Limperg Instituut

External environmental disclosure and reporting by large European companies

An economic, social and political analysis of managerial behaviour

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Abstract

This thesis seeks to provide explanations for and understandings of managerial behaviour in relation to corporate environmental disclosure and reporting (CED) by large Benelux and German companies over the seven-year period from 1989 to 1995. These years are significant, representing a time during which the word 'environment' attained mainstream economic, social and political status. The work is not only longitudinal but also cross-sectional, covering a variety of industry sectors.

Set within Burrell and Morgan's (1979) overarching framework on sociological paradigms, the nature and causes of CED are investigated using four theories (viz.: economic agency theory, managerial stakeholder theory, organizational legitimacy theory and political economy of accounting theory), each offering a different 'lens' for exploring variations in the volume of CED cross-sectionally and/or longitudinally. The thesis adopts a *teleological* construction to the application of these theories in the context of CED. That is, CED is seen as taking place not by accident or chance but due to the underlying goal that is served by it. Thus, managerial behaviour is investigated in relation to the goal(s) CED is perceived to reinforce, whether that goal be to reduce agency costs, manage divergent stakeholder groups, maintain or regain the status of organizational legitimacy, or as part of the arsenal of images and rhetoric used for the purposes of social construction in mystifying and mediating a challenge to the present business hegemony.

The empirical results based on the cross-sectional analysis provide partial support for the theories in finding an association between CED and a number of (proxies for) variables, including political visibility, industry environmental sensitivity, stakeholder importance, and (poor) environmental performance based on the eco-ratings of environmental pressure groups. The longitudinal analysis offers both complementary and alternative explanations and understandings of trends in CED over the period of the study, this analysis being presented from various different economic, social and political perspectives.

The thesis concludes with a discussion of public policy issues, particularly the role of the accountancy profession and the 'new kids on the block' presently engaged in the production and verification of corporate social, environmental and ethical reports, as well as so-called 'sustainability reports'.

Preface

All this was a long time ago, I remember,
And I would do it again, but set down
This set down
This: were we led all that way for
Birth or Death? There was a Birth, certainly,
We had evidence and no doubt. I had seen birth and death,
But had thought they were different; this Birth was
Hard and Bitter agony for us, like Death, our death.
We returned to our places, these Kingdoms,
But no longer at ease here, in the old dispensation,
With an alien people clutching their gods.
I should be glad of another death.

T. S. Eliot (Journey of the Magi, 1963)

The completion of this thesis sadly marks the end of my ten-year stay in the Netherlands. The offer to move to Amsterdam was originally made to me in the summer of 1993, during the latter stages of my term of office with the Fédération des Experts Comptables Européens (FEE) in Brussels. At that time my knowledge of environmental issues in a professional capacity was very much underfed. My only practical experience to date had been researching and drafting FEE's first European survey of environmental accounting and auditing activities and developments within the EU and EFTA countries. This, however, proved to be a springboard to other things. The Limperg Instituut (LI), an independent research co-operative between five Dutch universities, had decided to commit resources to furthering research in the field of environmental accounting and auditing at a European level and was looking for someone to take on the role of international co-ordinator. The package presented to me in July 1993 was unique, challenging and irresistible. As a full-time researcher, I had three quite different roles. My prime role was as international research co-ordinator in the field of environmental accounting and auditing for the LI, with a secondary role as a member of the technical department of Koninklijk Nederlands Instituut van Register Accountants (Royal NIVRA), the leading professional body for accountants in the Netherlands. The opportunity to undertake a research study towards a Ph.D. through the Department of Accounting at the Vrije Universiteit Amsterdam seemed to be the icing on the cake.

