	Partnership as strategy shared between sectors for meeting socio-employment challenges.	Denmark, Finland, the Netherlands, Sweden.
Business in the community	Soft intervention policies to encourage company involvement in governance challenges affecting the community (entrepreneurship and voluntary service).	Ireland, the United Kingdom.
Sustainability and citizenship	Updated version of the existing social agreement and emphasis on a strategy of sustainable development.	Germany, Austria, Belgium, Luxembourg.
	Regulating.	France.
Agora	Creation of discussion groups for the different social actors to achieve public consensus on CSR.	Italy, Spain, Greece, Portugal.

countries, corporate networks on CSR and research centres committed to CSR have been created, developing and incorporating the concept within the national framework. It is from these CSR networks and organisations that the Mediterranean discourse is being constructed. Issues linked to CSR at least in Spain, Greece and Portugal are mainly social in nature. An important characteristic shared by all these countries in their discourse on CSR is that their corporate fabric is made up of small and medium enterprises (SMEs). One of the most important elements in their strategy is therefore the promotion and development of CSR measures and instruments that include such companies.

Intermediary organisations

The analysis of the various countries and their grouping into models confirms the importance of a series of organisations. These organisations, half-way between administrations and the private sector, oil the wheels of the public–private relationship and provide spaces for dialogue, comprehension, proposals, exchange of opinions, research, and dissemination of best practices and of results. We have called them 'intermediary organisations' because they structure and facilitate communication and contact between the two sectors. Prospects of collaboration between administrations, companies and social organisations are enhanced if the number of intermediary groups dedicated to studying and strengthening these interactions is taken into account. These intermediary groups help encourage various aspects of CSR activities of this kind, and in addition to their role as facilitators, they also act as pressure or interest groups. There is a whole range of intermediary organisations acting as catalysts and mediators in the definition of CSR, its development and the implementation of public policies on the subject. There are multilateral programmes and round tables for discussion; coalitions and associations of companies. And research and training teams currently studying this subject are numerous.

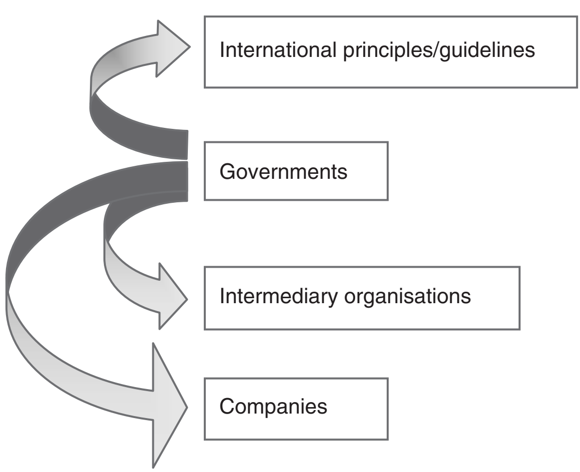
An analysis of some of the most important of these organisations in the EU-15 confirms that they are to be found at three distinct stages of the formulation of public policies on CSR: planning, implementation and evaluation. Intermediary organisations involved at the planning stage wield most influence on the subsequent policy. They shape the determination and definition of the issue, and so the formulation of possible solutions for dealing with issues appearing on the public agenda. In CSR policies, two groups of organisations have been identified in this planning phase: the Institute for Public Policy Research (IPPR) in the United Kingdom and the Unioncamere-Università Bocconi grouping in Italy.

Other countries have opted for essentially focusing collaboration between sectors (public and private) at the implementation stage. Once a government places CSR on its public agenda it has a strategy, and it focuses discussion on its application with and through the other sectors. Collaboration is normally channelled through corporate organisations representing companies and their joint action on CSR. Among these organisations two models can be identified: one concentrating on social debate, the multistakeholder, as in Denmark with The Copenhagen Centre. Another model is based on an organisation in the business sector which assumes these issues. One example here is CSR Austria, with which the government collaborates in carrying out its public policies on CSR. Also at the implementation phase are cases where intermediation is carried out through public bodies. These bodies take on the specific mission of making CSR better known, and strengthening other institutions (public or private) who manage part of its execution. This is so in Germany (its committee for parliamentary study transformed into a civil network for civic commitment), Portugal (its institute for development and inspection of employment conditions) and Ireland (the National Centre for Partnership and Performance).

In the last phase of public policies, evaluation, examples of organisations involved are less numerous. We believe that this is basically for two reasons: the recent origins of public policies on CSR, and in some countries the lack of a tradition of evaluating policies.[13]

Government action is also legitimised and reinforced by approaches established in documents drawn up by international organisations: the OECD guidelines for multinational companies, the ILO conventions, the principles of the Global Compact, and the initiatives of the European Commission, among others. The combination of the influence of and legitimation by international organisations and intermediary actors can be represented in Figure 7.4, which outlines possible fields of government action.

Figure 7.4: Multilevel governance in CSR policies



Beyond the bilateral relationship of government and company

To conclude our research we would like to emphasise the following points. Firstly, the considerable influence on the development of national public policies on CSR of a country's social, cultural and political context. Models of public policies and CSR outlined here corroborate this. Furthermore, any reader familiar with the literature on the evolution of the welfare state in Europe will have detected the similarities between our models of public policies on CSR and other groupings normally found when analysing different forms and experiences of the welfare state. These parallels should come as no surprise, particularly if we then take a closer look at the itinerary of European Commission proposals on development of CSR policies. An in-depth study of the relationship between models of public policies on CSR and models of development of the welfare state has long been overdue. This is essential, and not just for historical or academic reasons. A correct orientation of public policies on CSR will in the long term form a basic element in and symptom of any forthcoming discussions on redefinition of the welfare state.

Secondly, while in some countries CSR policies have been defined in relation to social issues, and an independent public policy created on the issue, in others government action has simply incorporated it into national policies on sustainability. We feel that the latter approach, focusing on sustainability, ties in with environmental traditions and 'green' policies, which group social issues under the concept of sustainable development. Conversely, in other countries the CSR approach ties in with company–society traditions, and relationships between these social actors and collective bargaining policies. Drawing up and designing postures on CSR is therefore not just a matter of concept but a political decision.

Thirdly, there are other elements that must be considered when analysing and developing any government framework for endorsing CSR. CSR must not be seen as divorced from the great political and economic challenges. In fact, it is sometimes presented as a response to and sometimes as the result of the new challenges created by economic globalisation (Crane and Matten, 2004). CSR is thus variously viewed as a response to the crisis of the welfare state (Middtun, 2004), a new model for governance (Middtun, 2004, Moon, 2004) and a framework linked to national competitiveness (Zadek, 2001). We argue that this debate on government action on CSR must not be confined to public policies. Governments must allow it a much wider context, embracing models of governance, the crisis of the welfare state and the new challenges created by the globalised economy. It also forms part of the frame for new relationships between governments, companies and society.

Finally, we would emphasise the importance of intermediary organisations in implementing CSR policies, with two main models. The Copenhagen Centre, whose organisational model is based on public–private cooperation, where government plays a very active role in its creation and subsequent promotion; and CSR Austria, which operates like a corporate organisation, clearly focused on backing the activity of the CSR lobby. If public policies on CSR are to take off, it seems vital to have a group actor who will address these questions on behalf of society, as a valid translator and intermediary between other public and private, profit and non-profit actors; an intermediary between State and company. Sometimes a public organisation may perform this role, usually from a managerial standpoint.

Notes

1. This paper stems from a collaboration between two of the lines of research of ESADE: Institute of Public Management (IDGP) and Institute for the Individual, Corporations and Society (IPES), which is sponsored by the Caixa Sabadell Foundation.
2. This research was possible thanks to the support of the Ministry of Economy and Finance of the Regional Government of Catalonia.
3. In addition, in 2004, the European Commission presented its Final result & recommendations of the European Multistakeholder Forum on CSR (CSR EMS Forum, 2004). This document establishes the recommendations made by the European Multistakeholder Forum on CSR and presented as the programme for future action by governments and the European Commission.
4. When referring to this document, the earlier strategic aim of the European Union, established in the Final Declaration of the Council of Europe in Lisbon (March 2000) is often forgotten: 'to make the economy of the European Union the most competitive and dynamic economy in the world, capable of sustainable economic growth, more and better jobs and greater social cohesion by 2010'.
5. Dominique Bé has spoken of the construction of a new social contract based on the concept of CSR: 'We have seen globalisation and the breakdown of the social pact established after the Second World War, consolidating a new model of social dialogue between workers, firms and governments in the west' (Conference 'Corporate Social Responsibility. A business contribution to sustainable development', ETNOR Foundation, Valencia). Perhaps there is as yet no agreement on this perspective. But the very formalising of the institution helps us appreciate that society requires new instruments of consensus and dialogue if it is to cope with the social and environmental challenges represented by globalisation, and the importance of involving all social actors in this new social dialogue.
6. Along this line, Moon (2004) analyses the CSR policy adopted by the British government when he suggests that it assumed CSR policies in response to a crisis in social governance and legitimacy affecting the country. Midttun (2004) views the development of CSR within the context of changes in the welfare state, based on a comparative analysis of three models. Gribben et al. (2001) present the role of governments in the creation of new models of social partnership to resolve social problems, coordinating with companies, social organisations and

local governments. Guarini & Nidasio (2003) also analyse the role of CSR in public–private partnerships as models of governance. Bendell & Kearins (2004) refer to the political dimension of CSR and its application to company administration and management to meet the demands of society.

7. We have therefore drawn up an index for the analysis of CSR policies that lets us isolate the basic elements in the construction of CSR strategies and their implementation:
   - National public policy on CSR: vision, mission and objectives; what the policy is named as within the country, the origin of the political discourse, the chronological evolution of the policy, the localisation of the discourse and the policy.
   - Government departments assuming liabilities on CSR policies.
   - Institutional and relational support from existing international agreements on CSR: Conventions of the ILO, OECD guidelines for multinational companies, United Nations Global Compact, participation in international bodies on CSR issues.
   - Regulation in its diverse forms. Positioning in the relationship between voluntary action and legislation.
   - Organisational structure for CSR policies: centralised/decentralised, transversal/sectoral, multistakeholder. Creation of new entities.
   - And finally: significant actors in the process, turning points and objectives, environment (socio-economic, political and cultural context, administrative tradition).
8. For further information on the results by each country please view: Lozano, Albareda, Ysa, Roscher, Marcuccio (2005) *Los gobiernos y la responsabilidad social de las empresas. Políticas públicas más allás de la regulación y la voluntariedad*. Barcelona: Granica.
9. Sources of information on government actions are based on the reports and discourses offered by the governments themselves.
10. As Kjaer et al. suggest (2003) on partnership models, we include the Netherlands in this model of CSR due to its policies tendency to adopt co-responsibility and dialogue for construction of alliances with other key actors.
11. The French government defends the premise that CSR forms part of the national strategy of sustainable development, and must be included within normal social policies, incorporating transparency and Socially Responsible Investment (METCS, 2004).
12. In Spain, Greece and Portugal similar processes occur through the creation of expert groups, working committees and forums. The Italian Government has thrown open the dialogue to all intervening actors by creating an Italian multistakeholder forum on CSR. However, in the design of public policy it has had restricted support from the business sector, specifically from the Unione Italiana delle Camere de Commercio, Industria, Artigianato e Agricoltura: Unioncamere (Italian Union of Chambers of Commerce, Industry, Craft and Agriculture), and the Università Bocconi in Milan, commissioned to design and implement the government project on CSR, the CSR-SC project (Unioncamere, 2003).
13. The organisations operating in this phase focus on reporting: on assessment of reports and their improvement, on monitoring for excellence to highlight best practices, as with social labelling in Belgium.

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8

The Global Reporting Initiative in Denmark: Emperor's New Clothes or Useful Reporting Tool?

Jette Steen Knudsen[1]

Introduction

In his 1776 magisterial *An Inquiry Into the Nature and Causes of the Wealth of Nations* Adam Smith argued that personal self-interest combined with 'a certain propensity in human nature … to truck, barter and exchange one thing for another' (Adam Smith 1976: 25) had resulted in the division of labour that according to Smith was the cause of the great improvement at his time of the productive powers of labour. Today the prevailing understanding of the role of business in society has changed. Business operating in less developed countries is increasingly held accountable for the protection of human rights, labour, the environment, etc., and therefore seeks to increase transparency on corporate action with respect to these issues. A range of certificates and auditing procedures has emerged in the name of the triple bottom line and sustainability accounting, which goes beyond financial accounting to include social and environmental performance. Much time, effort and money are spent producing these reports. Are these initiatives useful new reporting tools or are they akin to the emperor's new clothes as part of a corporate image campaign?

With its focus on the Global Reporting Initiative (GRI) in Denmark this chapter explores possible benefits to business and society of non-financial reporting schemes. The chapter is structured in the following manner: Part 1 describes how the business environment has changed. Part 2 evaluates possible benefits and pitfalls due to these new strategies for society, while Part 3 explores pitfalls from a corporate perspective. The use of the GRI in Denmark is examined in Part 4. Finally, Part 5 presents conclusions.

1 A changing business environment

Why do we see an emergence of social reporting? Although the idea of corporations taking on social responsibilities is clearly not new, there is a growing belief that companies should develop policies to tackle the

A. Kakabadse et al. (eds.), *Corporate Social Responsibility*

downsides of expanding international trade and investment (Stiglitz, 2002). An alliance of consumer groups, socially responsible investors, labour unions, environmentalists, human rights activists, church groups, etc., criticises what they see as the negative impact of globalisation evidenced in the behaviour of multinational corporations. They argue that global capitalism is the cause of growing income differences, poverty and exploitation of less developed countries. This new alliance has launched publicity campaigns aimed at firms whose behaviour is perceived to be especially unacceptable: in particular, extractive industries, pharmaceutical multinationals and consumer product producers (Kapstein, 2001). Such an alliance of anti-globalisation non-governmental organisations, labour and church groups played a key role in bringing the WTO negotiations to a halt at the Seattle meeting in November 1999 (Kapstein, 2001; Rugman and Verbeke, 2003). One result of these anti-globalisation sentiments is that '[corporations] hunt for a reconciliation of their profit-making strategies with the welfare of society and they search for ways to steer all parts of the company on a socially engaged course' (Craig Smith 2003: 160).

2 Benefits and pitfalls from a societal perspective

The changing business environment and subsequent new demands on business raise two fundamental questions for society: First, is this new agenda beneficial for society? Second, who should set priorities?

Benefits for society?

Fiscal restraints, weak and inadequate government institutions, etc., constitute key reasons why corporations and non-governmental organisations become involved in solving societal problems, such as protecting the environment and employee rights. From a societal perspective it is beneficial that corporations and civil society participate in solving problems that governments may be unable to handle.

Limits to society: who sets priorities?

A key issue to address from a societal perspective is who gets to set priorities. A core assumption of this paper is that to the greatest extent possible, democratically elected representatives should set the overall priorities concerning corporate responsibility initiatives with respect to the environment, human rights, etc. How else can one ensure that priorities reflect the priorities of the electorate? According to Robert Reich, if a society wants corporate decisions to reflect something more than a mere calculation of what is best for shareholders but is uncomfortable giving corporate officials discretion over how they balance these interests, it has two options. The first is to impose by law procedures through which stakeholders other than investors can participate directly in corporate decisions. However, any system of representation tends to prolong and complicate decision-making. In addition, according to agency theory, stakeholder representatives will only imperfectly reflect the interests of their constituents.

The second option is to rely on government to define a corporation's responsibilities to society (Reich, 1998). In short, governments should have the 'primary job of defining what is to be expected of corporate boards and executives – over and above their basic responsibility to maximize shareholder returns' (Reich, 1998: 15). In conclusion, corporate responsibility initiatives can provide significant benefits, but governments have the primary responsibility for setting key priorities.

3 Benefits and pitfalls from a corporate perspective

First, is this new business environment and subsequent new demands beneficial to companies? Secondly, what are the limits to this new agenda from a corporate perspective?

Benefits for business?

Margolis and Walsh (2000) have evaluated research on the relationship between the performance of corporate social initiatives and their financial performance. The research sample consists of an empirical inquiry into 95 studies published since 1972. When taken as an independent variable corporate social performance is found to have a positive relationship to financial performance in 42 studies (53 per cent), no relationship is found in 19 studies (24 per cent), a negative relationship is found in 4 studies (5 per cent), and a mixed relationship is found in 15 studies (19 per cent).[2] In short, although the evidence is mixed, corporate social performance seems to have a positive impact on financial performance.

Limits to business: the cost of meeting increasing demands?

Companies operating abroad must weigh the advantages of low-cost labour or low-cost inputs from abuse suppliers against problems caused by, for example, negative publicity and consumer protests (Spar, 2000). Furthermore, recent accounting scandals, such as those at Enron, WorldCom and Parmalat, have broken the trust that corporations enjoyed in the booming 1990s.

How much can reasonably be asked from companies? For example, what level of resources can companies be asked to devote to monitoring? The scale of the monitoring task can be huge. Furthermore, monitoring is expensive and time-consuming. Thus, The Gap for example spends $10,000 a year to hire independent monitors for just one factory in El Salvador (Kapstein, 2001).

Furthermore, how do we insure that monitoring standards are reliable? Certainly not all monitoring practices meet this requirement. For example, Dara O'Rourke, a professor at Berkeley, concluded that Ernst and Young's monitoring practices of a Vietnamese Nike subcontractor were deeply flawed (O'Rourke, 1997). These flaws raised serious questions about the legitimacy and competence of accounting firms as independent monitors of labour and environmental issues. O'Rourke proposes two fundamental changes in order to improve monitoring. First, some form of public disclosure is critical to insuring the quality of auditing. Public disclosure would shed light on current conditions in the plants and increase the public's belief that the corporation is making a good-faith effort to improve. Second, a better alternative to accounting firms would be 'local, truly independent monitors who speak the language, can make unannounced visits and enjoy the trust of the ... workforce' (*The New York Times* August 20, 1997 cited in O'Rourke, 1997: 11).

Next, this article examines possible benefits and drawbacks of the GRI for business and society in Denmark.

4 Example: the global reporting initiative in Denmark

In recent years there has been a large increase in the number of companies producing social and environmental reports. Examples include the *ISO 14000* series of standards concerning the environment, the *SA 8000* (*Social Accountability 8000*) concerning conditions in the workplace, and the *AA 1000* (*Accountability 1000*) for the external disclosure and verification of social, ethical and environmental information (Epstein, 2003).

This chapter focuses on the *Global Reporting Initiative* (*GRI*) that was established in 1997 as a joint initiative undertaken by the US NGO Coalition for Environmental Responsible Economies (CERES) and the United Nations Environmental Programme (UNEP). The GRI guidelines are for voluntary use by organisations for reporting on the economic, environmental, and social dimensions of their activities, products and services. The GRI incorporates the active participation of representatives from business, accountancy, investment, environmental, human rights, research and labour organisations from around the world. GRI became independent in 2002 and cooperates with UN Secretary-General Kofi Annan's Global Compact (http://www.globalreporting.org/about/brief.asp accessed 18 March 2005). A pilot set of guidelines (G1) was launched in 2000. During the trial period a number of companies volunteered in testing the guidelines and providing feedback to the GRI organisations. In 2002 the current set of guidelines (G2) was subsequently published.

The current framework consists of a set of core guidelines, the so-called 2002 Sustainability Reporting Guidelines, which are to be used together with the Technical Protocols.[3] In addition, sector supplements have been developed for financial services, autos, tour operators and telecommunications. Additional sector supplements are being prepared including financial services, logistics, mining and metals and public agency.[4] Issue Guidance

Documents concerning HIV/AIDS and public agency have also been prepared. The GRI guidelines constitute a framework for all sorts of organisations. However, the majority of GRI reporters are companies.

The core GRI guidelines contain a set of economic,[5] environmental and social principles and a set of indicators. These three guidelines are for voluntary use and can be implemented in an incrementalist manner. Corporate responsibility is seen as a process and since companies have different reporting capacities, 'one size' is not assumed to fit all. If a company only applies some of the GRI indicators, the company must explain how it uses the guidelines and indicate which indicators are omitted. If an indicator is found by a company to be 'not relevant', the company must explain why this is so. If a company applies the whole framework, it can claim to be reporting 'in accordance' with the GRI.

GRI critics

Danish companies have raised five criticisms against the GRI. First, measurement and calculation of the indicators are unclear. Each company make its own definitions. The calculation of water consumption illustrates how complicated reporting can be.[6] If for example the amount of water used in one company unit is considered to be insignificant, it can then be left out of the calculations, but it is up to the company to decide if water consumption in different units is insignificant or not. Furthermore, if the company rents a location where water and electricity costs are billed jointly, data are not available for each indicator.

Second, some of the indicators are ambiguous. This means, for example, that reporting on ethnic minorities can be difficult. In most European countries including Denmark, it is illegal to register an employee's nationality and ethnic background. But in Denmark a company can send social security numbers to the national public statistical agency (Danmarks Statistik). Subsequently, the company can obtain information concerning the number of employees of ethnic origin. However, the company cannot get such figures from most of its European subsidiaries. Therefore, the company is unable to report in accordance with the GRI, even if it wants to do so. Another ambiguous indicator concerns the freedom of association. China, for example, does not allow free association by law.

Third, the GRI organisation is mainly financed by business. Critics claim that this results in pliancy to business interests and downplays society's interests (Newton, 2004). The GRI retorts that governments are reluctant to pay. And four, the GRI provides standards for reporting and not for performance. There is no control of the listed firms' reports and performance (Newton, 2004: 45). Finally, in many cases the core indicators are 'narrative' indicators describing policies and procedures.

Next, this article examines the use of GRI in Denmark. In spite of Denmark's small population of five million people, Danish firms are responsible for 5 per cent of all triple bottom line reports produced in Europe (Acca & CorporateRegister, 2004). Therefore, we should expect to see GRI reporting well developed in Denmark.

Danish companies and the GRI

Five Danish companies use the GRI guidelines. Four users are large international corporations with many overseas subsidiaries (Danisco, Grundfos, Novo Nordisk and Novozymes). The fifth user is Dansk Standard (Danish Standard Association) which is an organisation with 216 employees, which only operates in Denmark.

Presentation of the five companies and their reports

Four of the five Danish GRI reporters are among Denmark's largest companies in terms of turnover and number of employees and have production sites and sales offices in many countries. The four companies include 1) Danisco, a food, enzyme and ingredients processor; 2) Novozymes, an enzyme producer; 3) Novo Nordisk, a pharmaceutical company; and 4) Grundfos, a mechanical engineering company. Danisco, Novozymes and Novo Nordisk are listed on the stock exchange; Grundfos is a privately owned company. Finally, Dansk Standard is a medium-sized non-profit organisation responsible for standardisation, certification and related activities, which receives an annual state subsidy close to one-third of its turnover.

Their annual reports are very dissimilar with respect to scope, content, structure and style. With the exception of Novozymes the reports are complements to the annual reports. Danisco's sustainability report covers both social and environmental data. Danisco's sustainability report is inspired by the GRI, but is not 'in accordance'.

As a former division of Novo Nordisk, Novozymes shares its early reporting history with Novo Nordisk. In 1993 Novo Nordisk made its first environmental report, and in 1998 it also began to produce a social report. In 1999 the social and environmental reports were merged into a sustainability report. In 2002, Novozymes became the first company in Denmark to merge its sustainability report with its annual report. The company now has one integrated report.

Novo Nordisk is the only Danish company which reports in accordance with the GRI. Novo Nordisk produces a sustainability report that complements the annual report. The 2004 report is more comprehensive than Danisco and Novozymes reports. Novo Nordisk plans to make an integrated report in 2005. The report from Novo Nordisk lists a range of detailed additional indicators, e.g., income tax, environmental tax, share of total purchases per geographical segment and so forth. The discourse in the report has a striking similarity with the discourse of aid and non-profit organisations. The report frequently makes use of terms such as participation, local ownership, inequality, poverty, local capacity building and local experts are used frequently.

Grundfos publishes separate social and environmental reports as supplements to the annual report. Grundfos published its first social report in 2001 and its second social report in 2004. The environmental report covers international activities while the social report focuses on Denmark only.

Dansk Standard publishes a so-called stakeholder report. The company has produced stakeholder reports since 2000. As a former public agency, it has produced ‘company accounts’ since the late 1990s. As a result, Dansk Standard started to produce stakeholder reports in 2000.

Corporate views of the GRI

Corporate views of the GRI differ. Some use the GRI as a source of inspiration, while others view it as the best available reporting tool.

The GRI is a useful source of inspiration

Danisco and Grundfos both use the GRI along with other available reporting standards. Danisco prefers the AA1000, which focuses on stakeholder engagement and management systems. Grundfos prefers the Business Excellence model because of its focus on employees, customers and society. In general, Danisco and Grundfos find the GRI too time-consuming to prepare, but both companies use the GRI as a source of inspiration. Danisco finds that reporting ‘in accordance’ with the GRI will never become a key objective for the company. Other companies in the food ingredients sector do not report in accordance with the GRI either and shareholders do not call for a GRI report. Danisco is far more interested in using the Dow Jones Sustainability Index and the FTSE4Good.

Grundfos finds that the GRI places too much emphasis on accounting indicators. Furthermore, it does not believe that there will be homogenous reporting in the future. Therefore, Grundfos does not see a reason to report ‘in accordance’ with the GRI. Grundfos is not listed on the stock exchange and therefore does not have to produce a report to satisfy investors.

The GRI is the best reporting tool and it anticipates future statutory reporting

Novozymes seeks to report ‘in accordance’ with the GRI and reached this goal in the 2004 report. Like Danisco, Novozymes also uses the AA1000 to manage its stakeholder process, but finds that the GRI constitutes the single best reporting framework for a triple bottom line report. According to Novozymes, it is a myth that the GRI is too complex. Even a company that reports ‘in accordance’ has the right to weed out non-relevant indicators. The GRI complements other frameworks used by Novozymes, e.g., the AA1000. However, because Novozymes produces an integrated report it is a challenge to use the GRI framework along with the IFRS (International Financial Reporting Standards) and the Danish Annual Reporting Act.

In contrast to Danisco and Grundfos, Novozymes is convinced that standardisation and homogeneity in reporting will become an issue of high priority in future. Standardisation is beneficial to both reporters and readers. According to Novozymes, advocates of diversity in reporting may primarily be interested in obtaining lucrative consultancy fees.

Novozymes expects that in the future the GRI will become the foundation of a universally acknowledged reporting standard and that non-financial issues to a still higher degree will become mandatory. If the GRI is to become a success, the presentation of data and figures needs to be streamlined so it resembles financial reporting guidelines. Novozymes expects that government agencies and organisations aiming to create standards for non-financial reporting will use the GRI as point of departure.

The GRI has to gain a foothold

Novo Nordisk uses the GRI, but doubts that the GRI will ever be a success. Novo Nordisk emphasises that the indicators and their calculations have to be defined much more precisely. Novo Nordisk argues that the GRI indicators can seem overwhelming for an international company with activities in many countries that do not already obtain such data.

Novo Nordisk is not interested in funding the development of new guidelines. Novo Nordisk wants to be a GRI stakeholder, not a donor. However, Novo Nordisk appreciates that the GRI organisation needs to develop a long-term strategy to finance its activities in order to become a self-sustaining entity. In the long run goodwill and arbitrary donations constitute an insecure means of subsistence.

The GRI as a standardised guideline helps create a professional report

Dansk Standard used the GRI for the first time in 2003. Dansk Standard plans to continue using the GRI in the future, but has not made a decision as to whether reporting in accordance with the GRI should become a priority. The company has several reasons for choosing GRI as a reporting tool, even if it only is a medium-sized company for whom many indicators are not particularly relevant. The prime reason is that using a standardised reporting framework adds to the professionalism of the report. Furthermore, Dansk Standard employees strongly favour sustainability reporting and their push has been a major driving factor behind Dansk Standard's interest in the GRI.

Is the GRI a label?

In general, the companies do not consider the GRI to be a positive label which helps corporate image building. Before they were asked to participate in an interview for this study, some companies were not even aware that they appeared on the GRI website that lists companies using the GRI guidelines. Danisco was unaware that it had made it onto the list because the firm had not been in touch with the GRI organisation. The company supposes that the GRI organisation found Danisco at the FTSE4Good or

DJSI websites and screened its report to see if Danisco was also a GRI user. Dansk Standard had reported to the GRI organisation that it was a GRI user, but did not know that there was a list of GRI reporters.

According to Novozymes, if the reader of a report knows that the annual report is a GRI report, this will help the reader to know exactly what kind of data to expect. Novo Nordisk states that at the very most appearing on the GRI list constitutes is a kind of co-branding for the company and the GRI organisation. To legitimise its existence the GRI organisation has to prove that companies use the guidelines. To Novo Nordisk it is not particularly important to be on the GRI list. The most important thing is the status of being one of the very first firms to issue a sustainability report. Because of this special status it is also advantageous for the GRI organisation to have Novo Nordisk listed as a GRI user.

Does the GRI change the behaviour of reporting companies?

The companies agree that reporting generally changes company behaviour. The reason is that in order to finalise the report a company has to decide which indicators to report on. Once the company has chosen the relevant indicators, it can start to gather data. The process of gathering data serves as an eye-opener to the company, and often the company will become aware of areas in which performance is not as it should be. This is a step toward influencing the decision-making process in the company, and all companies argue that changes have been made as new indicators have given rise to improvements.

Novozymes and Novo Nordisk already had a long reporting tradition and the GRI has not changed the way they behave or report. If the GRI did not exist, the companies claim that they would be undertaking the same kind of reporting and they would have the same kind of activities and same level of sustainability.

5 Conclusion

What then are the potential benefits to business and society of the GRI? Companies emphasise that the GRI has helped them to identify areas in which reporting can be improved. Most GRI users view the GRI as a source of inspiration. They do not strive to report 'in accordance' with the GRI. However, Danish GRI reporters already had responsible profiles when they started using the GRI. Therefore, it might be more appropriate to say that GRI helps best performers become even better.

However, factors such as the lack of clear enforcement mechanisms as well as corporate self-selection of GRI indicators suggest that societal needs are not necessarily well-served by this framework. From a societal perspective the GRI indicators have a latent role to play. If non-financial reporting continues to grow and possibly even become mandatory, the GRI may become a source of inspiration.

Notes

1. My thanks to Katrine Plesner for research assistance and to Danisco, Dansk Standard, Grundfos, Novo Nordisk and Novozymes for their helpful input.
2. Corporate social performance is treated as a dependent variable, predicted by or causally preceded by financial performance, in 19 of 95 studies. In these studies, the majority of results (68%) point to a positive relationship between corporate financial performance and social performance. The conclusion often drawn from these studies is that firms that make money have the ability to devote resources to social initiatives (Margolis and Walsh, 2000: 10).
3. The technical protocols cover child labour, energy and water. Protocols for health and safety are being prepared at the time of writing.
4. The aim is to provide transparency in public agencies.
5. The economic indicators are wider than traditional corporate financial indicators. Economic indicators also emphasise a company's impact on the economy of society.
6. The author is grateful to Novo Nordisk for pointing out this example.

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9

Social Construction as a Mode of Regulation: Reconstructing CSR in Denmark

Eva Boxenbaum

Introduction

The objective of this paper is to show how social construction operates as a mode of self-regulation for businesses that voluntarily seek to become corporate citizens. Modes of regulation are of much contemporary interest. As the economic context is changing, new ways of regulating business behaviour are emerging. There is much debate, and little consensus, on appropriate business behaviour and acceptable modes of regulation. Regulation tends to be associated with one of two approaches: positive reinforcement of desirable behaviour, or negative reinforcement of undesirable behaviour. The former uses incentives (i.e., a carrot) to reward businesses for good behaviour. The incentives are often financial rewards (e.g., profit) that are seen as the direct or indirect result of good business behaviour. The aim is to encourage good behaviour. Negative reinforcement of undesirable behaviour comes as a punishment (i.e., a stick) for bad behaviour and takes the form of sanctions that are imposed on actors to prevent them from behaving in undesirable ways. For instance, legal sanctions can make it highly undesirable for businesses to act in certain ways. The objective here is to prevent bad behaviour.

These two modes of regulation share two assumptions, namely that regulation is external and that it is relatively easy to define good and bad business behaviour. From a social constructivist perspective, these assumptions are questionable. Regulation can also be internal and good and bad business behaviour can be socially constructed. The central issue is how certain behaviour comes to be seen as respectively good and bad, and how these interpretations become widespread and normalised in society. At a theoretical level, the notion of isomorphism in New Institutional Theory explains the trend towards homogeneity. Isomorphism refers to the claim that businesses within the same organisational field tend to replicate one another as a way to obtain legitimacy (DiMaggio & Powell, 1991). The theory explains the normative, regulatory and cognitive processes that lead to isomorphism

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and to institutional constraints on organisations (DiMaggio & Powell, 1983). In other words, institutions prescribe what is legitimate ('good') behaviour and what is illegitimate ('bad') behaviour. It is therefore important to examine institutions to understand the construction of respectively good and bad business behaviour.

New Institutional Theory explains the relatively widespread consensus on good and bad business behaviour, and accounts for stability and homogeneity. However, the theory says little about how institutions can be altered deliberately and hence be used as a mode of regulation. The theory offers little explanation of institutional change processes. Change is seen as resulting from major events that lead to abrupt changes and a subsequent new equilibrium. Little is known, however, about the change processes that lead from one equilibrium to another. The present analysis is an attempt to show how an institution is deliberately altered in practice.

The case study is an analysis of how a group of Danish business actors changed the existing Danish institution of corporate social responsibility (CSR) following two major abrupt events. The Danish institution of CSR, i.e., a normalised meaning and associated practices, emerged in the period 1994–2001 as the Social Democratic government developed, diffused, and promoted a particular understanding of CSR in Danish society. In 2001, two major events occurred, namely the European Commission's publication of a green paper on corporate social responsibility and the election of a Liberal government in Denmark. This study followed immediately from the two events and examines how an innovative project group, composed of business actors, altered the institutionalised meaning of CSR. The analysis focuses entirely on the cognitive processes at the group level, and leaves aside subsequent cognitive and behavioural changes at a larger societal and institutional scale. The objective is to show how institutional change is a social construction process that operates as a mode of regulation. In the following, I first present the methodology and then turn to a presentation of results. I finally discuss the implications of recognising social construction as an effective mode of self-regulation.

Methodology

At a theoretical level, the analysis builds on New Institutional Theory (DiMaggio & Powell, 1983; 1991; Meyer & Rowan, 1997). New Institutional Theory explains how social institutions generate stability and homogeneity among organisations within the same organisational field (DiMaggio & Powell, 1983, 1991). The theory has devoted much attention to explaining how and why macro-level institutions, formed by the state, the elite, and the professions, constrain and guide organisational behaviour at a micro-level. Relatively little effort has been devoted to studying how and why institutions emerge and change (Hoffman, 1999; Fligstein, 1991; DiMaggio

& Powell, 1991). The objective of this analysis is to identify the process through which institutions are altered.

The empirical object of study is the Danish institution of *corporate social responsibility* (CSR). The analysis looks at how a group of business actors reconstructed the CSR institution following two major events in 2001: a change from a Social Democratic to a Liberal Danish government, and the European Commission's publication of a green paper on CSR. The case study is an innovative project, initiated by business actors, which takes the form of a partnership between two large Danish firms. The project received partial financial support from the European Union for three years and had as its objective to innovate and intensify CSR activities in the business setting. I collected data on this project in its preliminary phases, i.e., at a time when the CSR orientation was being conceived and the CSR activities planned. I observed meetings over a period of six months, analysed working documents written during the same period, and carried out individual interviews with nine key actors in the project. The data collection focused on the cognitive dimension, that is, on the way actors understood and interpreted the notion of CSR.

The unit of analysis is the social mindscape of the innovative project group. Social mindscape refers to the part of human cognition that is neither individual nor universal, but which is social or cultural in nature (Zerubavel, 1997). A social mindscape is similar to notions of collective cognition and cognitive structure, except it highlights the dynamic properties of cognition by implicitly referring to a landscape. This dynamic property is favourable to study cognitive change. The analysis seeks to identify the changing social mindscape of the group. Individual mindscapes never fully overlap (Zerubavel, 1997), but empirical studies show that collective cognition gradually emerges when individuals work together (Langfield-Smith, 1992; Laukkanen, 1994). Since most group members had little previous working experience with each other, the social mindscape of the group formed during the process of working together. It also changed over time as the project developed. The objective was to identify changes in the social mindscape of the group over time.

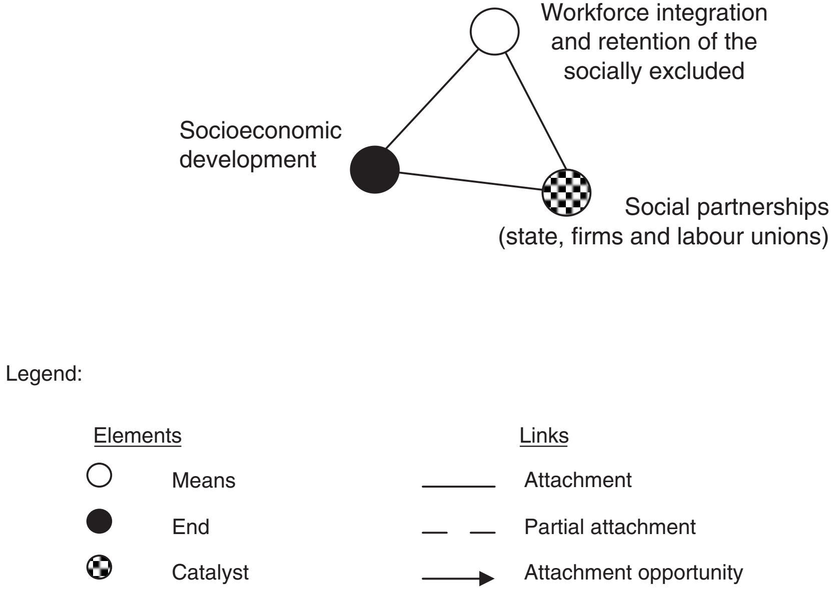
Data analysis consisted in identifying rationalised means–ends designations, which reflect the notion of an institution (Dobbin, 1994). I first identified the CSR institution that the Social Democratic government institutionalised from 1994 to 2001 as it served as an institutional starting point for the project group. I used government policies, law texts, and ministerial web pages as data source for identifying key elements in the CSR institution. The key elements were of three types: means, ends and catalysts. The ends are the stated purposes, while the means are the behaviours and practices that supposedly lead to the stated purpose. The catalysts are the tools that reinforce the link between means and ends. The role of catalysts is to increase the likelihood that the desired behaviour will occur. Having identified the initial institution, I proceeded to identify changes in the mindscape of the innovative project group. I analysed the different data sources, and triangulated them with each other, to identify the most significant new elements and attachments. The result is a simplified step-by-step account of changes to the original CSR institution. I present the changing institution in the form of five consecutive pictures that show the process of change. The five pictures are abstractions, condensations, and selections of the most significant changes in the CSR institution that occurred in the social mindscape of the innovative project group over a period of six months.