The early years of my tenure were spent working mainly for the LI and NIVRA. In 1994, I organised a one-day meeting of European researchers and representatives of professional bodies in the field of environmental accounting and auditing. The meeting took place in Amsterdam in April of that year and resulted in the establishment of an informal network (the Environmental Management, Accounting and Auditing (EMAA) Contact Network). For a variety of reasons, outright co-operation between the members of the EMAA Contact Network proved too ambitious but a decision was taken to organise the first European workshop for researchers and practitioners. This initiative resulted in the EMAA Workshop

on *Environmental Accounting and Sustainable Development*, which was held at Noordwijkerhout in the Netherlands in late 1995. The workshop was a success in terms of creating contacts and fostering closer ties between different target groups. The primary goal of establishing a broad research agenda, however, proved to be a 'bridge too far' and it was left to the different groups to go their own separate ways.

My role within NIVRA was also gratifying. For most of the first half of 1995 I was involved in organising the plenary and parallel sessions for the NIVRA 100 Centenary Conference *People for People* hosted jointly by NIVRA and the International Federation of Accountants (IFAC), which was held in Amsterdam in May 1995. Over the years I was also involved in a number of other projects and initiatives for NIVRA, including my role as guest editor of the international edition of *De Accountant* and my work with Nancy Kamp-Roelands in producing the first major European survey into state of the art of corporate environmental management within Europe's largest companies, all of which contributed to making my time in the Netherlands a pleasure and a privilege.

However, by far the most challenging aspect of the last ten years has been the work which follows in this book. Had I known in 1993 what I know now, I doubt very much whether I would have moved to Amsterdam, let alone agreed to undertake a thesis. None of us can, of course, know what lies ahead and there is a school of wisdom which suggests that we should travel the journey of life as if we are riding a mule backwards so that we focus on the moment and not on what is to come. However, I have laboured persistently over the last decade with the issue of whether I should or should not continue with the thesis. Even now, as I put in place the final piece of the jigsaw, I am still unsure as to whether I made the right decisions. There is much about the work which follows with which I am uncomfortable and I struggle to convince myself that what I have done matters in the slightest in the wider socio-political context of the deplorable damage modern industrial capitalism is doing to our social communities, human welfare and the natural environment. Those interested will find many of these personal, subjective and professional struggles documented in the notes to the various chapters which follow.

One of the principal reasons why the research work took so long to complete was my almost complete lack of knowledge and understanding of accounting in its wider socio-political context (i.e. beyond a simple functionalist or instrumentalist, neo-classical economics perspective). Despite (or perhaps because of) many years of higher education and training and practice as a chartered accountant, including several years as a highly-paid technical expert on UK and European financial accounting and reporting issues, I was completely unprepared for the challenges that a serious, concerned approach to CSR research required. There is no doubt that it would have been far easier to have tried to fit the research study into the framework of traditional financial accounting or to have researched corporate environmental disclosure (CED) from within a neo-classical (or neo-institutional) framework. However, my growing knowledge and understanding of the relationship between economy and ecology, particularly in the context of modern capitalist economies, and of the role of business and accounting in these economies, made any attempt to fit CED into a 'contracts-based' or 'markets-driven' framework appear nonsensical.

There were in fact many, very steep learning curves to be negotiated before I felt able to begin the theoretical and empirical work which follows. These related not only to philosophy

of science issues (ontology, epistemology and methodology) but also to my own personal values, attitudes and beliefs. In seeking my own personal truth, I came to the conclusion that the rhetoric behind the related concepts of 'sustainable development' and 'sustainability', as presently being used in academic, business, government and accountancy circles, is largely devoid of philosophical, scientific, professional and moral authenticity. Simply put, 'the Emperor has no clothes'. Over the last decade, I have become a vociferous, unvarying critic of my academic peers and fellow accountancy professionals. Almost all of what I read in the mainstream academic economics and accounting journals and professional accountancy magazines is nonsensical to me now. Being a radical humanist and spiritual ecologist, that is perhaps to be expected. But there is a certain sadness in knowing that it is one's radical, critical views and outspoken conduct, borne out of a genuine, conscious passion and conviction, which have closed doors rather than opened them. Had it been possible, I would have liked to continue my academic career in some capacity or other. But the compromises that I would have been required to make were too high a price to pay.