Results: reconstructing the institution of CSR

The first picture of the CSR institution (Figure 9.1) is the one that the Social Democratic government in Denmark developed and diffused from 1994 to 2001. The government ran a public campaign on CSR, which called for firms to take part in the social responsibility for the development of the Danish welfare state. Firms were to demonstrate their commitment by hiring and keeping employed individuals who would otherwise be excluded from the labour force. The initiative came from the Ministry of Social Affairs and was a response to demographic predictions that seemed quite unfavourable to the economic well being of the Danish welfare state in the long-term. It was predicted that the year 2000 level of public services could not be maintained in year 2010 unless taxes were increased or the demands on public services and income support were diminished (Ministry of Labour, et al., 2001). The government opted to solve this problem by increasing the active labour force. More citizens on public income support were to join or remain in the labour force, and the government called for Danish firms to take part in this collective responsibility. In particular, firms were requested, as a moral obligation, to hire and retain individuals who were excluded from the labour force due to illness, handicap, lack of work experience, and linguistic or sociocultural barriers (Ministry of Labour, et al., 2001: 21). In analytical terms, the government created a means–ends designation, where workforce integration and retention of non-integrated individuals (the means) were seen as leading to socio-economic development (the end) as pictured in Figure 9.1.

To reinforce this means–end designation, and encourage firms to be socially responsible, the government developed a catalyst in the form of social partnerships between the state, firms and worker unions. The social partnerships consisted of making better interfaces between the three partners' modes of operation. For example, union agreements came to include social clauses that supported the governmental initiative. Government also made financial and practical support available to firms that employed people with reduced work capacity. For instance, the government paid a

Figure 9.1: The traditional Danish CSR institution, 1994–2001



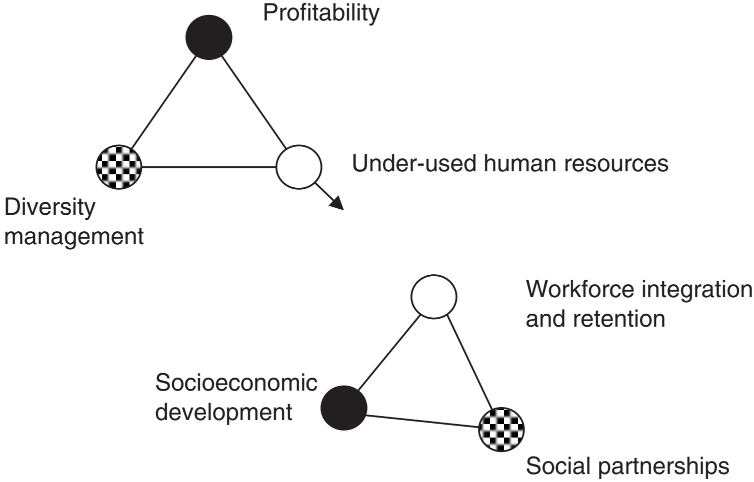
part of employee salaries, under the term *flex jobs*, so that firms were not penalised financially for being socially responsible. These programmes particularly targeted immigrants, refugees, the physically challenged, long-term unemployed, students needing internships, and individuals suffering from long-term sickness. A research programme was initiated to measure the effect of the CSR campaign on firm behaviour over the period of 1998 to 2006 (Kruhøffer & Høgelund, 2001). The government also made legal provision for attaching conditions to public financial support. In a law proposal that took effect in 2001, the government writes that: 'The purpose of this law is to make the labour market more inclusive by allowing public authorities to attach social clauses to financial support. By a social clause is understood initiatives that contribute to prevention, retention and integration in the labour market' [translated from Danish] (Danish Parliament, 17 April 2001). As social partnerships came to be institutionalised in Danish society, the connection between the three elements in Figure 9.1 was cognitively reinforced. The reinforcement resulted in a fairly stable and relatively uncontested CSR institution (Figure 9.1), which was largely synonymous with an *inclusive labour market*.

By 2001, the CSR institution in Figure 9.1 had attained a normative status. It had become an institution. That was until two major events in

2001 raised question about the normative meaning of CSR. The first event occurred in July when the European Commission published a Green Paper on CSR (Commission of European Communities, 2001). This paper presented a much broader conceptualisation of CSR than that institutionalised in Denmark. The integrative labour force was included in this document, but only as one among several dimensions of CSR. The fact that other member states apparently had different or broader understandings of CSR may have provoked a reflection about the actual meaning of CSR. The conclusion drawn from a parliamentary hearing in January 2002 on the Green Paper on CSR shows that the Danish government favoured its own (labour market) definition of CSR over the proposed EU definition as the latter is excessively broad and hence difficult to implement and measure (Danish Parliament, European Committee and Social Committee, 2002). The second event in 2001, which also stimulated reconsideration of the Danish CSR institution, was a change of government in November that year. The Liberal government replaced the former Social Democratic government, which implied more government collaboration with firms than with labour unions. In the months after the election, the Liberal government did not pronounce an official CSR orientation. It was during this time of reflection that the innovative group, consisting of members from two large Danish firms, received funding to prepare a detailed proposal to an EU programme offering partial funding for three years to develop and implement an innovative project related to labour market policy.

The Danish CSR institution was an implicit point of departure for the innovative group. They found it lacking in appeal, however, for managers preoccupied with financial performance. In fact, the traditional Danish CSR institution lacked a clear motivator for firms to act responsibly, other than a moral obligation to the socioeconomic development of Denmark. It is this additional incentive, in the form of the profitability end, that the project group attaches to the CSR institution in Figure 9.2. The profitability end was found in a North American institution with which several group members were familiar from international work experience. The imported institution is a North American HRM model that, much like the Danish CSR institution, consists of an end, a means and a catalyst. The end is firm profitability, while the means is the hiring, promotion and retention of underused human resources. The idea is that certain groups of individuals, particularly women, immigrants, handicapped, youth and natives, do not get an opportunity to use their full potential due to a range of institutionalised social barriers in the work environment. The rationality is that if this hidden human resource potential is found and put to use, and if managers are able to diminish social barriers, then the firm is likely to benefit financially. This rationality is pictured graphically in Figure 9.2, which shows an institution composed of profitability (end), underused human resources (means) and diversity management (catalyst). Diversity management is a

Figure 9.2: Import of a North-American HRM institution

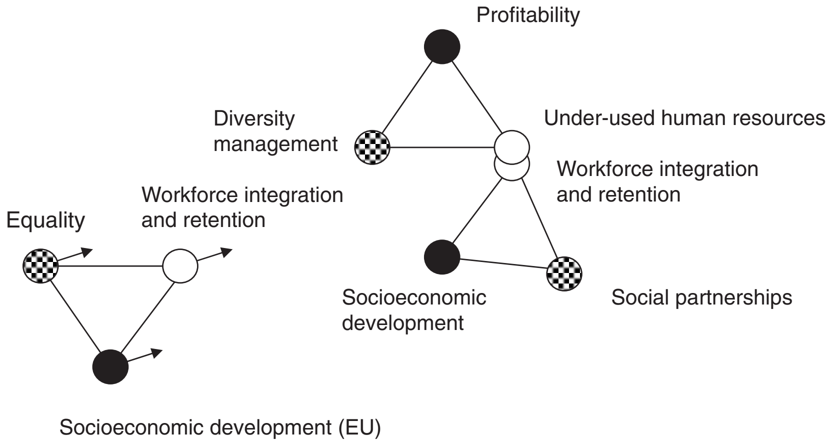


See Figure 1 for legend

management philosophy that favours an egalitarian, accommodating approach to employees, identifies and values individual strengths, generates synergy between complementary skills of different individuals, and gives individual employees an opportunity for personal development.

The group members very familiar with the imported institution introduced it to those who knew less about it. To convince everyone of the underlying rationality of this institution, they presented research results and international practice examples that support this means–end designation. They also invited expert consultants and immigrants to tell the group about their real life experiences. The intention to combine this imported institution with the original one was manifested in an early working document, which states that 'the project must contribute to integrating the goals for diversity management and social responsibility with the firms' particular business strategies' [translated from Danish] (confidential working document from January 2002). After group members endorsed the rationality of the imported institution and the intention to combine it with the CSR institution, the two institutions were implicitly attached to one another (see Figure 9.3). The opportunity for attachment lies in an overlap between the two means. The two means are not identical, but there is significant overlap between them, and it is this overlap that allows the group to merge them. They thus combined the two institutions.

Figure 9.3: Import of an EU institution from the funding source



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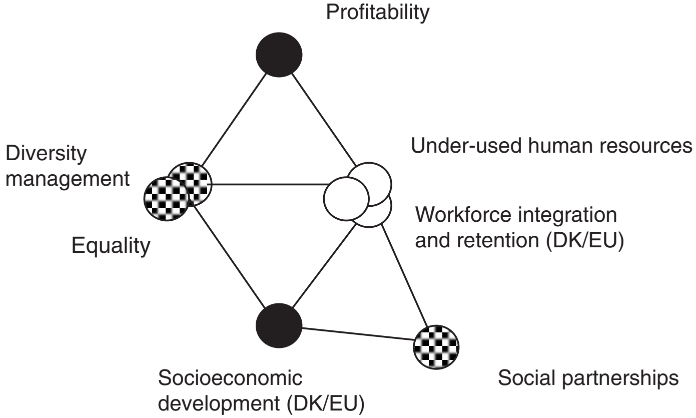
Having now incorporated profitability into the CSR institution, the group turned their attention to developing a detailed proposal for EU funding. The proposal had to meet the criteria of the funding body, which offered 50/50 funding of accepted projects. Minimal conditions were that the project is innovative, aligned with EU labour market policy, and structured as a partnership between several Danish and European firms. But the funding body also carried an implicit means–ends designation: the rationality for offering financial support to European businesses. This rationality is pictured in the new institution appearing in Figure 9.3. It consists of an ultimate goal of making Europe the most competitive knowledge economy in the world by year 2010. In Lisbon in 2000, European leaders agreed to make this the goal for Europe. Socioeconomic development is an obvious precondition and was seen as an intermediary goal for reaching the ultimate one. It is the intermediary goal of socioeconomic development that appears in the new institution in Figure 9.3. The rationality further states that socioeconomic development can only be achieved if as many people as possible are integrated and retained in the active workforce; hence the means of workforce integration and retention in Figure 9.3. Finally, equality is seen as the catalyst for this process. According to the funding source, equality refers to egalitarian, non-discriminatory treatment of all workers and potential workers, no matter their handicap, gender, age or ethnicity. The EU institution resembles the original Danish one in some regards. This is no surprise since Denmark is part of the EU and has contributed to EU

Figure 9.4: Integration of three institutions



See Figure 9. 1 for legend

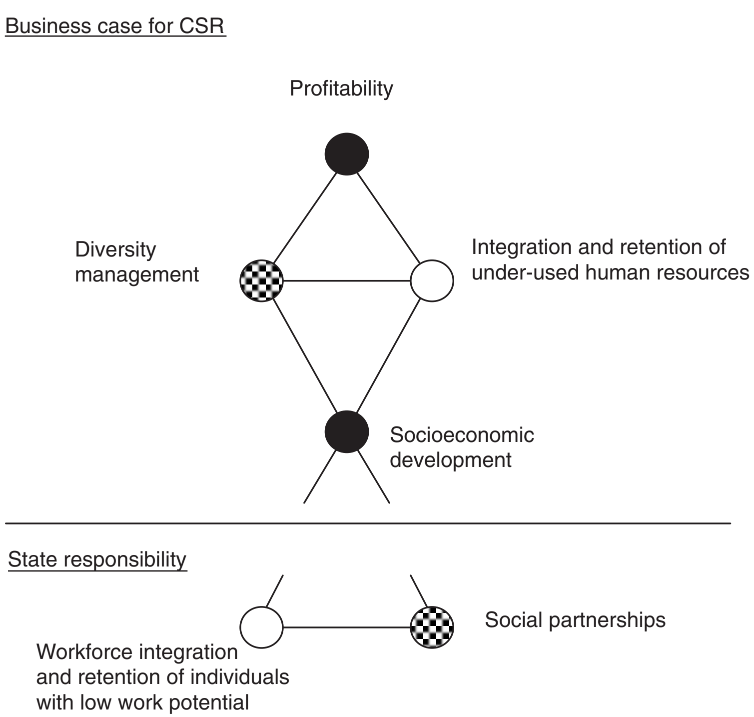
policy over the past two decades. Hence, it was easy for group members to endorse the rationality of the EU institution and see the (financial) benefit of integrating it into the emerging reconfigured institution.

The EU institution is integrated into the reconfigured institution through the merger of three elements (Figure 9.4). Firstly, the two ends of socio-economic development in respectively Europe and Denmark are directly compatible since Denmark is a member of EU and they share socio-economic interests. Secondly, the two means of workforce integration and retention in Denmark and EU are merged. While the targeted groups are not completely identical, there is much overlap between them. Women and immigrants are two key differences. Denmark, contrarily to some other European countries, has one of the world's highest participation rates of women. However, Denmark lags behind most other nations in the integration of immigrants. Aside from different priorities in the targeted groups, the two means are almost identical and hence easily merged. Thirdly, the catalyst of equality is easily integrated under the umbrella of diversity management (catalyst) since the latter includes equality as one of several dimensions. The catalyst of diversity management hence absorbs the equality catalyst. The result is a reconfigured institution that is composed of three integrated institutions, one from the Danish government, one from North America business culture, and one from the European Union.

Having integrated the three institutions, the innovative group partially detached the original catalyst of social partnerships (see Figure 9.5). This catalyst is no longer required to sustain the reconfigured CSR institution since there is now a business case for CSR (the upper part of Figure 9.5). Profitability makes the new institution inherently more attractive to businesses than was the original CSR institution. Accordingly, the social partnerships catalyst is no longer that essential. This catalyst is therefore moved to a secondary position and linked to workforce integration and retention of individuals with little potential to generate profit for the firm. These are the individuals who were excluded when the three means were merged in Figure 9.4.

The main difference between the upper and lower part of Figure 9.5 is that the semi-detached reconfigured institution in the lower part of the

Figure 9.5: Division of reconfigured institution into a business case for CSR (upper part) and traditional state responsibility (lower part)



See Figure 1 for legend

figure has only one end, socio-economic development, while the upper part of the figure has two ends, socio-economic development and profitability. The upper part of the reconfigured institution is unique in that it tries to create synergy between two ends. It employs in other words a win–win perspective, which eliminates the traditional dichotomy between firm interest and collective social interests. This win–win perspective is one of the most remarkable and innovative features of the reconfigured CSR institution. The inclusion of the profitability end makes it more likely that the reconfigured institution will be voluntarily implemented in the business setting. The reconfigured CSR institution may encounter fewer barriers on its way from discourse (policy) to action (practice) than did the traditional CSR institution. While the traditional institution may, in principle, have been more desirable from a societal point of view, the reconfigured institution is more likely to be implemented in practice. It remains to be seen which one produces the most responsible firm behaviour in practice.

Conclusion

The empirical analysis showed how an innovative project group of business actors socially reconstructed the Danish institution of corporate social responsibility (CSR) as they implemented it in practice. They altered the institution, the original rationalised means–ends designation, by selecting, adopting and integrating two other institutions from abroad. The resulting reconfigured institution is continuous with the original Danish institution of CSR, yet the institution changed as business actors added institutions from the European Union and North America. In other words, they altered an institution while also being somewhat constrained by it.

The reconfigured institution differs from the three individual institutions in an important regard: it employs a win–win perspective. It has *two* ends: socio-economic development and profitability. This double end is interesting for several reasons. For one, it allows for disparate goals of multiple stakeholders to be merged with one another, which challenges the conviction among some stakeholders that the two goals of socio-economic development and profitability are inherently incompatible. Secondly, the addition of the profitability end makes the reconfigured CSR institution more attractive to business actors. It probably increases the likelihood that CSR will be voluntarily implemented in the business setting. If this is the case, social construction may be quite effective as a mode of (self-) regulation in a voluntary CSR context. Thirdly, the win–win perspective indicates that CSR is an institutionalised construction that can be altered and adapted to fit different contexts and purposes. This finding is important for research on modes of regulation. External regulators may employ a CSR construction that differs from that used in firms or in a particular national context, which may give rise to conflicts about the true meaning of CSR. It is therefore important to be aware of different social constructions of CSR when developing and implementing modes of regulation, particularly if the selected modes of regulation rely on social or ethical norms. Good and bad business behaviour may not be entirely constructed, but there is probably more interpretive flexibility than is often recognised in the current CSR debate.

My contention is that social construction deserves more attention as a mode of self-regulation. It appears, from this analysis, that it is an effective mode of regulation, particularly in a voluntary CSR context. The actors in this analysis apparently had an underlying intent behind their cognitive constructions and reconstructions of CSR. It is this intent that gives social construction potential as a mode of regulation. While actors may not be able to stand completely outside institutions, they obviously have some flexibility for combining existing institutions in new ways and hence for reconstructing an existing institution. Institutional change therefore deserves more attention as an area of regulation. This study is a first step towards building a theory about institutional change processes and developing a model of how social construction operates as a mode of regulation in the contemporary economy.

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Part III

Actions and Challenges

10

Social Performance: Key Lessons from Recent Experiences within Shell

Titus Fossgard-Moser

1 Introduction and background

This paper summarises present understanding, approaches, tools and challenges in relation to the concept of social performance within the Shell Group, and provides recommendations for improved future performance. Although based on learnings from a range of Shell projects and experiences, the findings draw primarily on four detailed *Social Performance Reviews* undertaken between 2001 and 2003.

As part of a broader and growing strategic focus in the area of social performance, these reviews were commissioned to assist the Shell Group understand the key parameters of social performance including strategic and organisational approaches, and tools relevant to enhanced performance. The reviews were also intended to help understand the present status of social performance and provide recommendations on how to improve performance at individual review sites and more broadly across the Shell Group. To maximise potential learnings, the reviews covered a range of operational, geographic and socio-political contexts and included one major operation from each of Shell's core businesses (Box 10.1). Summaries of the different review sites are provided in the Appendix.

Box 10.1: Social performance reviews

Shell Business	*Operation and location*
Chemicals	Norco refinery, USA
Exploration and Production	The Athabasca Oil Sands Project (AOSP), Canada
Gas and Power	The Oman Liquefied Natural Gas Project (OLNG), Oman
Oil Products	SAPREF refinery, South Africa

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A team consisting of Shell International and local review site personnel, and local and international consultants undertook each review. In each case, the review process included document review and interviews with internal and external stakeholders and combined both qualitative and quantitative methodologies. In total over 200 internal and external stakeholders were consulted including: local residents and community based organisations, local and national non governmental organisation representatives, other companies, industry associations (e.g. trade unions, fishing associations), academics, and local and national government representatives. A structured participatory community assessment was also undertaken at three of the review sites, involving the participation of approximately 2,000 local residents.

Subsequent sections of the paper summarise the key findings and strategic and operational implications of the reviews as follows:

- The business case for social performance (*section 2*);
- Defining social performance (*section 3*);
- Delivering social performance (*section 4*);
- Social performance management framework (*section 5*); and
- Social performance integration, gaps and way forward (*section 6*).

2 The business case for social performance

2.1 The existing business case

The Shell Group's commitment to social performance is articulated in the Shell Group Business Principles as part of a wider commitment to contribute to sustainable development. In addition to this corporate commitment, the reviews highlighted the business case for good social performance in a number of areas.

Gaining and maintaining a licence to operate and grow

> '*Based on their history of compliance and based on the potential for reducing emissions, we thought they were a good target for a thorough investigation by the EPA.*'
>
> (United States, Environmental Protection Authority (EPA) official talking in relation to Shell's Norco Chemical facility as part of a CNN news report on Norco)

The reviews highlight that good social performance is an important determinant of the ability of Shell operations to secure and maintain a licence to operate and grow. At a national level, governments both explicitly and implicitly increasingly include social performance 'criteria' in the allocation of energy development licences. At the same time there is also a growing tendency for governments through national and regional legislative frameworks to regulate the environmental and social performance of companies, following the granting of licences.

At a local level, the reviews illustrate the impacts that communities and other stakeholders such as international NGOs can have on the ability of Shell operations to operate and grow – either through 'formal' mechanisms (e.g. legislative frameworks including scope for public participation), or informal mechanisms such as direct protest, media campaigns and sabotage.

Reduced operational costs and delays

Failure to adequately identify and manage social performance issues can have significant operational costs. In the case of Norco, Shell Chemicals and its refinery joint venture partner found it necessary to spend $50 million in order to address long-standing community grievances about pollution, a lack of local economic benefits and inadequate consultation. Similarly, poor historical social performance in operational control and community engagement has led to an estimated incremental cost of $13 million at the SAPREF refinery.

In contrast good social performance can result in direct and indirect cost reductions. For example, AOSP's (Athabasca Oil Sands Project) proactive approach to social performance and stakeholder engagement is estimated to have saved $US 3 million through avoiding lengthy public hearings.

Facilitated access to project finance

Multilateral development banks (e.g. World Bank, European Bank for Reconstruction and Development), as well as more commercial banks (e.g. HSBC, ABN Ambro) now include environmental and social risks as part of their lending appraisal processes (cf. the Equator Principles).[1] Adequate a priori identification and management of these risks is likely to avert potential funding delays. For example effective management of the resettlement requirements of the Nanhai petrochemical project in China by Shell and its Chinese Joint Venture Partner supported successful external project financing for this project.

Enhanced reputation

> '*Shell is seen by the SRI community as a good guy in Europe and a bad guy in the US … Norco was a tangible example to show our UK colleagues why Shell has a bad social and environmental reputation in the US.*'
>
> (SRI analyst, *Norco Review* (2003))

Good social performance is an increasingly critical driver of Shell's global reputation. This may extend to the buying preferences of retail customers, the ability to attract and retain top 'talent', the attitude of the investment community towards Shell, as well as the attitudes of governments and regulatory authorities in the granting and renewal of operating licences.

2.2 The future, key challenges and opportunities

> *'People in the town used to say that noise and flaring was aggravating but they accepted what they were living next to. Now people expect an operationally safe and nuisance free plant.'*
>
> (Norco Community Relations Manager, *Norco Review* (2003))

> *'Managing community relations is part of your business. It now needs to be treated like safety as a non negotiable and cannot be cut when you're cutting costs.'*
>
> (Manager, *Norco Review* (2003))

The review findings demonstrate that there is already a strong business case for social performance and if anything this is likely to increase. Shell operations have impacts – positive and negative – on people and communities beyond the fenceline, and societal expectations about how Shell addresses these impacts are rising. Moreover those who are, or consider themselves adversely affected by operations, or who do not receive the benefits they expect, have a growing voice through regulatory processes, direct action, the media and the campaigning and advocacy activities of NGOs (Box 10.2).

The reviews indicate that the greatest management opportunities and social performance challenges are likely to be related to operations or activities with the following characteristics:

- Major new projects causing permanent change in land use or long term change to local or national economic structures;
- Facilities such as chemical plants, refineries, terminals, pipelines, oil depots with communities in close proximity;
- Closure – especially where facilities are a key part of the local economy;
- Operations with a poor HSE record which have damaged, or are perceived to have damaged the environment, natural resources or health;

Box 10.2: Changing expectations and increased global interconnectivity: the case of South Africa

The abolition of apartheid in South Africa has led to wide ranging social reform, including a new constitution that places sustainable development and environmental protection at the fore. One consequence is that communities who traditionally had limited input to decisions (e.g. location of industrial facilities) with a potential impact on their lives, now have the ability to directly input to, and impact upon such decision making processes. Moreover in those cases where local communities feel that industry and government is moving too slowly, they are linking up with other national and international NGOs and advocacy groups. The consequence, as experienced by the SAPREF refinery is that businesses in order to maintain their 'licence to operate and grow' now need to be more proactive in engaging external stakeholders and involving them in activities which have a potential impact on their lives.

- Joint ventures with companies without strong HSE/ethical/social performance systems – because of the barriers this presents to integrating social performance into operations;
- Operations in sensitive locations, i.e. where any of the following are present:
  - Violent conflict – interstate or civil war, ethnic or religious violence;
  - High levels of inequality;
  - Minority groups and a history of discrimination/tension;
  - Indigenous or subsistence based groups;
  - Major political change; and, or
  - Failed states.

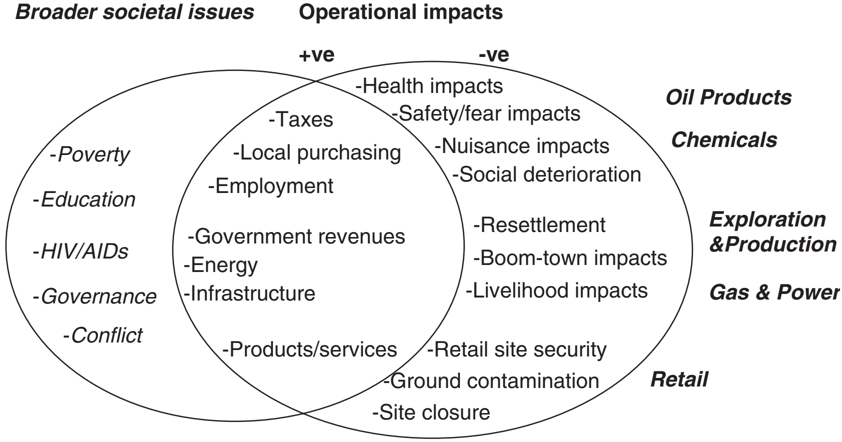
To conclude, good social performance is now expected of Shell and can be achieved in a way that adds value to the business and society at large. Moreover despite their complexity, social issues can be systematically identified and managed in a structured manner similar to other core business issues such as health safety and environment (HSE).

3 Defining social performance

3.1 Fundamentals of social performance

The reviews highlight a number of ways in which Shell operations have positive and negative impacts on the communities and societies where they operate. *First and foremost* are the impacts associated with Shell operations themselves. These include direct and indirect, short and long term, positive and negative impacts. Second there are other ways in which operations can

Figure 10.1: Generic social performance impacts associated with Shell's major businesses



contribute more broadly, principally through social investment programmes. Some of the generic positive and negative impacts associated with Shell's major businesses, as well as areas of broader contribution are highlighted in Figure 10.1.

3.2 Negative operational impacts

The reviews demonstrate there will always be some negative impacts where communities live close to existing or planned Shell operations. For new operations, key negatives usually relate to impacts on, and disruption to existing livelihoods, without evidence of local benefits; whilst for existing operations, key impacts generally relate to health, safety and nuisance concerns related to day-to-day operations. More specific impact types include the following.

Livelihood impacts

> '*The air and water are now polluted, there are no more berries, the noise drives the animals away, and what meat there is no longer tastes as it once did*.'
>
> (Elder, Fort McKay, *AOSP Review* (2002))

> '*We have travelled the sea for generations from Africa to India, but we have never seen the word "forbidden" 'til now … the Gas plant blocked a large part of our traditional fishing area, and when we tried to fish elsewhere, north or south, we were rebuffed by local residents*.'
>
> (Fisherman, *OLNG Review* (2001))

Shell operations sometime require temporary or permanent access to areas of land or sea that have previously formed the basis of economic livelihood for local people. In their most extreme form projects may require the per-

Box 10.3: OLNG impact on local fishermen

To enable LNG ships to safely collect LNG cargos, an operational requirement for the OLNG (*Oman Liquefied Natural Gas Project*) facility was a marine exclusion zone 500m in width and extending approximately the same distance out to sea. Although a traditional fishing area, the initial environmental impact assessment predicted no net negative impact on fishermen on the basis that relative to the total potential fishing area, this exclusion zone represented only a small fraction. However subsequent consultation with fishermen revealed that with the marine coast-line carefully 'divided' up between communities, the exclusion zone in fact represented almost a third of the relevant community's fishing area and thus had a substantial negative impact on local livelihoods. As a consequence OLNG developed a series of compensation measures and permitted fisherman to continue fishing in the relevant area in between the arrival and departure of LNG cargos.

manent physical relocation and resettlement of communities. Under such circumstances Shell operations have the potential to cause uncertainty, disruption and stress in all circumstances and can damage communities' bases for livelihoods (see Box 10.3) and access to important cultural or recreational sites. Moreover and as highlighted by both the Norco and SAPREF reviews, short-term mismanagement of such issues can create long-term (i.e. over 40 years) negative legacies among local stakeholders.

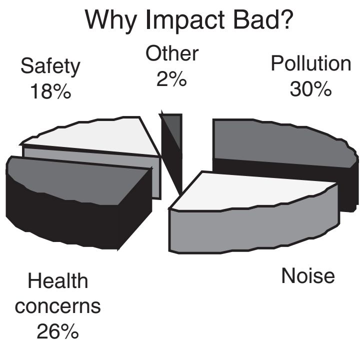
Health, safety and nuisance impacts

> '*Are the refineries giving us jobs and money for our school because they are killing us with pollution? Above all else they must reduce the pollution.*'
>
> (Local NGO representative, *SAPREF Review* (2003))

> '*After the 1973 accident* (two residents were killed) *there was trauma. That's when people started to see Shell as the enemy.*'
>
> (Local resident, *Norco Review* (2003))

Shell operations can cause negative health and safety impacts, as well as more general nuisance impacts. During the construction phase of projects, factors such as an increased probability of road accidents and increased disease exposure (often associated with migrant workforces) – especially to sexually transmitted diseases – are most prevalent. During the operational phase, and especially in the cases of major facilities such as refineries with communities living in close proximity, health and safety, and nuisance impacts (real and perceived) of living close to such facilities represent the major social performance issue for local stakeholders. In this regard Figure 10.2 illustrates the key concerns of local community members living close to the Shell Chemical's Norco facility in Louisiana, USA.

Figure 10.2: Perceived negative impacts of living next to Norco refinery (n=589)



Source: *Norco Review* (2003)

Cultural and community lifestyle impacts

> *'Everyone has to eat, everyone needs light but now if you are excluded from the new cash economy you can no longer rely on nature to provide because of the lack of access to trap lines and no hunting because everyone is working.'*
>
> (Elder, Fort McKay, *AOSP Review* (2002))

> *'This (Fort McMurray) was a family community, now there's lots of single parents, as well as high levels of alcohol and drug use. Cocaine has become the drug of choice.'*
>
> (Fort McMurray resident, *AOSP Review* (2002))

Shell operations bring social change and especially in culturally and socially sensitive contexts, have the potential to undermine and ultimately destroy local traditions, cultures and values. Typical factors contributing to such a decline include: the interaction between 'outsiders' and local communities; introduction of monetarised exchange system as well as increased disposable income; and damage of the assets (for example hunting areas) on which traditional culture and livelihoods may be based.

Social infrastructure impacts

> *'The issue here is not one of lack of jobs, but lack of social services, housing and child-care. For example last week my son was sick and we had to wait 4 days before seeing a doctor.'*
>
> (Fort McMurray Resident, *AOSP Review* (2002))

Shell projects can place significant added pressure on existing social infrastructure, including housing, roads, schools and hospitals, due to the associated influx of workers, other service providers and people looking to benefit speculatively from a project. If infrastructure is limited in the first place, the impact can be significant and generate project opposition from users whose access to services has been reduced and from those responsible for service provision (e.g. municipal and local government).

Insecurity and violence

Security for Shell operations can intimidate communities and be open to abuse by militias or other armed forces. Moreover certain Shell operational practices such as employment and contracting and land compensation payment can – if not appropriately managed – also be the (unintended) cause of conflict within and between communities. Finally Shell operations, particularly during the construction phase often act a 'magnet' for numerous individuals and organisations seeking to economically benefit from the project (the so-called 'honey pot effect'). Not only can this lead to increased conflict during the construction phase, but frequently once the construction phase is complete, migrants remain and in the absence of other economic opportunities turn to crime as a means of sustaining themselves.

Indirect economic impacts

> '*There's camp jobs out there that I cannot compete with. Childcare doesn't pay much. They can make $22/hour cleaning rooms at the camp. As a child carer you earn no more than a garbage man.*'
>
> (Manager, Child Care Centre, Fort McKay, *AOSP Review* (2002))

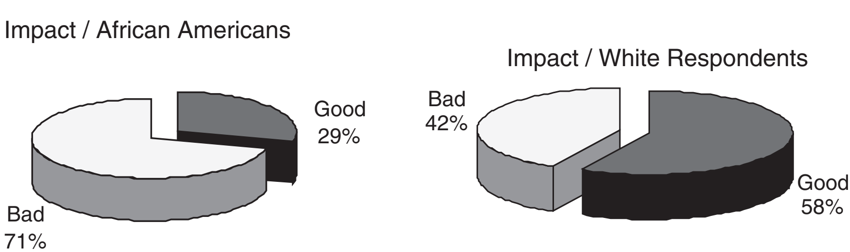
Oil and gas production can have the indirect effect of damage to the non-oil economy (e.g. by fuelling local inflation) particularly during the construction phase of projects and where during operation phase the net economic contribution of a project (i.e. particularly via government revenues) is large relative to the regional or national economy as a whole (the so called 'Dutch disease').

Vulnerability to negative impacts

> '*We have accepted the gas plant with all its impacts, but we have yet to see any benefit for our community.*'
>
> (Fisherman, *OLNG Review* (2001))

The reviews highlight that for almost every Shell project there are likely to be individuals and groups within communities more adversely impacted than others. Typically their cultural (e.g. First Nation communities in Athabasca), socio-economic (e.g. African-American people at Norco, fishermen in Oman), or ethnic status make them more vulnerable to the impacts of Shell operations, while at the same time (for example due to lack of relevant skills) least able to participate in any opportunities associated with a particular development. The consequence, particularly in the absence of proactive measures on behalf of Shell is often a lower level of support than from other groups living in the same area and similarly impacted (see Figure 10.3). Indeed the reviews have clearly shown that a failure to identify, engage and

Figure 10.3: Differing community perceptions of Norco (n=589)



Source: *Norco Review* (2003)

work with vulnerable groups can have significant long-term negative reputation and operational consequences for Shell operations. To the contrary when Shell operations do constructively engage vulnerable groups, it can bring significant mutual benefits.

3.3 Positive operational impacts

The reviews also show that Shell operations can and do bring a number of significant positive impacts. These include a number of direct and indirect, short and long term benefits at a local, regional and national level. Moreover many of the previously identified negative impacts can, if managed effectively become positive, rather than negative. Other key areas include the following.

Local economic development

> '*Shell has worked hard to provide opportunities for Fort McKay. A critical element has been their willingness to allow us to get in on the "ground floor"* (e.g. at beginning of the project) *as well as their willingness to take risks and be open with us.*'
>
> (Fort McKay Group of companies, *AOSP Review* (2002))

Box 10.4: AOSP use of local employment to build local capacity

Building upon the priority the local community of Fort McKay placed on 'tangible long term economic benefits from the project', the AOSP undertook various activities to maximise local supply chain opportunities and at the same time build community capacity. Specific activities included:

- Identifying at the beginning of the project, local supply chain opportunities relevant to local communities that were not on the critical path for the project's construction, but were of a type that would be required in the operational as well as in the construction phase (e.g. camp catering and earth removal) and would allow the community to build its capacity over time.
- Providing assistance to local Fort McKay (and other businesses) in overcoming barriers that might prevent them doing business with the project. In particular providing support and training in the following areas: access to capital (through bank financing and through government matching funds); organisational development (structure, human resources, training); cost analysis / equipment and materials; safety and risk management systems; and, contracting administration processes (invoicing, bid preparation).
- Use of an 'open-book' system with the community to build capacity and ensure 'fair' profit.

In monetary terms, the results have been significant with approximately $Can 1.2 million/month of contracts now going to local community companies. Moreover through involvement in the project community capacity, organisation and unity have been built increased (for example there are now lower levels of alcohol addiction).

> *'Even though his Majesty was emphatic in emphasising Sur residents priority in terms of contracts and employment, local businesses didn't benefit at all. … the cake was carved in Muscat and we got the crumbs.'*
>
> (Local Businessman, *OLNG Review* (2002))

A consistent theme in all the reviews is the priority local stakeholders place on the contribution Shell operations make to the local economy (Box 10.4); in particular through direct and indirect (i.e. via major contractors) local employment and supply chain opportunities (Fossgard-Moser, 2003). Against this background, it is worth noting that the significant contribution Shell projects often make to the national economy (for example the OLNG project contributes 18 per cent of Oman's GDP), and the efforts made by Shell operations to procure products and services nationally are not perceived locally as relevant.

Social infrastructure, including energy services

Despite the additional pressures Shell projects can place on existing social infrastructure the reviews also highlight that with adequate coordination and planning with relevant governmental authorities, there are often opportunities to improve social infrastructure in such areas as roads, housing, health facilities and availability of energy services. For example the OLNG project worked with local government to upgrade the quality of a number of roads and assisted in the design and implementation of a world-class waste disposal facility.

Revenue management

Another very important benefit that accompanies Shell projects is the royalties and accompanying revenues paid to producing country governments. In some cases such as Nigeria, Colombia and the Philippines, there are explicit provisions for a proportion of these revenues to be returned to producing areas; in others it at the discretion of national government. Although an area that Shell cannot directly control, it is one in which Shell operations can and will be increasingly expected to play a role.

3.4 Broader contributions

The reviews also show how Shell operations make important contributions through their social investment programmes, although as discussed further in section 5, social investment alone, however well managed, is only one element of good social performance. The review findings support existing best-practice learning; in particular that Shell social investment programmes:

- are the outcome of consultation with potential beneficiaries and include their input in project design and implementation;
- complement rather than duplicate or conflict with other local and regional development plans and programmes;

- are usually undertaken in partnership with others;
- focus on capacity building, rather than 'bricks and mortar';
- contribute not only financial resources, but other intangible assets, such as the use of the Shell operations (for example health facilities) and products (for example solar panels), as well as human resources and skills; and
- have a clear business rationale, are managed in a professional manner, and include a well-defined exit strategy.

4 Delivering social performance

> '*Shell has no social obligation to the residents of Fort McKay beyond providing jobs and ensuring the environmental and social impacts are minimised. The issue of royalties is perhaps a place where Shell could exert some pressure on government.*'
>
> (Chief, Fort McKay, *AOSP Review* (2002))

> '*Social performance is not about cheques anymore.*'
>
> (Community member, *Norco Review* (2002))

4.1 Overall social performance objectives and strategic approaches

Improved understanding of the different ways Shell operations impact on the communities where they operate has led to the adoption of the following social performance definition:

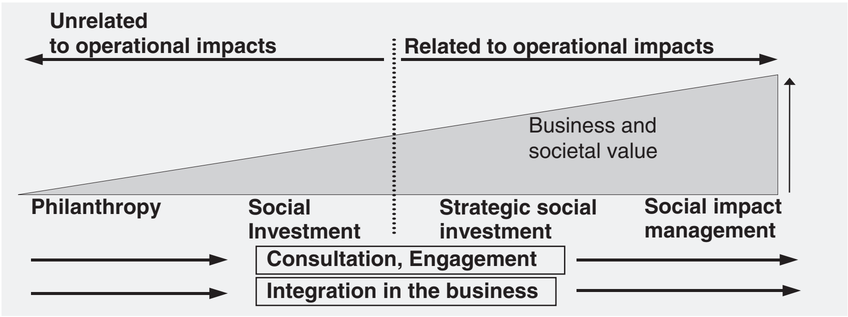
> 'Social performance is an ongoing process that incorporates all the different ways Shell operations contribute positively and negatively, directly and indirectly to the communities and societies where Shell operates.'

This definition fits within the overall commitment of the Shell Group to sustainable development, as articulated in the Shell Group Business Principle. More specifically three related social performance objectives have been developed:

- Avoid and/or minimise the negative impacts to local communities and other stakeholders from Shell's operations;
- Optimise the positive opportunities to local communities and other stakeholders from Shell's operations; and
- Undertake activities to contribute more broadly to the societies and communities where Shell operates.

In fulfilling these objectives a number of strategic approaches are available to Shell operations including what may be referred to as *social impact management*, *strategic social investment*, *social investment* and *philanthropy*. Importantly and in relation to delivering greatest business and societal

Figure 10.4: Delivering social performance



Box 10.5: Examples of social impact management

- The design of a pipeline route to minimise adverse impacts on local communities.
- Where unavoidable the undertaking of resettlement in a manner that ensures affected individuals or communities have at minimum the same standard of living after resettlement as before.
- Mutually acceptable compensation paid to fishermen for loss of access to fishing grounds.
- The way a refinery manages its air emissions to minimise impacts on local communities.
- Routine activities to ensure optimisation procurement of local products and services.
- Engagement in policy debate around use of oil generated revenues.

benefit, the reviews highlight most emphasis must be placed on how operational impacts are identified and managed through good social impact management, and how project related opportunities (such as local employment) are enhanced through strategic social investment. Of lower significance, operations should also seek to make broader contributions through well-structured social investment programmes (Figure 10.4).[2]

Social impact management concerns *ongoing and routine activities to enhance local and national socio-economic benefits and avoid and minimise negative impacts from Shell's operations and activities* (Box 10.5). The reviews highlight that management of core project impacts (many of which were identified in section 3) is *critical* for good social performance and the accompanying realisation of associated business and societal benefits.

Links between social performance, environmental performance and operational excellence

The reviews also highlight the close links between good social performance and environmental performance. For example health fears among local communities are often linked to the real or perceived concerns related to

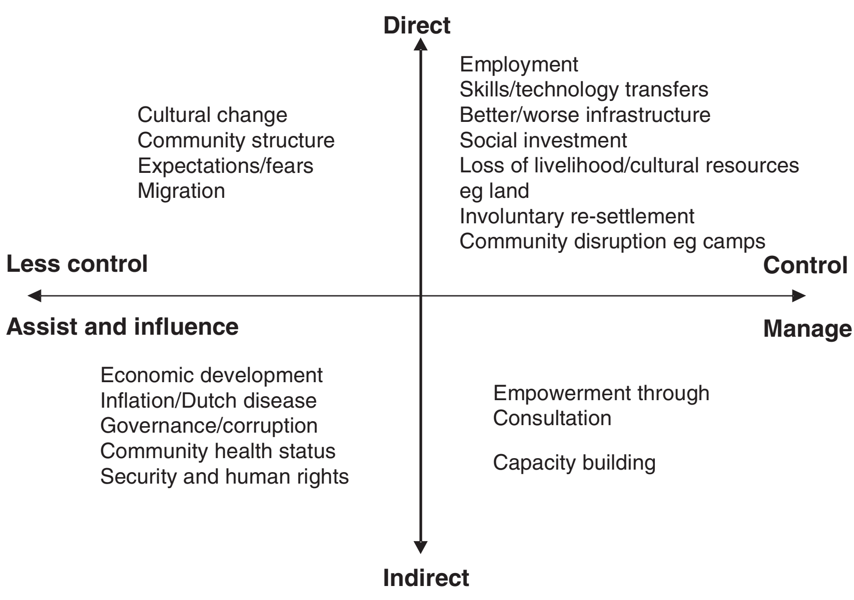
Shell's environmental emissions. Moreover, given the close links between operational excellence and good environmental performance (e.g. flaring is often a consequence of operational problems), good social performance is often ultimately linked to operational excellence.

Control versus assist and influence

The reviews highlight that whilst Shell operations have direct control over many social performance impacts, for example refinery emissions and project employment; there are other indirect impacts, such as the economic impacts deriving from the way in which oil revenues are managed, where Shell can only aim to 'assist and influence' (See Figure 10.5).

Whilst it is first and foremost critical that Shell operations identify and manage those impacts over which they have direct control, Shell operations will increasingly be judged by the extent to which they also recognise and seek to assist and influence the management of indirect impacts. Box 10.6 provides a number of examples in this regard.

Figure 10.5: Social impact management strategies for direct and indirect impacts



Strategic social investment concerns *activities undertaken by Shell operations linked to operational impacts and concerned with enhancing project related opportunities to local communities and other stakeholders* (Box 10.7).

Strategic social investment is about leveraging stakeholder opportunities related to Shell projects and activities. In general this requires a more open and flexible 'mindset', including for new projects, opportunities being

Box 10.6: Examples of assisting and influencing by Shell

- The AOSP and other oil sands developments have caused a number of negative indirect social impacts including the reduced availability of low cost housing, increased pressure on infrastructure, as well as decreased availability of public services (such as child care). A number of collaborative activities have been undertaken to alleviate these problems. For example funding a traffic study that subsequently 'triggered' the release of provincial funds to improve roads. Similarly AOSP used its influence with municipal government to help ensure the construction of more low cost housing. Finally in the area of revenues the project is assisting the neighbouring community of Fort McKay in advancing land claims that may longer term lead to oil sands development on First Nation land and associated First Nation oil revenues.
- At an international level, and in relation to more transparent use of government oil revenues, Shell is participating in and supporting the UK government led Extractive Industries Transparency Initiative. The initiative's aim is to increase transparency both in terms of the payments made by extractive companies to governments, as well as the subsequent use of these revenues by governments.

Box 10.7: Examples of strategic social investment

- In the Philippines, Shell Philippines Exploration (SPEX) successfully used the Shell Filipinas Foundation to maximise the training and employment opportunities for local community members interested in working during the construction phase of the $2.5 billion Malampaya gas project. For both the Subic and Batangas components of the project a 'Joblink centre' was established, where all unemployed local residents were able to register. Those with relevant skills were placed directly with contractors, those without skills were provided relevant training before placement with contractors. As a consequence the project (through its construction contractors) hired close to 3,000 workers from local communities and over 75% of the workers came from the five communities most affected by the project. These workers completed the project within schedule and budget and accumulated more than 11 million man-hours without lost-time incident.
- In Slovakia, Shell Retail is making retail space available (and thereby providing market access) for a number of products being produced through a micro-credit programme operated by the local NGO Integra and supported by the Shell Foundation.

identified and integrated early into project design. For example in Colombia one company routinely selected over-size generators for its oil separation facilities. In collaboration with local government, the company would then use the surplus capacity to supply electricity to local communities; in the process dramatically reducing the threat of guerrilla sabotage to its facilities, and establishing considerable goodwill with local communities and government (Fossgard-Moser and Bird, 2005).

Box 10.8: Examples of social investment

- In response to the opinions and priorities expressed by local residents, the Norco chemical plant established the Norco Community Development Foundation, the purpose of which – working in collaboration with relevant local stakeholders – is to support programmes in the areas of: Job creation and workforce development; business development/attraction/retention; youth programmes; and housing development and rehabilitation
- As part of a broader commitment to spend 1.5% of its profits on sustainable development issues, OLNG established a *community fund*, which with input from a number of external stakeholders provides support for programme funding in a number of areas including social and economic development, education and training, cultural activities, environment and safety, science and technology and infrastructure.

Social investment concerns *the support for activities unrelated to a project's direct impacts, but related to the operation's overall social, economic and environmental responsibilities and business objectives* (See Box 10.8). It includes grants and donations programmes, as well as more structured social investment programmes and Foundations. There are also growing external expectations for Shell to participate and positively influence public policy in relation to broader societal issues.

Philanthropy is *the giving of grants and donations usually unrelated to an operation's social and environmental responsibilities or its business objectives* (e.g. donation to a local youth football team, support for an arts programme). This is an area in which there have historically been – and in some contexts remain – strong societal expectations. Nevertheless, the reviews suggest that philanthropy is the least important aspect of social performance.

4.2 Stakeholder engagement as the cornerstone of social performance

> '*Effective stakeholder consultation is the art of "thinking and problem solving together".*'
>
> (Manager, *AOSP Review* (2002))

> '*Shell did strive for openness with us, despite the issues. Talking personally with people. A human interaction. People not roles. That worked well. We appreciated it. It is different to other companies. A real plus.*'
>
> (Norco community member, *Norco Review* (2003))

> '*SAPREF is only reactive on specific issues. There is no plan. When SAPREF sees it as useful, they consult with us, but only when it suits them.*'
>
> (Local NGO, *SAPREF Review* (2003))

A consistent theme through all the reviews is that the key 'ingredient' to any successful social performance strategy is stakeholder engagement. Effective identification, assessment, delivery and communication of social

Box 10.9: Typical local stakeholder groups

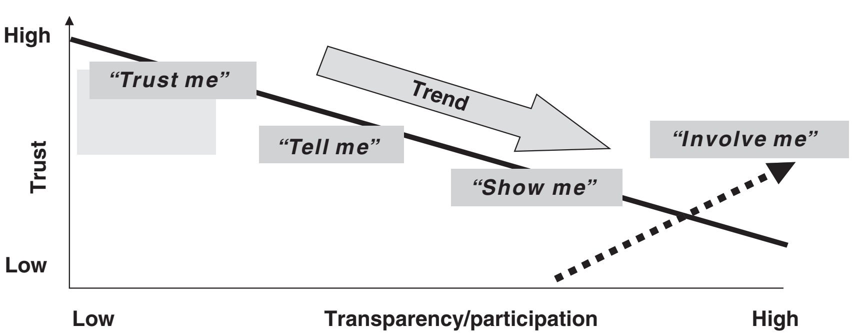
- Community leaders, organisations and representatives of different groups
- Local businesses and business organisations
- Local government
- Business partners
- Employees
- Academics
- Local and national NGOs
- Media

performance issues can only be achieved through sustained and structured external and internal dialogue. Stakeholder engagement is crucial to (i) better understand the distribution of impacts; (ii) focus on those who are most impacted and would otherwise not benefit; and (iii) ensure that interventions are welcome and appropriate. From a Shell perspective, stakeholder engagement helps operations achieve business objectives and is also the key mechanism to ensure Shell employees themselves have a realistic understanding of the social consequences of their activities.

In realising the above benefits, the reviews have further highlighted the importance of Shell operations consulting not only those stakeholders perceived to be important for their 'formal' licence to operate (e.g. government ministries), but also other stakeholders important for their 'informal' licence to operate (Box 10.9).

'Good' stakeholder engagement is about two-way dialogue and agreed actions. It includes involving stakeholders in the identification of potential impacts and issues, and *collaborative* development of possible solutions to these and their subsequent implementation and monitoring. In this regard the reviews have all highlighted – irrespective of levels of local democracy or history of NGO activism – the movement from a 'trust me', to a 'tell me', to a 'show me', to an 'involve me' world (Figure 10.6).

Figure 10.6: Changing societal expectations



Box 10.10: Norco Community air monitoring programme

To complement its own air monitoring programme, the Norco plant, in collaboration with local community groups, government authorities and external technical experts have established a community air monitoring programme. Six air-monitoring locations have been collaboratively selected, from which air samples are taken on a regular basis and analysed for the presence of more than 140 chemicals, with the findings regularly shared with the community.

For new operations, the key consultation challenge is how to involve stakeholders in relevant aspects of design and construction in order to minimise negative and optimise positive impacts. For existing facilities where local communities live in close proximity, the key challenge is to ensure that environmental and social performance plans are developed collaboratively and consequently reflect key concern areas (e.g. noise, flaring, air emissions, etc).[3] External stakeholders should also be involved in activities concerned with monitoring the impacts of such plans (e.g. community based air monitoring programmes – Box 10.10), including the development of agreed environmental and social performance measures.

In terms of the '*how*' of stakeholder engagement the reviews show that:

- Effective stakeholder engagement requires Shell operations to approach stakeholder engagement in a *structured and professional manner*, as for other core business areas.

Box 10.11: Participatory community surveys

The OLNG, Norco and SAPREF reviews included community surveys that placed strong emphasis on community participation in survey design, implementation and ownership of findings. More specifically:

- Survey objectives included understanding (i) community perceptions of the impact of the respective projects; (ii) community development priorities; and (iii) assets, including specific skills of potential relevance to the different facilities employment and procurement needs.
- The survey design included input from local community members, both in terms of the 'cultural appropriateness' of the questions, as well as questions of particular relevance to the community.
- The survey approach focused on identifying community assets upon which facilities could be built.
- As part of survey implementation, a team of community members were hired, provided with training on interviewing techniques and given responsibility for undertaking the survey and returning all completed questionnaires.
- Survey results were fed back and discussed with the community.

Box 10.12: Pernis Residential Advisory Board

In 1998 and as an outcome of consultation with local stakeholders, the Pernis refinery in the Netherlands established The Pernis Residential Advisory Board. The principal purpose of the board is to provide on an ongoing basis a formal means through which local community concerns (principally nuisance, and environmental and safety concerns) can be discussed and addressed. The panel has representatives from each of the six residential communities (representing a total of 450,000 people) impacted by the refinery, and is chaired by an independent chairperson. In addition a representative of the Dutch Environmental authorities acts as a permanent advisor to the panel.

- *Ownership and responsibility* for stakeholder engagement must lie with Shell and not be outsourced externally.
- Different *tools* exist to assist managers in the identification, prioritisation, and engagement with stakeholders. For example *Participatory Community Surveys* (Box 10.11) are an important means of understanding community perceptions and priorities.
- A range of informal and formal mechanisms exist by which Shell operations can ensure a structured and ongoing approach to stakeholder engagement. The Residential Advisory Board established by the Shell Pernis refinery in Holland (Box 10.12) is one such example.
- Key principles of good stakeholder engagement include:
  - Under committing and over-delivering;
  - Clear definition of boundaries of what is and is not possible;
  - Focusing on developing mutually agreed processes that lead to long-term relationships; and
  - Ensuring that any commitments made by Shell are fully delivered on.
- In some instances, external stakeholders will not have the prerequisite levels of organisation and skills to engage effectively with Shell operations. In such circumstances Shell should support capacity building of local stakeholders to engage on a more 'level footing' with Shell.

4.3 Organisation and responsibility for social performance

> '*He* (referring to the refinery manager) *chairs community meetings and the presence and assistance of the leadership team at meetings contributes positively to the community sense of SAPREF.*'
>
> (Community member, *SAPREF Review* (2003))

> '*I schedule a lunch meeting with the Fort Mckay First Nation Chief every quarter so we can sit down together over a steak sandwich and conduct a detailed health check of the relationship between the AOSP and Fort McKay.*'
>
> (Senior Vice President, AOSP, *AOSP Review* (2002))

The importance of organisation and leadership in the effective delivery of social performance is another key finding of the reviews. Specifically:

- *The presence of a senior champion and senior management support* for social performance is typically critical for effective delivery of social performance.
- Responsibility for the actual delivery of social performance is ultimately (in a similar fashion to HSE) *a shared responsibility* of the management team and is likely to involve, in particular, the HSE, Human Resources, Security, Contracting and Procurement and External Affairs functions (Fossgard-Moser and Ruiz-Larrea 2002).
- Projects with significant social performance issues are likely to require *a dedicated social performance manager* with the overall responsibility of coordinating and championing the Shell approach on a day-to-day basis.
- To achieve a sense of shared responsibility of social performance requires: (i) including a range of managers in the review team for social impact assessments; (ii) establishing a social performance working group to develop and monitor the social management strategy and plans; (iii) providing internal training to line managers to increase awareness of social performance; and (iv) including relevant social performance targets on line managers scorecards.
- Ensuring in the selection of senior managers for operations with existing or potential social performance issues, adequate awareness of and sensitivity to social performance.
- Many of the impacts associated with Shell's operations result from actions by contractors and their sub-contractors. Shell's approach to social performance therefore needs to extend beyond its own internal boundaries.

In conclusion this section has sought to summarise present understanding within Shell in relation to (i) where the focus of social performance activities should be; (ii) the different strategic approaches for managing the direct and indirect impacts associated with Shell operations; and (iii) the underlying importance of stakeholder engagement for the effective management of all aspects of social performance. The next section presents a 'Social performance management framework' and associated tools to assist operationalisation of the findings presented in the preceding sections.

5 Social performance management framework

The review findings have helped inform the development of:

- an overall social performance management framework;
- a generic template for social performance plans and associated planning tools;

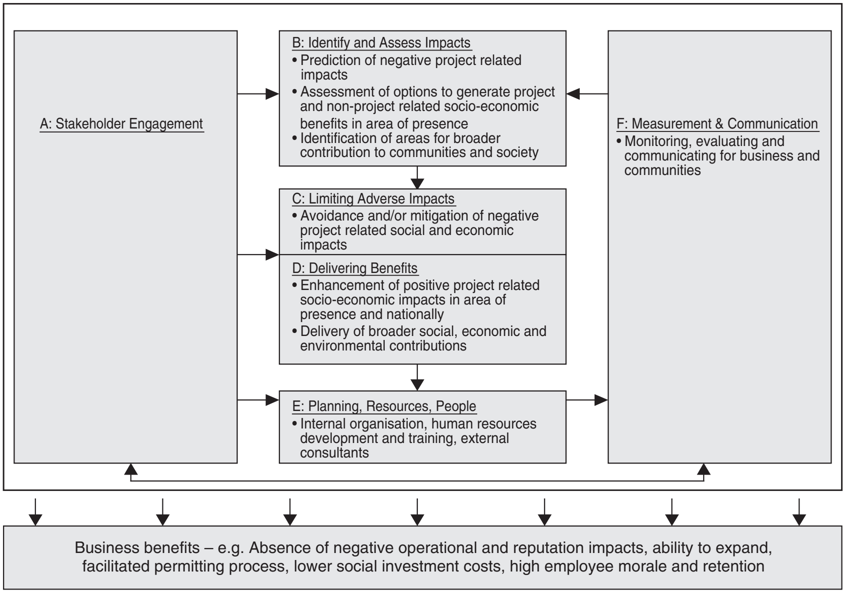
- guidelines to assist management of a number of specific social performance issues; and
- a review process to assist operations assess and improve their performance and generate broader learnings for the Shell Group.

5.1 Social performance framework

Key aspects of the social performance framework summarised in Figure 10.7 emphasise that:

- The framework is not intended to lead to a separate social performance management system within Shell. To the contrary the operational nature of most key social performance issues means that they are best managed as part of existing management systems.[4]
- Since understanding of social performance issues and the delivery of social performance is not something achievable by Shell alone, the core approach that runs through the framework is engagement with stakeholders and working in partnership.
- Using this approach, the core tasks for Shell managers are to:
  - Identify and assess the potential impacts of Shell operations;
  - Limit adverse impacts and deliver project and non project related benefits;
  - Track and report performance, and
  - Organise and train human resources for social performance management.

Figure 10.7: Social performance management framework



5.2 Social performance plans

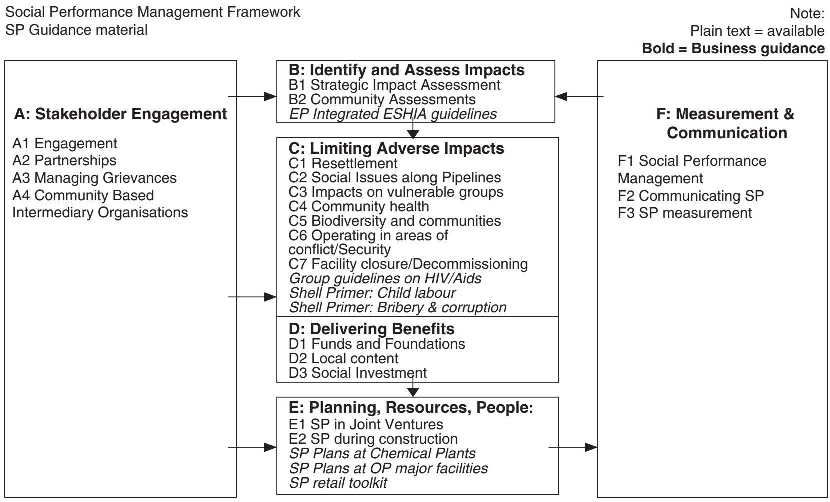
The reviews have highlighted the value of Shell operations developing and implementing social performance plans. Building upon the management framework presented in section 5.1, these are intended to incorporate the following elements:

- Overall social performance vision and objectives;
- Summary of the business and social context;
- Summary of key stakeholders and their issues;
- Actions to minimise negative impacts;
- Actions to enhance project and non project related benefits;
- Actions to measure and report on social performance;
- Budget and resources to implement the plan; and
- A timetable for periodic review of performance against objectives.

5.3 Social performance guidance notes

To facilitate management actions in the area of social performance, including the development and implementation of social performance plans, a series of Shell Social Performance Guidance notes are presently being developed. These notes build upon existing Shell policies and guidelines and provide practical and succinct guidance to managers on a number of key social performance themes (Figure 10.8).

Figure 10.8: Social performance guidance notes and other tools within Shell



5.4 Social performance reviews

Building upon the methodology and findings of the four initial social performance reviews (that form the basis for this paper), SP Reviews are in themselves becoming an important tool within Shell, with six further reviews now completed. In particular and in the absence of either internal or external social performance standards, SP Reviews are becoming a standard approach to:

- Provide an assurance tool for the operation and business (e.g. gas and power, oil products) on how SP is understood and implemented within the relevant operation.
- Provide a mechanism for the operation to identify gaps in its processes, procedures, organisational approach and implementation of social performance.
- Provide a mechanism for engagement with external stakeholders and the development/enhancement of a common action plan.
- Demonstrate to stakeholders the operational commitment, through providing an additional opportunity for input and local plan development.
- Provide an opportunity to share best practices around SP implementation both within Group and externally.
- Provide a mechanism to raise social capabilities amongst the business or operation's team.

In conclusion, the SP Reviews have been important in helping the Shell Group develop an overall management process for social performance, a template for SP plans and specific guidance on how to manage key social performance impacts, as well as a mechanism to help ensure assurance and ongoing learning. As considered in the final section, the key challenge now is to ensure integration of this framework and tools into Shell's businesses and their operations.

6 Social performance integration, gaps and way forward

> '*We had the opportunity to visit another Shell refinery in Denmark. It was so clean there, you could eat your food off the floor.*'
>
> (Residents Group, *SAPREF Review* (2003))

> '*We need clarification from the Centre in terms of what is expected.*'
>
> (Senior manager, *Norco Review* (2003))

The reviews indicate that despite much progress a number of important gaps in Shell's capacity, understanding and management of the social aspects of its business operations remain. Overcoming these gaps will be key to ensuring greater consistency in social performance standards across the Shell Group. This section seeks to summarise the activities already underway to respond to these gaps, as well as identify future challenges and approaches to address these.

6.1 Social performance integration

In response to the growing importance of social performance to the Shell Group, a number of activities have taken place at both a corporate and business level to ensure a more systematic and integrated approach to social performance.

Shell Group

There is presently no specific Shell Group social performance standard. Nevertheless a number of related standards and policies exist, including:

- *Shell Group Reputation Standard*, including the requirement for every business and operation to have a stakeholder engagement and social performance plan.
- *Shell Group Minimum Health Standard*
- *Shell Group Security Standard*
- *Shell Group ESHIA Requirement* that all new operations and major modifications to existing projects undertake an integrated Environmental, Social, and Health Impact Assessment (EHSIA).

An additional response to improved social performance management has been the creation of the Shell Group Social Performance Management Unit (SPMU) in early 2002. The objective of SPMU is to develop the capacity within Shell business areas and support functions to deliver leadership in managing the impacts of operations and products on communities and society. The four core areas of work are to:

- *Consolidate and validate the framework for SP*
  Work with the business to capture existing experiences and pilot new approaches, resulting in guidance notes, tools, performance measures and address critical SP issues.
- *Provide competence development and training*
  Raising awareness and building capacity within business and operations.
- *Communicate learnings*
  Ensure cases, guidance notes, tools and learnings are captured and disseminated internally.
- *Provide strategic consultancy services*
  Support on demand basis to business operations with Shell and external consultants to maximise innovation and development.

Shell businesses

Complementing the SPMU's strategic activities, Shell's major businesses (chemicals, exploration and production, gas and power, and oil products) have also undertaken a range of activities to better integrate social performance into business operations.

- *Shell chemicals, and Shell oil products businesses*
  - Agreed business target that all major facilities with a potential community impact (e.g. refineries, chemical plants, pipelines) should have a social performance plan in place by end of 2004.
  - The inclusion by Shell chemicals of social performance indicators in the performance contracts of all chemical plant managers.
  - The development of a process to assist Shell's depot sites enhance their social performance (presently being piloted in Brazil).
  - The commissioning of further social performance reviews.
- *Shell exploration and production, and gas and power businesses*
  - The requirement that all new projects in Shell undertake an integrated environmental, social, and health impact assessment.
  - The development of social performance guidelines by E&P and requirements for all major operations to have a social performance plan by the end of 2005.
  - Awareness training for all Shell's gas and power business developers and governors in the area of social performance.
  - The appointment of social performance advisors on key projects.
  - The inclusion of social performance criteria as part of Shell's internal 'Value Assurance Review Process' used to assess the economic, technical and socio-political feasibility of new projects
  - The commissioning of further social performance reviews.

6.2 Gaps and next steps

SP understanding and implementation is still in its early days. There remain important challenges to achieving Group-wide excellence in social performance, including:

- Ensuring that there is greater consistency in social performance across the Shell Group and its different operations;
- Maintaining the present momentum, particularly as the company responds to the 2004 reserve recategorisation issue and accompanying reorganisation and strategic focus;
- The integration of social performance principles into joint venture projects where Shell is not the operator and/or operates in social political contexts potentially in conflict with some social performance principles;
- Further developing Shell's understanding and approach to those issues and impacts over which it does not have direct control, but can play an 'assisting and influencing role';

- Further developing understanding and accountability for social performance particularly among senior and 'line managers';
- Working with internal and external contractors responsible for the construction of many Shell operations to ensure Shell's social performance principles are included in their business practices;
- Developing an internal cadre of social performance professionals; and
- Ensuring succession planning for senior managers – particularly for facilities with a social impact – includes social performance criteria.

In this respect social performance priorities for the next few years are likely to include:

- *Maintaining* the momentum achieved in the businesses in developing social performance systems and tools and monitoring progress on implementation.
- *Focusing* corporate/business attention on accelerating social performance management by the operations/facilities that present the greatest social performance risks to the Group.
- *Awareness raising* on social performance amongst key audience not yet engaged e.g. business developers, human resources, succession planners, supply chain managers and managers of 'high risk' operations and facilities.
- *Measuring* social performance at corporate and business level through 'process' indicators i.e. implementation of the social performance management framework.
- *Measuring* social performance at OU/facility level through evidence from community based surveys of external satisfaction with social performance and progress in meeting locally determined targets and objectives.
- *Developing* Shell minimum standards for social performance.

In achieving the above, it is important that there continues to be senior management recognition that social performance is a critical element in earning the trust that underpins business performance. Major steps have been taken, and significant lessons learned from past experience. The challenge now is to ensure integration such that SP becomes routinely managed similar to other core business functions.

Appendix: summary of different social performance review sites

Athabasca Oil Sands Project: Muskeg River Mine, Canada

(www.albiansands.com)

The Muskeg River Mine Project is part of the Athabasca Oil Sands Project. It is a US$ 5.7 billion joint venture in which Shell Canada has a 60 per cent stake, which expects to produce 150,000 bpd from the oil sands. The SP review took place during the construction phase, before production started in late 2002. The project has a 20 year lifecycle. The mine is located in the Wood Buffalo region in remote northeast Alberta. Approximately 55,000 people – of which 15 per cent are aboriginal – live in the vicinity of the MRMP. The most directly impacted community is the First Nation/Metis community of Fort McKay, 4 km from MRMP. The presence of the oil sands industry since the mid 1960s has meant living standards in the region are generally higher than the national average. However a history of exclusion has meant the First Nation and Metis communities have not been able to reap the benefits of this. Infrastructure and education levels are lower, and unemployment and alcohol abuse is higher, than in non-indigenous communities.

Shell NORCO Chemicals and NORCO Motiva Refinery, USA
(www.shellus/norco/)

The facilities consist of a chemicals plant and refinery located on the Louisiana industrial corridor. Built in 1916, Shell is 50 per cent shareholder in the refinery, having transferred ownership to Motiva Enterprises LLC in 1998. Shell is owner and operator of the chemicals plant, which dates from the 1950s. Externally, both facilities are perceived as Shell owned. Nearly 20 per cent of Norco's 3,600 inhabitants are African American, and 80 per cent white. The two communities live in separate sections of the town, with the African American community of 'Diamond' located close to the fenceline. Town infrastructure is limited, in terms of education, health services and transport links. Norco's African Americans have lower average incomes and a higher rate of unemployment than white residents.

OLNG, Oman (www.omanlng.com)

Located in the Al-Sharqiyah region of Eastern Oman, OLNG is the country's first liquefied natural gas plant, with a capacity of 6.6 m tonnes/year and project cycle of 25 years. The two year construction period was completed in 2000 at a cost of $2 bn. It is 50 per cent government owned, with Shell, Total, Mitsubishi, Mitsui, Partex and Itochu owning remaining shares. OLNG is part of a government strategy to diversify its economy beyond oil revenue dependence, promote job growth and regional development. As the largest single private sector investment in Oman, it is expected to increase GDP by 8–10 per cent. The most directly impacted communities are those of Al-Ghalila and El-Bar, and the coastal town of Sur. Traditionally dependent on fishing and agriculture, these communities are facing problems of long-term unemployment, a low skills base and a growing level of emigration to the capital and Gulf states.

SAPREF Refinery, Durban, South Africa (www.sapref.com)

A Shell /BP joint venture, built in 1963 in the South African (SA) port city of Durban. With around 500 employees and 600 contractors, it has capacity to process 180 barrels of crude oil a day and produces 30 per cent of South Africa's petrol. SAPREF is located in Durban's Southern Industrial Basin, which generates around 9 per cent of South Africa's GDP. Durban's population is racially diverse: 56 per cent African, 27 per cent Indian, 14 per cent white and 3 per cent coloured. There are significant racial and socio-economic differences between the different communities surrounding SAPREF. Long-term exclusion has meant that black communities, and to a lesser extent Indian and coloured communities, have had limited access to quality housing and public services, low education levels, high unemployment, and relatively high levels of crime and alcohol/drug abuse. Historically, people have had no say in decisions affecting their livelihoods (e.g. relocation or pollution).

Notes

1. Over 20 'mainstream' banks are now signatories to the Equator Principles.
2. Historically Shell's approach to social performance has been more concerned with social investment and philanthropy than social impact management and strategic social investment.
3. It is important to note that despite the growing adoption by the Shell Group of the international environmental standard ISO 14001, this standard does not include external stakeholder input, and as a consequence at a community level is not widely understood or trusted as a credible measure of a refinery or plant's performance.
4. For example if flaring is a key community concern, then it is best managed as part of the environmental management system.

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11

Novo Nordisk A/S: Integrating Sustainability into Business Practice

Mette Morsing and Dennis Oswald

Introduction

> *'We all have a vision of how we'd like the world to be. For a company like Novo Nordisk committed to sustainable development, that vision is one of trust, openness, shared values and partnerships. We translate that as the Triple Bottom Line – social and environmental responsibility and economic viability. In an age where companies are scrutinised and transparency is the only way to gain trust, social responsibility is vital to maintain a business advantage.'*
>
> (CEO Lars Rebien Sørensen, Novo Nordisk)[1]

Novo Nordisk defines sustainable development as being about preserving the planet while improving the quality of life for its current and future inhabitants. From a business perspective this involves the inclusion of economic, social and environmental considerations in the business strategy. During the 1990s many companies experienced an enormous pressure from critical stakeholders, governments, media, NGOs and international organisations to demonstrate that they had adopted sustainable business practices.

> The days when Aristotle Onassis could tuck his whalers out of sight behind convenient icebergs are almost gone. New technologies and open borders render most forms of economic, environmental, and social abuse increasingly visible. Indeed, far from being drowned in a floodtide of useless information, many of the world's citizens – thanks in large part to the public interest groups a number of them support – are becoming increasingly adept at keeping track of the activities of corporations and governments.[2]

The concept of 'sustainability' is often traced back to the World Commission on Environment and Development (the Brundtland Commission) report which coined the following definition: 'Sustainable Development is development that meets the needs of the present without compromising the ability

A. Kakabadse et al. (eds.), *Corporate Social Responsibility*

of future generations to meet their own needs'.[3] As the number of organisations that claim to adhere to sustainable business practices increases, so does the number of pieces of information that is prepared and disseminated about these practices. In a recent publication, the ACCA (Association of Chartered Certified Accountants) and CorporateRegistar.com reported that in 1993 there were fewer than 100 cases of corporate non-financial reporting worldwide, but by 2003 there were over 1,500 reports produced worldwide on an annual basis.[4] As these practices become more common amongst corporations, there has been criticism as to whether these same firms are purely 'window dressing', with no ambitions to embed sustainability in their business practices. A recent survey on corporate social responsibility in *The Economist* stated:

> Under pressure, big multinationals ask their critics to judge them by CSR criteria, and then, as the critics charge, mostly fail to follow through. Their efforts may be enough to convince the public that what they see is pretty, and in many cases this may be all they ever intended to achieve. But by and large CSR is at best a gloss on capitalism, not the deep systematic reform that its champions deem desirable.[5]

This case raises the question of how managers can adopt appropriate management control systems to communicate to employees and other stakeholders what behaviour is desired, and to ensure that their corporate sustainability claims are implemented at the operational level. That is, how can organisations demonstrate that their sustainability declarations are not just 'good looks'. Specifically, this case unfolds Novo Nordisk's long-term commitment to sustainable business practices and the company's validations of these practices by focusing on how issues of sustainability are integrated and cascaded throughout the entire organisation via the company's 'Way of Management'. The Novo Nordisk business unit – Diabetes Finished Products – is used as an example.

Introduction to Novo Nordisk A/S

Novo Nordisk A/S was founded in 1922 by August Krogh, a Danish Nobel laureate in physiology. He was inspired by two Canadian researchers, Frederick Banting and Charles Best, who had begun extracting insulin from the pancreas of cows in the previous year. August Krogh's wife, Marie, had type 2 diabetes; therefore, he established Nordisk Insulinlaboratorium to produce insulin for the treatment of diabetes. In 1925 two former employees, Harald and Thorvald Pedersen, established a competing insulin company, Novo Terapeutisk Laboratorium. In 1989, the two companies merged and became Novo Nordisk A/S.

Today, Novo Nordisk is a world leader in diabetes care; the company also holds a leading position in hemostasis management, growth hormone therapy and hormone replacement therapy. Novo Nordisk previously was involved in the production of enzymes. However, a demerger in 2000 saw the establishment of Novozymes, which took over the enzymes production, leaving Novo Nordisk to focus entirely on healthcare. Novo Nordisk headquarters is located in Denmark, on the outskirts of Copenhagen, and employs approximately 20,000 employees in 78 countries. Novo Nordisk markets its products in 179 countries.

Appendix One provides Novo Nordisk's current organisational structure. From 2002 Corporate Stakeholder Relations became part of the executive management team along with R&D, Quality, Regulatory & Business Development, Finance and Operations.

Novo Nordisk is a company based on research. Research and development expenditures equalled 43.2 per cent of the total wage costs in 2004 and have been in the range of 15.0–16.6 per cent of total turnover over the period 2000–2004. During this same period, Novo Nordisk had between 526 and 778 active patent families, with between 85 and 145 new patent families per year.[6]

Financially, Novo Nordisk has performed well, with strong growth in turnover combined with continued high profitability; the market value of Novo Nordisk has followed the booming American pharmaceutical sector and recently it has outperformed the European pharmaceutical index. In 2004, Novo Nordisk reported an operating profit of 6,980 million Danish kroner (DKK), turnover of DKK 29,031 million and a diluted earnings per share of DKK 14.83. Additionally, Novo Nordisk reported a return on invested capital of 21 per cent in 2004. Over the period 1 May 2004 to 30 April 2005 Novo Nordisk had a negative share return of 1.55 per cent; however, over the last five years (1 May 2000 to 30 April 2005) Novo Nordisk's share return equalled 44.17 per cent.[7] Appendix Two provides key financial data for the last five years, and return data for Novo Nordisk, the Danish market, and other large European pharmaceutical companies over the same period.

The share ownership of Novo Nordisk ensures that the organisation has a high degree of freedom, as it is not open for takeovers, for example, from larger pharmaceutical companies. Specifically, total share capital is divided into A-shares and B-shares (each B-share carries 1/10 of the votes of an A-share). The A-shares are non-listed and held by Novo A/S (which is a private limited Danish company that is 100 per cent owned by the Novo Nordisk Foundation which was established with the merger in 1989). The B-shares are publicly traded on the Copenhagen, London and New York stock exchanges. As reported in the 2004 Annual Report, Novo A/S controls 26.1 per cent of the B-shares, giving it 70.6 per cent of the total number of votes. Large block-holdings of the remaining B-shares include large institutional investors like the Danish ATP Pension Fund (4.3 per cent), The Capital Group Companies (10 per cent), and Fidelity Investments (4.4 per cent). Additionally, the company itself holds 6.4 per cent of the shares. 'Other' investors hold the remaining 48.8 per cent, which includes employees.[8] Novo Nordisk's board of directors consists of ten members: seven elected by the shareholders and three by the employees.[9] Novo Nordisk's six executive directors as well as the directors of the Novo Nordisk Foundation are not represented in the Novo Nordisk board, which is in accordance with the general guidelines of corporate governance at the Copenhagen, London and New York stock exchanges. It has become an increasingly important issue to demonstrate that Novo Nordisk is doing business according to these guidelines. However, the former CEO, Mads Øvlisen, has been a chair of Novo Nordisk since 2000, but he has recently announced his retirement by 1 March 2006.

Sustainability as part of Novo Nordisk's business strategy

Novo Nordisk has worked strategically with environmental and social responsibility for more than a decade, and today sustainability is an integrated part of the business strategy. Engagement in stakeholder dialogue and corporate social responsibility is extremely important to Novo Nordisk, and the company believes that trust is imperative:

> 'Public authorities and NGOs have sharpened their tone, and we must take them seriously', says President and CEO of Novo Nordisk, Lars Rebien Sørensen. 'It is important to be open and honest about our stand and our actions. Trust has to be earned.'[10]

Executive management at Novo Nordisk has made corporate values and sustainability an integrated part of the company's corporate brand. Mads Øvlisen, Novo Nordisk's chairman, often expresses strong views in the business press, on a number of occasions on the front page, on issues of sustainability. Additionally, many Danish business managers agree that he is the embodiment of corporate sustainability.[11] He has participated in a number of government and business initiatives in this area, as well as contributing to the foundation of the European Academy of Business in Society. He is also an adjunct professor of corporate social responsibility at Copenhagen Business School.

Novo Nordisk's annual financial report of 2003 demarcates top management's dedication to sustainability, as it carries the same title as the sustainability report 2003: 'What does being there mean to you?' In the welcome letter the CEO, Lars Rebien Sørensen and the chairman, Mads Øvlisen, explain why stakeholders matter to core business:

> Whom do corporations serve? Not so many years ago, we would have said 'shareholders', without hesitation. But increasingly business enterprises are recognising commitments to serve other stakeholders – such as customers, employees, societies at large – in addition to shareholders. In order to serve the long term interest of stakeholders, companies must regard it as core part of their business to assume a wider responsibility and consider broadly the wide range of factors which may impact its ability to generate returns over long periods of time.[12]

The conspicuous commitment to sustainability is reinforced in the 2004 annual report, which is the company's first integrated triple bottom line report combining economic, environmental and social results. In the opening, the commitment is stated clearly by Lars Rebien Sørensen and Mads Øvlisen on page 1 of the 2004 Annual Report:

> Novo Nordisk takes a multi-pronged approach to providing better access to health through capacity building, a preferential pricing policy for the poorest nations and funding through the World Diabetes Foundation, which is now reaching out to many millions of people with diabetes. In terms of sustainability, Novo Nordisk demonstrates its determination to play a leading role by setting a target for an absolute reduction of CO_2 emissions over the next decade. When people can overcome the challenges of diabetes, we must as a company tackle the global challenges of social and sustainable stewardship.