Be that as it may, I have moved on from the place and time which saw the birth, development and completion of the research project presented here. I am grateful for the experience, not least because, if nothing else, I am surer of my own position on many matters philosophical, ideological and metaphysical. Perhaps that is one of, if not, the most important aspects of any Ph.D. research programme.

Personal acknowledgements

There are a great number of people to whom I owe a considerable debt of gratitude for all that I have learnt and experienced academically over the last ten years. My two promoters, Jan Klaassen and Paul Jansen, allowed me the opportunity to reflect on and question much of what is traditionally taken for granted in accounting research. For that, and their continued support, both financial and otherwise, over the years, I am deeply grateful. To my colleagues at the Department of Accounting at the Vrije Universiteit Amsterdam I should like to express my appreciation for their interest and support. I am particularly grateful to Kees Camfferman for his much-valued comments and analysis throughout the life of the Ph.D. project.

My time at NIVRA (1994 to 2001) gave me a great deal of pleasure. NIVRA's financial and administrative support was a key factor in the continuance of my stay in the Netherlands. In this respect, I would like to acknowledge the friendship and support I received from the management and staff at NIVRA, particularly the late Cees Dubbeld, Wim Moleveld, Ton van Wielink, Willem Verhoog, André Werring, and Hans Prikken. I should also like to pay particular thanks to Nancy Kamp-Roelands with whom I had the pleasure of working on a number of NIVRA publications.

My association with the Limperg Instituut has been a source of sustained joy. I am deeply grateful to Hans Blokdijk, Ed Broeze, José Lourens, Ernita Pfaff and Marcelle Weisfelt for the many enjoyable years at Weerdestein 97 and later at Van Leijenberghlaan 197c. I wish to pay singular thanks to Roel Soeting and Fred Drieënhuizen for their close personal friendship and ardent support over the last ten years, without which the journey would have been much more difficult and far less agreeable.

There are many persons who have been directly involved in the Ph.D. research project itself and whose assistance was crucial to its successful conclusion. In this connection, I would like to thank the members of the reading committee for their comments on the final draft. I would also like to express my sincere appreciation to my team of content analysts, Anja Bavelaar, Clara Cravos, Marion de Graaf and Marcelle Weisfelt. Marcel Ursem was also part of my team and deserves a special thanks for his work in obtaining the vast number of corporate reports which came to occupy every inch of spare space at the LI's offices. I am also greatly indebted to Peter Dekker for his invaluable assistance and advice in all matters statistical and to Madeleine Hertzberger and her staff at the NIRA library for doing such a wonderful job in filling my many requests for books and journal papers. I would also like to ackowledge the contribution of all the companies and environmental organizations that chose to participate in the project by providing copies of their reports and/or completing the survey questionnaires. The co-operation and support of all the individuals concerned is very much appreciated. I should also like to thank all those who were kind enough to comment on draft chapters of the thesis, notably, Amanda Ball, Nancy Kamp-Roelands, Dave Owen, Maria Rosa Rovira Val, Jeffrey Unerman and David Woodward. The financial and administrative support of the Free University, the LI and Royal NIVRA is also appreciatively acknowledged. All views expressed in the study and any remaining errors, of course, remain the responsibility of the author.

There are also many individuals who have played a part, both large and small, in assisting me along the way. For their personal time and support, I should like to specifically acknowledge my gratitude to Roger Adams, Chris Nobes and Michael Power. I should also like to thank Saskia Slomp for her help in the very early stages of my move to Amsterdam and continued support over the years. I would like to pay an exceptional acknowledgment to Rob Gray and Dave Owen. The dependable support of these two stalwarts of corporate social responsibility (CSResp) and corporate social and environmental reporting (CSR) has been a source of enormous strength over the past ten years. Without it, I would have given up the ghost long ago. Rob Gray in particular devoted a considerable amount of time and energy in the early years to fostering my deeper and more critical understanding of science in general and accounting in particular, as well as offering much-valued comments and criticisms on the final draft of the thesis. This is a debt I can never repay. Through *The Centre for Social and Environmental Accounting Research* (CSEAR) and particularly the annual *CSEAR Summer Schools* I was fortunate enough to make contact with many like-minded individuals. Particularly, I would like to thank Pascale Anton, Jan Bebbington, Frank Birkin, David Campbell, David Collison, Colin Dey, Anouk van Heeren, Carlos Larrinaga, Linda Lewis, Brendan O'Dwyer and Ian Thomson. A very special thanks also goes to Sue Gray of CSEAR for her attentive assistance on so many occasions over the years.