In 2002, the inclusion of Stakeholder Relations as part of the executive management team demarcated a strengthening of Novo Nordisk's sustainability focus. In 2004, the Stakeholder Relations area was expanded and Lise Kingo (Executive Vice President) became responsible for corporate communications, human resources and occupational health service in what is now referred to as 'People, reputation and relations'; currently there are approximately 200 employees working in this group. Ms Kingo believes that her group is responsible for the two most important assets in Novo Nordisk: the people and the brand. This department drives, challenges and monitors Triple Bottom Line strategies and helps the business units to implement new activities in relation to sustainability by:[13]

- Monitoring issues and spotting trends that may affect future business;
- Engaging with stakeholders to reconcile dilemmas and find common ground for more sustainable solutions;
- Building relationships with key stakeholders in the global, international and local communities of which Novo Nordisk is a part;
- Driving and embedding long-term thinking and the Triple Bottom Line mindset throughout the company;

- Accounting for the company's performance and conveying Novo Nordisk's positions, objectives and goals to audiences with an interest in the company;
- Translating and integrating the Triple Bottom Line approach into all business processes to obtain sustainable competitive advantages in the marketplace.

History of sustainability

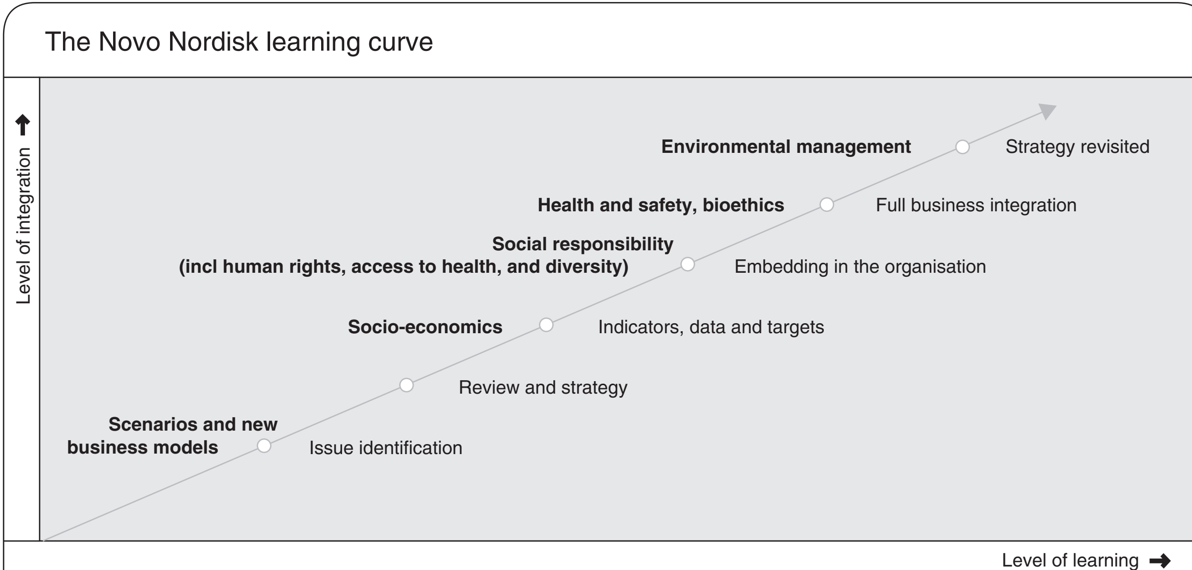
The focus on sustainability is not new for Novo Nordisk. In the late 1960s Novo Nordisk was confronted with severe stakeholder criticisms for the first time, and a close interaction with a broad variety of stakeholders have been part of the company's strategy since then. Novo Nordisk's first encounter with stakeholder criticism was surrounding new production methods that introduced genetically engineered micro-organisms, resulting in the development of a new product line of enzymes. These enzymes were important ingredients in many products (e.g., detergent). Environmentally oriented NGOs, as well as scientific articles, first raised awareness that the use of detergents with enzymes could lead to those in contact with the product developing allergies, and that the dust from the production process could have implications for employees' health. Novo Nordisk's sales fell dramatically, and the company reacted with a strong and fast response by developing dust-free enzymes presenting no risk for the consumers.[14] Sales rose again and enzyme production became an important part of Novo Nordisk's production in Denmark, USA and Japan.

In 2001, Novo Nordisk was once again confronted with criticism from NGOs. A consortium of medical companies, including Novo Nordisk, raised the issue of protecting intellectual property rights with the South African government. This led to major public criticism of the consortium members, who were accused of giving priority to profits at the expense of the health of less advantaged people. Again, Novo Nordisk reacted fast. By engaging in dialogue with the NGOs, the company defined a new policy to strengthen the company's presence and development of medicines to combat diabetes in developing countries. A new pricing policy and the establishment of the World Diabetes Foundation in late 2001 can be seen as a strategic result of Novo Nordisk's response to the criticism.

Issues of importance for sustainability in Novo Nordisk have changed from a predominantly environmental focus to a focus that includes health, safety and bioethics issues, and a focus on how to integrate issues of social responsibility. To illustrate the concurrent broadening of the scope Novo Nordisk has developed a learning curve, shown in Figure 11.1.

The learning curve shows that Novo Nordisk perceives sustainability as a continuous learning process, in which the company needs to be able to take in new issues and integrate these concurrently in the business strategy towards 'full business integration'.

Figure 11.1: Novo Nordisk learning curve



The Novo Nordisk learning curve reflects how issues related to sustainable development are bering integrated in our business. Stakeholder engagement is key to identifying the relevant issues and helps shape our way of dealing with them. For each issue, indicators are identified to track performance, once our response has been defined. Scenarios and new business models were introduced in 2003. At the other end of the continuum, we have revisited our environmental strategy, while social responsibility – particularly our responses to access to health and diversity in the workplace – and socio-economics have matured.

Source: Corporate stakeholder Relations Strategic Plan 2004–05, March 2004, p. 15.

How does Novo Nordisk meet its objectives of being sustainable?

In 1997, the Novo Nordisk Way of Management (see Figure 11.2) was introduced as an overall guideline to ensure that Novo Nordisk's strategic goals were reached at the operational level. A central part of the strategic goal is the integration and implementation of sustainable business practices:

> The Novo Nordisk Way of Management serves as the solid footing from which innovative ideas can take off. Its immediate strengths lie in its consistency, coherence and systematic follow-up methods. It is the way we do things.[15]

The Novo Nordisk Way of Management was designed and introduced to strike a balance between corporate control and decentralised decision-making. It was implemented as a reaction to the situation in the previous year where company systems, procedures and routines were standardised and centralised at headquarters in Bagsværd in Denmark, and this had led to dissatisfaction among managers in the foreign subsidiaries who found that the systems did not always fit with the local situation and needs. As an illustration of this balance, Henrik Gürtler, CEO of Novo A/S, saw the Novo Nordisk Way of Management as an opportunity to develop new and motivating control systems throughout the entire organisation:

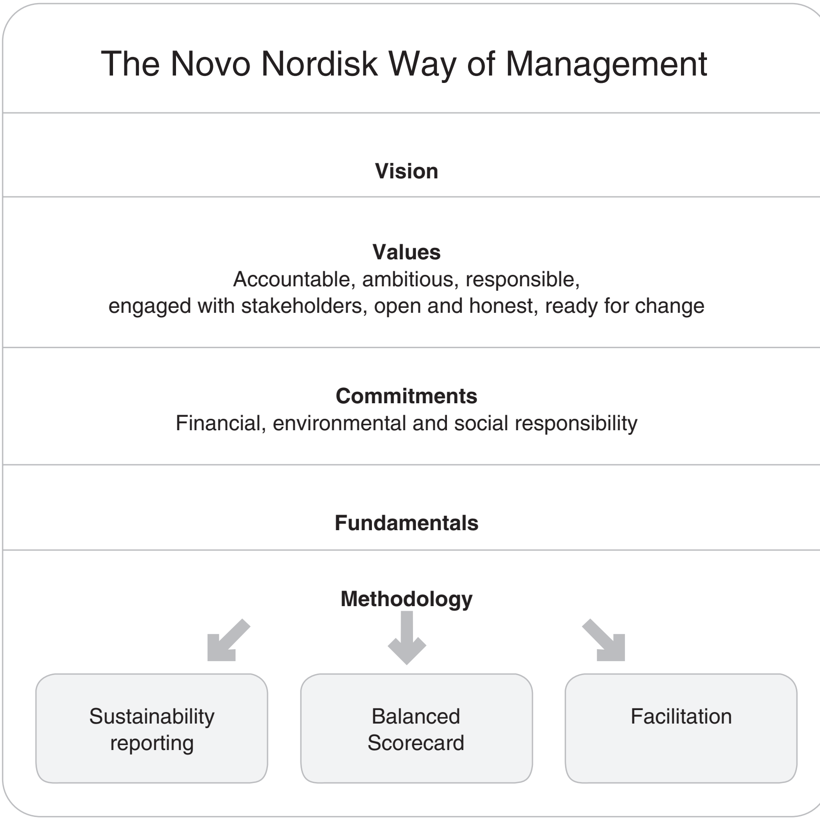
> New initiatives and management programmes were introduced regularly, but they had no effect across borders. They were encapsulated and never seemed to make much difference outside corporate headquarters. It annoyed me, and when the Novo Nordisk Way of Management was designed as a new and overall guideline, I decided to do something about it.[16]

Then CEO, Mads Øvlisen explained the Novo Nordisk Way of Management for all managers and employees in a letter in January 1997:

> The Novo Nordisk Way of Management is a comprehensive and easy-to-use guide which should allow you to use your insight and judgment in complying also with the 'local' management and quality system derived from this corporate basis for use in functions an departments throughout Novo Nordisk.[17]

The Novo Nordisk Way of Management extends beyond products and manufacturing operations to include all activities, and as such it is a broad frame that describes the rationale that should set the tone and the standards amongst managers and employees in the entire organisation. Additionally, Novo Nordisk has also developed a vision, values, commitments and fundamentals in order to inspire and guide its employees to achieve superior performance. These are included in Appendix Three.

Figure 11.2: The Novo Nordisk way of management



> The Novo Nordisk Way of Management serves as the solid footing from which innovative ideas can take off. Its immediate strengths lie in its consistency, coherence and systematic follow-up methods. To people working at Novo Nordisk, it simply is the way we do things.

To ensure that the entire organisation understands and adheres to the Novo Nordisk Way of Management, the company has developed a methodology consisting of three elements: facilitators, sustainability reporting and balanced scorecard. Each of these elements is discussed below.

Facilitators

The Facilitators are a team of around sixteen high-profile professionals at the holding company, Novo A/S. Each of them has a professional background from senior specialist or managerial positions in Novo Nordisk or

Novozymes. They travel in pairs to visit all business units and levels of the entire organisation every third year. The first team of facilitators was recruited internally in 1996; the Facilitator team has a blend of ages, sex, professions and nationalities. They serve to assess, assist and facilitate units and projects to perform better. Their tasks are:[18]

1 Through on-site auditing/faciliting of departments, factories, affiliates, assess whether or not the company-wide minimum standard requirements or 'ground rules' as specified in the Novo Nordisk Way of Management are met.
2 Through on-site advice and help, assist the unit in questioning and correcting identified non-compliance with these requirements.
3 Through on-site identification of 'best practices' applied, facilitate communication and sharing of these across the organisation.

A facilitation is a structured, planned assessment of the status of the Novo Nordisk Way of Management within the unit or project with the aim of developing agreed actions for improvement. In conducting the facilitation, the facilitators will:[19]

- Obtain objective evidence through a fact-finding process;
- Provide objective, validated assessments and conclusion;
- Include recommendations for improvements where appropriate;
- Agree on action plans with unit or process managers;
- Follow up on the implementation of the action plan;
- Fulfil their responsibilities in a manner demonstrating integrity, objectivity, and professional behaviour.

The facilitation process consists of three stages. First is the pre-facilitation, in which the scope of the facilitation is identified and material to support the process is developed. Second is the facilitation itself, in which facilitators meet with the individual unit or project members, and an agreement is made on how to improve. Finally, a post-facilitation process is conducted, in which the facilitator is responsible for following up and reporting to executive management on the achievements with respect to the action points agreed upon in stage two. Appendix Four provides excerpts from a recent facilitation at the Diabetes Pharmaceutical Site Hillerød.

Sustainability reporting

Sustainability reporting is used to ensure that sustainability thinking becomes part of everyday business practices at Novo Nordisk. In 1989 Novo Nordisk produced its first environmental management review as part of its proactive stakeholder strategy – long before environmental reporting became compulsory for companies like Novo Nordisk. In 1994 Novo Nordisk produced its first environmental report including resource consumption, emissions and use of experimental animals. Later, in 1998, a social report was issues, and since 1999 Novo Nordisk has published annual reports on sustainability integrating environmental, social and economic concerns.[20] For the first time in 2004, Novo Nordisk has integrated this information with its financial results, and now reports a combined social, environmental and economic report – The Annual Report 2004. These reports address issues recommended by United Nation's Global Compact, the Global Reporting Initiative's 2002 Sustainability Reporting Guidelines, and follow the approach laid out in the AA1000 Framework; the reports deliver a comprehensive documentation of Novo Nordisk's ambitions, goals, initiatives, results and new targets for environmental and social responsibility.

Novo Nordisk is renowned nationally and internationally for its dedication to corporate sustainability and for pioneering new agendas and concurrent development of stakeholder relations. Recent recognition includes being ranked by Corporate Knights Inc. in February 2005 amongst the top 100 sustainable companies in the world, and being ranked second in the world by SustainAbility and the United Nations Environment Programme in November 2004 for its ability to identify and manage social and environmental issues as accounted for in its sustainability report. Additionally, their Sustainability Report 2003 won the 1st prize (for the sixth time!) of the European Sustainability Awards (sponsored by the Association of Chartered Certified Accountants), and in Denmark, Novo Nordisk has won six prizes for the best annual social report awarded by the Association of Danish Accountants and the Danish business newspaper *Børsen*.[21] In the annual image analysis reported in *Børsen*, Novo Nordisk has in 1992, 2001, 2002, 2003 and 2005 ranked either one or two, with a high score on the corporate social responsibility element. In 2004 Novo Nordisk was second to A. P. Møller.[22]

In order to measure its progress towards sustainability, Novo Nordisk uses a Triple Bottom Line approach which links a set of key targets to sustainability goals. Appendix Five provides details from Novo Nordisk's Annual Report 2004 on the specific indicators used, and the reason for using them (impact). As shown in this Appendix there are six strategic areas for Novo Nordisk's triple bottom line performance:

1 Living our values
2 Access to health
3 Our employees
4 Our use of animals
5 Eco-efficiency and compliance
6 Economic contribution.

'Living our values' aims to measure whether business actions are consistent with corporate values. Three performance metrics are used to gauge how well the company performs in this area; two of which are taken from an annual employee survey (eVoice) and one is directly related to the use of facilitators (discussed above).

'Access to health' is included as a means to ensure that the company as a pharmaceutical is involved in promoting improvements in global health standards. Two measures are used to gauge Novo Nordisk's presence in less developed countries.

'Our employees' is included to ensure Novo Nordisk maintains high standards in relation to its workforce. Four performance measures are used to gauge Novo Nordisk's treatment of their employees; two of these measures are taken from the eVoice employee survey.

'Our use of animals' is included to ensure Novo Nordisk, as a pharmaceutical is in good standing with a key stakeholder group – animal welfare groups (in particular, the Danish Animal Welfare Society). Two metrics are used to ensure the ethical treatment of all animals used in research.

'Eco-efficiency and compliance' is included to measure Novo Nordisk's impact on the environment. Four performance measures are included to measure the organisation's use of water and energy, their compliance with regulations and the implementation of ISO 140001.[23]

'Economic contribution' is more than the traditional area of financial performance – it also covers the company's socio-economic impacts. Five metrics are used, including traditional measures such as operating profit margin and return on invested capital, but also one metric that measures how much the company contributes to the national economic capacity (total taxes as a percentage of turnover).

The Triple Bottom Line is used as a firm wide tool to ensure Novo Nordisk takes actions that are consistent with operating as a sustainable company. All metrics used in the Triple Bottom Line report aggregate performance across all business units to present the full picture. Novo Nordisk does not report Triple Bottom Line performance at a disaggregated level (i.e., for each business unit), but does provide specific and detailed data for eight major production sites.

> Transparent reporting is a vital instrument for us in accounting for our performance on the Triple Bottom Line. This is where we can account for our approach to doing business in a single document and cohesively present performance, progress, positions and strategic initiatives as well as the dilemmas and key issues we face as a pharmaceutical company. Most importantly, what we present in the report is the result of our interactions and engagements with stakeholders. (Susanne Stormer,[24] manager in Corporate Stakeholder Relations and responsible for Novo Nordisk's sustainability reporting)

Balanced scorecard

Rather than assessing each division with a Triple Bottom Line performance report, Novo Nordisk relies on the balanced scorecard:

> The Balanced Scorecard is the management tool for embedding and cascading the Triple Bottom Line approach throughout the organisation. The Scorecard is a vital element of the corporate governance set-up in Novo Nordisk and thus a very powerful tool to ensure integration of the sustainability approach into all business processes.[25]

Novo Nordisk has been using balanced scorecards since 1996; it was introduced primarily as a finance initiative. The administration of the scorecards rests with the Finance, Legal and IT department, which has a mandate to use the best management methods, of which balanced scorecards are viewed as an effective tool. The involvement of finance personnel with respect to balanced scorecards is to facilitate workshops (that is supporting management teams), assist in setting of targets, reviewing balanced scorecards, and changes to / improvements in financial management (i.e., integrating the balanced scorecard with processes).

Novo Nordisk cascades its balanced scorecard down to the business unit level, from which it translates into individual employees' personal targets, which are set and reviewed on a biannual basis. Specifically, a balanced scorecard is prepared for the organisation as a whole; this scorecard is then cascaded down to the executive VP level (currently there are five executive VPs, each with their own scorecard). From this level, each of the twenty Senior VPs also has a balanced scorecard (i.e., the business unit level). From this level there is no formal mandate that the scorecards are further cascaded; however, in some business units, scorecards may be prepared for each individual sub-unit (e.g., a particular factory). In general, the sub-unit typically is evaluated on a collection of KPIs, rather than having objectives in each of the four traditional sections of a balanced scorecard.

Novo Nordisk currently has a total of twenty-four objectives in its balanced scorecard under the following four headings: (1) Customers & Society, (2) Finance, (3) Business Processes, and (4) People & Organisation. To facilitate the operation of the balanced scorecard, each objective is 'owned' by one of the five executive areas at Novo Nordisk. Corporate Stakeholder Relations is responsible for seven of the twenty-four objectives. These are:

1 Increase internationalisation
2 Support diversity
3 Ensure talent development
4 Ensure performance management
5 Ensure superior company reputation

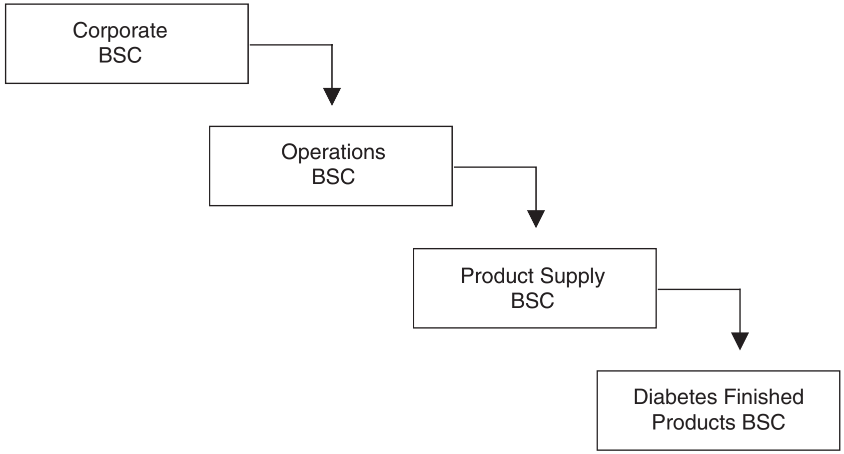
6 Ensure environmental, social, and ethical performance
7 Improve our collaboration with key stakeholders in diabetes care worldwide.

The use of the balanced scorecard at Diabetes Finished Products

One of the key business units at Novo Nordisk is Diabetes Finished Products (DFP). This group is responsible for the production and distribution of all products related to the treatment of diabetes. In 2004, the group produced 807 million units of its four key products (Penfill® 3 ml filling, Prefilled 3 ml total, Penfill® 3 ml blister, and Insulin vials).[26] There are approximately 3,100 employees, spread across eight sites and DFP headquarters. Appendix Six provides the organisational chart for DFP. Specifically, there are five production sites (three in Denmark, one in the United States, one in France); Novo Nordisk is currently expanding another production facility in Brazil. Additionally, there is a logistics unit, and a manufacturing development unit that works to take new products to mass production. Eric Drapé is the Senior Vice President of Diabetes Finished Products. Eric is a pharmacist by training, and has been with Novo Nordisk since 1990. He has been in his current role since January 2004; his previous position was as a site manager (VP) at the French production facility.

Figure 11.3 illustrates how the balanced scorecard is cascaded from Corporate to DFP. However, in our illustrations (Appendices Seven through Nine), we do not include information for Corporate, as objectives we have chosen are 'owned' by Corporate Stakeholder Relations, not Operations.

Figure 11.3: Cascading of the balanced scorecard



To illustrate how specific critical success factors (CSF) are cascaded through the organisation, Appendices Seven through Nine describe the KPI, the KPI definition and the 2005 target for three CSFs for Operations, Product Supply and Diabetes Finished Products. The three CSFs illustrated are those that are most closely aligned with the social and environmental issues in Novo Nordisk's Triple Bottom Line. In these examples, we do not include information for Corporate, as objectives we have chosen are 'owned' by Corporate Stakeholder Relations, not Operations. However, all objectives are cascaded from Corporate.

The first CSF (Appendix Seven) is to ensure environmental, social and ethical performance. With respect to DFP only one KPI is included, EPI performance, which is intended to measure the relation between total yield of product and consumption of water and energy. Further up the organisation, the emission of carbon dioxide (CO_2) is also measured. Noticeably missing from the corporate balanced scorecards[27] are any KPIs which measure social and ethical performance – most likely a reflection of the general difficulty of defining meaningful and quantifiable social indicators at a corporate level.

The second CSF (Appendix Eight) is a focus on supporting diversity and social responsibility. Throughout the organisation three KPIs are used. The first is intended to ensure that each level of the organisation supports diversity and ensures equal opportunities to its employees. The second is the number of employees that have evaluated progress according to the OA. Finally, there is a metric which focuses on the functioning and value of the Job Transfer Centre, which is a centre that has been established in connection with the company's global sourcing strategy, according to which new jobs are created abroad, not in Denmark. The Job Transfer Centre assists Novo Nordisk employees in those units that are facing staffing changes to find a new job within, or outside Novo Nordisk.

The third CSF (Appendix Nine) is to ensure talent development. Similar to the previous CSF, the use and number of KPIs is consistently applied throughout the organisation. Specifically, two KPIs are used. The first is the utilisation of talent pools with respect to the filling of new or vacant VP positions. The second KPI is the results of the section of questions on an annual employee survey (eVoice) which aims to gauge perceptions of employee development.[28]

As a SVP, Eric is responsible for the balanced scorecard for his business unit, and he believes that it is an effective management tool:

> The primary benefit [of the balanced scorecard] is to secure that people are aligned to the strategic goals of the company, and that they are not working for something which is not necessary to work for. We have full alignment, and that's very convenient and comfortable.[29]

Eric is responsible for the 2005 DFP balanced scorecard, which has twenty-seven KPIs: three in Finance, twelve in Business Processes, eight in People & Organisations, and four in Customers & Society (Appendix Ten illustrates the CSFs, CSF rationale and KPIs for DFP's 2005 balanced scorecard). There is no formal cascading of this balanced scorecard to the seven VPs. Nevertheless, each site is responsible for, and evaluated on, the majority of KPIs that are in the DFP balanced scorecard (each site is evaluated on approximately twenty KPIs).

The formal monitoring of the sites is done on a monthly basis. Specifically, data on all KPIs is calculated and updated into Novo Nordisk's IT system (PEIS), and each site manager must prepare a monthly report which explains any deviations from targets. Additionally, any deviation that is significantly large (gaining a red designation in the system) must be answered with a specific action plan. Eric also has informal discussions with his VPs every one to two months. The purpose of these meetings is to gauge how performance is proceeding. In addition to the monthly monitoring and informal discussions, Eric meets each of his site managers twice a year. The purpose of these meetings is to discuss the monthly action plans, but also to discuss the overall site's balanced scorecard.

In addition to being evaluated on the balanced scorecard, Eric's (and his VPs) bonus compensation is also tied to balance scorecard performance. Appendix Eleven provides Eric's Performance Index for 2005. As shown, Eric is compensated based on thirteen KPIs (two in Finance, three in Customers, six in Processes and two in People & Organisation). The weighting scheme works as follows: if Eric achieves each target, he receives a score for that KPI of 100. If he exceeds the target, then the score for the particular KPI is greater than 100; if he does not achieve the target, then the score for the particular KPI is less than 100. Each KPI score is multiplied by its respective percentage weight (e.g., 15 per cent for Investments). The achieved index score is equal to the sum of the weighted scores across all of the KPIs. For Eric, the amount of bonus he receives is 50 per cent dependent on his achieved index score and 50 per cent dependent on the achieved index score of Product Supply. For each VP in DFP, their bonus calculation is similar, except each VP only has ten KPIs influencing their bonus calculation. Of these ten, some are mandatory (across all sites) and some are voluntary (agreed between Eric and each VP). The voluntary KPIs tend to be related more to social objectives, as they are geared towards addressing issues which reflect the local environment. The payment of the bonus to each VP is 50 per cent dependent on their achieved index score, and 50 per cent dependent on the achieved index for DFP. Finally, Novo Nordisk uses stretch targets in that in 2005 to receive a full bonus Eric (and his VPs) must have an achieved index score of 105 (if targets are only hit (i.e., not exceeded) then only a 50 per cent bonus is paid).

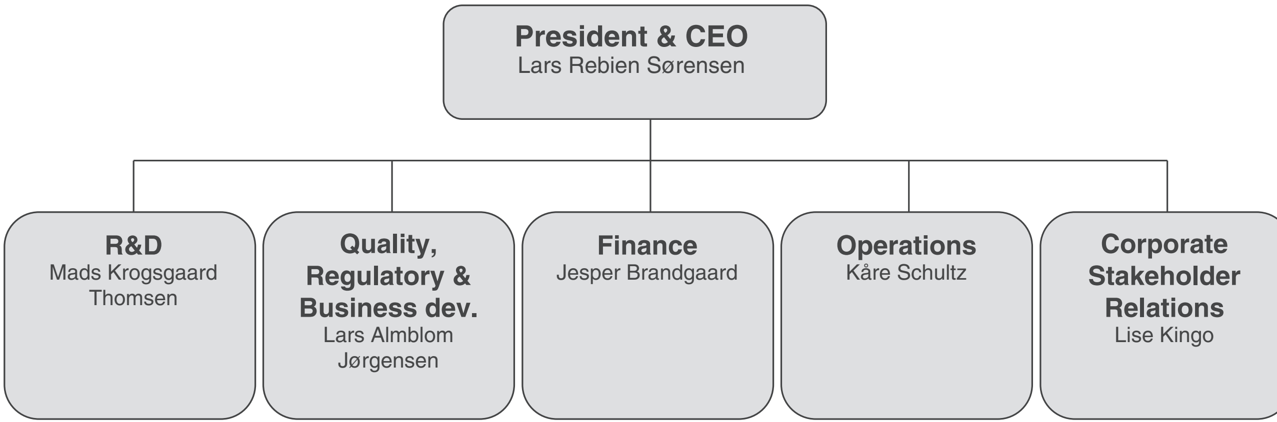
Conclusion

Novo Nordisk is an excellent example of an organisation that attempts to consider sustainability as an integrated part of its strategy and in all of its business decisions. To meet this goal, the company has adopted the Novo Nordisk Way of Management as a primary tool to ensure all actions taken by employees meets the corporate objective. Within this management tool are three pillars that are used as control mechanisms to operationalise Novo Nordisk's corporate objectives: the facilitators, the annual reporting and the balanced scorecard. The question that remains, however, is to what extent each of these pillars is effective in influencing behaviour at the operational level.

Acknowledgments

We sincerely want to thank manager Susanne Stormer for her generous invitation to Novo Nordisk A/S and for helping us collecting data and checking facts and figures for this case study. From Novo Nordisk we also want to thank Lito Valencia, business analyst in Finance and Business Integration, Hanne Schou-Rode, VP of Knowledge, IT & Quality in Corporate Stakeholder Relations, and Eric Drapé, SVP in Diabetes Finished Products for their time and constructive reflections. And we appreciate the valuable input to the case from professor Niels Mygind, Copenhagen Business School, Stephanie Robertson, Lene Hougaard Pedersen, Henrik Nielsen, research assistant at Copenhagen Business School, and Henrik Melgaard. Finally, we gratefully acknowledge financial support from Copenhagen Business School, London Business School and the European Academy of Business in Society (EABIS).

Appendix One   Novo Nordisk A/S Organisational Structure



Source: Internal document provided by Susanne Stormer.

Appendix Two Selected Financial Information

Panel A: Financial Statement Information (in DKK million)

	2000	*2001*	*2002*	*2003*	*2004*
Sales	20,485	23,385	24,866	26,158	29,031
Operating Profit	4,703	5,410	5,927	6,422	6,980
Net Profit	3,154	3,620	4,116	4,833	5,013
Total Assets	24,597	28,662	31,612	34,564	37,433
Total Current Liabilities	5,860	6,138	6,152	7,032	7,280
Total Long-term Liabilities	2,117	2,824	2,983	2,756	3,649
Equity	16,620	19,700	22,477	24,776	26,504
R&D / Sales (%)	16.6	16.6	15.9	15.5	15.0
Net Profit Margin (%)	15.4	15.5	16.6	18.5	17.3
Return on Invested Capital (%)	22.3	22.7	20.5	19.5	20.6

Panel B: Share Return Information

Company	*Country*	*Current (%)*	*5 Year (%)*
Astrazeneca	UK	–11.47	–3.99
Glaxosmithkline	UK	16.48	–22.78
Novartis ‘R’	Switzerland	2.16	9.08
Novo Nordisk ‘B’	**Denmark**	**–1.55**	**44.17**
Roche Holdings ‘B’	Switzerland	–11.29	–11.82
Sanofie-Aventis	France	32.65	80.82
Schering	Germany	18.89	7.08
Shire Pharmaceuticals	UK	5.87	–39.68
UCB	Belgium	13.74	9.71
Danish Market (KFX)		23.14	17.77

Source: Novo Nordisk A/S – Annual Report 2004; Net profit margin equals net profit as a percentage of sales; Return on invested capital equals operating profit after tax (using the effective tax rate) as a percentage of average inventories, receivables, property, plant and equipment and as well as intangible assets less non-interest bearing liabilities including provisions (the sum of above assets and liabilities at the beginning of the year and at year-end divided by two).

Source: Thompson Financial Datastream; the current return is calculated over the period May 1, 2004 – April 30, 2005 and the 5 Year return is calculated over the period May 1, 2000 – April 30, 2005.

Appendix Three Novo Nordisk's Vision, Values, Commitments and Fundamentals

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The Vision
We want to be the world's leader in diabetes treatment
We offer products and services in other areas where we can make a difference
We deliver competitive business results
A job with us is more than 'just a job'
Our values are reflected in our actions
Our history shows that it can be done

The Values are six corporate values to guide decision-making and action: accountable, ambitious, responsible, engaged with stakeholders, open and honest, ready for change

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The Commitments are a reflection of the commitment to sustainability and to integrating the Triple Bottom Line thinking in organisational practices

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The Fundamentals consist of ten behavioural guidelines on how to organise and behave in everyday organisational life in all units at all levels in Novo Nordisk:

1. Each unit must share and use better practices
2. Each unit must have a clear definition of where accountabilities and decision powers reside
3. Each unit must have an action plan to ensure improvement of its business and performance and working climate
4. Every team and employee must have updated business and competency targets and receive timely feedback on performance against these targets
5. Each unit must have an action plan to ensure the development of teams and individuals based on business requirements and employee input
6. Every manager must establish and maintain procedures in the unit for living up to relevant laws, regulations, and Novo Nordisk policies
7. Each unit and employee must know how they create value for their customers
8. Every manager requiring reporting from others must explain the actual use of the report and the added value
9. Every manager must continuously make it easier for the employees to liberate energy for customer related issues
10. Every manager and unit must actively support cross-unit projects and working relationships of relevance to the business

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Source: http://www.novonordisk.com/about_us/about_novo_nordisk/the_charter.asp

Appendix Four Example of a Recent Facilitation

Following are excerpts from a recent facilitation at Diabetes Pharmaceutical Site Hillerød:

Facilitation Start Date: 15 November 2004
Facilitation End Date: 22 December 2004

Purpose and Scope of Facilitation
The purpose and scope of the facilitation is to assess the state of compliance, within Pharmaceutical Diabetes Site Hillerød, with the Novo Nordisk Way of Management, excluding Financial Commitments, and to agree and follow up on actions resulting from the facilitation and to report the results.

At the time of the facilitation the organisation is influenced by a number of changes. The unit VP and the QA (quality assurance) VP were appointed in the Q4 2004 and several department managers have been appointed to their current position within 2004.

Executive Summary
The facilitation of DPSH in Site Hillerød has shown a unit dedicated to live up to the targets and challenges set by Diabetes Finished Products (DFP). All interviewees were aware of the Novo Nordisk Way of management and feel that the unit and management are living up to the values of Novo Nordisk. Facilitations show that there are different levels of compliance amongst the departments with respect to the implementation of Fundamentals.

The unit is highly focused on achieving its business targets, sometimes at the expense of overlooking the quality of some of the management processes such as APIS and development planning.

DPSH is currently developing its own strategy in alignment with DFP strategy and business plans. There is a clear understanding by all in the unit that focus must be on supporting the needs defined in the production agreements. Roll out of cLEAN™ is at variable stages within the different functions within DPSH.

Target setting based on the DPSH Balanced Scorecard and follow up needs to be improved for both teams and individuals. The lack of specific targets in some teams also influences the frequency and quality of feedback given in the organisation and needs to be enhanced.

DPSH is as an organisation in close daily contact with its key stakeholders within Novo Nordisk and interviewees are aware of their customers needs.

Source: Internal document provided by Eric Drapé, SVP Diabetes Finished Products.

Appendix Five Indicators of Triple Bottom Line Performance

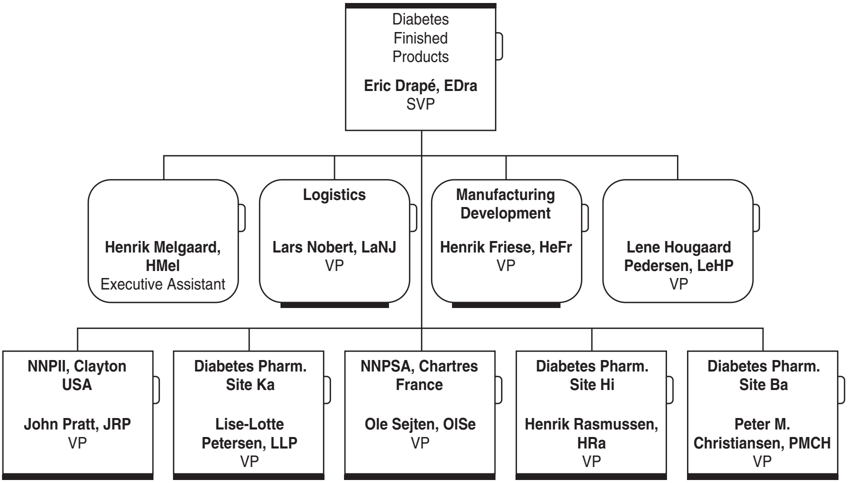
STRATEGIC AREA	INDICATORS	IMPACT
Living our values Two indicators show how we live up to the company's values, as perceived by employees. This is measured as part of the climate survey, eVoice, conducted annually. One indicator shows follow-up on the facilitation process.	Average of respondents' answers as to whether social and environmental issues are important for the future of the company.	Organisational support for and understanding of responsible business practices.
	Average of respondents' answers as to whether management demonstrates in words and action that they live up to our Values.	Integration of corporate values in all decisions.
	Percent of fulfilment of action points planned arising from facilitations of the Novo Nordisk Way of Management and Values.	Corrective actions on values following facilitations.
Access to health Two indicators measure progress on one of the programmes for global access to health, the best possible pricing scheme in Least Developed Countries (LDCs). In 2004 there were 50 LDCs.	Number of LDCs where Novo Nordisk operates.	Access to essential medicines.
	Number of LDCs which have chosen to buy insulin under the best possible pricing scheme.	Affordability of essential medicines.

STRATEGIC AREA	INDICATORS	IMPACT
Our employees Four indicators measure standards of health and safety in the workplace, employee development and equal opportunities.	Frequency of occupational injuries.	Increased quality of life for employees, improved work flow and productivity, and less absence due to illness.
	Employee turnover rate.	Influx and outflux of knowledge.
	Average of respondents' answers as to whether their work gives them an opportunity to use and develop their competences/skills.	Increased competence level for employees and increase competence capital in the company.
	Average of respondents' answers as to whether people from diverse backgrounds have equal opportunities (for example in terms of hiring, promotion and training) at Novo Nordisk, regardless of gender, race, ways of thinking etc.	Increased diversity in the workplace.
Our use of animals		
Two indicators track efforts to reduce the number of experimental animals and improve their welfare.	Percent of animal test types removed from external and internal specification.	Reduction and replacement of experimental animals.
	Housing conditions for experimental animals, considering the needs of the animals.	Improved welfare of experimental animals.

STRATEGIC AREA	INDICATORS	IMPACT
Eco-efficiency and compliance	Annual improvement in water efficiency.	Water use efficiency.
Two environmental indicators, eco-productivity indices (EPIs), are based on eco-efficiency thinking and reflect internationally adopted views. Full compliance with local laws and regulations is a company policy. Certification of production facilities is instrumental to that end.	Annual improvement in energy efficiency.	Energy use efficiency.
	Compliance.	Compliance with regulatory requirements. Accidental releases.
	ISO 14001 implementation.	Pollution prevention through decreased use of raw materials, water and energy and decreased environmental impact per produced unit.
Economic contribution		
Five financial measures for reporting to shareholders and the financial markets serve as indicators for economic contribution.	Operating profit margin.	Contribution to company efficiency, growth and investors' economic capacity.
	Growth in operating profit.	Contribution to company growth and investors' economic capacity.
	Total corporate tax as share of sales.	Contribution to national economic capacity.
	Return on invested capital.	Efficiency of invested capital, contribution to asset base, and investors' economic capacity.
	Cash to earnings (three-year average).	Contribution to the company's degree of freedom in terms of available cash funds (resources).

Source: Novo Nordisk A/S Annual Report 2004.

Appendix Six Diabetes Finished Products: Organisational Chart



Source: Internal document provided by Eric Drapé, SVP Diabetes Finished Products.

Appendix Seven Cascading of Balanced Scorecard 2005 – Ensure Environmental, Social and Ethical Performance

	Operations	Product Supply	Diabetes Finished Products
KPI	1. EPI performance 2. CO_2 emission reduction target	1. EPI performance 2. CO_2 emissions reduction strategy and action plan. 3. CO_2 emission reduction target.	1. EPI performance
KPI Definition	1. EPI is calculated as the relation between the total yield of product to the respective consumption of water and energy. Performance is tracked annually against previous year. 2. CO_2 emission reduction target to be approved by Environment & Bioethics Committee and communicated to relevant stakeholders.	1. EPI is calculated as the relation between the total yield of product to the respective consumption of water and energy. 2. A CO_2-compliance plan for Bagsvaerd and Hillerod to be drafted and implemented. 3. Establish an implementation plan for the CO_2 strategy with base year 2004.	1. EPI is calculated as the relation between the total yield of product to the respective consumption of water and energy. Performance is tracked quarterly against previous year. Simple average of the two index is the target.

Appendix Seven Cascading of Balanced Scorecard 2005 – Ensure Environmental, Social and Ethical Performance ***continued***

	Operations	**Product Supply**	**Diabetes Finished Products**
Target 2005	1. Increase the eco-productivity index for water in the period 2001–2005 by an annual average of 5% corresponding to a total increase in EPI of 30% end of 2005. Increase the eco-productivity index for energy in the period 2001–2005 by an annual average of 4% corresponding to a total increase in EPI of 25% end 2005. 2. S&R to set target.	1. Increase the eco-productivity index for water in the period 2001–2005 by an annual average of 5% corresponding to a total increase in EPI of 30% end of 2005. Increase the eco-productivity index for energy in the period 2001–2005 by an annual average of 4% corresponding to a total increase in EPI of 25% end 2005. 2. CO_2-compliance plan approved by PS management. Information seminar for key internal stake-holders to ensure effective implementation of the CO_2 strategy. 3. Include the CO reduction target in PS BSC06.	1. 2005: Water: 101 Energy: 99

Source: Internal documents provided by Eric Drapé, SVP Diabetes Finished Products.

Appendix Eight Cascading of Balanced Scorecard 2005 – Support Diversity

	Operations	Product Supply	Diabetes Finished Products
KPI	1. Equal opportunity implementation. 2. Number of EVPs/SVPs that have evaluated progress achieved according to plan as part of the OA process.	1. Equal opportunity implementation. 2. Number of employees that have evaluated progress achieved according to plan as part of the OA process. 3. JTC (Job Transfer Centre) process is running smoothly.	1. Equal opportunity implementation. 2. Number of employees that have evaluated progress achieved according to plan as part of the OA process. 3. JTC process is running smoothly.
KPI Definition	1. Action plans for 2005 achieved. 2. EVPs/SVPs have evaluated progress.	1. % of targets in the action plans for 2005 achieved. 2. % of EVPs/SVPs that have evaluated progress. 3. The KPI measures: A) JTC's ability to send the right people to the right job; B) The interviewers acceptance of these candidates.	1. % of targets in the action plans for 2005 achieved. 2. Progress evaluated. 3. The KPI measures: A) JTC's ability to send the right people to the right job; B) The interviewers acceptance of these candidates.
Target 2005	1. % of targets in the action plans for 2005 achieved; Red < 80%, Yellow 80%, Green > 80%. 2. % of EVPs/SVPs have evaluated progress according to plan from OA (combined SVPs); Red <95%, Yellow 95%–99%; Green 100%	1. 80% 2. 100% 3. When JTC has relevant candidates for vacant positions, 90% of those vacant positions must be filled by a JTC candidate.	1. Target >= 80% 2. Target = 100%; Evaluation done according to templates from Corporate Responsibility Management. 3. When JTC has relevant candidates for vacant positions, 90% of those vacant positions must be filled by a JTC candidate.

Source: Internal documents provided by Eric Drapé, SVP Diabetes Finished Products.

Appendix Nine Cascading of Balanced Scorecard 2005 – Ensure Talent Development

	Operations	Product Supply	Diabetes Finished Products
KPI	1. Utilisation of talent pools – % of VP positions filled from talent pools. 2. Employee perception of development based on eVoice survey (development theme).	1. Utilisation of talent pools – % of VP positions filled from talent pools. 2. Employee perception of development based on eVoice	1. Utilisation of talent pools – % of VP positions filled from talent pools. 2. Employee perception of development based on eVoice
KPI Definition	1. VP positions (new or vacant) filled from talent pools. 2. Percentage of units score.	1. VP positions (new or vacant) filled from talent pools. 2. Units to score an average of >= 3.0 on the mandatory eVoice theme ‘development of people’.	1. VP positions (new or vacant) filled from talent pools. 2. Percentage of units score 3.0 or above 0 on the mandatory eVoice theme ‘development of people’.
Target 2005	1. % VPs filled from talent pools. Red <55%, Yellow 55%–60%, Green >60%.	1. 60% 2. 85%	1. Target >= 60% 2. Target = 85%

Source: Internal documents provided by Eric Drapé, SVP Diabetes Finished Products.

Appendix Ten Diabetes Finished Products – 2005 Balanced Scorecard

CSF	CSF – Rationale	KPI
FINANCE		
Realise growth in operating profit	Secure industry competitive growth	Operating Profit
Ensure competitive ROIC – Working Capital and Investments	Ensure industry competitive return on invested capital	Inventory
Investments	Ensure investment management	Investments
BUSINESS PROCESSES		
Improve productivity in DFP	Secure cost efficiency in production	Output vs. cost (unit costs) Approval of batch records Reduction in number of NCs
Timely and efficient execution of investment portfolio	Critical to increase production capacity in future demand and to improve productivity	Progress on major investments projects
Ensure successful implementation of IT projects	Successful implementation and use of IT	IT project milestones
Improve quality management focus in all business processes	Quality issues and documentation will be subject to increasing attention from both customers and authorities	% of non-conformity reports approved Audit NC timeliness Inspection readiness

Appendix Ten Diabetes Finished Products – 2005 Balanced Scorecard ***continued***

CSF	CSF – Rationale	KPI
PEOPLE & ORGANISATION		
Increase internationalisation	Support the globalisation of Novo Nordisk	Internationalisation initiatives carried out
Support diversity / social responsibility	Enhance and promote innovation, attraction and reputation	Equal opportunity implementation
		Evaluated progress achieved
		JTC process is running smoothly
Ensure talent development	To ensure specialist and leadership capabilities that will support and drive growth	Utilisation of talent pools
		Employee perception of development
Ensure performance management	Improve individual performance and alignment with overall business goals	Implement uniform global performance management system
	All units with absence due to illness >5% have to decrease this absence	Absence due to illness
CUSTOMERS & SOCIETY		
Ensure superior customer satisfaction – Improve production quality	Product Quality is a critical parameter for achieving customer satisfaction	Customer complaint
Ensure environmental, social and ethical performance	Help the organisation to ensure social, environmental, social and bioethical performance	EPI Performance
Ensure timely and efficient delivery to market	In order to be the world's leading diabetes care company we have to have products ready to meet customer demands	Affiliate inventory level
	Launch of Levemir®	Levemir® finished product production

Source: Internal document provided by Eric Drapé, SVP Diabetes Finished Products.

Appendix Eleven Performance Index 2005 – for Eric Drapé

	Diabetes Finished Products						
	Weights		YTD Dec 2005 Results Target	Expected	Index	Weighted perf.	Perf. +/–
Finance	**40.0**					**40.0**	**0.0**
Investments		15.0	1,762	1,762	100	15.0	–
Operating costs*		25.0	2,539	2,539	100	25.0	–
Customers	**30.0**					**30.0**	**0.0**
Stock outs		5.0	10	10	100	5.0	–
EPI performance		5.0	100	100	100	5.0	–
Production output **							
- 3ml Penfill, fill		10.0	345	345	100	10.0	–
- disposables pack (NL,FP,IL)		5.0	164	164	100	5.0	–
- vials pack		5.0	102	102	100	5.0	–
Processes	**20.0**					**20.0**	**0.0**
NN248 timeliness ***		2.5	100	100	100	2.5	
Unit cost		2.5	100	100	100	2.5	–
Number of actual recalls		5.0	4	4	100	5.0	–
FDA Inspection readiness		2.5	100	100	100	2.5	
QAP		2.5	80%	80%	100	2.5	–
COGS20, volume/fte		5.0	100	100	100	5.0	–
People & Organisation	**10.0**					**10.0**	**0.0**
Decrease in absence		5.0	10	10	100	5.0	–
JTC		5.0	90	90	100	5.0	–
Total		**100.0**				**100.0**	**0.0**

** Operating profit target is AB05 plus logbooks and approved target corrections.*
*** Target to be corrected downwards if reduced demand in local markets create excess capacity.*
**** Final product specification. Target is August. If target is reached in September = index 66,6, October = index 33,3, November or later = index 0. If target is reached in July = index 133,3, June = index 166,6 and May or sooner index 200.*

Source: Internal document provided by Eric Drapé, SVP Diabetes Finished Products.

Notes

1. Novo Nordisk (2003), 'Take Action. Make the Triple Bottom Line Your Business', May, p. 2.
2. Elkington, J. (1999), *Cannibals With Forks. The Triple Bottom Line of 21st Century Business*, Oxford: Capstone, p. 161.
3. World Commission on Environment and Development (1987), *Our Common Future*.
4. ACCA and CorporateRegister.com, 'Towards transparency: progress on global sustainability reporting 2004', p. 8.
5. Crook, C. (2005), 'A survey of corporate social responsibility', *The Economist*, January 22nd, p. 2.
6. Novo Nordisk A/S, Annual Report 2004, pp. 49, 60 and 98.
7. Sources: Novo Nordisk A/S, Annual Report 2004, p. 38 and Thompson Financial Datastream.
8. Novo Nordisk A/S, Annual Report 2004, p. 108.
9. For more than 30 years it has been mandatory to have employees represented at the board of directors in Danish companies, see for example: Rose, C., *Medarbejderrepræsentation i danske bestyrelser*. Center for Kreditret- og Kapitalmarkedsret, Copenhagen Business School Press, 2004, pp. 21–32.
10. Novo Nordisk A/S, Annual Report 2004, p. 18.
11. For example: 'This is Mads Øvlisen, the former CEO of Novo Nordisk and one of the most admired individuals in Danish business. As he retired in 2000 after 19 years as chief executive officer in Novo Nordisk, he had increased the number of employees from 4.000 to 15.000. He has won prizes for his management style of trustworthiness, and he has made Novo Nordisk synonymous with corporate social responsibility. But he has remained the approachable Mads with tucked-up sleeves. Øvlisen is a success, a living legend, a walking lump of gold', *Euroman*, March 2005, p. 46.
12. Novo Nordisk, Annual Report 2003, p. 2.
13. Corporate Stakeholder Relations' Strategic Plan 2004–05, March 2004, slide 2.
14. See: http://www.novonordisk.com/about_us/history/milestones_in_nn_history.asp
15. Ibid, p. 13.
16. Quote from CEO Henrik Gürtler, Novo A/S, June 2, 2005.
17. 'Novo Nordisk Way of Management: a short interpretation guide to the fundamentals', preface, 1997.
18. Novo Nordisk: 'The facilitation process: charter of standards, procedures and guidelines', 1998.
19. Ibid.
20. These reports are available at http://www.novonordisk.com/sustainability/sustainability_in_short.
21. For further accolades, refer to http://www.novonordisk.com/sustainability/news.
22. Berlingske Nyhedsmagasin, no. 13, April 29–June 13, 2005, p. 28.
23. ISO 14001 is an environmental management standard with auditing tools and procedures.
24. Quote from Susanne Stormer, June 19, 2005.
25. Corporate Stakeholder Relations' Strategic Plan 2004–05, March 2004, p. 13.
26. Source: information supplied by Eric Drapé.
27. Please note that the corporate balanced scorecard is not printed in the case. However, the balanced scorecards from Operations, Product Supply and Diabetes Finished Products are presented in Appendix seven.

28. eVoice is an annual survey which asks a minimum of forty-eight questions around eight mandatory themes (Vision and Values, Development of employees, Employee engagement, Equal Opportunity, Stress and workload, Quality mindset, Performance orientation, and Internationalisation). In addition, each unit and project group can include up to an additional seventy-two questions from twelve themes (Customer orientations, Winning culture, Working climate, Empowerment, Cooperation across functions, Communication, Innovation, Planning and execution, Working conditions, Novo Nordisk policies, Best Practice, and Reporting).
29. Interview with Eric Drapé on October 26, 2004.

12
Creating a Corporate Responsibility Culture: the Approach of Unilever UK

Thomas Lingard

Introduction

It could be argued that one of the greatest determinants of an organisation's ability to integrate the principles of corporate responsibility into its core business is connected to the tendency of that organisation to attract and recruit individuals who are most likely to behave in a responsible way. In doing so, organisations encourage a *collective* social responsibility as they bring together a group of individual people for whom social responsibility is important. This article examines some of the factors which I believe contribute to a sense of collective social responsibility at Unilever UK, and how I believe this greatly helps the company's corporate responsibility performance.

The factors, taken together suggest three things. First, that it is the corporate culture and values which influence the internal business processes, not the other way around. Second, that corporate responsibility is not about teaching people ethics, but about allowing them to use their own personal values to guide them in their work. Third, that consistent communications are a vital element in reinforcing a company's commitment to corporate responsibility.

Unilever is a global consumer goods business. The UK is both home to one of its corporate head offices as well as itself being an important market with annual sales worth over Euro 3bn. Unilever has a history of promoting staff from within, rather than recruiting externally for management positions. As a result, Unilever UK requires a steady stream of high calibre graduates who are prepared to learn management skills in one of a number of defined functions, such as marketing, finance, human resources or supply chain management as part of its highly regarded training programme – The Unilever Companies' Management Development Scheme (UCMDS).[1]

Like many Unilever managers, I began my career on this scheme, working in Business Systems, Finance, Category Management and most recently

A. Kakabadse et al. (eds.), *Corporate Social Responsibility*

Corporate Responsibility. For the past two years I have also been part of the team of interviewers who conduct the first round interviews for this scheme. In the sections that follow I would like to explain why corporate responsibility is important for a business like Unilever, and in particular look at how that importance is now being reflected in the recruitment and training of our high calibre graduate intake.

Corporate Responsibility and Unilever UK

Unilever's Corporate Purpose includes the following statement:

> To succeed also requires, we believe, the highest standards of corporate behaviour towards everyone we work with, the communities we touch, and the environment on which we have an impact. This is our road to sustainable, profitable growth, creating long-term value for our shareholders, our people, and our business partners.

While the rest of the statement is more specifically connected to the production of consumer goods that meet the needs of consumers around the world, these last two sentences make it clear that responsible behaviour is seen not as an optional extra, but as a necessary condition for success.

There are many arguments to support this theory, but one of the most interesting and convincing comes from the corporate culture perspective. The approach a company takes to corporate responsibility issues will play a key role in the overall organisational culture, as both these things must ultimately be rooted in a sense of the organisation's values. If you believe that organisational culture impacts performance through the motivational effect it has on employees, it follows that corporate responsibility must do so too.

Another aspect which links corporate responsibility to organisational performance concerns how business decisions are made. Companies increasingly need to ensure that business decisions take into account the views of a number of different internal and external stakeholders. But in one sense, *companies* don't make decisions – people, individuals acting in the name of the company do, and in order for those people to make decisions that reflect the corporate desire to maintain 'the highest standards of corporate behaviour' they need to be aware of the relevant social and environmental impacts that their business decisions will have and be inclined to take those impacts into account.

So if it is the nature of the people within the business that, through the decisions they make, have the greatest impact on that organisation's corporate responsibility performance, how can companies ensure that they are attracting and recruiting those employees that will enhance, not detract from that performance?

In the section that follows we will examine how Unilever UK's approach to the recruitment and training of graduate management trainees ensures that the next generation of business managers remain committed to Unilever's approach to corporate responsibility.

Recruiting and training graduate managers

Attracting talent

Unilever began its annual graduate recruitment activity in 1954, each year selecting some of the country's best graduates for the UCMDS scheme. The first thing to point out is that competition for high calibre graduates is tough – many of the people that Unilever would like to employ are sought after by other companies too. While graduate selection appears from the outside to be a matter of employers choosing from a pool of applicants, companies are only too aware that applicants have to choose them too.

This is one of the reasons why Unilever is keen to talk to those graduates applying for jobs about the work that Unilever is involved in on a range of Corporate Responsibility issues. Opening the 2004 graduate recruitment brochure you see this on the first page:

Five big reasons to join us:

1. Unilever is one of the world's greatest consumer goods companies and plays an active role addressing global environmental and social issues
2. Our brands include some of the biggest and best-known in the world – they're a familiar part of daily life right around the globe
3. As a graduate, you'll get your teeth into a real job from day one
4. You'll receive all the training and support needed to launch a management career – ideally in just two years
5. And you'll work with bright, stimulating often brilliant people who haven't had to sacrifice their individuality to have a highly successful career

The order of those reasons is not a coincidence. We know that in 2004, 42 per cent of our target group of graduates saw working for a socially responsible company as very important, while only 30 per cent attached the same level of importance to earning an above average salary.[2] In real terms this means that on balance people would rather work for an average salary for a company which they feel reflects their own personal values. This is important for Unilever as while it has a very evident commitment to corporate responsibility, jobs in manufacturing firms rarely match the sky-high salaries paid by city financial institutions. So as a graduate recruiter, Unilever is well placed to benefit from the increase in high calibre graduates wanting to work for socially responsible firms.

This trend is particularly true of high calibre individuals who have a better developed sense of what motivates them, what they value and what they have to contribute. Less emotionally intelligent applicants are often more interested in what that starting salary is and where they will be based than whether the values and culture of the organisation match their own. During the interviews we look for candidates who can articulate why they want to work for Unilever, rather than another consumer goods company. Candidates for whom corporate responsibility is a key issue find it easy to construct a solid response to this question.

But there are also implications for retention of staff too. It is not good enough just to have an external image of being a responsible company, as the new recruits will leave very quickly if the image doesn't match the reality. Anecdotal evidence suggests that even those people who didn't consider Corporate Responsibility as a factor when looking for a job, find it becomes a reason for staying longer once they've joined.

Selecting leaders

The UCMDS programme has a very transparent recruitment process. Candidates are required to have a good degree in any discipline (with some exceptions for the technical functions such as Supply Chain and Innovation and Technology Management). Successful applicants tend to have extremely strong academic records, but a great emphasis is placed on assessing the 'whole person' and not screening out people who may have dropped a grade here or there. The criteria against which candidates will be assessed are given in the recruitment literature. These criteria or 'leadership competencies' are shown in the box on the next page.

Readers outside the UK may be surprised to learn that Unilever UK does not require graduates to have studied a relevant degree for jobs in functions such as finance, marketing or sales. This is partly for historical and cultural reasons, and partly because we believe that a person's attitude, character and behavioural competencies can be a better indicator of leadership potential.

The three round selection process is designed to give candidates the opportunity to demonstrate the extent to which they possess these competencies. It is a challenging process, but this format is no different from that used by many large organisations.

What is important from a corporate responsibility perspective is the nature of the competencies that are used in the assessment and their link to Unilever as a responsible business. I would suggest that, in particular, the first three competencies in the list below have a particular bearing on Unilever's capacity to behave as a responsible company.

In the assessments that we use, candidates are faced with complex but plausible business situations where in addition to financial, HR, marketing and supply chain issues there are potential moral conflicts. We do not

Self-Confident Integrity: You act with integrity and principles underpin your behaviour, motivating you to stand up for your beliefs and take difficult decisions when necessary.

Breakthrough Thinking: You generate new ideas, delving beneath the surface and using conceptual and lateral thinking to create business advantage.

Organisational Awareness: You use your understanding of an organisation's culture to make an impact, working within both formal and informal structures to achieve goals.

Change Catalyst: You're excited by the opportunities change brings and respond positively to challenges. You adapt creatively and will actively promote the change process.

Objective Analytic Power: Even in complex situations, you objectively assess what needs to be done, quickly grasping the issues and breaking a problem down into its component parts.

Developing Self: You seek opportunities for self-development and invest time and energy seeking feedback and learning from your experience.

Team Commitment: You value being part of a team and demonstrate cooperative working to achieve shared goals.

Team Leadership: You motivate a team by taking a lead in problem solving, clarifying tasks and creating an environment in which everyone can contribute.

Business Motivation: You're excited by working in business and are inspired by profit, competition, customer satisfaction and the chance to make things happen.

Passion for Growth: You're ambitious, always want to do your best and possess an entrepreneurial approach grounded in the desire to meet and exceed targets.

assess an individual candidate's morals, instead we look for their ability to sense when moral issues are relevant and to stand up for their own beliefs, even when challenged as outlined in the 'Self-Confident Integrity' competency. We do this as it is our view that this is a critical leadership competency and because a sensitivity to these moral dilemmas is a key business requirement for future leaders operating in an increasingly complex world.

The competency of 'Breakthrough Thinking' is relevant for obvious reasons to any fast moving consumer goods company but is also of great relevance to corporate responsibility. Many of the corporate responsibility dilemmas that business faces today require people who can see beyond the current, accepted approaches to these problems and can really grasp the underlying issues in order to come up with new, creative solutions. Candidates who generate genuinely new approaches to diffusing the tensions in the case studies used often score highly in this area.

'Organisational Awareness' also tests candidates sensitivity to cultural issues which may have a bearing on the case study in question. This sensitivity is also important from a corporate responsibility perspective. As the world becomes more interconnected and interdependent, managers will need to be more sensitive to the way in which the business touches the lives of people outside of the business. The first step towards embedding Corporate Responsibility in a business is being able to fully understand the impact that business has on the world, and candidates who score highly on this competency are likely to be more able at doing that.

But the key point is that these competencies were selected because Unilever believes these are the competencies required for leaders of the future. No amendments were made to 'embed' Corporate Responsibility into this process. It is simply that the culture of the business is already geared to respecting and valuing certain behaviours which reflect Unilever's corporate desire to operate to the highest standards around the world. The end result is a corporate culture where moral issues are respected and managers have the necessary skills to ensure that issues of corporate responsibility are handled sensitively wherever they arise within the business.

Training managers

Code of Business Principles training

Like many businesses, Unilever has a Code of Business Principles – a statement which describes how we will behave in our dealings with a variety of internal and external stakeholders.

In 2003, Unilever began to take greater steps to ensure that all employees knew what the code meant for them as individuals in their specific functions. To do this Unilever developed a training programme and a variety of associated materials to help deliver the training. Employees are taken through the training programme by a relevant senior manager, thus emphasising its importance. The training consists of a number of business related ethical dilemmas which employees are asked to discuss and debate what action should be taken. In many cases there is no clear right or wrong answer, but the training is designed to heighten awareness of the issues which if managed insensitively could risk breaching the company's code.

This training was compulsory for all UK employees and an independently run telephone hotline is made available for employees who wish to report suspected breaches of the code.

Being exposed to this training soon after joining further reinforces the belief that these issues are really important to the company. The fact that this whole process is managed by Human Resources rather than the Communications team is a further indication of the level of integration of this code within the business. The Code is recognised as part of the formal policies of the company, and failure to comply with it is a disciplinary offence.

Unilever's Code of Business Principles

Standard of Conduct: We conduct our operations with honesty, integrity and openness, and with respect for the human rights and interests of our employees. We shall similarly respect the legitimate interests of those with whom we have relationships.

Obeying the Law: Unilever companies and our employees are required to comply with the laws and regulations of the countries in which we operate.

Employees: Unilever is committed to diversity in a working environment where there is mutual trust and respect and where everyone feels responsible for the performance and reputation of our company. We will recruit, employ and promote employees on the sole basis of the qualifications and abilities needed for the work to be performed. We are committed to safe and healthy working conditions for all employees. We will not use any form of forced, compulsory or child labour. We are committed to working with employees to develop and enhance each individual's skills and capabilities. We respect the dignity of the individual and the right of employees to freedom of association. We will maintain good communications with employees through company based information and consultation procedures.

Consumers: Unilever is committed to providing branded products and services which consistently offer value in terms of price and quality, and which are safe for their intended use. Products and services will be accurately and properly labelled, advertised and communicated.

Shareholders: Unilever will conduct its operations in accordance with internationally accepted principles of good corporate governance. We will provide timely, regular and reliable information on our activities, structure, financial situation and performance to all shareholders.

Business Partners: Unilever is committed to establishing mutually beneficial relations with our suppliers, customers and business partners. In our business dealings we expect our partners to adhere to business principles consistent with our own.

Community Involvement: Unilever strives to be a trusted corporate citizen and, as an integral part of society, to fulfil our responsibilities to the societies and communities in which we operate.

Public Activities: Unilever companies are encouraged to promote and defend their legitimate business interests. Unilever will cooperate with governments and other organisations, both directly and through bodies such as trade associations, in the development of proposed legislation and other regulations which may affect legitimate business interests. Unilever neither supports political parties nor contributes to the funds of groups whose activities are calculated to promote party interests.

The Environment: Unilever is committed to making continuous improvements in the management of our environmental impact and to the longer-term goal of developing a sustainable business. Unilever will work in partnership with others to promote environmental care, increase understanding of environmental issues and disseminate good practice.

Innovation: In our scientific innovation to meet consumer needs we will respect the concerns of our consumers and of society. We will work on the basis of sound science, applying rigorous standards of product safety.

Competition: Unilever believes in vigorous yet fair competition and supports the development of appropriate competition laws. Unilever companies and employees will conduct their operations in accordance with the principles of fair competition and all applicable regulations.

Business Integrity: Unilever does not give or receive, whether directly or indirectly, bribes or other improper advantages for business or financial gain. No employee may offer, give or receive any gift or payment which is, or may be construed as being, a bribe. Any demand for, or offer of, a bribe must be rejected immediately and reported to management. Unilever accounting records and supporting documents must accurately describe and reflect the nature of the underlying transactions. No undisclosed or unrecorded account, fund or asset will be established or maintained.

Conflicts of Interests: All Unilever employees are expected to avoid personal activities and financial interests which could conflict with their responsibilities to the company. Unilever employees must not seek gain for themselves or others through misuse of their positions.

Compliance – Monitoring – Reporting: Compliance with these principles is an essential element in our business success. The Unilever Board is responsible for ensuring these principles are communicated to, and understood and observed by, all employees. Day-to-day responsibility is delegated to the senior management of the regions and operating companies. They are responsible for implementing these principles, if necessary through more detailed guidance tailored to local needs. Assurance of compliance is given and monitored each year. Compliance with the Code is subject to review by the Board supported by the Audit Committee of the Board and the Corporate Risk Committee. Any breaches of the Code must be reported in accordance with the procedures specified by the Joint Secretaries. The Board of Unilever will not criticise management for any loss of business resulting from adherence to these principles and other mandatory policies and instructions. The Board of Unilever expects employees to bring to their attention, or to that of senior management, any breach or suspected breach of these principles. Provision has been made for employees to be able to report in confidence and no employee will suffer as a consequence of doing so.

In this Code the expressions 'Unilever' and 'Unilever companies' are used for convenience and mean the Unilever Group of companies comprising Unilever N.V., Unilever PLC and their respective subsidiary companies. The Board of Unilever means the Directors of Unilever N.V. and Unilever PLC.

General skills training

All graduates joining the business have a training programme developed that reflects their particular function, but in addition all graduates attend a residential General Skills programme which introduces them to Unilever's business model and provides an overview of the various business functions. This course is especially important given the policy of recruiting graduates of all disciplines who may not have had any formal business training.

In 2004, a new module was incorporated into this compulsory course – Corporate Responsibility and Sustainability. The module was developed in partnership with the sustainable development organisation Forum for the Future and the learning objectives specified that delegates should:

1 Know that Unilever is committed to Corporate Responsibility, which means taking Sustainable Development seriously throughout all aspects of the business.
2 Know that Unilever has three key sustainability programmes in water, agriculture and fish, and invests significant resources into these.
3 Know that there are specialists in the UK (internal and external) who are able to support Unilever employees on these issues, and where they can go for more information.
4 Understand what Sustainable Development means and why it is important.
5 Understand that each person and each business function has a role to play in making a contribution to sustainable development in the company.
6 Understand that sustainable development is a complex challenge to face with conflicting imperatives from a range of stakeholders.
7 Be able to explain to their team what Unilever's commitment to sustainable development is, as well as one or two ways they can contribute as a business function.

The learning objectives are achieved through a variety of presentations, discussions, activities and a game inviting delegates to perform a simplified version of a life-cycle analysis of a product, noting all the potential economic, social and environmental impacts, both positive and negative, that may occur during that product's life-cycle from the production of its raw materials to use of the product by the end consumer.

This type of exercise has proved extremely useful for stimulating discussion on the ability of managers to influence these impacts, and for improving the awareness of managers of the range of impacts for which the business is either directly or indirectly responsible. In a large organisation, such exercises are useful as they allow managers a glance of its total impact. In other large organisations sometimes only senior executives are privy to this 'total view', but by that time they are likely to be far removed from the everyday decision making responsible for the company's impacts.

The views of young managers

Following the introduction of this training programme, in March 2005 we asked those who took part in the training what they thought of it. The results were interesting for a number of reasons. We were pleased to see that the learning objectives had largely been met with 93 per cent of respondents saying the training helped them significantly in understanding what corporate responsibility is and why it is important to Unilever. Furthermore, 100 per cent of respondents said that the training had helped them in some way to identify potential corporate responsibility issues in their own jobs and of these 62 per cent said it had significantly helped them to do this.

What was more interesting was that although the session was run as an informative management training session rather than a 'feel-good' exercise, when asked whether their perception of Unilever had changed following the training 86 per cent said that they felt happier knowing that Unilever takes corporate responsibility seriously. However, many respondents added comments confirming the fact that the training was for them a reassuring confirmation of what they already believed to be true.

> *'This hasn't changed my perception of Unilever as I think that CSR is already widely publicised.'*
>
> Course Participant

> *'I have always viewed Unilever as an ethical employer and this was confirmed by the presentation.'*
>
> Course Participant

> *'My perception hasn't really changed, I already knew that Unilever was committed to sustainable development, but it's good to see a session on this kind of issue in a General Skills course.'*
>
> Course Participant

But there were also some interesting insights into the course participants' views of Unilever's approach of linking corporate responsibility activities to key business objectives. One participant was surprised that corporate responsibility activities were often justified using 'a business case':

> *'I feel mildly cynical about Unilever's motives – it seems environmental issues are addressed to increase sales rather than* [for reasons of] *genuine environmental care.'*

This comment provides (albeit anecdotal) evidence of the strength of a tendency to behave responsibly simply as an accepted norm of business behaviour, rather than something which needs to proved with a business case every time a decision needs taking.

Next steps for Corporate Responsibility training?

The corporate responsibility sessions we have run as part of the General Skills programme was only a pilot, but the response has been such that it will remain a part of this annual training programme for the foreseeable future. This will ensure a consistent, if basic, level of training on corporate responsibility issues for all new graduate recruits. But that still leaves a great deal of scope to apply the same principles to training that other managers within the business will receive.

Around 50 per cent of managers recruited by Unilever UK arrive as mid-career recruits, all of whom will undergo a formal induction programme, and for consistency we will look to apply the same principles in the General Skills programme to the induction programmes that these managers will receive. This is a more challenging task as induction programmes are managed locally rather than by a central team, but one which is equally important.

While these general introductory programmes are helpful in raising awareness, most corporate responsibility issues are function-specific. Brand managers need to understand what 'responsible marketing' is, supply chain managers need to focus more on understanding how to ensure that Unilever's Code of Business Principles is adhered to throughout the supply chain. As the issues become function-specific, so the responsibility of ensuring that training on these issues is provided shifts towards Unilever's functional management. This is made easier by the fact that at a global level, many functions have their own 'Academy' responsible for the development of training for managers around the world working within that function and corporate responsibility specialists in Unilever's global head office have already begun working with those academies to support that process.

Reinforcing the Corporate Responsibility culture

The training centre is a nice place to discuss corporate responsibility. As a CR manager, you have a captive audience who know they are there to listen and debate. But what really matters is what happens when you're back at the office and have to compete for attention with the everyday task of running a business creating, making and selling consumer goods. In this section I will firstly outline how Unilever UK's organisational structure supports a culture of embedding corporate responsibility into the core business functions. Secondly I will examine two particular challenges we have faced over the past couple of years and the steps we have taken to minimise their impact from a corporate responsibility perspective.

Organisational structure

The key principle of Unilever UK's approach to corporate responsibility management is one of integration, and this is reflected in the structures that support it. While there are numerous roles within the company which incorporate some aspect of the management of the business' social, environmental or economic impact on society, there is only a small central team who advise on this area.

But this is as it should be. Most corporate responsibility work is done by managers working within Supply Chain (including HSE), Human Resources, Marketing or Research & Development functions. The role of the specialist CR professional is to maintain the overview and advise senior management of any potential gaps or issues which need addressing. If the task of addressing those issues or filling those gaps belonged to a large specialist CR team, integration would be more difficult, the organisation would become more complex, and accountability for the issues would be unclear. With only a small team, ownership of those issues is impossible and it is clear that responsibility must lie with the relevant mainstream function. The one exception is within the area of community investment where the work concerns building relationships with local community stakeholders. Unilever, like many companies, integrates this activity under the overall corporate responsibility umbrella.

When the going gets tough ...

It is no secret that during 2004, Unilever's financial performance was not what many had hoped for. As we approached the end of our five-year Path to Growth strategy, many of the targets we had set ourselves had been achieved. Unfortunately, the objective of top-line growth of 5–6 per cent was not one of them. Growing the business while maintaining profitability was already a key focus area, but the pressure had been turned up. The challenge was to make corporate responsibility relevant in this tougher than ever business environment.

One of the first actions was to re-examine some of the community investment programmes. We ensured that funding was being directed towards those programmes which were most likely to deliver value for the business and the community partners. Secondly we sought to promote our role as advisors to the business, rather than simply as acting as an internal 'police' telling people what they should or shouldn't be doing. That positioning as a specialist service has led to us being involved in advising senior managers on topics as diverse as the closure of a manufacturing site, cause related marketing programmes, and new product launches. As more people find out about what is essentially a free internal consultancy, so we create a demand from within the business for that service and we increasingly find that the doors are open and people are happy to listen.

Why many friends are better than one good one

As with many large businesses, Unilever tends to restructure itself from time to time. The process of embedding (or reinforcing) corporate responsibility within the business must therefore explicitly take account of that. In real terms this means that having senior sponsorship, while helpful, is not the only thing that matters. Senior people tend to move around the business and champions of corporate responsibility can soon be moved to another part of the organisation. This discontinuity can threaten any kind of business programme which is associated with a particular leader or manager and so is also true of a corporate responsibility programme.

The solution to this problem therefore is to avoid any single person championing corporate responsibility, but to pursue a scattergun approach of building a broad base of support for and interest in the corporate responsibility activities of the company. Fortunately the approach of Unilever UK supports this idea: the graduate training programme alone is reaching around 75 young managers a year spread across all business units and all functions, and the advisory service we provide to managers around the business is helping us make friends at middle management level in the Marketing, HR and Supply Chain functions. Ultimately I'd like to see more opportunities for managers from these and other mainstream functions to undertake a secondment to the corporate responsibility team, so they can transfer back into that function with a specialist understanding of what CR means in their own functional context.

Conclusions

So what can we conclude from these practical examples? I would like to suggest three things:

1. Corporate culture and corporate responsibility. Much of the practice described here has not come about because of a conscious desire to integrate Corporate Responsibility into existing business processes. Instead the conscious choice has been to encourage a certain kind of culture and a certain kind of values because of a belief that this will ultimately lead to the right business results. So a practical step for an organisation wanting to integrate Corporate Responsibility more fully might wish to look at its culture and values to see whether they are likely to be compatible with the notion of corporate responsibility.

2. Enabling, not teaching. Much of what is relevant to corporate responsibility does not need teaching. Most people get a good grounding in understanding ethical issues from their parents or school teachers. Codes of conduct are a useful and important reference tool and policy aid, but as we all know many failed companies such as Enron had exemplary codes. What is really important is that companies 'give permission' for employees to use their own personal values in the workplace, using their own instincts to flag up potential issues and conflicts. This can be encouraged through code of conduct workshops and other training, but a good way to start is recruiting managers who display a tendency to do this as a matter of course.

3. Consistency of communication. Problems can arise if communication about corporate responsibility is inconsistent. For new employees, communication before and after joining needs to match up. If you're told as a potential recruit that Corporate Responsibility is important to the company, you'll be surprised if when you join your line manager doesn't know what it is.

Similarly, telling managers that Codes of Conduct are important without making it easy for people to report suspected breaches sends out very mixed messages about whether the company genuinely wants to know if there is a problem, or whether they just want to be being seen to do the right thing.

Future challenges

As a business we are aware of the changing world in which we operate. We are also aware that society is changing, that our consumers and many other stakeholders expect more of us than ever before. In the twenty-first century it is not enough for a business to be successful and to operate to the legal minimum standards – society expects more, and so the job of the manager moves away from one of running a profitable, legally compliant business to one of running a profitable, sustainable, socially acceptable business. There is evidence in Unilever's heritage to suggest that right from the early days of Lever Brothers, when William Hesketh Lever not only created a business which aimed to 'to make cleanliness commonplace' but also built houses for his workforce in Port Sunlight, that this second view has been the dominant philosophy of the company's management.

But the challenges have moved on since then. New dilemmas are emerging linked to globalisation, sustainable development, public health and the responsibility of producers versus that of consumers. While the challenges are new, the skills and competencies needed to deal with these issues are very similar, and those companies who both encourage a corporate culture sensitive to the expectations of society and who respect personal integrity as a key leadership competency when recruiting managers, will be well equipped to meet those challenges.

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Part IV

Questions and Perspectives

13

From the Margins to the Mainstream: Corporate Responsibility and the Challenge Facing Business and Business Schools

Peter Lacy and Charlotte Salazar[1]

Introduction

In a globalising world, companies are exposed to an ever more complex web of stakeholder groups, whose interests and expectations they are expected to manage. This is not all one-way traffic. The long-held belief, recently espoused by *The Economist*,[2] that financial performance conflicts with social and environmental performance is being challenged by companies themselves. In addition to being seen as a way to manage costly reputational and regulatory risks, leading companies and entrepreneurs see well managed corporate responsibility as a way to improve performance and create new business opportunities. The traditional 'externalities' of economics, usually defined, and often still taught, as outside of business' remit, are steadily becoming very real factors in corporate decision making. However, despite these developments, integrating corporate responsibility into the mainstream operations of the vast majority of companies is a challenge that remains to be met.

In evaluating this lack of progress, the critical lens focused on business has shifted to include other actors. The role of business schools in equipping corporate leaders to deal with the economic, social and environmental elements of business has been brought into question. This chapter will consider the – often parallel – challenges facing both companies and business schools in integrating corporate responsibility into their core operations. It will also examine their response to these challenges. In an attempt to chart a path forward, we will look at how companies and business schools can work together to integrate corporate responsibility into the mainstream of everyday business theory and practice.

A. Kakabadse et al. (eds.), *Corporate Social Responsibility*

Corporate responsibility in companies: at the margins or in the mainstream?