Finally, I should like to thank my family and close friends for just being there.

CJH
Moulin d'Haljoux, Ciney
December 21, 2003

Notes for readers

This book was a challenge to conceive, a challenge to research and a challenge to write. As a result, it is not an easy read. Many of these challenges stem from the fact that the subject matter of my thesis, corporate environmental disclosure (CED), is explored from several different theoretical perspectives. In doing so, this gives rise to what are termed 'paradigm distinctions', which remain a central and critical feature throughout the book. These different perspectives represent alternative views of reality (ontology), the forms of knowledge that are possible (epistemology), and the methods of research that are used for the acquisition of that knowledge (methodology). These three philosophical issues are interrelated with one another, methodology being derived from epistemology which, in turn, is determined by ontology. Thus, in order to understand the perspective of different theories that sit within different paradigms, it is necessary to have an understanding of these different philosophical issues.

The complexities and challenges do not end there. Theories represent abstract versions of reality. Social scientists scale down the complexities of the social world they seek to explain and understand through the use of a carefully selected nexus of assumptions, many of which are often taken for granted but which can have a significant influence over not only what is studied but also what is revealed by those studies. More importantly, perhaps, many of the philosophical issues and embedded assumptions are absent from much of published research. Most scientific journals are themselves wedded to a particular paradigm and therefore there is a presumption that it is unnecessary to address issues which are obvious to the editor, the editorial board and those who normally read the journal. However, scientific work that employs different theoretical perspectives to explain the same phenomenon brings these philosophical issues and embedded assumptions to the surface. In short, it becomes impossible to ignore them. This book therefore covers a broader range of philosophical and theoretical issues and assumptions than might normally be found in a single piece of published research. As a result, there are lots of references (note: multiple references are presented in alphabetical rather than chronological order) and footnotes to each chapter. I am aware that this disrupts the flow and can be annoying to some readers. The footnotes, however, have an important purpose. Apart from illustrating my own attempts at understanding the subject matter, more importantly they serve to draw attention to issues which should not be overlooked and bring alternative viewpoints to the reader's attention.

I have also tried my best to avoid some of the complicated, confusing and frustratingly pretentious language that appears in many published academic research papers. My aim has been to try to understand issues for myself before attempting to explain them to others. In doing so I have to work within my own intellectual limits. There are many issues that I simply find very difficult to understand and issues which I have skimmed over, omitted or run away from simply because I did not have the inclination, time and/or energy to pursue them further. Yet, even when I think I understand something, and none of us can ever be certain we do really understand *anything*, the issue remains unsettled and unresolved in my mind. Academic research, like so many other aspects of life, is not a journey to the mountaintop but a constant, never-ending learning process.

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Abbreviations and acronyms used in the text