Corporate responsibility, or one of its many synonyms, is a concept now familiar with the vast majority of companies. Whether it is in response to external pressures, from government, civil society or the public, or driven by an internal belief in the economic benefits of responsible business practices, many companies are now starting to take concrete steps to deal with social and environmental issues. In addition, the rise of socially responsible investment and the growing interest amongst mainstream investors and pension funds in long-term sustainability has sent explicit signals to companies that their management and performance on corporate responsibility is viewed by the financial community as a guide to future success.

In a first step to responding to these pressures, many companies have created a function within their business dedicated to corporate responsibility. Initially this was acknowledged as a positive first phase in moving corporate responsibility to the mainstream of business. However, recent thinking and discussion has been more ambivalent and departments focusing solely on corporate responsibility have attracted criticism for making social and environmental issues appear the preserve of specialists outside of core business.

Critics argue that whilst corporate responsibility operates in specialist departments on the margins of core business, it risks being a 'built-on' addition to real business with no particular relevance to mainstream operations in, for example, strategy, marketing, finance and accounting, and human resources. Driven by demands for greater transparency and accountability, a key objective of these departments is often to communicate their company's corporate values and responsible business practices to its stakeholders. However, by creating a specialist department that often deals more with the message rather than the content of corporate responsibility, critics claim that some companies have effectively created their own 'Achilles Heel': a very public but not always substantial declaration of their record on corporate responsibility. For example, Smith and Cohon observe in the *Financial Times* that, 'CSR [corporate social responsibility] in most companies is in a ghetto: it is a marginalised and marginal activity, often left to a dedicated department with the task of getting the message out about a company's good works.'[3]

Nevertheless, this does not imply that all corporate responsibility specialists or departments are inherently a bad idea. The dangers that Smith, Cohon and others point to, occur where the false impression is created that the existence of corporate responsibility specialists and departments is an end in itself. This can lead to complacency amongst other managers and can impede the consideration of how corporate responsibility affects their function, giving them the false security that 'the corporate responsibility team will take care of that'. In the long-run, such a lack of authenticity may even cause more problems than it solves. Nevertheless, these same specialists and departments can, if well managed, undoubtedly be an enabling force and central reference point in companies.

For corporate responsibility to move to the next level and become a seriously applied area of business practice, companies may be required to rethink their business model to align long-term financial sustainability with long-term social and environmental sustainability. As Grayson and Hodges point out in *Corporate Social Opportunity*, only when companies consider at a strategic level how corporate responsibility can contribute to their business model, can societal concerns be translated into actionable objectives for mainstream business operations.[4] This is by no means a seamless process and a great deal of companies struggle to take corporate responsibility to the next level. This was highlighted by a recent study of corporate leaders carried out by the Centre for Corporate Citizenship at Boston College, with the US Chamber of Commerce and Hitachi Foundation, which found that of the companies surveyed, only 10 per cent are taking meaningful action to rethink corporate strategy and embed corporate responsibility into core operations.[5]

For companies to break the mould and create new responsible business strategies, they often have to address collective business, social or environmental issues, such as HIV/AIDS or carbon emissions, which they alone cannot solve. As SustainAbility observes in its report *Gearing Up*, businesses in this situation are confronted with the 'prisoner's dilemma': do they risk taking action and assuming the risks (and costs) alone, or do they wait to 'free-ride' on others' efforts?[6] For corporate responsibility to become embedded in company strategy, firms therefore have to consider complex, new and sometimes risky business models.

Developing managers capable of dealing with complexity

To enable companies to deal with this level of complexity and to translate this into actionable business practices, there is a growing recognition that the knowledge and skills to manage the financial bottom line must be complemented with the ability to manage the social and environmental dimensions of a business' operations. By building capacity amongst mainstream business professionals, companies aim to equip decision makers with the ability to evaluate the broad impact of their operations, in order to mitigate risk, improve business performance and to create new opportunities.

Whilst there is an initial understanding of the importance of mainstream knowledge and skills on corporate responsibility, it is not yet explicit how much these issues influence companies' recruitment and people development policies. Much is made of the significance of positive corporate reputation in winning the 'war for talent', yet it is far from clear if companies actively seek out candidates with knowledge or skills on corporate responsibility when hiring. Moreover, the manner in which companies align their people development policies with corporate responsibility is at best opaque. Little is understood on how companies translate their stance on corporate responsibility into actionable policies on performance criteria, performance assessments and rewards systems.

Perhaps partly driven by these reasons, companies are starting to look externally for help in building capacity on corporate responsibility. Support for management education in this area has gained traction with companies, governments, and other stakeholder groups. From the corporate side, Bernard Giraud, both Executive Director of CSR Europe, Europe's largest business network on corporate responsibility, and Director of Sustainable Development and Social Responsibility at Danone, stresses the importance of corporate responsibility in Danone's future recruits: 'We see a need for recruiting future managers who can handle matters of complexity. This includes … managers in charge of various business functions such as supply chain, finance, marketing, etc. Understanding that business must take into account both societal and economic factors is a trait we look for when seeking future managers.'[7]

National governments and international governmental organisations also support the role of business education in raising the bar on corporate responsibility. For example the UK Department of Trade and Industry (DTI) created the UK CSR Academy last year to respond to the growing need for 'promoting CSR competencies into the education, training and on-going professional development of all managers – not just CSR specialists.'[8] Furthermore, the European Union (EU) Commission's 2004 Multi-stakeholder Forum on CSR, with representatives from business, policy makers and other groups, found a strong need for network organisations such as the European Academy for Business in Society (EABIS) and the European Foundation for Management Development (EFMD) to encourage universities and business schools to include corporate responsibility in their research and teaching.[9] In addition, the recent business-led appeal to the European Union, governments and to other companies (*European Roadmap for Businesses: Towards a Sustainable and Competitive Enterprise)* includes explicit reference to the role that business schools must play in educating today's and tomorrow's managers on these issues:

> This is an appeal to … business schools and universities to integrate in mainstream management education curricula the acquisition of knowledge and skills necessary to fully exercise corporate responsibility. This will be recognised as a major contribution to European competitiveness and sustainability in the future.[10]

As support grows amongst various stakeholder groups for business education in assisting corporate responsibility thinking and application, so too do the concerns about leaving corporate responsibility at the margins of the curriculum. Swanson and Orlitzky (2004), for example, find that executives that downplay ethics in decision making and prefer extraordinarily high salaries for themselves have received more business school education than their peers.[11] Swanson's claim (2004) that business school teaching should impart that 'business people not only serve themselves but society as well',[12] resonates with the views of the late Ghoshal (2004), who believed that by reinforcing companies' primary focus on maximising shareholder value, business schools encouraged students to divorce ethics from their decision making, freeing them 'from any sense of moral responsibility'.[13]

Neither have criticisms been limited to vocal individual scholars. Mainstream business media have also highlighted the dangers of neglecting corporate responsibility in mainstream curricula. In their recent investigation of why business schools 'stand accused of being responsible for much that is wrong with corporate management today,' *The Economist* considers if the lack of business ethics in MBA curricula has contributed to the irresponsible behaviour of managers involved in recent corporate scandals, such as those at Enron and Worldcom.[14] Skapinker reflects on the same point in the *Financial Times* and finds current business school teaching lacking a 'philosophy of business that aims for more than the maximisation of profit.'[15]

These views do not necessarily represent the entirety of business, government, or other stakeholdes but they do highlight the concerns of those organisations spearheading change in corporate responsibility. As pioneers, the organisations quoted here have a strong voice and are looking for resonance within the business education community. To date, with a few exceptions, business education has failed to answer this demand in a coherent way. This failure is due to a widespread lack of understanding of the debate and of its strategic value within the core curricula of business schools, particularly in the MBA.

Corporate responsibility in business schools: at the margins or in the mainstream?

The pressure on business schools to transform themselves is being met with a variety of responses. These include a growing number of courses and seminars, consulting, new academic research and teaching networks. However, balancing the demands of the business world for immediate hands-on solutions with the priorities of the academic world to develop sound research is proving difficult. As illustrated in the case of companies earlier in this article, whilst there may be some role for 'add-on' or stopgap features in research, education and training – particularly in the early stages of development – ultimately, to be sustainable, the concept will have to be integrated into the mainstream of theory and practice or it will not have a long-term impact.

In the vast majority of cases, this is not happening. A study by Nottingham University Business School's International Centre for Corporate Social Responsibility and EABIS in conjunction with EFMD (2004), revealed that European business schools are still a long way from integrating teaching on corporate responsibility into the mainstream curriculum. Starting from the premise of enlightened companies, that all business functions should manage the societal impact of business, business school teaching should be looking to embed 'responsible' thinking into everyday business decisions. Eighty per cent of respondents to the survey stated that they are 'undertaking activities of some kind to bring CSR into their business teaching mainstream'. However, a closer analysis finds that what is understood by this description varies greatly. Just under half of the respondents cited optional modules, while only a third compulsory ones. Twenty per cent said that they embedded seminars, special events and conferences on the role of business in society into other modules and courses. However, the great variance in how terms and theory were understood by respondents means that the extent of embeddedness will need to be assessed in much greater depth in future surveys. Furthermore, given that CSR course providers were over-represented in the sample (half of the respondents were taken from a CSR researchers and teachers database), it is doubtful that these results can be extrapolated to the majority of the European business school community.[16]

The study also found that where teaching on corporate responsibility does happen, is very heterogeneous and often dependent on the interpretation of the sole specialist professor that 'owns' corporate responsibility within an institution. Results found 40 different labels for courses on corporate responsibility within the institutions that responded (25 per cent of all European business schools).[17] The fact that so many labels are used at only a quarter of European business schools indicate the comparative ease with which these courses are validated and their orientation to individual teachers' special expertise. Furthermore, the proliferation of course titles generally considered of fringe status within business schools (with reference to the disciplines of sociology, philosophy, culture) highlights that in the majority of cases, corporate responsibility is not a subject considered appropriate at the 'hardcore' of mainstream business teaching, in for example finance, strategy or HR. Findings of a similar study carried out by Navarro and Carver (2004) in North America echo those of Matten and Moon (2003), with only 40 per cent of the 50 top US business schools stipulating a course on the ethics or social responsibility of business.[18]

Findings such as these have led to a number of responses from scholars and business school bodies. Two American academics, Swanson and

Windsor, have publicly called on the Association to Advance Collegiate Schools of Business (AACSB), to include a 'foundation course' on business ethics as a minimum standard for business schools. They believe that this should come over and above what AACSB has termed 'infusion' in core courses.[19] The Association of MBAs' new criteria for the accreditation of MBA programmes and pre-experience Masters in general management demands that corporate responsibility forms part of the essential core of the curriculum, and encourages its integration with the rest of the curriculum taught. EFMD, working in partnership with EABIS, is also considering ways to integrate corporate responsibility teaching into its EQUIS accreditation. Whether the inclusion of corporate responsibility is through stand-alone courses, as proposed by Windsor and Swanson, or integrated into mainstream subjects, there is an identifiable academic demand for corporate responsibility to be taken seriously by business schools.

Pressure is also growing from the bottom up on corporate responsibility in business schools. In increasing numbers, business students are looking for more and better teaching on sustainability issues. Indeed, student groups such as *Net Impact* have been responsible for the development of global movements on issues surrounding corporate responsibility and have used this momentum to demand that societal issues be treated seriously in business school curricula. The Aspen Institute's survey on MBA student attitudes on business and society, *Beyond Grey Pinstripes* (2003), showed that students on some of the highest ranked MBA courses in the world are dissatisfied with the teaching they receive on the social responsibilities of companies. Of 16 courses offered on the standard MBA, over 60% of respondents believed that at least 10 of these should address corporate responsibility, ranging from finance to human resource management and strategy. When asked to identify changes they would recommend to better educate students about the social responsibilities of companies, respondents frequently suggested integrating corporate responsibility into core courses.[20]

With business, government, students and academics themselves calling for corporate responsibility to move up the business school agenda, the question remains why has this not happened? The answer may be more to do with internal pressures on business schools, rather than with those external pressures previously described. Business schools sit on an uncomfortable fault line between the academic and business worlds. On the one hand they must achieve academic legitimacy through quantifiable analysis and scientific precision. On the other, they must deliver relevance to the knotty and complex real-world challenges of everyday management. The two masters to whom business schools must answer seem to be pulling them in two very different directions.

At their extreme, critics of business schools, notably Pfeffer and Fong (2002),[21] claim that by operating within the social sciences, business schools have created functional disciplines which do not always reflect the intertwined and complex reality of today's global business environment. For this reason, the very purpose and legitimacy of business schools in developing adequate business leaders has been called into question. Pfeffer and Fong's research (2002) finds 'substantial questions about the relevance of [business schools'] educational product and doubts about their effects on both the careers of their graduates and on management practice.'[22] Mintzberg (2004) also finds fault with business school teaching in developing managers equipped for the complexities of busienss. In his book *Managers not MBAs: A Hard Look at the Soft Practice of Managing and Management Development*, Mintzberg (2004) argues that MBA programmes do not impart the practical skills needed for the 'craft' of management but offer 'specialised training in the functions of business, not general educating in the practice of management'.[23] It has also been argued that the theoretical parameters of disciplines encourage faculty to create and disseminate knowledge within their own subject area, with many academic journals solely devoted to one area of business education. Some critics find this to be an overly clinical approach that is not connected to the realities of management. For example, Bailey and Ford (1996) assert 'that business schools appeal to one another as scholarly communities through a plethora of academic journals that are absolutely divorced from the challenges of everyday management'.[24]

The rigid academic structures of management science do not easily allow for the integration of complex, interdisciplinary issues, such as corporate responsibility. As such, it is often left at the margins of core curricula within the remit of specialists, such as the business ethics professor. This is borne out by the results of the previously mentioned Nottingham Business School/EABIS/EFMD study that found the single most important driver of the corporate responsibility agenda in European business schools has been the initiatives of individual faculty members, and not the direction of Deans or other institutional decision makers.[25] Mirroring the 'ghetto' scenario of corporate responsibility within companies, it is likewise viewed within business schools as a fringe subject, not really worthy of serious consideration by those at the hardcore of business education, i.e. the MBA. Whilst the business school system remains within its own entrenched boundaries there are real challenges in making corporate responsibility a legitimate, and publishable, area of research and teaching.

However, the pressure for business schools to transform themselves is growing. Laura Tyson, Dean of London Business School, notes that her customers, those that purchase executive education and recruit her MBAs, have come to disregard the deep functional knowledge traditionally imparted through business education. Instead, what they most look for in their future managers are 'global business capabilities' –the knowledge, skills and attributes to deal with the financial, social and environmental complexity of global business and 'integrity' – the ability to remain true to clearly expressed values.[26] The question that must now be posed to both business and business schools is how to move forward out of the respective 'ghettos' they have created for corporate responsibility?

Business and business schools: building progressive alliances

Reforming business education and building mainstream business competencies on corporate responsibility cannot happen in isolation. One group needs the other to progress: companies can provide business educators with the real-life responsibility issues to be included in teaching and research and educators can provide companies with MBAs and executive training courses that build their managers' knowledge and skills base on corporate responsibility. Indeed, the very cross-cutting nature of corporate responsibility demands a multi-stakeholder approach to finding workable solutions and this is true both inside and outside of the debate about education and corporate responsibility. In looking to increase the impact of corporate responsibility, SustainAbility points to the need for 'progressive alliances' between companies, governments and civil society to meet the scale of global problems.[27] Such alliances should also include business schools.

It is also important that both companies and business educators come together to identify the respective barriers and enablers each poses to the development of corporate responsibility as a mainstream business issue. One such barrier is the apparent lack of strong company demand for the inclusion of corporate responsibility in executive training and MBAs, products of which business is the direct 'end user'. By working in collaboration with business schools, companies will have to be much more direct about the value, if true, that they place on corporate responsibility in the curriculum. Furthermore, critics argue that until companies truly acknowledge corporate responsibility as relevant to day-to-day business, then the impact of even the most responsible business education will be negligible in a workplace that sidelines societal issues. As Skapinker highlights in the *Financial Times*, business school education is 'likely to have only a marginal effect on how … students behave once they graduate', especially when this is into an economic system that 'measures success purely by the generation of shareholder return'.[28]

Thus, both business schools and business have to make contemporaneous changes in order for corporate responsibility to take root as a serious issue in both business theory and practice. By working together on these changes, companies and business schools can leverage their respective core competencies and can ensure that they have a stake in creating new forms of business education. In recognition of the value that these two communities can bring to each other, EABIS was formed. Launched by the Deans of

Europe's top business schools and the CEOs of multinational companies two years ago, EABIS is designed to address the current 'disconnect' between business education and the needs of the corporate world in creating knowledge and skills on corporate responsibility. By providing a forum for business and academic leaders to jointly overcome the lack of mainstream knowledge and skills on corporate responsibility, EABIS acts as an agent for change and an enabling force for the integration of societal issues into business education and practice.

With over 50 members from business and academia, EABIS brings together practitioners and educators throughout Europe to integrate corporate responsibility into business theory and practice through projects on research, education and training. Examples of EABIS' work include the 3-year, EU funded project, 'CSR Platform'. This project will create Europe's central reference point on corporate responsibility research. It will connect researchers across geographies, disciplines and generations to create a more cohesive European research area on corporate responsibility. Importantly too, the 'CSR Platform' will connect researchers with businesses, academics and policy makers and other stakeholders to provide them with a real opportunity to jointly set the agenda for corporate responsibility research, ensuring it is business relevant and brings value to all stakeholders.

A second EU funded research project, 'RESPONSE,' led by INSEAD, is designed to understand how managers from multinational companies frame and enact corporate responsibility across their different business practices, functions and markets. In line with the project's aim to investigate the business realities of enacting corporate responsibility, RESPONSE has been 'co-created' from the outset in collaboration with business. EABIS corporate founding partners IBM, Johnson & Johnson, Microsoft, Shell and Unilever, have all played an active role in setting the initial research agenda and in planning the project's design and implementation.

Projects are also underway to transform the segmented MBA curriculum into an integrated programme that teaches tomorrow's business leaders how to manage the trade-offs between economic, social and environmental issues. This is being spearheaded by London Business School, an EABIS founding partner, in a pioneering project that will look for innovative ways to integrate corporate responsibility across all disciplines within the MBA curriculum, including the development of mainstream cases and teaching approaches.

In direct response to the marginal situation of corporate responsibility within many companies, Ashridge, a founding partner of EABIS, will investigate the skills and attitudes required to integrate societal issues into mainstream business thinking, building on previous work they carried out for the UK DTI on the Slipman Report, *Changing Manager Mindsets*.[29] Covering over 3,000 managers across Europe, Ashridge will provide an indicative 'snapshot' of what European business is doing 'on the ground' regarding corporate responsibility, and where the gaps are in terms of skills development. Ashridge's work is complemented by a training project led by Copenhagen Business School that aims to create high-involvement executive 'action learning' programmes to deal with corporate responsibility within the context of everyday business.

Conclusion

Considering the scale of the global issues that now face companies, it is essential that managers have the ability to address areas outside of the traditional boundaries. To do so, companies and business schools need to work together to ensure corporate responsibility thinking is built into business education in a way that reflects the real issues that managers deal with in everyday decisions, not just in times of crisis. If corporate responsibility is to progress to the next stage, new knowledge and skills will be critical. Getting it right can only be achieved if corporate responsibility is transformed from a marginal issue into a mainstream reality.

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CSR and Stakeholder Involvement: the Challenge of Organisational Integration

Mette Morsing and Steen Vallentin

Introduction

In the survey of CSR published by *The Economist* in January of 2005, Clive Crook argues that the CSR movement has, at least on the face of it, won the battle of ideas concerning modern business capitalism. In fact, there has not been much of a battle at all, since the opponents have never really turned up. Unopposed, Crook argues, the various fractions of the CSR movement have managed to distil a widespread suspicion of capitalism into a set of demands for action: 'they have held companies to account, by embarrassing the ones that especially offend against the principles of CSR, and by mobilising public sentiment and an almost universally sympathetic press against them. Intellectually, at least, the corporate world has surrendered and gone over to the other side' (Crook, 2005: 3).

The proviso that the corporate world has only surrendered intellectually suggests that the victory of the CSR movement is not a total one, far from it. Companies are being accused of only paying lip-service to ideals of good corporate citizenship. While some regard developments in the field of CSR as the creation of 'win–win' situations, others see it as 'a sham, the same old tainted profit motive masquerading as altruism' (ibid.: 4). Even to the most innocent observer, Crook suggests, 'plenty of CSR policies smack of tokenism and political correctness' (ibid.). Although he readily admits that it is hazardous to generalise about motives, Crook argues that the short answer to the question of whether CSR is mostly for show must be 'yes'. For most companies CSR does not go very deep, it is 'little more than a cosmetic treatment', 'a gloss on capitalism' at best (ibid.).

For Crook, this gives little cause for concern as he does not believe that companies belong 'on the other side' (i.e. the side of CSR advocacy) and that capitalism needs a fundamental reform – as suggested by many CSR advocates. In order to improve capitalism, you first need to understand it, he argues, finding that the current thinking behind CSR fails to meet the test. Of course, CSR advocates would suggest that it is Crook who fails to truly understand the moral dimension of the capitalist economy. Either

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way, it is not our concern in this article to argue for one view of morality or the other. Our concern is the matter of corporate approaches to CSR. Like Crook, we believe that it is hazardous to generalise about the motives behind corporate CSR policies and approaches. In fact, we believe that it is hazardous to say anything definitive at all about corporate motives concerning CSR since such motives are essentially inaccessible to empirical enquiry. If we ask corporate leaders about their motives for engaging in CSR-related activities we expect to get a strategic and politically correct answer. As Crook suggests (ibid.: 10), companies operate in a climate of opinion, and currently there seems to be little that corporate leaders can gain from being openly and publicly opposed to CSR. So we can expect corporate heads to be able to talk the talk – when asked about CSR. To what extent they are willing to walk the talk is another matter.

We can never really be sure whether or to what extent corporate activities in the field of CSR are driven by moral values as opposed to strategic/instrumental concerns. This means that the tension between the moral and the strategic/instrumental point of view concerning CSR is here to stay. The tension between the moral and the strategic/instrumental point of view is constantly reflected in the arguments that corporate leaders use for engaging in CSR and in the doubts raised by various constituencies concerning the underlying motives. In other words, although it is difficult to speak meaningfully about 'the real motives' of corporate leaders, the matter of motive reappears on a socially constructed level as a reflection of corporate reasoning and stakeholder perceptions concerning corporate CSR policies and programmes. What matters is not motives as such but the company's ability – through words and actions – to come across as credible and trustworthy to its stakeholders on a long-term basis. Although this may suggest to reduce CSR to a public relations exercise as Crook suggests, we argue that it takes more than politically correct public statements, official policies and glossy reports to convince often sceptical audiences about a company's commitment to CSR. It takes some level of business integration and some level of stakeholder involvement to accomplish this task.

Although it is often argued that top managerial commitment to CSR is a prerequisite for the successful implementation of CSR activities (Lozano, 1996; Pruzan, 1998; Hemingway & MacLagan, 2004), it is, in itself, not enough to ensure that the company benefits from its CSR engagement in terms of improved risk management, organisational functioning, market or civic positioning (Paine, 2003). In order to be able to benefit from engaging in CSR we suggest that top management must commit to an integration of CSR into core business, and that this implies employee and stakeholder commitment.

Most case studies in the field of CSR focus on best practice companies, which have made a substantial commitment in terms of resources and are very open about it. Considering the politically sensitive nature of the topic it is more difficult to get access to study companies that have yet to make a full-fledged commitment to CSR and may choose not to do so for various reasons. Our case is one such company and it can, in this respect, be considered a 'unique case' (Yin, 1984). Thus, we have had to make the case anonymous. In the remainder of the article we refer to our case company as 'Case Corp.'. We were invited to follow a process of analysing Case Corp.'s CSR commitment for one year, and we collected data as participant observers, interviewing managers, studying company documents and media coverage of the company. Although an anonymous case study has some obvious limitations in that we cannot be very specific about management-, company-, industry- and nation-specific variables, it has allowed us to get a rare glimpse 'behind the scenes' of a company, which is in the process of coming to terms with its CSR commitment.

In this article we discuss top managerial reasons for committing to CSR and distinguish between two approaches to implementing CSR: an easily decoupled form and an integrated form. We argue that the integrated form (Weaver et al. 1999) is most likely to provide strategic benefits. Then we introduce Case Corp. and its top managerial approach to CSR. We then present the external stakeholders' perception of Case Corp.'s CSR commitment as a contrast to top management's perception. Finally, we conclude by suggesting that it requires a particular form of top managerial commitment to benefit from CSR activities, i.e. a commitment to organisational integration of CSR and stakeholder dialogue. We also discuss the challenges involved in changing managerial mindsets regarding CSR integration.

CSR: top management and the matter of integration

For some managers, as Paine (2003: 23) argues, the turn to values, ethics and CSR needs no corporate justification. It is a moral statement evoking something that is worthwhile in and of itself – the language used is one of responsibility, humanity and citizenship rather than commercial advantage. However, this is far from always the case. As suggested also by Crook, the idealist stance seems to be more of an exception than a rule among corporate leaders. The repertoire of strategic arguments for some level of corporate commitment to CSR includes reasons relating to risk management, organisational functioning, market positioning and civic positioning (ibid.: 7). From the top managerial point of view, CSR is in many instances not so much about doing good as it is about avoiding bad publicity (Klein, 2001). That is, CSR can be about minimising risks associated with individual and corporate misconduct, carelessness, neglect and insensitivity. CSR may also be part of a positive, as opposed to defensive, effort to energise employees around a positive self-image (Fombrun & van Riel, 2004). CSR can be part of an effort to shape the company's identity and reputation, to build its brands and earn the trust of customers, suppliers and other business partners (Post et al., 2002). And CSR can be part of an effort to improve the company's license to operate and legitimacy in the community (local or global), building good relationships with non-market constituencies such as governments and NGOs and promoting a view of the company as a good corporate citizen 'that obeys the law, pays its taxes, and respects society's basic ethical standards' (Paine, 2003: 20). Of course, top managerial efforts in the field of CSR may also be based on a vaguely defined amalgam of all these reasons.

In this article, we adhere to a definition of CSR emphasising stakeholder relations and the responsibility of the company to take 'into account all of those groups and individuals that can affect, or are affected by, the accomplishment of organizational purpose' (Freeman, 1984: 25). While there is general agreement that companies need to take account of their stakeholders (Post et al., 2002; Smith, 2003), the ways to do so vary considerably. While there has been much speculation and theorising on corporate motives for engaging in CSR, we suggest that the matter of *how* stakeholders are taken into account are directly related to the company's prospects of benefiting from its articulated CSR commitment. We suggest that to benefit strategically from CSR efforts, top management must commit to taking stakeholders into account in corporate decisions and actions in a way that implies an integration of CSR issues into core business.

In making this argument, we draw on Weaver et al. (1999) who make a distinction between two forms of corporate responsibility in their study of how companies integrate ethical programmes: the *integrated* form and the *easily decoupled* form. Integrated structures and policies affect everyday decisions and actions in a company, including corporate strategy and planning. They are likely to be supported by other policies or programmes and the manager(s) and employees who are occupied within the specific policy area will regularly interact with other departments and their managers (Weaver et al. 1999: 540). Other structures and policies, however, are decoupled more easily. They are marginalised and disconnected from the mindset and everyday thinking of ordinary managers as well as from everyday organisational activities. According to Weaver et al. (ibid.: 541), '[a]n *easily decoupled* structure or policy provides the appearance of conformity to external expectations while making it easy to insulate much of the organization from those expectations. Although the structure or policy exists, there is no guarantee that it will regularly interact with other organizational policies and functions or that employees will be accountable to it.' Such decoupling is likely to occur when demands of institutional legitimacy appear to conflict with other organisational goals concerning, for instance, core business. It is usually related to functions developed in response to external pressures, CSR being an obvious example. Decoupling is particularly likely in the case of companies that tend to communicate their CSR messages to employees through memos, company magazines and policy documents, without any particular efforts being made to actively and continuously engage employees in a process of dialogue that can support employee ownership of corporate policy. CSR policies and programmes may be presented without any indication that the message is relevant for the individual employee in terms of his or her responsibilities, goals and particular organisational circumstances. Consequently, the individual employee may consider such messages to be personally irrelevant (ibid.). Other stakeholders are not likely to find this kind of responsible behaviour very rewarding either.

The integrated form implies a top managerial commitment to CSR in terms of structure and process. Here, CSR is not just the domain of top management, it involves other actors located at different levels of the organisation who might serve as internal change agents continually pushing the boundaries of the company's commitment to CSR. The integrated form thus leads to a view of CSR as a continuous process of learning, change and development that ideally affects the whole organisation, unlike the easily decoupled form in which commitment to CSR is more a reflection of top management's desire to appear legitimate to the outside world. Under the latter circumstances CSR may not have much relevance outside the board room. Top management maintains full control over proceedings with CSR policies and programmes being decoupled from, and thus having little impact on, everyday business operations.

Based on our case study we suggest that the level of CSR integration will be important in determining what benefits a company can reap from its CSR activities in terms of improved risk management, organisational functioning, market positioning and civic positioning.

CSR in Case Corp.

Case Corp. is a formerly state-owned company providing products and services to private customers and organisations. In the 1990s, the company was fully privatised and today it runs a number of foreign-based subsidiaries with more than 50 per cent of its turnover coming from foreign sales. It is a prosperous and wealthy company in growth.

In the 1990s, the new top management introduced a vision and values statement, which, among other things, highlights the company's strong commitment to the society in which it operates. The rhetoric of this statement as well as the corporate website clearly reflect the company's heritage as a state-owned company with an obligation to serve society and its citizens. It is stated that: 'We more than fulfil our cultural, social and environmental responsibilities.' Case Corp.'s commitment to social responsibility manifests itself in two overall ways. First of all, an array of CSR-related programmes has been launched. Secondly, top management has been very eager to portray Case Corp. as a company that is not only very profitable but also intensely aware of its social or societal responsibilities. There has, however, been no commitment to CSR in structural terms or in terms of reporting.

Case Corp.'s approach to CSR is top-down; it is embodied and promoted by top management rather than a product of dialogue involving stakeholders. Additionally, the matter of CSR has usually been kept separate from core business issues such as customer service. The one-way approach applies to the internal as well as the external communication of Case Corp. CSR-related activities are increasingly becoming a part of the official self-understanding and storytelling of Case Corp. CSR is becoming part of the effort to create a strong corporate identity and a strong corporate culture based on positive values. Nevertheless, no steps have been taken to involve or engage employees systematically in a dialogue concerning CSR. Employees are essentially being told how they are supposed to think and feel about the social responsibilities and social performance of their company. The same applies to the external communication. In spite of occasional public scepticism concerning the CSR profile of Case Corp., top management insists on portraying Case Corp. in a very positive light – with few reservations.

Case Corp.'s portfolio of CSR-related activities can be subsumed under four headings: human resource programmes; sponsoring and partnerships; environmental policy and reporting; stakeholder communication. In the human resource department, Case Corp. has a number of special programmes targeting specific groups of employees. These social programmes focus on issues such as gender and leadership, integration of ethnic minorities, senior employee policy, training to overcome dyslexia, integration of disabled employees and work practice for disadvantaged youth. An equal opportunity project covers several of these activities. Its aim is to develop the competencies of staff and management to harness the advantages of diversity on all levels of the organisation.

In the area of sponsoring and partnerships, Case Corp. has defined three focus areas. In order to fulfil its vision of assuming cultural and social responsibility, the company supports sports, cultural and humanitarian activities. In sports, Case Corp. sponsors talent development, it engages in league, team and personal sponsorships and it invites VIP customers and business relations to sports events. Cultural sponsorships include major cultural institutions as well as music festivals, the latter allowing the company to reach a younger audience and customer group. In the humanitarian area, Case Corp. has engaged in a partnership with a humanitarian organisation and in addition it supports a number of other such organisations through sponsorship or corporate membership.

According to its vision and values statement, Case Corp. will assume an environmental responsibility *beyond* the requirements of the law. Compared to other large companies, the environmental impact of Case Corp. per employee is moderate. In this respect, Case Corp. can be considered a relatively sustainable company. Still, the company has not made any real commitment in the field of environmental sustainability. The company has, although it is not obliged to do so, for a number of years published an environmental report describing its environmental activities and progress in words and figures. The report has been requested by a number of customers and investors. Also, Case Corp. wants to live up to the demands of ISO 14000 and EMAS, even though the company is not certified according to either standard. However, Case Corp. has chosen not to invest resources in setting up environmental data processes. Consequently, the data in the report lack accuracy and verification, and the report reports on achievements and sets goals primarily in a narrative format. For these reasons, it is not used actively in public communication of Case Corp.'s environmental initiatives. It should also be mentioned that the environmental policy and reporting only covers domestic activities (while more than 50 per cent of the company's revenues are generated abroad). Thus, Case Corp. has taken steps towards formalising its environmental responsibilities without making any real commitment in terms of resources.

The same essentially applies to the company's approach to stakeholder communication. The vision and values statement identifies investors, customers, employees and society as the key stakeholders of Case Corp. Nevertheless, and in spite of the company's size and the number of relevant stakeholders whose interests the company has committed itself to serving, Case Corp. has no stakeholder relations department and no stakeholder communications strategy. Which is not to say, of course, that the company does not communicate with its stakeholders. What is missing, however, is a central coordinating mechanism (apart from top management). A number of different departments are currently involved in stakeholder communication, each being, at least partly, responsible for a particular set of relationships but with no incentives to coordinate their communicative efforts with other departments. Over the last couple of years Case Corp. has engaged in different initiatives concerning stakeholder reporting. None of these initiatives have yet resulted in any formal decision to prepare such reporting.

Summing up: Case Corp. is characterised by managerial ownership of the CSR process. What is missing is organisational integration, as CSR, to a large extent, seems to be decoupled from the everyday business of the company. CSR consists of ad hoc projects initiated and communicated by top management. Employees and other stakeholders are informed about CSR-related activities rather than involved in dialogue. Although the company has a portfolio of CSR-related activities there is no coherent guiding strategy, no structural underpinning in the form of a stakeholder relations department or similar function, and the company has made no formal commitment to social or environmental reporting. Now, how does the company appear to the public eye?

Case Corp. in the public eye

In spite of the implemented policies and programmes and the communicative efforts of top management to let stakeholders know about the good deeds and intentions of the company, the public perception of Case Corp. is not one of a superior performer in the field of CSR – quite the contrary.

To explain this, we have to look at the societal standing of the company. Case Corp. is a big, dominant and high profile company domestically. It is one of the most publicly visible companies in the country due to its size, its status as former state-owned monopoly status and its advertising. Having a dominant presence in society, the company is used to getting a 'bad rap' in the media – negative stories concerning its activities will usually make the headlines. In the media, Case Corp. is portrayed not just as a very profitable privatised company, that has successfully managed a turnaround process, but one that today emerges as a highly competitive market player. Case Corp. is portrayed as a company that exploits its former monopoly status and the competitive advantages that it has been awarded by the state. The company is seen as being exclusively profit seeking, putting more emphasis on shareholder value than customer service. No one, presently, questions the company's ability to make money. Its social commitment is another matter.

Case Corp. has acquired a reputation for being guided by the demands of capital markets rather than social concerns. And fiduciary trust is of a different currency than trust relating to social concerns. A recently conducted survey and focus group analysis show that Case Corp. does not currently have a high public profile in terms of CSR. Using an index scale, where index 0 corresponds to 'Not at all socially responsible' and index 100 corresponds to 'Very socially responsible', Case Corp. reaches index 43 – a rather low assessment. Many respondents indicate that they have simply never heard of anything that would define Case Corp. as a socially responsible company. The focus groups suggest that Case Corp. is perceived as reactive and not proactive in terms of CSR. You only hear about Case Corp. and CSR when management has to justify or defend the company's actions in the light of critical media coverage.

What is the potential, then, of the implemented programmes in terms of CSR-related strategic benefits? In the area of HR, the focus on diversity definitely has a lot of potential. As a CSR-related activity, sponsorships attract a fair amount of cynicism as they often seem to be motivated by commercial rather than social interests – they are often considered as marketing exercises first and foremost. Humanitarian partnerships can attract cynicism, particularly when – as in this case – the partnership organisation has little to do with the core business of the company. Such a partnership can be considered as an attempt by the company to buy goodwill, friends and allies at a low price, while otherwise maintaining business-as-usual.

The areas of environmental policy and reporting and stakeholder communication are characterised by the lack of any real commitment.

All in all, the top management of Case Corp. has not managed to convince the general public that it is driven by moral reasoning – 'the better way' argument, and it has failed to gain many of the potential strategic benefits of CSR. The CSR engagement is not providing a risk-reducing buffer against critical media coverage, and in terms of organisational functioning the HR programmes may make a positive difference but CSR is not really an integrated part of the organisation. In terms of market position and civic positioning CSR does not seem to make much of a positive difference for Case Corp.

Even so, the top management of Case Corp. seems quite content with the current state of affairs. They see no need for radical change and no need to rethink the business model. What is needed as they see it, however, is for the company to inform better about its CSR activities and overall stance on social issues. The challenge is to get the right information across to the relevant external constituencies in order to make them understand the significance of Case Corp.'s CSR activities. In other words, the suggested strategy amount to 'more of the same'.

Conclusion

Although we obviously have no insights into Case Corp.'s top management's moral versus strategic/instrumental motives for their CSR commitment, we can conclude that the company has not achieved much from it in terms of strategic/instrumental benefits: i.e. improved risk management, market or civic positioning. Neither are there any clear indications of improved organisational functioning. At the present time, Case Corp.'s approach to CSR seems to be of the easily decoupled variety, without a systematic integration of CSR into core business.

With a clearly business-oriented, shareholder driven top management and with no strategic/instrumental benefits from a comprehensive CSR engagement, one is tempted to ask why Case Corp.'s top management makes no strategic changes to benefit from its resource-demanding commitment to CSR. Cheney & Christensen (2000) have suggested that financial success may in fact become an obstacle to further organisational developments, because corporate success can lead to corporate self-seduction on the part of top managers (Cheney & Christensen, 2000: 259). Good financial results can serve as 'proof' that top management is making the right decisions, including decisions concerning CSR and stakeholder relations: 'if it ain't broke, don't fix it'. Success can lead to a kind of managerial self-absorption (ibid: 266), which may or may not be damaging to the future prospects of the company but which, either way, stands in the way of change. In Case Corp. top management confronts a negative reputation but not a life-threatening scandal. At the same time, the company is producing good financial results. Consequently, top management has no urgent need to rethink the business model and to walk the talk, so to speak, in a manner more consistent with the company's articulated commitment to CSR. In fact, a rethink in terms of an integration of CSR may endanger short-term business prospects. While we in this article have suggested that organisational integration of CSR into core business can be a prerequisite of strategic benefits, we also acknowledge that managerial mindsets are difficult to challenge and change, particularly when a company is experiencing a long period of growth and economic prosperity. It is an open question as to what it takes to integrate CSR into the core business in a company like Case Corp.: an economic decline, a corporate scandal or a generation shift?

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15
The Meanings of Social Entrepreneurship Today

Juliet Roper and George Cheney

An important avenue toward responsible and sustainable business is *social entrepreneurship*, although its appearance has been more marked in practice than in academic research. Indeed, there is but a nascent body of academic literature published on the subject, with a smattering of studies across disciplines. In this paper we draw on that literature, as well as popular discussions and contemporary case studies, to explore the development of the concept of social entrepreneurship and its motivations, its promises and its implications. As a working definition of 'social entrepreneurship,' we observe that it most generally entails a marriage between the idea of innovative business start-up or oganisational transformation *and* socially inspired values. At the same time, we stress the diversity of economic, political and social phenomena associated in one way or another with the term 'social entrepreneurship' while also emphasising the broad appeal of the term. Thus, social entrepreneurship is a contested term and concept around which there is significant socio-political energy and vigorous debate today.

The renaissance of social entrepreneurship: historical and socio-political perspectives

Central to any discussion of social entrepreneurship are the questions of who should and who can take responsibility for the needs of civil society. Indeed, ideologically based questions emerge regarding the continuance and health of a civil society that is necessarily distinct from either the political or economic sectors. Answers to these questions have varied throughout modern history according to the prevailing, predominantly economic, theories upon which national governance has been based.

In the years immediately following the Second World War and until the early 1970s, the governments of most western democratic countries followed the Keynesian model of social democracy, with fixed currency exchange rates to guard against inflation, nearly full employment, and a solid welfare system in place for those who needed it. Social services such

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as health and education were provided by the State. The economic and social stability enjoyed at that time ensured hegemonic acceptance of the model. That hegemony met with serious challenge at the time of the major oil shortage in 1974 when rising inflation undermined the logic of fixing exchange rates.

From the early 1980s many of those countries that had maintained their welfare state systems for over twenty years shifted to a new economic paradigm of laissez-faire or free market neo-liberalism. This model, in contrast to its predecessor, is characterised by deregulated markets and privately owned enterprises, with minimal involvement of the State in the economic sector. Part of the process of moving over to neo-liberalism required the 'corporatisation' and eventual privatisation of previously state-owned assets. Very often, those assets were in the key economic areas of transport, energy and communications. Marketisation and varying degrees of privatisation were also extended to the sectors of health and education and, in some cases, to corrections and disaster relief. As the role of the state was withdrawn, income tax rates were typically lowered as individuals were encouraged to take responsibility for their own welfare. The shift towards deregulated economies in countries throughout the world was encouraged by those who pursued the concept of a global economy. Once policy deregulation began to include capital and securities markets, from 1987, financial trading grew exponentially, as investors sought to capitalise on shifts in national currency values, leading to economic instability in several less industrialised countries. The growth in financial trading was facilitated by the development of new communication technologies (Castells, 2000).

By the late 1990s it had become apparent that the neo-liberal model was not ensuring the welfare of all people. Indeed, the growing gap between rich and poor individuals (and countries) had become clear. Large corporations, because of their ability to choose where to invest capital, could wield economic power to an extent that made regulation difficult (Gray, 1998; Grossman, 1998; Karliner, 1997). The extension of market principles into government and civil society (by virtue of individual rather than collective responsibility) has led to a blurring of the boundaries between these sectors beyond even what had been experienced in the form of public–private partnerships before the 1990s.

Although laissez-faire approaches to economic governance have featured in other periods of our history, it is arguable that once the Keynesian model with its system of social welfare had been experienced, people were no longer prepared to accept governments which abdicated responsibility for those who could not fend for themselves. It was the rejection of the neo-liberal model and its negative consequences that led to the rise of a compromise, commonly referred to as the Third Way (Giddens, 1998). Embraced by Britain's current New Labour government, New Zealand's current Labour government, the former US government of Bill Clinton, amongst others, The Third Way reinstates government responsibility for social services such as health and education but also embraces a free market for business and supports unbridled free trade as the goal of both national and global economies – including the specialisation of national economies in areas where they can presumably best compete with low prices on the world market. The Third Way looks for the rebuilding of a strong civil society through community effort in partnership with government, but without resource to an entitlement based approach to social welfare (Mendes, 2000). The Third Way model, however, has not gained universal acceptance, and the US for example, has back-pedalled from it under the administration of George W. Bush. Some of the resistance to Third Way economics is reflected in the challenges facing social entrepreneurship, as we discuss at the end of the chapter.

Governments today can no longer afford to provide social welfare to the extent that it was provided under the Keynesian model. Because they have sold the previously state-owned assets which not only were fundamental to the countries' infrastructure but also provided revenue streams, they have less income to redistribute. This is true as well in some countries of northern and western Europe, even though their commitments to the Welfare State have not been eroded as much as those in the US, the UK and Australasia. In many cases, revenue from income tax was also reduced. Raising taxes again would increase revenue but would be likely to be politically unpopular. To exacerbate the problem, technological advances in health care have increased human life expectancy rates, and have created a demand which is expensive to meet. These fundamental problems have contributed to the rise of a range of societal trends, organisational structures, and individual initiatives, all of which come under the generic umbrella term of 'social entrepreneurship'. We explore the range of uses of this term in the following section.

Models of social entrepreneurship

Introduction

As we have already indicated, there is no single way to characterise socially entrepreneurial ventures. This makes some 'mapping' of the range of actual and possible projects and enterprises all the more important to us – in that the unifying symbol as well as its diverse practical implications represents an important cluster of trends today. In fact, it is both reasonable and common to identify certain ventures in the private, public and third/independent sectors as examples of social entrepreneurship. While the term is most commonly used to apply to 1) examples of 'a socially engaged private sector' and 2) 'more entrepreneurial approaches in the not-for-profit sector' (CCSE, 2001), we also find initiatives largely or wholly within the public sector which are framed similarly (Dees, 2001).

In this section, we summarise key features of organisational models of social entrepreneurship, including the basic assumptions underlying these arrangements and the practical implications of them. Here we consider not only transformations of typical or traditional understandings of 'doing business' in any one sector but also explore how partnerships across sectors are often pursued under the rubric of social entrepreneurship. We will now consider socially entrepreneurial ventures in each sector, private, not-for-profit, and public, respectively, while also commenting on hybrid or bridge forms.

Private social entrepreneurship

The recent academic and popular literatures suggest that working within the private sector gives the social entrepreneur an advantage in terms of the orienting to *planning, profit, and innovation* – three of the goals which are discussed most frequently. And, as we discuss in the section on social entrepreneurs themselves, CEOs and leaders of non-publicly-held companies report the greatest freedom to pursue their cherished values.

Socially oriented purpose business ventures can draw upon a wealth of experience in terms of market analysis and the conduct of feasibility studies (Campbell, 1998). They are already operating with profit in mind. And, depending on their accustomed market, they recognise the importance of innovation on a continuous basis. Perhaps the single most important activity for the new business start-up, or the business that is charting a new course into the social seas, is a systematic process for generating and screening ideas (Thalhuber, as cited in Campbell, 1998). A balance between the open and democratic generation of ideas and the discerning of genuinely good and feasible ones is crucial. Too much openness risks impracticality; too linear and controlled a process can mean a loss of potentiality.

Generally speaking, then, self-styled socially entrepreneurial enterprises assume greater latitude in adopting and adapting the popular business trends of the day. As we will see in the discussion of leadership that follows, much of this freedom or autonomy is held by value-driven, charismatic leaders.

Social entrepreneurship in the not-for-profit sector

In a very real sense, social entrepreneurship has been going on within the non-profit sector for a long time though without the label. Many social-movement organisations, social advocacy groups, and community initiatives have been started and sustained all over the world through the passion, insight and creative work of people that fit our contemporary application of the idea of the entrepreneur.

To be sure, part of the entrepreneurial trend in many non-profits has been increased competition for funding resources from private foundations and government agencies (De Leonardis and Mauri, 1992). This reality has made formerly foreign activities like market analysis and strategic planning part of the regular functioning of non-profits in a way not widely imagined as recently as the mid-1980s.

In a detailed study of social entrepreneurship in the realm of community economic development, Wallace (1999), looks especially at non-profits that set up profit-making activities in needy urban environments. These activities range from the offering of specific health and educational resources to small-business incubators. While the specific governance, fiduciary and organisational structures of such enterprises vary greatly, most of these ventures involve at least these characteristics: an orientation toward the regeneration or expansion of economic activity, collective advancement of the public good rather than exclusionary support for private interests, community ownership or control, and participative democratic structures (Pearce, 1994).

Above all, as Wallace (1999) sees them, the socially entrepreneurial arms of non-profits have the resources and freedom to experiment in ways not usually open to resource-and-regulation strapped parent organisations. Thus, she sees social-purpose enterprises as ways of bringing together the energies of all three sectors to combat entrenched economic and social problems in urban communities.

Non-profits that assume an entrepreneurial posture are less hesitant to implement concepts and practices from marketing, strategic planning and systems for the analysis and control of costs. In other words, a certain blurring of sector boundaries is taken for granted, often as necessary for survival.

Public-sector social entrepreneurship

Theories and models of entrepreneurship in the public sector are derived in large part from economic applications of business and market models to the public sphere – an effort which began in earnest in the 1960s and 1970s. In one of the first papers on the subject, Ostrom (1964) considered how water resources management might benefit from some injection of entrepreneurial energy. Above all, she distinguished between private and public entrepreneurship by observing the significant political and administrative constraints on the latter. Public organisations have a more difficult time adapting to changing circumstances and innovating owing to constitutional, executive and legislative considerations, as well as to sheer habit. In other words, the private sector allows for greater freedom and experimentation, as seen from this standpoint.

As Shockley et al. (2002) explain, even through the 1990s, the theories and models of public-sector entrepreneurship overwhelmingly stressed rational economic calculation and especially direct responsiveness to market data. However, as Kirzner (1999) argued, this linear and rather mechanical idea of entrepreneurship as applied to public agencies overlooks the fact that true entrepreneurship is something more and beyond mere calculated responses to the environment of decision; it entails an 'alertness to hitherto unnoticed opportunities' (39). Thus, there is a process of discovery and creativity not fully accounted for in the traditional rational-economic model, and it is precisely that 'spark' that the idea of entrepreneurship is meant to convey.

As we have already discussed, so-called Third Way economic and social policy is especially amenable to the symbols and methods of entrepreneurship, as an essential part of this ideology is that there is no inherent alienation between public and private interests.

Conclusion

If there is one theme that runs through the discussions of social entrepreneurship in every sector, it is *adaptability*. According to Baumgartner and Jones (2002), 'feedback loops' are crucial to the success of socially entrepreneurial ventures: positive feedback loops are self-reinforcing, whereas negative ones help adjust an organisation that is clearly off course. 'A successful policy entrepreneur is able to correctly assess which goals will be most attractive to the constituency groups she is targeting and will adjust her tactics accordingly to maximize her chances for success' (Feeley, 2002: 126). In this way, the core message is one which is compatible with the contemporary themes of organisational agility, self-correcting systems, and the learning organisation. Nevertheless, as (Johnson, 2000) concludes from her extensive review, models of good practice and means of evaluation are lacking in this arena.

The social entrepreneurs: value-driven and charismatic leadership

Introduction

Having considered a range of meanings and models for social entrepreneurship, we now turn to consider the types of individuals who are adopting this label or who have been identified with it. As described in professional publications, popular magazines, and cross-over journals, these individuals fall into three general categories: 1) newly emergent or experienced CEOs who style themselves and their organisations as both innovative and socially responsible, 2) administrators of non-profits or social advocacy groups who import business and market-based models to improve their organisation's performance and enhance its longevity, and 3) at large philanthropists who see themselves as catalysts for both organisational and societal change. Here we consider each type in turn before moving to the question of the centrality of charismatic leadership in social entrepreneurship.

In his book *The Rise of the Social Entrepreneur*, Leadbeater (1997) explained their emergence in terms of the social gap created by the shrinking welfare state in most industrialised countries. Further, the author argued that enterprising individuals, working especially at the community level, could well be encouraged to create new organisations as well as to reform existing ones. At the broadest level, Leadbeater envisioned, the three sectors could learn from one another if socially entrepreneurial efforts were allowed to flourish.

The CEO as social entrepreneur

Good examples of the first category of social entrepreneurs above, innovative and socially-conscious CEOS, are the founders of the companies The Body Shop, Ben and Jerry's, and Patagonia. In all three cases, the founders began with strong visions of socially responsive business and succeeded in instilling their values in the organisation. Key to the successes of these founding CEOs – Anita Roddick, Ben Cohen and Jerry Greenfield, and Yvonne Chouinard, respectively – was their ability to 'imprint' a privately held company with guiding values. For example, Anita Roddick, who founded The Body Shop in 1976 as an alternative to non-value-driven cosmetics firms, described her social commitments as developing in childhood and staying with her throughout her career with the company (Grant, 2004). In all these cases and other similar ones, the relative autonomy of the company has allowed for the consistent pursuit of social values – at times against the prevailing wisdom of financial analysts and in marked contrast to some competitors.

In a study of social entrepreneurs across sectors, Dees (1998) identifies five characteristics of such individuals: employing a mission to create and sustain social value, recognising and pursuing new opportunities to support that mission, engaging in continuous innovation, acting boldly without being limited to existing resources, and exhibiting a heightened sense of accountability to stakeholders. Importantly, what distinguishes this set of qualities from those of 'regular' entrepreneurs is the social commitment and the lack of interest in financial reward for its own sake. However, Drucker (1990) has argued that the traits of the social entrepreneur are not in fact substantially different from those of the standard business entrepreneur.

In her survey of social entrepreneurs in Canada's private sector, Johnson (2003) explains that these individuals begin with a strong sense of social justice, view for-profit activities as a means to an end rather than an objective in itself, and are able to use resources so that 'their reach often exceeds their grasp' (3). Interestingly, Johnson finds a growing number of young self-identified social entrepreneurs in Canada today.

Social entrepreneurs in the public and third sectors

In the public and not-for-profit sectors, the stage for social entrepreneurs is certainly different. Financial constraints may be far greater. Government regulations on policy and practices may be far more stringent. And, the mission of the organisation may be largely shaped by the efforts of predecessors and by precedent. Still, new organisations do arise in the third or independent sector, and governmental agencies often engage in public–private partnerships and other joint ventures that involve creative combinations of organisational interests in a project-focused way.

With special attention to social entrepreneurship in the UK, Thompson, Alvy and Lees (2000) examine the role of social entrepreneurs in a society where the welfare state is stretched well beyond its means. They then look at several examples of community partnerships and centres that target issues such as joblessness, training and after-school involvement. One of these is the Castleford Community Learning Centre of West Yorkshire, which represents a coming together of community groups which then engaged local social services and private sources (see also (Thompson, 2002). Although exhibiting a variety of organisational structures and funding formulas, all of these programmes feature a person or small group of individuals who are ambitious, driven, and focused on addressing a pressing social need. In every case, too, the objective of the organisation is clearly defined.

One of the most famous cases of social entrepreneurship in the not-for-profit sector is the Grameen (People's) Bank of Bangladesh, which involves an elaborate network of field representatives who assist citizens, especially women, in the creation of small businesses (Papa, Auwal and Singhal, 1995). Founded by Muhammad Yunus, the Grameen Bank is an extraordinary example of grassroots mobilisation through the inspired and innovative efforts of a leader. At the same time, as is the case with many value-driven organisations, the Bank demands so much of field officers that overwork, exhaustion and burnout are common.

In organisations like the Grameen Bank, we may well find examples of what Sfeir-Younis (2002) calls spiritual entrepreneurship: a paradigmatic shift away from traditional entrepreneurship expressed in the form of a personal challenge: 'How can I encourage everyone associated with this enterprise to work from the highest possible level of awareness?' (44). Such a vision entails profound commitments to ethics in the treatment of others (including competitors), the linkage of the organisation to the idea of a self-realisation, and constant reflection on the contribution of the organisation to society. Although coming out of a United Nations agency context, Sfeir-Younis argues for the application of this term and model to the private sector as well.

Philanthropy and social entrepreneurship

Long before the terms 'sustainable' and 'socially responsible' business were in common usage, there were identified and self-styled philanthropists. As is well known, many of the so-called 'robber barons' of the late nineteenth and early twentieth centuries – men such as Andrew Carnegie and John D. Rockefeller, in their later years bequeathed huge sums of money to educational and other social service institutions. Today, the Bill and Melinda Gates Foundation is now the world's largest organisation of its kind. Finn and Burton (2004) offer examples of successful businesspersons who are using low-interest loans as a kind of philanthropy to stimulate the creation of new socially responsible businesses.

Today as in the past, philanthropic work often represents a shift away from traditional business pursuits, or at least a parallel 'social stream' for successful business leaders at turning points in their careers. The question remains, however, as to the marketing advantage of such efforts, as we will discuss in the final section of this paper.

The enduring question of charisma

All commentators on social entrepreneurs agree that exceptional personal characteristics, usually held by a single person though sometimes manifested by a group, are not only helpful but essential to success. In fact, Waddock and Post (1991) argue that significant personal credibility is key to the social entrepreneur's work and to her ability to enlist the commitments of others. These points revive a long-standing issue in the study of leadership and authority in organisations: Can socially responsible, sustainable ventures succeed *without* charismatic leadership?

Weber (1978), of course, identified three ideal (or pure) types of authority, with corresponding forms of organisation: Charismatic, traditional, and legal rational. The classic situation of charismatic authority is the new religious sect, centred literally on the charisma of an individual (prophet, divinity or just an exceptional person). Traditional authority is captured in royal lineage but also in the rationale for action that is expressed as 'That's the way we do things around here.' Legal-rational authority is invested in the system of rules, standards and practices: in other words, bureaucracy. With all its failings, bureaucratic authority and organisation is thought to be the most modern, freeing individuals from the rigidity of traditional authority and the whim of charismatic leadership. However, the motivating power of charismatic leadership is undeniable, and most organisations (in any sector) will try to 'bottle' the charisma of the founder for further use. 'The routinisation of charisma' was Weber's phrase for the paradox of an organisation (whether value-driven or otherwise) trying to capture and maintain the charisma of the founding members.

A survey of writings on today's social entrepreneurs suggests that Weber's (1978) model of charismatic authority and leadership may need to be revisited. In one of the largest systems of worker-owned-and-managed cooperatives in the world, the Mondragón Cooperative Corporation in the Basque Country, Spain, many present-day employees sense a lack of the motivating force of the company's founder, a Roman Catholic priest. In the context of expansion, financial success, globalisation of markets, and the importation of management systems and programmes from abroad, the core social values at Mondragón are under pressure, and the company's very identity as a democratic and value-driven business is threatened. In a number of his interviews there, in 1992, 1994 and 1997, Cheney (1999) found both explicit calls for charismatic leadership among the older employees and a sense of 'something missing' from younger ones. The personal nature of leadership in socially entrepreneurial ventures may be more than beneficial; it may be necessary.

Discussion

Depending upon the way in which we choose to view it, the strengths or weaknesses of the concept of social entrepreneurship lie in the fact that most of its applications are in the form of a hybrid between private, non-profit and public sectors. As described, one such hybrid is found in non-profit organisations with an entrepreneurial offshoot that generates revenue for the organisation's social objectives. With greater emphasis on the private, for-profit sector, a hybrid model is emerging whereby businesses lend money and expertise to non-profits. Increasingly, this latter model is linked to public pressure for businesses to demonstrate a measure of social responsibility. Taking the model a step further, Porter (2003) argued that the most realistic and desirable way for any business to be socially responsible is through what he calls 'strategic philanthropy': selected giving in areas tied directly to the company's interests and in arenas that the company can justly claim to have knowledge and a direct stake. His use of the term clearly suggests an indirect financial return on the philanthropic investment. Indeed, Porter stated that the exercise of traditional philanthropy does not make good business sense as it does not provide a tangible return. In a more refined consideration of types of philanthropy today, Reis and Clobesy (2001) support the notion of strategic philanthropy yet emphasise that highly motivated and visionary business leaders can bring together networks of organisations in new community ventures.

Like the term 'strategic philanthropy', 'social entrepreneurship' is an articulation (Hall, 1986; Slack, 1996), a combination of two concepts that do not naturally fit together and yet which seeks acceptance as common sense. It is the lack of a natural fit that renders the term open to resistance and challenge. Challenges, implicit or explicit, range from different interpretations of how the terms might justifiably be joined to denial that they should be used together at all. Johnson (2003) suggests that the lack of examples of social entrepreneurship to be found in Canada, in comparison with Britain and the US, 'reflects a discomfort with the terminology of social entrepreneurship' (5). The reason for the discomfort, she further suggests, is that many Canadians reject the move towards the market as a means of income redistribution and still regard the state as their 'provider of choice' for social services. Language is a key component in the shift towards rationalisation of the concept of social entrepreneurship. This is because discourse acceptance precedes or runs in parallel with material acceptance. Thus we see the emergence of terms that were previously restricted to the business sector, such as 'social venture capital', 'social return on investment', 'invest' rather than 'donate' (CCSE, 2001); 'revenue streams', and 'client groups' (Johnson, 2003) applied to the social and public sectors.

If the colonisation of the social and public sectors by the language of business is accepted, the breakdown of barriers between the sectors becomes normalised. However, the terms cited are in contrast to the distinction made by Thompson (2002) between entrepreneurs who create social or artistic capital rather than financial capital, with social capital referring to that which is valuable to communities (413). The concept of social capital, without a financial element, also emerges in David Bornstein's (Bornstein, 2004) descriptions of social entrepreneurs, with examples that include the Crimean War nurse, Florence Nightingale.

In its least problematic formulation, social entrepreneurship seeks to marry rational economic calculation and socially inspired vision (Shockley, Frank and Stough, 2002). At a time when money for social initiatives is short, this could offer a way forward for non-profits in an increasingly competitive environment. It can also be seen as a way for business to balance profit with public responsibility (Reis and Clobesy, 2001).

On the other hand, opposition could arise from the close association of the term 'entrepreneur' with the creative-destructive aspects of capitalism (Schumpeter, 1934). Those who are concerned about the negative aspects of business will be resistant to the blurring of the boundaries between public, private and civil society suggested by social entrepreneurship with the potential for increased influence of business beyond the private sector (Reis and Clobesy, 2001). The non-profit sector has long been associated with the creation and maintenance of a strong civil society. Marketisation of that sector, then, calls that association into question (Eikenberry and Kluver, 2004) with concerns for the viability of an independent civil society. Furthermore, if business has the power to choose which non-profits are to benefit materially through socially entrepreneurial partnerships, what happens to those which are not chosen and therefore are marginalised?

We suggest that a parallel can be drawn between the concept of social entrepreneurship and that of sustainability because sustainability is equally open to broad interpretation. Like social entrepreneurship, sustainability can favour either the social and environmental or the economic sectors, depending upon which model is adopted. The model of *weak sustainability* preferences the economic and so parallels the model of social entrepreneurship which seeks direct or indirect financial reward for the business entrepreneur. *Strong sustainability* favours the social and environmental over, or at least on par with, economic development, upholding the social values of a truly civil society based social entrepreneurialism. Interpretations are derived from the beliefs and experiences of individuals. Social entrepreneurs and their work should ultimately be judged by the quality of the social outcomes, and that assessment should be made independently of the private interests of those entrepreneurs.

With concepts and movements such as social entrepreneurship, environmental sustainability and social responsibility, it is crucial that we pay close attention to the persuasive uses of the terms as well as to their practical implication. All of them are contested, value-laden labels which can be used to reference a wide variety of interests, motives, activities, and outcomes.

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16

From Corporate Responsibility to Good Governance and Scalable Solutions

Seb Beloe, John Elkington and Jodie Thorpe[1]

The need for governance

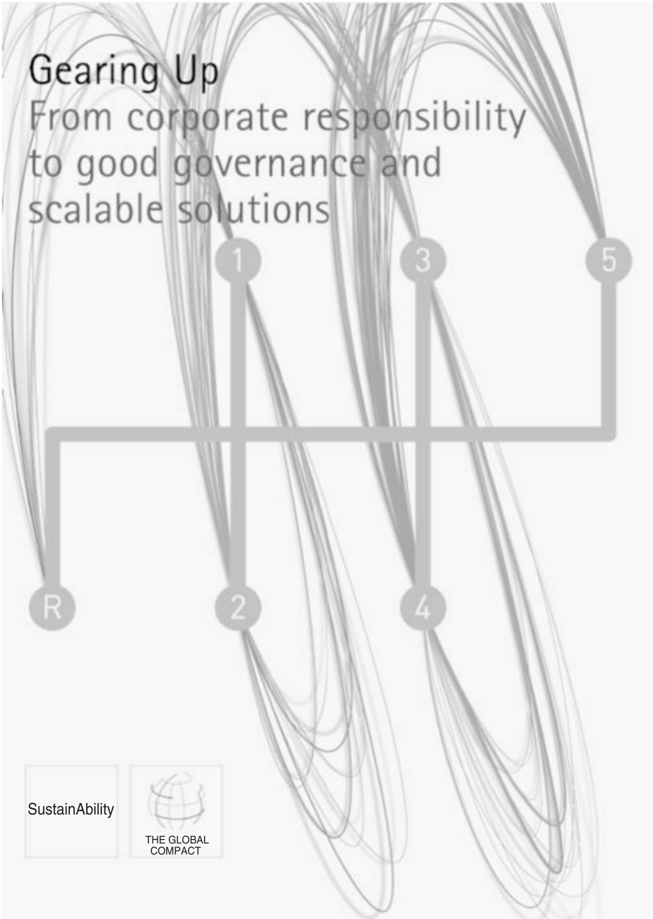
In 1999, UN secretary-general Kofi Annan set out a vision for the Global Compact[2] – calling on business leaders 'to join the United Nations on a journey'. Five years later, the secretary-general commented that at the time, globalisation had appeared like 'a force of nature' seeming to 'lead inexorably in one direction: ever-closer integration of markets, ever-larger economies of scale, ever-bigger opportunities for profits and prosperity'. However, even ten months before the Seattle protests against the World Trade Organisation (WTO), he also felt it necessary to warn that globalisation would only be as sustainable as its social foundations. 'Global unease about poverty, equity and marginalisation', he stressed, 'are beginning to reach critical mass.'

These issues are no less important today, although some focus has shifted to political and security concerns in the wake of 9/11, Iraq and Madrid (which, some would argue, are intimately connected to unresolved problems of poverty and inequity). In tackling such challenges, the world will need to pay more attention to the need for new forms of governance.

This chapter looks at the emerging agenda and considers how business can work with governments to help deliver solutions. It is based on the report *Gearing Up: From corporate responsibility to good governance and scalable solutions* (and see Figure 16.1), prepared by SustainAbility for the United Nations Global Compact. (See www.sustainability.com/publications/gearing-up.) It quotes some of the interviews and surveys that were undertaken, and highlights two of the four case studies that formed the backbone of the research.[3] The case studies highlight initiatives that seem to be building momentum and explore the role of business leadership in preparing the ground for wider policy change.

A. Kakabadse et al. (eds.), *Corporate Social Responsibility*

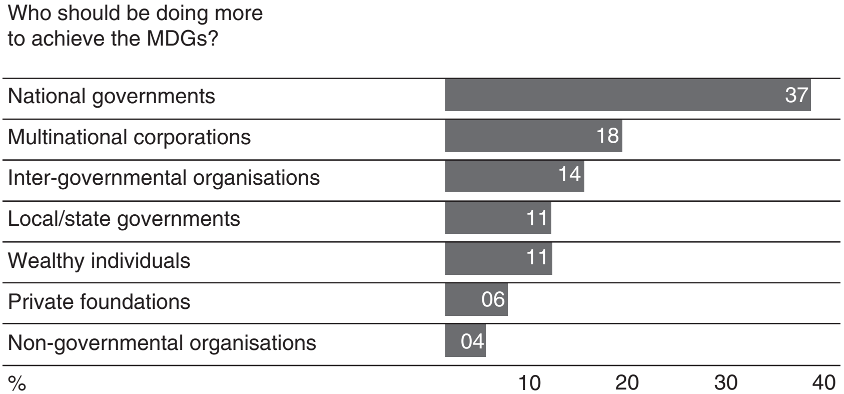
Figure 16.1: Gearing up: from corporate responsibility to good governance and scalable solutions



Rights, rules and systems

As society evolves, so do expectations of institutions. In the 1960s and 1970s, for example, government was seen to be the predominant actor in delivering development while at the same time protecting the environment. In the 1980s and 1990s, however, there was an increasing focus on market

Figure 16.2: Who should be doing more to achieve the MDGs?



solutions. Now, in the post-9/11 world, the emphasis is shifting again towards system-level responses as challenges like the UN's Millennium Development Goals (MDGs)[4] are increasingly beyond the reach of any single actor (whether from government, the private sector or civil society).

This system-level response is the 'missing piece' in sustainable development efforts, according to Oran Young of the Governance for Sustainable Development Programme.[5] 'There are many aspirations', notes Young, 'but the problem is how to achieve them. The missing piece has to do with initiatives to restructure institutional arrangements – the rights, rules and decision-making systems that establish social practices governing the relations among players. This may not be managed by something conventionally called government – it may be managed by governance systems without formal government agencies at all.'

The public, too, sees non-governmental actors as critical to delivering progress on the MDGs, according to a poll by Harris Interactive.[6] The results suggest that although the public still places the prime responsibility for achieving the MDGs on national governments (37 per cent of respondents), significant emphasis is also placed on major corporations (18 per cent) (see Figure 16.2). While making more funds available was one key role they identified for the private sector, respondents also emphasised that essential changes to business practices would be required to achieve substantial progress.

Corporate responsibility – hitting limits?

In response to increasing societal expectations, the last 10 to 15 years have seen leading companies begin to demonstrate more open and transparent business practices, more ethical behaviour, respect for diverse stakeholder groups and a commitment to add economic, social and environmental value – an approach known as 'corporate responsibility' (or CR).[7] However, it is also becoming increasingly clear that while a small but growing number of bold and visionary companies have made considerable strides, and are to be commended for their achievements, their numbers are likely to remain small as long as the business case[8] for getting in front of the corporate pack remains relatively weak. There is a sense that the current approach to CR is insufficient.

To take a few simple examples:

- DuPont has achieved its target of reducing greenhouse gas emissions by 65 per cent from 1990 levels. Nevertheless, absolute global CO_2 emissions have increased 8.9 per cent since 1990, compared with the 60 per cent reduction the Intergovernmental Panel on Climate Change has called for by mid-century.
- DaimlerChrysler South Africa provides HIV/AIDS care and treatment to employees and families – with insurance benefit for up to 23,000 people. Yet overall in the world's poorest countries, less than 10 per cent of the six million people who need anti-retroviral medicines currently get them.
- Due to its anti-bribery policy, BP dismissed 165 people and terminated 29 contracts with third parties in 2003 – yet globally, corruption is proving an intractable challenge.
- While some food and beverage companies are beginning to assess their contribution to obesity and chronic disease, type 2 diabetes – strongly linked to obesity – is rapidly emerging as a global pandemic.

Overall it seems that the various CR initiatives which claim to contribute to sustainable development are not yet achieving the necessary critical mass. This is not surprising, given the fact that most voluntary efforts were largely designed as free-standing initiatives aimed at dealing with specific challenges as they related to particular corporations. By contrast, resolving major sustainable development challenges will require more concerted action from all sectors of society. Slow progress on the Kyoto Protocol, the limited political traction achieved by 2002's World Summit on Sustainable Development, and the collapse of the Cancún trade talks all underscore the complexity of this challenge. Yet the consensus is that the costs of failure will be enormous.

The cost to business will likely include a further weakening of societal trust, injecting growing friction into companies' operating environment. In addition to business disruptions and quantifiable financial costs, the results are likely to include ever-rising demands on business to contribute to environmental and social equity. Yet, as trust continues to erode, the private sector's ability to engage in governance debates successfully – and to define where the justifiable and necessary boundaries of CR lie – will be further undermined. Strikingly, however, all too often CR efforts do not explicitly consider such systemic issues.

A paradox

At the heart of the matter lies a paradox based on two premises. First, the voluntary corporate responsibility movement has evolved as a pragmatic response to pressing environmental, community or human rights issues. Companies are being asked to address problems and even deliver public goods because governments have been unable or unwilling to do so. But second, because of the weakness – or absence – of appropriate governance systems, CR initiatives are generally disconnected from wider frameworks. As a result, they are at risk of amounting to little more than drops in the ocean when compared to the scale of the challenges. At worst, they may even undermine long-term solutions.

This is potentially a major problem. As Mary Robinson of the Ethical Globalisation Initiative told us, 'Many companies involved in corporate responsibility initiatives are only now beginning to recognise that individual efforts could have a much greater impact if they were scaled up by working with wider industry groups and with a broader set of stakeholders.' And, she continues, 'We shouldn't expect that business would be either able or willing to scale up their own efforts in addressing social issues without direct support and involvement from government and civil society. It's a two-way process.'

Critically, as some of our respondents noted – and a point we strongly endorse – the central challenge is not to get companies to take on the responsibilities of governments but to help ensure governments fulfil their own responsibilities. Our case studies all underscored the crucial roles that governments must play, whether in setting the course, developing incentives or helping to create a stronger business case.

We recognise the complexity of the challenges and solutions we are attempting to describe. Clearly none of the key actors we refer to – business, government or civil society – are homogeneous. And their specific contexts and challenges change at the global, national, regional and local levels. In addition, involving business in governance is likely to be most straightforward where existing institutions are strongest, especially in the world's well-established democracies. Where governance institutions are weak or absent there is the greatest potential for relationships between business and government to be perverted due to corruption, 'regulatory capture'[9] and other such problems. There is also a risk of local priorities being disregarded in the face of foreign agendas. Yet where governance is weakest is often where the greatest sustainable development challenges and the greatest imperatives for action lie.

Rethinking self-interest

Some critics see calls for business to engage directly in governance as dangerously naïve. They note that business interests are already engaged, for example through the funding of US presidential campaigns, and argue that this is a key part of the problem. But there are good examples to range alongside the bad and ugly. Think, for instance, of the vital, constructive role played by some parts of the business community in South Africa in the waning days of the apartheid regime. While many companies benefited from and actively supported apartheid, some far-sighted business leaders helped smooth the transition to democracy.

During the 1980s, representatives of some major companies began meeting clandestinely with the African National Congress (ANC), when it was still a banned (and socialist) movement – worried that the escalating violence and absence of social justice and democracy would lead to irreversible polarisation if something was not done. Once the ANC was 'unbanned', the business community already had a positive relationship through a group known as the 'Consultative Business Movement'. Ultimately, in collaboration with the South African Council of Churches, it helped broker multiparty peace negotiations.

Clearly, the actions of business people were in their own self-interest, but at the same time supported the national interest. According to André Fourie of NBI in South Africa, 'the initiative was started by a few visionary business leaders – but by the end everyone was behind it. In hindsight it seems so sensible! But at the time, the reaction to the efforts of the early business leaders was that it was "stupid and dangerous".' In this case business leaders took principled steps into the area of governance and systemic change. And they took these steps because the issues were directly linked to core success factors for their businesses.

Progressive alliances

Given the clear gap between the nature and scale of the challenges we face and the potential of current responses to bridge that gap, are there some other promising examples where the private sector is showing leadership and preparing the ground for positive governance responses? Some think not. As David Korten told us, 'The idea that publicly traded corporations constituted for the sole purpose of maximising the short-term profits of shareholders can provide consequential and constructive leadership toward resolving any of the Millennium Development Goals is simply wishful thinking.' Like it or not, surveys of trust in institutions routinely show that Korten's analysis accords with the views of many others – from academics and development practitioners to much of the general public.

But this need not be the case. What follows is our assessment of how responsible business can help contribute to the necessary restructuring of market economies and the evolution of sustainable governance systems, along with a discussion of some of the steps business must take in order to credibly, legitimately and effectively play such a role. It is based on four case studies[10] of 'progressive alliances'[11] between business, governments and NGOs that explore how business might engage in appropriate efforts – and ensure that they deliver results. Amongst the conclusions are the following:

- *Market solutions will continue to be crucial in solving global challenges*, but the evidence of current market failures suggests the need for new approaches at the level of governance and market signals, including pricing.[12] Governments have a critically important role to play in these areas.
- *Companies can (and should) take a lead*, in initiating new approaches to addressing challenges like the MDG targets, particularly where there are governance failures at the national or global level. Clearly, companies are most likely to take the lead where the business case is compelling – although some companies are thinking about long-term strategy as well as shorter-term imperatives.[13]
- *Ultimately, however, scaling requires wider collaboration*. There are limits to what individual companies can achieve, as BP's problematic experience in trying to tackle corruption in Angola has demonstrated.[14] Well-designed and clearly targeted alliances leverage the core competencies of different players, and also help ensure that they become stakeholders in the creation of new rules.
- *Companies can bring innovation, implementation skills and other forms of know-how to bear*, particularly where markets and relevant policies are involved. They also have a good deal of financial muscle. The financial sector, meanwhile, has a key role both in creating real incentives for positive action and in ensuring longer-term scalability.
- *Governments and multilateral agencies must create the preconditions for scale* by moving CR beyond the leadership companies, re-tuning market incentives and helping change societal behaviour. Multilaterals cannot generally regulate, but they do have influence – including over governments. Ultimately, with societies facing competing choices on how to allocate scarce resources, governments' key responsibility will continue to be making judgements about priorities.
- *Civil society organisations potentially bring expertise and credibility*. They can help to make the preferences of society known in a more responsive and immediate fashion than most electoral processes allow (although issues of accountability loom large here, too[15]). This role can be strengthened where civil society forms coalitions around issues and positions. In addition, civil society is often well placed to bridge gaps between companies, governments and multilateral organisations and the grassroots, to provide expertise and to act as watchdogs, ensuring initiatives remain on track.
- *Finally, there is a central role for corporate advocacy*. Our cases show how companies can play a role in developing policy frameworks to address key challenges. Yet generally companies have not made strong, coherent

calls for the systemic changes that would be necessary to scale up the initiatives they are involved in. Meanwhile, regressive corporate lobbying is a key barrier to scaling up CR responses. Think of the sugar industry and obesity or the pharmaceutical industry and HIV/AIDS.

Proceed with caution

Our case studies include some existing efforts in which business is contributing to – and often taking a lead role in – governance processes. But what are the risks inherent in suggesting that non-elected bodies with profit as a core motive engage directly in governance and public policy processes? Here are some issues raised by our interviewees and respondents:

- *Who should drive?* When it comes to picking priorities, it is clear that only governments have the necessary legitimacy, although business and markets play a critical role in achieving the rapid scaling of solutions. As Elliot Schrage of the US Council on Foreign Relations puts it, 'The car shouldn't decide what road to take – rather the driver should decide how to use it. Similarly, it's not that companies and governments are incompatible, but they have different roles.' To stretch the metaphor slightly, modern cars and their engines are increasingly efficient helping drivers reach their destinations more quickly and easily – and, hopefully, the same will increasingly be true of business.
- *What if our failures outnumber successes?* Given the scale of the challenges, experimentation is key, which guarantees failures along the way, some of them spectacular. We need to make the space for experimentation and innovation, with rapid prototyping, shared learning from failures and a determination to deploy scalable solutions as fast as possible. We must mimic natural evolution, but lacking evolutionary timescales we will need to fiercely select from the field of innovations those that are most likely to succeed and invest in them. As noted above, NGO expertise is emerging as key to many innovation processes.
- *What happens where governance is weak?* In some developing countries – and at the global level – there is a risk of unequal relationships dominated by more powerful entities, including large companies. More concerted efforts are needed to strengthen the capacities of governments and civil society. 'Southern governments need to consciously invest in the capacity to manage negotiations and relationships not only with global corporations but also with domestic commercial entities,' notes Kumi Naidoo of Civicus.
- *What if CR is seen as someone else's agenda?* Several interviewees warned that CR could suffer if it were to be seen as an Anglo-Saxon concept. But most also stressed that, while the language is contested and many of the models currently clustered under the CR label have been most fully developed in the Anglo-Saxon world, there are underlying principles that

are universal. Still, there is an urgent need both for a more balanced debate on CR globally, and for global ideas and practices to be translated in a locally meaningful way. 'You can't organise these processes of change simply at the global level,' explains Sir Mark Moody-Stuart, Chairman of Anglo American. 'You've got to get the right actors together in the right way at local level to exert influence on government and persuade them to do the things that need to be done.'