AAA	American Accounting Association
ACCA	Association of Chartered Certified Accountants
AICPA	American Institute of Certified Public Accountants
AR	Annual report and accounts
ASC	Accounting Standards Committee
ASSC	Accounting Standards Steering Committee
BS	British Standard
BCSD	Business Council for Sustainable Development
CAPM	Capital Assets Pricing Model
CBI	Confederation of British Industry
CCAB	Consultative Committee of Accountancy Bodies (UK)
CEA	Corporate environmental accounting
CEC	Commission of the European Communities (European Commission)
CED	Corporate environmental disclosure
CEFIC	Conseil Européen des Federation de l'Industrie Chimique (European Chemical Industry Federation)
CEP	Council for Economic Priorities
CER	Corporate environmental reporting
CERCLA	Comprehensive Environmental Response Compensation and Liability Act
CERES	Coalition for Environmentally Responsible Economies
CFCs	Chlorofluorocarbons
CICA	Canadian Institute of Chartered Accountants
CSEAR	Centre for Social and Environmental Accounting Research
CSR	Corporate social and environmental reporting
CSResp	Corporate social responsibility
DEFRA	Department for Environment, Food and Rural Affairs (UK)
DTI	Department of Trade and Industry (UK)
EAT	Economic Agency Theory
EBIT	Earnings before interest and tax
EC	European Community
EC AAF	European Commission (EC) Accounting Advisory Forum
EEA	European Environment Agency
EEB	European Environment Bureau
EERA	European Environmental Reporting Awards (renamed 'European Sustainability Reporting Awards' (ESRA))
EFFAS	European Federation of Financial Analysts' Societies
EFTA	European Free Trade Association
EIAs	Environmental Impact Assessments
EMAS	European Community eco-management and audit scheme
EMH	Efficient Market Hypothesis
ENGO	Environmental Non-Governmental Organization
EPA	Environmental Protection Agency
ERAS	Environmental Reporting Awards Scheme
ER	Environment report (corporate)
ERA	Environmental Reporting Awards
ES	Environmentally-sensitive

ESRA	European Sustainability Reporting Awards
EU	European Union
FASB	Financial Accounting Standards Board
FCA	Full cost accounting
FEE	Fédération des Experts Comptables Européens (Federation of European Accountants)
FRS	Financial Reporting Standard
FoE	Friends of the Earth
FRC	Financial Reporting Council
FRS	Financial Reporting Standard
FSC	Forestry Stewardship Council
GAAP	Generally Accepted Accounting Practice
GATT	General Agreement on Tariffs and Trade
GRI	Global Reporting Initiative
GMO	Genetically-modified organisms
HSE	Health, Safety & Environment
IAPC	International Auditing Practices Committee
IAS	International Accounting Standard
IASB	International Accounting Standards Board (previously IASC)
IASC	International Accounting Standards Committee
IASB	International Accounting Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICC	International Chamber of Commerce
IFAC	International Federation of Accountants
IFRSs	International Financial Reporting Standards
IGO	International Governmental Organization
IISD	International Institute for Sustainable Development
ISEA	Institute of Social and Ethical Accountability
ISO	International Standards Organization
LES	Less environmentally-sensitive
MST	Managerial Stakeholder Theory
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
MSF	Médecins Sans Frontières
NAFTA	North American Free Trade Agreement
NGO	Non-Governmental Organization
NPV	Net Present Value
OECD	Organization for Economic Co-operation and Development
OFR	Operating and Financial Review
OLT	Organizational Legitimacy Theory
OR	Other Report (corporate)
PAT	Positive Accounting Theory
PBIT	Profit before interest and tax
PEAT	Political economy of accounting theory
PERI	Public Environmental Reporting Initiative
PRPs	Potentially Responsible Parties
PTA	Positive Theory of Agency
SA	Social accounting
SEA	Social and environmental accounting
SEAL	Social and environmental accounting literature

SEC	Securities and Exchange Commission
SFS	Summary financial statements
SIG	Special Interest Group
SOP	Statement of Position
SR	Social report (corporate)
SRA	Social responsibility accounting
SusRA	Sustainability Reporting Awards
TBL	Triple bottom line (reporting)
TNC	Transnational Corporation
TRI	Toxic Release Inventory
UK	United Kingdom of Great Britain and Northern Ireland
UN	United Nations
UNCED	UN Conference on Environment and Development
UNCTAD	United Nations Conference on Trade and Development
UN CTC	United Nations Centre for Transnational Corporations
UNEP	United Nations Environmental Programme
ISAR	Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting
UNWCED	United Nations World Commission on Environment and Development
US	United States of America
US EPA	United States Environmental Protection Agency
WBCSD	World Business Council for Sustainable Development
WEF	World Economic Forum
WICE	World Industry Council for the Environment
WTO	World Trade Organization
WWF	World Wide Fund For Nature (formerly known as the World Wildlife Fund)