Trust and legitimacy

A final concern voiced by many interviewees and respondents about involving business in new forms of governance links back to negative perceptions of corporate lobbying. David Korten puts it starkly: 'The most important responsibility of the corporate sector in addressing the Millennium Development Goals is to stop funding disinformation and lobbying campaigns that seek to undermine any serious effort to achieve them.'

Lobbying by business is an inevitable, critically important part of democratic politics, but – almost by definition – is usually reactive. So is it time to rethink how lobbying is done? True, industry insiders counter that this is a 'no go' area: 'You can't be transparent about lobbying,' said one business interviewee. 'Why would a company show its hand?' And many outside industry were equally sceptical.

Not surprisingly, many concerns about involving business more deeply link back to the problematic, controversial history of corporate lobbying against progressive policy on sustainable development challenges. But we conclude that there is an increasingly urgent need to re-engineer corporate lobbying and to promote a wider understanding of the favourable business conditions that lobbying[16] seeks to secure.

Furthermore, there is a clear and growing need for companies to speak out in favour of policies that deal proactively with sustainable development issues – and an increasingly robust business case for doing so.[17] This business case rests on a growing recognition that social and environmental pressures are not going to go away, and it behoves companies to lobby governments to address these issues directly as a way of taking the heat off of the private sector, which is ill-equipped to address these issues.[18] Companies that resist regulation on principle may find that a more positive approach can bring opportunities to work with government and other stakeholders in ensuring that rules are efficient, provide a solid basis for long-term planning and are consistent both within government and across different states and regions.[19]

In addition to rethinking lobbying, greater trust will need to be built through increased transparency and the open, interactive and reasonably equal involvement of major stakeholders, especially civil society. Many traditional relationships between business and governments that have been most distrusted have been strictly two-party affairs. As Fanny Calder, an associate fellow at the UK's Royal Institute of International Affairs, explains, 'Big business has often had very close relationships with governments – this is not new. To be legitimate, however, business should be attempting to influence governments through processes that involve other actors.' Good ideas will struggle to get off the ground if the process is seen as illegitimate.

Conclusion

This project began with three questions: First, does the CR movement have the capacity to deliver real progress on sustainable development? Second, where do governments fit in the CR puzzle? And, third, can business play a constructive role in governance by preparing the ground for wider policy change? Our conclusions are as follows:

- *CR as currently practiced lacks the capacity to deliver real progress* on sustainable development because there are insufficient links to wider governance systems – despite having achieved change within a narrowly defined area.
- *Government has a key role to play in strengthening CR* – by changing or developing incentives and creating a stronger business case. Government can also help achieve critical mass by acting as a convener in 'progressive alliances'. Most importantly, government needs to set the course.
- *Business can bring fresh perspectives and innovative, more efficient models*, while mobilising further weight behind global processes, transferring necessary skills and technologies and helping create new policy frameworks. Business can also play a positive advocacy role.

Some businesses, sensing their own vulnerability to new regulation or a wider backlash, are beginning to get involved. Whether it be in helping fine-tune the 'market infrastructure' for carbon-trading or in developing sector-wide anti-corruption standards, there is a growing role for enlightened companies to help change the rules of the game to address pressing social and environmental issues and maintain their long-term licenses to operate.

But in order to be trusted and taken seriously, business will first need to ensure two parallel changes. The first will involve a shift from engagement in a seemingly endless list of special projects, which often fail to address the company's main impacts, to a more coherent approach with stronger links between CR and both core business activities and wider governance frameworks. The second change will involve business working harder to increase transparency and external engagement, and to overcome enormous scepticism about its ability to play a constructive role. These are undoubtedly tough challenges. But we have confronted – and overcome – tougher ones.

Case Study 1

California Climate Action Registry
Linking to markets

The United States – the largest emitter of greenhouse gases (GHGs)[20] and, perhaps not coincidentally, a notable 'sceptic' on climate change – represents the most important market where business has not yet provided a convincing response to the issue of climate change. One example, though, of how business is helping to prepare the ground for an effective response is the California Climate Action Registry.[21]

The Registry was established by the State of California in 2000 to encourage companies and other organisations operating in California to increase energy efficiency and cut GHG emissions. Protocols and tools developed by the Registry enable companies to register GHG emissions baselines for their operations, and then measure changes against this baseline.

The Registry serves as a:

- Key component in developing the 'market infrastructure' and accounting frameworks for trading carbon;
- Means of engaging the technical expertise of business in crafting solutions;
- Open-source model, allowing stakeholders to review protocols in detail.

The number of Registry members doubled from 23 at its launch in 2002 to 45 in early 2004, including companies such as BP and PG&E Corporation.
Key success factors:

- The involvement of the State of California provides confidence to business that registered GHG reductions will be honoured in future regulatory regimes.
- The use of the GHG Protocol developed by the World Resources Institute (WRI) and the World Business Council for Sustainable Development (WBCSD) as a key foundation document encourages NGO support.
- There is a growing sense in the US business community that GHG regulation is coming, coupled with a desire among switched-on business leaders to prepare for (and help shape) regulation.
- There is a growing interest among investors (e.g. pension funds) in carbon exposure.

Key challenges

Although the number of companies participating is significant, it is still minute when compared with the overall business community. But the Registry is working hard to build critical mass.

Potential pitfalls:

- Lack of political traction for action on climate change would leave the Registry vestigial, unconnected to other aspects of market infrastructure.
- The emergence of alternative regulatory approaches or shifting priorities could result in a loss of support from business.
- Any loss of support from the NGO community could undermine legitimacy.
- A public perception that the industry is trying to configure the system in its own favour, a concern expressed around emission trading regimes in the US, would weaken credibility.

Case Study 1 ***continued***

Conclusion

The Climate Action Registry demonstrates the value of involving business in the provision of technical expertise in developing and testing of complex economic instruments to reshape market frameworks. The initiative has also provided a framework (known as the Climate Action Registry Reporting Online Tool, or CARROT) for companies to report their performance over time.

The Registry also illustrates the importance of involving government and NGOs to provide predictability and credibility respectively. Ultimately, however, the example illustrates that with issues of long-term overuse of the public commons, the business case only becomes compelling for companies when regulatory action is expected. This is the critical driver in stimulating business interest in addressing climate change.

Companies that are committed to this regulatory agenda could be taking bolder action. For example, a small group of companies have joined WWF in calling for mandatory caps on carbon-dioxide emissions[22] in the US. Leadership companies could also help the financial community understand the value of effective carbon risk management by disclosing information on how they quantify their risk and what they are doing to protect and boost the company's value.

Case Study 2

Extractive Industries Transparency Initiative (EITI)
Offering incentives

The EITI[23] encourages companies in the mining, oil and gas industries, together with host governments in resource-rich countries, to publish revenue flows from the extractive industries to host governments – and to complement these with the publication of government receipts. The aim is to make it easier for civil society in these countries to hold governments accountable for how such revenues are managed and distributed.

Launched by the UK Government at the World Summit on Sustainable Development in 2002, the EITI is supported by a growing number of countries (e.g. Azerbaijan, France and Ghana) and companies (e.g. Rio Tinto and Shell). Civil society groups, including the Publish What You Pay coalition, are also active. The EITI has been particularly timely given the increased oil development in West Africa and the Caspian Sea region in the last few years, areas with notably poor records on corruption.

In June 2003 the EITI's principles and actions were agreed, and Azerbaijan, Ghana, Indonesia, Nigeria, Sierra Leone, and Trinidad and Tobago volunteered as potential pilots for the scheme. Work has been ongoing since then to create an adequate framework for revenue disclosure within each country. Given the complex nature of corruption and the range of actors and interests involved, priorities and positions are bound to vary enormously. Yet trust is being developed

Case Study 2 ***continued***

through the process as the EITI focuses on finding common ground and identifying incentives – using the combined persuasive power of the different actors involved to bring companies and countries on board. The narrow scope (one sector and one aspect of corruption) has also made it easier to gain consensus.

In 2004 Nigeria became the first country to host a stakeholder workshop on the initiative. A Steering Committee has been formed with a view to ensuring full publication of 2004 revenues in early 2005. Also in 2004, the number of signatories to an 'Investors Statement' in support of the EITI doubled to 57, which collectively represent US$6.9 trillion. The longer-term significance of investors in driving this agenda is huge.

Key challenges

While the initial momentum is promising, some important actors from both business and government have still not signed on. The initiative may risk stalling unless a few key (and successful) pilots are achieved in each world region, creating momentum and pressure for peers to follow suit. Failure to achieve critical mass in a meaningful way would likely result in withdrawal of support by the NGO community, and possibly other actors.

A more intrinsic barrier to achieving the aims of the EITI is the lack of well-developed civil society institutions in some implementing countries. Successful implementation will require quite sophisticated advocacy organisations that can engage with policy-makers and companies on fairly equal terms, holding both to account.

Conclusion

Given the negative impact of corruption on the operating environment for business,[24] there is a medium- to long-term business case for companies to engage in anti-corruption efforts. There are clear roles that business (including the investment community) can play in influencing governments to curb corruption and in providing mechanisms like reporting frameworks to enhance transparency, accountability and the quality of governance.

While individual companies can show (and have shown) leadership – including publishing payments unilaterally – this strategy can be perilous in some situations. For example, when BP in Angola promised transparency around their payments to the Government, the announcement was met with a swift rebuke and a threat to the company's future in the country. BP was forced to back down. The energy giant's experience underlines the importance of collective solutions. In particular, there is a need for collective private sector advocacy to persuade governments and wider society that bribery and corruption are unacceptable and, ultimately, counter-productive.

Notes

1. John Elkington is co-founder and Chair of SustainAbility; Seb Beloe is Director of Research and Advocacy; Jodie Thorpe led the *Gearing Up* project and is evolving SustainAbility's global governance work.
2. The Global Compact brings companies together with UN agencies, labour and civil society to support ten principles in the areas of human rights, labour, the environment and anti-corruption. See www.unglobalcompact.org
3. SustainAbility is also grateful for the financial support the project received from five corporate sponsors: Novartis, Pfizer, SAP, DaimlerChrysler and Novo Nordisk.
4. The Millennium Development Goals or MDGs are part of UN Secretary General Kofi Annan's road map towards the implementation of the United Nations Millennium Declaration – and are a summary of the development goals agreed at international conferences during the 1990s. See www.developmentgoals.org
5. http://fiesta.bren.ucsb.edu/~gsd/about/about.php
6. Results based on a balanced sample of nearly 4,000 people in the US.
7. This definition is based on a variety of definitions produced by among others the WBCSD, BSR and IBLF. Corporate *Social* Responsibility is often also used in this sense.
8. Here, and throughout the chapter, we use the term 'business case' to refer to the extent to which CR improves business value, as conventionally defined. See SustainAbility for UNEP, *Buried Treasure: Uncovering the Business Case for Corporate Sustainability*, 2001, and SustainAbility / International Finance Corporation / Ethos Institute, *Developing Value: The Business Case for Sustainability in Emerging Markets*, 2002.
9. The theory that interest groups such as companies seek to promote their interests in the regulatory process, which leads over time to regulatory agencies being dominated by those they regulate. www.economist.com
10. These case studies were: the California Climate Action Registry on climate change; provision of anti-retrovirals against HIV/AIDS in the workplace in South Africa; Oxford Vision 2020 on tackling chronic diseases, including type II diabetes; and the Extractive Industries Transparency Initiative on corruption. This chapter includes a synopsis of the cases on the California Climate Action Registry and the Extractive Industries Transparency Initiative.
11. The Copenhagen Centre has developed the following definition of progressive alliances: 'People and organisations from some combination of public, business and civil constituencies who engage in voluntary, mutually beneficial, innovative relationships to address common societal aims through combining their resources and competencies.' Also called global action networks and social partnerships.
12. A good example of how companies can work with governments to develop effective governance is the UK's Emissions Trading Group that helped develop a greenhouse gas emissions trading scheme: www.uketg.com
13. For example, see *Gearing Up* for the case on Novo Nordisk's actions on type 2 diabetes.
14. See the case study on the Extractive Industries Transparency Initiative included in this chapter.
15. See SustainAbility / UN Global Compact / UNEP, *The 21st Century NGO: In the Market for Change*, 2003.

16. Lobbying is understood to involve any activity engaged in by individuals or organisations (directly or through hired representatives) and directed to elements of government in an attempt to influence legislation or policies in a way that is favourable to the interests of the lobbying group.
17. For example participation in the California Climate Action Registry is based primarily on the business need to participate in the creation of new regulatory standards and systems.
18. Adair Turner, former director general of the Confederation of British Industries, quoted in Simon Caulkin and Joanna Collins, *The Private Life of Public Affairs*, Green Alliance, 2003.
19. For example the UK Business Council for Sustainable Energy was set up explicitly to contribute to consistent and efficient UK government policy on sustainable energy.
20. Greenhouse gases are heat-trapping gases – both naturally occurring and 'synthetic' – that are emitted into the atmosphere. Anthropogenic sources of GHGs have increased markedly in the last century and are a major contributor to climate change.
21. www.climateregistry.org
22. http://worldwildlife.org/news/displaypr.cfm?prid=42
23. http://www2.dfid.gov.uk/news/files/extractiveindustries.asp
24. According to a 2002 survey, 39 per cent of companies had lost business because a competitor had paid a bribe. John Bray, *Facing Up to Corruption 2003: Tacking the Hard Questions*, Control Risks Group, 2003, p. 8.

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17
CSR in the Boardroom: Contribution of the Non Executive Director (NED)

Andrew P. Kakabadse, Nada K. Kakabadse and Ruth Barratt

Introduction

The debate on the 'appropriate' nature of the relationship between business and society has a long history. Philosophers of more ancient times such as Plato and Aristotle, pondered on the morality of the relationship between business and society. In recent times attention has focused on the concept of CSR (Klonoski, 1991; Greening and Gray, 1994; Wood, 1991). CSR has provoked numerous debates and definitions, some supportive and others critical. The neoclassical economists and proponents of market liberalisation and profit-maximisation (Friedman, 1962: 133; Arrow, 1997: 143) suggest that the only social responsibility of business it to 'use its resources and engage in activities designed to increase its profits so long as it ... engages in open and free competition without deception or fraud'. In contrast, CSR advocates (Jones, 1980: 59–60; Jones et al., 2002: 21) promote the notion, 'that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law or union contract', and furthermore, the obligation should be 'voluntarily adopted'. Similarly, McWilliams and Siegal (2001) argue that CSR represents 'actions that appear to further some social good, beyond the interests of the firm and that which is required by law'.

Supportive of the McWilliams and Siegal (2001) thesis, it is argued in this chapter that CSR is in the long-term interests of business. An emerging body of evidence indicates that companies pursuing socially progressive policies achieve longer term success, with better performing stocks, carry less debt and demonstrate better treatment of stakeholders (Collins and Porras, 2000).

Research into the linkage between CSR and profitability has produced varied results, some purporting greater profitability (Waddock and Graves, 1997), others concluding little difference (McWilliams and Siegal, 2000), whilst still others report a negative correlation (Wright and Ferris, 1997). Despite the somewhat tenuous relationship between CSR and firm prof-

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itability there appears to be an emerging, intuitive belief amongst academics, managers and stakeholders alike of the importance of steering firms towards more socially responsible practice (Egri and Herman, 2000; McWilliams and Siegal, 2000; Prahalad and Hamel, 1994). Towards this end, social reporting (Jackson and Bundgard, 2002), adopting a 'triple bottom line' discipline (Clarke, 2001) towards greater stakeholder engagement (Clarkson, 1995), has become compelling in recent years in an attempt to address the shortcomings of the Anglo-American models of corporate governance. In fact, it has been noted that institutional investors are prepared to pay a premium for sound governance (McKinsey and Co, 2000).

As the movement towards CSR adoption seems to be gaining ground, attention has focused on the role and contribution of Non Executive Directors (NEDs) as proponents of corporately responsible practice. Ibrahim et al. (2003) found that the presence of NEDs in the boardroom was likely to lead to a company engaging in socially responsible activities, on the basis that NEDs hold 'wider organisational roles' than their executive counterparts (Johnson and Greening, 1999). Although NEDs are governed by the same legal responsibility as other board members, it is argued that the nature of their role leads them to adopt a more counter-balancing view than other executive members (Kakabadse et al., 2001). However, to date, there has been insufficient exploration of how NEDs, or other External Directors, affect corporate behaviour (Forbes and Milliken, 1999; Ibrahim et al., 2003; McNulty and Pettigrew, 1999; Oliver, 2000). Such lack of examination has been attributed to the difficulties researchers face in gaining access to, often, high profile and 'always-busy' individuals (McNulty and Pettigrew, 1999).

As NEDs are considered an important influence on CSR enterprise application, the purpose of this chapter is to enhance understanding of the contribution of NEDs toward greater CSR practice within Anglo-American enterprises. An exploratory study was undertaken, adapting a qualitative methodology, in order to gain an in-depth appreciation of the role of the individual NED within the boardroom (Harrison and Freeman, 1999) and their contribution to CSR application throughout the organisation. The study results indicate that presenting CSR as a business case and utilising language conversant in most boardrooms, considerably assists CSR adoption. Additionally, encouraging NEDs to transfer their CSR experience to the boards of other organisations, namely promoting boundary spanning, is particularly potent. The chapter finishes on a high note concluding that NEDs are powerful allies in the pursuit of corporate responsibility.

Corporate citizenship: the role and contribution of the NED

Criticism has been directed towards companies such as Shell, BP and others as having 'hijacked' the CSR agenda by aggressive public relations (PR) and marketing in order to enhance their corporate reputation (Mahon and

Wartick, 2003; Woolfston and Beck, 2005), especially as research has come to light linking how a positively portrayed corporate image enhances corporate reputation, profit maximisation and market value (Fombrun and Shanley, 1990). Thus, certain companies have embarked on the distinct communication of their CSR activities through social reports and the 'marketing of their good deeds'. This, in turn, has invoked scepticism that social responsibility is a PR exercise leaving others doubtful of the firms motives, particularly if the organisation is perceived to have a declining public image or needs to legitimise certain of their actions (L'Etang, 1996).

Yet despite scepticism and the negative impact of well publicised corporate scandals such as Enron or WorldCom, or environmental disasters such as Union Carbide's in Bhopal, debate has highlighted the dilemmas decision-makers face in being good managers maximising shareholder value, whilst concurrently balancing the needs and requirements of society, behaving in a way that is both ethical and equitable towards the needs of diverse stakeholders (Freeman E, 1994; Hosmer, 1994; Stark, 1993; Sundman, 2000; Wicks A, 1996). Many commentators concur that the critical link is between financial demands and social needs. Waddock and Graves (1997) describe the link between corporate social performance and financial performance as a 'virtuous circle'. Their research showed a link, but could not satisfactorily distinguish which of the two were the predominant influence for CSR enhancement. They concluded that the two variables operate together, strengthening each other, facilitating a shared philosophy and 'strategic intent' within the organisation. Szwajkowski and Figlewicz (1997) reached a similar conclusion, arguing that both financial and social performance are driven by effective management in terms of stakeholder value orientation and practice. It is within this more positive context that scrutiny of the role and contribution of the NED/External Director, has become an emerging focus of inquiry.

NEDs have been identified as providing 'the formal link between the shareholders of a firm and the managers entrusted with the day to day functioning of the organisation' (Forbes and Milliken, 1999). As such, NEDs are sometimes referred to as 'part time', 'independent' or 'outside' directors. An NED's supposed knowledge of the external business environment and their position, independent of executive responsibility, is considered to allow them a 'unique' vision of the system that surrounds and maintains organisational 'well-being' (Johnson and Greening, 1999; Higgs, 2003). They are privy to the inner workings of the organisation and yet, in theory at least, independent of it (Roberts, 2002; Higgs, 2003).

However, despite their seemingly pivotal role in the mentoring of organisational performance (Alderfer, 1986; Kakabadse et al., 2001; Meyer, 2000; Westphal, 1998, Higgs, 2003), NEDs have not received a great deal of attention from the academic community (Oliver, 2000; Forbes and Milliken, 1999: 489; McNulty and Pettigrew, 1999). Most writings in the field of board performance and CSR has been either practitioner-based or of a more prescribed nature (Pettigrew, 1992: 165). Further, more in-depth analysis has been based on publicly available data (McNulty and Pettigrew, 1999: 48). Such limited reporting may be due to the difficulties faced by researchers in gaining access to high-profile individuals and partly also, as Kahl (1957: 10) highlights, 'those who sit amongst the mighty do not invite sociologists to watch them make the decisions about how to control the behaviour of others'. So little documentation exists regarding NEDs contribution to corporate strategy or their influence on corporate behaviour, in particular CSR (Forbes and Milliken, 1999: 489; McNulty and Pettigrew, 1999).

With that said and despite restriction, certain studies have penetrated the inner sanctum of the boardroom. McNulty and Pettigrew (1999) report that NEDs play an influencing role in the setting of strategy, thus contradicting the belief that NEDs act merely as a rubber stamp to the desires of the Executive. Their research shows that although most proposals put forward were ratified by the board, Executive Directors, the managers of the corporation, spend a great deal of time behind the scenes ensuring that their plans meet with the approval of the board. Therefore unacceptable propositions rarely ever reach the official table.

Similarly, Kakabadse et al. (2001), in their study also found that NEDs influence strategic behaviour. They note that the role of NEDs has become more 'professional', with many boards now using specialist recruitment agencies to source prospective NEDs with specific knowledge and skills. The same study drew attention to the heterogeneous nature of boards, emphasising the steep and challenging learning curve for new NEDs in their adoption to the culture and customs of the board specifically, and the enterprise in general.

Johnson and Greening's research (1999) found that NEDs hold both profit goals, in line with agency theory, and wider non-profit goals, displaying a strong 'stakeholder orientation', recognising that the organisation has responsibilities to groups other than shareholders (Johnson and Greening, 1999; Wang and Dewhirst, 1992). Johnson and Greening (1999) believe that the value of NEDs is in considering and addressing external constituencies, thus improving the organisation's relationship with its environment. In parallel to the external interface, scholars have argued that internally, NEDs enhance the overall performance of the board by stimulating a desire on the part of insiders to 'keep their house in order' (Fombrun and Shanley, 1990), particularly through good governance (Dutton and Jackson, 1987; Fombrun and Shanley, 1990). Line management may view their governance responsibilities as merely an extension of their managerial function (Forbes and Milliken, 1999), but, in contrast, it is the NEDs who are more likely to be sensitive to negative media attention and ensuing reputation loss (Greening and Gray, 1994; Johnson and Greening, 1999). Thus, NEDs have been attributed with enhancing corporate performance, strengthening the organisation's reputation (and in turn protecting their own reputation), and as a result, providing legitimacy to the organisation's activities (Dutton and Jackson, 1987; Fombrun and Shanley, 1990). With such a broad span of contribution and expectation, the question that has arisen is, how? – how can NEDs effectively respond to such a spectrum of demand? One perspective to have emerged from the resource dependency literature is that of the NED as boundary spanner (Daily and Cannella, 2003; Geletkanycz and Hambrick, 1997; Hillman and Dalziel, 2003; Wang and Dewhirst, 1992), bridging the boundary between the organisation and its environment through feeding contextually driven information to management. The logic behind such a contention is that resource dependence theory argues that organisations are comprised of external and internal coalitions, existing in an environment that contains scarce and valuable resource essential to organisational survival (Dalton et al., 1999; Hillman et al., 2000; Johnson et al., 1996; Selznick, 1949). As early as 1949, Selznick (1949) suggested that organisations gain access to external resources through co-optation, particularly through the office of the External Director.

Cognisant of the positive effect of the boundary spanning responsibilities of NEDs, attention has more recently extended to how can NEDs fulfil the organisation's corporate social performance (CSP) mandate (Pava and Krausz, 1997; Wood, 1994)? Individuals capable of understanding and anticipating the complex demands that may be made on the organisation and, as a result, instituting appropriate governance procedures, are being recognised as an invaluable resource (Barratt, 2005). Pundits have gone further by putting forward the case that the presence of such individuals at board level may in itself provide for competitive advantage (Geletkanycz et al., 2001; Petrick et al., 1999). Certainly, the broad span of interlocking activities of NEDs is highlighted in the UK, where 61 per cent of NEDs are identified as holding multiple boardroom positions at any one time (Pierce, 2001). It is such breadth of overview and experience that is purported to be of value in the campaign to embed CSR into the boardroom agenda.

The study

Yet, as stated, irrespective of desire and anticipation, limited documented evidence exists adequately explaining the role and contribution of the NED, particularly towards CSR application. Therefore, the primary objective of the exploratory study reported in this chapter is to highlight NED contribution towards instituting and/or enhancing an organisation's CSR orientation and behaviour. To achieve this, in depth, semi-structured interviews were pursued, from which multiple case studies were developed with individual NEDs forming the centre of each case. Adopting the Harrison and Freeman (1999) argument that case study research is an 'excellent method for theory building', particularly if the 'field is still young', a number of different methods for data collection were adopted in order to understand organisational and individual contexts and gain insight into the role and contribution of NEDs towards CSR application within Anglo-American boards. Twenty six semi-structured interviews were undertaken, of which fourteen were with NEDs, six with senior line managers and six with industry experts including functionally expert senior managers, a leading NED recruiter and a governance expert. Interviews were held on a confidential, one-to-one basis. In order to capture 'thick descriptions' (van Aken, 2005) of participants' experience, interviewees were encouraged to reflect, at their own pace, on their own understanding and experience of their NED role and their contribution towards CSR promotion in the boardroom. All interviews were tape-recorded and transcribed.

A profile of each interviewee was additionally compiled using data sources such as company documents, newspapers and the Internet. Each interviewee profile included historical data, such as their educational and work background; demographics, such as gender, age; information on the companies with which they were currently and previously involved paying attention to 'major business incidents', such as, involvement with organisations in difficulty, acquisition, merger or scandal. In total, the interviewee sample represented 52 US and UK corporate boards.

With a total of 26 interviews, collected data was analysed utilising firstly, within-case and subsequently cross-case analysis in order to increase the generalisability of the findings and to gain a greater insight concerning the importance of context (Eisenhardt, 1989; Huberman, 1994; Miles and Huberman, 1992; Yin, 1994). Saturation of information was considered to have been reached by the twenty-sixth interview and, as no new insights emerged, the collected data was becoming repetitious (Eisenhardt, 1989), so no further interviews were conducted.

Findings

Three overarching, and to some extant, overlapping themes emerged,

1. Bounded Rationality: Recognising and acting on the constraints to the CSR debate
2. Boundary Spanning: Source of Enlightenment
3. Boardroom Language: The business case for CSR.

Bounded rationality

The concept of bounded rationality refers to the inability of human beings to access and understand all necessary information in order to make a fully informed decision. On this basis it is argued that decisions are based on limited and incomplete knowledge (Simon, 1957). Many interviewees identified with the concept of bounded rationality referring to their experience of constraint through employment for large enterprises, particularly multinationals. One NED, board member to an organisation with 23 million customers, described his understanding of the business as a 'patchwork quilt'.

> '*So what you do is you create a bit of patchwork in the top left hand corner, that might be a license in Italy. You then perhaps go down to Spain and jump into bed with* [name removed] *and think well, we'll do a deal here too. So there's lots of little mini deals all over the place. It was extremely difficult for other Non Executive Directors to assess the strength of that business.*'
>
> NED, Participant 4

The 'bounding of rationality' emerged as a common experience and led some NEDs to use personal scenarios to enhance their understanding of the challenges facing their organisation(s).

> '*There is a tendency to look at things from individual experiences; you know my granny has had a bad experience with her hip, or something, and therefore we extrapolate from that all grannies have bad experiences with their hip.*'
>
> NED, Participant 5

An additional reason for being bounded as a NED is the attempt of certain boards to reduce complexity through principally working in 'financial terms'. As one prominent NED put it '*these things were almost always financial*' (NED, Participant 7). The interviewees reported that little opportunity arose for discussing 'soft' issues. Boardrooms were not perceived as the appropriate place for developing social strategies. Individual projects were reported as primarily examined at regional or local level, but rarely discussed in a strategic setting such as a boardroom. This finding confirms Corrall's (1973) long held argument that organisational environment and directors' work is becoming increasingly more complex and in order to cope, 'unconsciously' certain softer issues become neglected.

Although individual projects were rarely discussed, certain significant initiatives were identified as setting the 'tone' for the organisation. This emerged as particularly true for those organisations where board members were encouraged to become more deeply involved with the organisation and make contact with executive management. Thus, extending the role of the NED beyond the confines of the boardroom counteracted the negative effect of rationality bounding. The emerging positive outcome was confirmed by managers, interviewed as part of this study, who reported themselves as encouraged by enlightening their NEDs and by the support they received from their board.

> '*I think we've got several people on our committee who, in a sense, have their own reputations to protect and don't want to be associated with a company that would deferentially affect their reputation. So, we have support from a high level, from our Non Executive Directors, about what we are doing here as indeed we do from our executive directors. Our Chief Executive is very supportive of what we are doing. The business case has to be demonstrated, but once that is, the requisite signalling of priority from the top comes through clearly*.'
>
> Expert, Participant 3

In addition to exposure from interacting with line management, certain of the respondents described how the setting up of board level committees to address issues of CSR occurred at the behest of the NED/External Directors who brought their experience from outside the organisation. Thus, one counter to bounded rationality is to work closely with line management. The other is to leverage those NEDs who have had to overcome resistance to corporate responsibility initiatives on other boards and as a result have formed their own CSR framework. This leveraging of experience, termed boundary spanning, is the topic of the next section.

Boundary spanning

Irrespective of its PR potential, most of the interviewees described adopting the CSR agenda as '*the right thing to do*', meaning a shared mindset that is necessary to attain when addressing board level strategic issues.

> '*We did it because it was smart. It was the right thing to do. Even in hindsight it was smart because we've had a lot of good feedback from people who said, boy they do care! You can't buy that! You have to do that! You have to work on that! It was just the right thing to do*.'
>
> NED, Participant 14

Further, those NEDs who sat on boards of 'enlightened' companies (i.e. companies with a compressive CSR infrastructure and practice) brought their insight and enthusiasm to the host board.

> '*He is one of our senior Non Executive Directors, but is also on the Board of* [name removed]. *He argued that we were not giving sufficient attention to CSR as a growing area of concern for investors and indeed governance and indeed the public more generally. The initial reaction by the* [name removed] *Board, including I would say the Chief Executive, tended to be more "This is a kind of froth! This is all a complete blind alley – this corporate social responsibility! This is not what business is about! It's one of these elaborate con tricks." Most of the Non Executive Directors said "No, wrong. We do have to pay attention to this. It is a growing area and we need to get our act to be a bit more convincing"*.'
>
> NED, Participant 2

The same interviewee continued. *'If you have a big customer base and you are in the public eye, you do these things because you have to, you respond to threat'* (NED, Participant 2).

The above comments concur with the results of a recent study by Corporate Reputation Watch (CRW, 2004), who suggest that 93 per cent of senior executives believe that their customers and consumers consider corporate reputation to be extremely important. The CRW (2004) reports that many 'brand' companies take CSR seriously.

However, the lack of urgency to promote CSR in the boardroom was reported by NEDs who worked for companies that, despite their size, had few customers as they dealt with governments, 'middle men', or their products were traded as commodities.

> *'People are buying our products on the forecourts and so you have little direct interface with the mass customer base. We* [name removed] *can afford to be in the middle of the pack rather than leading it, but we certainly couldn't afford to be behind the pack. I think to some extent we've begun to make good (meaning, strategically consider CSR).'*
>
> NED, Participant 6

Despite the organisational lack of urgency, Participant 6 emerged as a boundary spanning sensitive NED, striving to transfer knowledge and experience of CSR application from one board to the next. Overall, the boundary spanning oriented NEDs described their role as 'educating' the board and ultimately the organisation. One senior executive in charge of safety outlined the advantages of boundary broadening NEDs.

> *'He* [the NED] *said to the Chief Executive and the Executive Directors that unless they improve their safety performance they will not improve as a company. That has been made fairly clear at a number of different levels and the committee is absolutely uncompromising in its expectations of the company's executives. I regard him as a powerful ally.'*
>
> Expert, Participant 1

Another NED talked at length about the growing desire among boards to provide greater guidance to their organisation on CSR application as well as other issues and how he felt that this momentum was spreading across the NED community.

> *'I won't say networking, but, that's just it. It multiplies in the community. There is more of a definite feeling for more than just making a profit.'*
>
> NED, Participant 14

The respondents identified boundary spanning as one aspect of networking and as an increasingly important element of the NED role. The point being made is that CSR pursuit is substantially aided by boundary spanning oriented NEDs.

Boardroom language

In the promotion of CSR, the study participants reported attentiveness to language as an important consideration. Further, for CSR to be treated as a serious boardroom issue, consideration of reputational risk emerged as an additional critical consideration.

> '*Well, the minute you talk corporate social responsibilities the average Chief Executive wants to be sick in his hat. He sees it as a brake shoe. Sees it as an impediment. Whatever you're going to tell him about it, it's going to be an impediment to profit. It means you can't go mine at three cents an hour in Papua New Guinea or wherever.*'
>
> NED, Participant 4

Aside from the concept, numerous study participants reported a distaste among board members simply for the term CSR. Their irritation is described below:

> '*Corporate social responsibility is a horrid term, I suspect it'll keep evolving. In the new company we are going to have a committee, a board committee that looks at this area, but we are not going to use CSR as a title.*'
>
> NED, Participant 3

The distaste for the term CSR stems from a distinct shared understanding that the role of the board (and each board member) is primarily to protect and enhance the position of the shareholder. Unless a business case can be clearly presented on behalf of CSR the respondents reported it as a recipe for, as one NED put it, '*giving away company profits*' (NED, Participant 5).

As a counter to CSR, the language of reputational risk emerged as more acceptable in the boardroom. A number of NEDs stated that risk orientated words and meanings were easier to relate to and act upon.

> '*So what I am trying to say is, that this was a good example of something that we were doing for social responsibility. But, I told everybody, make no mistake about it. This is not a social project. This is a project where we are going to increase our market share with* [name removed] *and that this is what it is all about.*'
>
> NED, Participant 10

One NED reported their organisation titling their CSR committee as the 'Committee for Risk and Reputation'. Through adopting risk based language, board members reported themselves as better able to discuss CSR issues as hard financials, rather than as soft, difficult to pin down, problems.

> '*You cannot put mange-tout on the labelling of the package if they have been picked by children of six with blisters on their feet. Your customers don't want to know about all this. But if they were to know about it they would be deeply unhappy. And that's an ethical issue we said and they said* [certain consumer groups] *don't give us ethics – What are ethics? – What's right? – Those children might be supporting* [pause] *orphaned siblings. – Quite right they were! So, we knew the issues were complex, but put it in terms of risk to reputation and we can deal with it.*'
>
> NED, Participant 4

Further, by not adopting appropriate boardroom lexicon any individual NED's credibility was reported as undermined. Directors did not perceive CSR as boardroom friendly terminology.

> '*If you haven't run a business and you don't have a financial background you might be at a disadvantage in a boardroom.*'
>
> NED, Participant 11

Although the interviewees emphasised that boardroom preponderance is for attention to financial and reputational role matters, certain NEDs recognised how such concerns limit their consideration of other issues.

> '*We are now moving from the financial to the language of risk and therefore you can start looking at something like reputation, but not in terms of ethics and morality which most boards can't deal with. I've never heard of a moral debate in the boardroom. Not once. But I've certainly heard good debates on an analysis of risk.*'
>
> NED, Participant 4

Supportive of CSR promotion, the study respondents reported that once the enterprise's reputation was considered as established, the board fought hard for its protection and nurture. Certain respondents quoted the Johnson and Johnson example, where the decision was made to remove all products from retail store shelves after a sabotage incident led to worries about contamination. Such a decision was considered as having made itself. The reputation of the company as an ethical provider of safe products made the decision easy.

There was only one '*right thing to do*' (NED, Participant 7).

In similar vein, another NED outlined how within his company, if a food item was found to be suspect, the entire batch would be removed. He held no doubt that line management would know to do this without referring to the board, as the board had actively promoted throughout the enterprise the protection and enhancement of the organisation's reputation.

> *'The agenda should be driven off what are the risks, and particularly the non-financial risks, to the company, reputational risk and so on. Some of them are more immediate risks. So safety will be the number one, probably the number one item on the agenda of every meeting.'*
>
> NED, Participant 3

Discussion

This study highlights the three avenues to effective CSR adoption in the boardroom, namely, present CSR in business case terms, link CSR pursuit to the enhancement of corporate reputation and encourage the NEDs to extend their experiences through effective boundary spanning, transferring knowledge from boards of which they are/or have been members, to their host organisation. In particular, the study participants emphasise that the boundary spanning capacity of each NED substantially contributes to CSR becoming a distinct boardroom agenda item. Critical, however, is that each NED has been afforded the opportunity to experience adoption of CSR on one or other board(s) in their personal portfolio. Further, the study reveals that although certain Executive or Non Executive Directors may be unwilling to accept the need for CSR, even as part of a business case, once an organisation goes down the road to becoming a 'good corporate citizen' the possible loss of reputational risk encourages greater responsiveness to CSR application. This finding is supported in the literature which highlights corporate reputation as becoming a critical 'organisational resource' (Deephouse, 1997; Mahon and Wartick, 2003). So, the study reported in this chapter concludes that for whatever reason, once CSR becomes accepted onto the boardroom agenda, it is 'here to stay'.

As part of getting to meaningful social responsibility application is effective boundary spanning, the other consideration is 'business casing' CSR, particularly in terms of language usage. Not positioning CSR within the preferred language of the boardroom, identified as both quantitative (Butcher and Harvey, 1999; Kinard et al., 2003) and reputational oriented (Paine, 1994, Wulfson, 2001), leaves board members uncomfortable with the label CSR, which, as shown, holds connotations of simply 'giving away profits'. Porter (2003: 41) agrees and continues that 'corporate leaders are now giving lip service to this, but they do not ultimately understand it'. As one NED in the study emphasised, adopting a project based approach considerate of risk to reputation, facilitates a more positive CSR outcome. One example, provided by another NED is of a company working in Africa which establishes a number of HIV programmes thereby ensuring for a healthy workforce, but in so doing increases political support, raises worker moral and improves corporate reputation.

Concluding this study, two recommendations are offered.

- That advocates of CSR tread a careful line to ensure that 'would-be converts' do not fall at the first hurdle because of exposure to overly complicated or 'politically naïve' stakeholder language and models.
- That the language of CSR in the boardroom adopt a numerical or risk to reputation tone (or both) if soundly responsible practice is to be a prominent strategic item on the agenda.

A limitation of this study is that only boards of Anglo-American enterprises have been scrutinised. Further comparative work needs to be pursued examining continental European and Asian board dynamics and governance controls. Additionally, concurrent examination of boards whose organisations are at different stages in their life cycle, is recommended.

However, the results from this exploratory study suggest that despite the 'one sided' governance structure of the boards under scrutiny, commonalities across certain industries and life cycle positioning do emerge. Despite criticism, NEDs/External Directors have emerged as a significant and positive influence on CSR adoption, creating their own licence to share their CSR experience with their board colleagues and the whole organisation.

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