Chapter 1

Preliminaries

> *The [environmental] agenda is dead easy; as always, it will be moral and social accountability, responsibility and openness. It will always embrace ethics, justice ... democracy [and] people's responsibility to each other. ... As governments become leaner and less socially responsible, and cede power to companies and the private sector, so the civil society will scratch around for organizations to trust and respect. Responsible environmentalism, or something that fully embraces the debate about nature and its resources, becomes the only intellectual option outside evidently failing capitalism and fatally flawed communism*
>
> *John Vidal (1996, p.5)*

1.1 Introduction

The subject matter of this thesis is corporate environmental disclosure and reporting (hereafter, CED)[1] by large Benelux and German companies over the seven-year period from 1989 to 1995. These years are significant, representing a time during which the word 'environment' attained mainstream economic, social and political status. The work is not only longitudinal but also cross-sectional, covering a variety of industry sectors. The nature and causes of CED are investigated by employing three theories, each offering a different 'lens' through which to explore, predict and explain variations in the volume of CED both across firms and over time. These three theories are compared and contrasted within an overarching meta-theoretical framework which employs Burrell and Morgan's (1979) seminal work on sociological paradigms to analyse the ontological, epistemological, methodological and human nature aspects of each theory. An understanding of these meta-theoretical issues is seen as crucial for a proper comprehension of the role played by theories in socially constructing an image of the world within which large corporations[2] operate and of how and why CED is employed by the executive of these corporations towards some specific, economic, social and/or political end.

The first of these three theories, economic agency theory (hereafter, EAT), focuses on the *economic* nature of the firm and the 'agency problem' that persists in large corporations where ownership is diffused and separated from control. Managerial stakeholder theory (hereafter, MST), takes a wider *socio-economic* perspective, drawing on the managerial model of stakeholder theory under which senior management is seen as striving to manage conflicting socio-economic relationships between the organization's various internal and external stakeholders. These relationships are explored within a neo-pluralist visualisation of modern, liberal economic democracies. Organizational legitimacy theory (hereafter, OLT), broadens this analysis still further by taking a *socio-political* perspective to explore how management's use of CED may be explained by reference to social values, attitudes and norms within society. A fourth theory, political economy of accounting theory (hereafter, PEAT), is employed in a supplementary capacity, pulling back the lens of analysis even

further to provide a radical, Marxian interpretation of the changes in the volume of CED over the period of the study. In this context, PEAT is concerned primarily with the role corporate reporting plays in preserving existing power asymmetries and inequalities over the distribution of income, wealth and power within capitalist societies as a whole.

The thesis adopts a *teleological* construction to the application of these theories in the context of CED. That is, CED is seen as *teleological*, taking place not by accident or chance but due to the underlying purpose or design that is served by it[3]. Thus, managerial behaviour is explained in terms of the underlying goal which CED is perceived to reinforce, whether that goal be to reduce agency costs (EAT), to manage divergent stakeholder groups (MST), to maintain or regain the status of organizational legitimacy in the eyes of the 'relevant publics' (OLT), or as part of the arsenal of language, images and rhetoric used for the purposes of immanent legitimation and social construction of perceptions to hide, mystify and mediate the 'environmental crisis' between money capital and nature (PEAT). Using traditional hypothetico-deductive research methodology, a set of hypotheses is developed using the three main theories chosen for the study of CED (EAT, MST and OLT). These hypotheses describe putative associations between CED, the dependent variable, and two or more independent variables, which are tested using statistical regression techniques. CED is defined and captured using a form of content analysis to record the volume of CED which appears in reports forming part of a corporation's regular reporting cycle. The approach significantly departs from and adds to prior research in the field of corporate social and environmental reporting (hereafter, CSR[4]) by including not just the annual report and accounts but also corporate social and environment reports. A number of variables, including political visibility, industry environmental sensitivity, stakeholder importance, environmental performance and the perceptions of and campaigns by environmental pressure groups, are employed to test for an association between variations in proxies for these variables[5] and the volume of CED. In addition, an interpretive approach is employed with each of the four theories to explore possible, alternative as well as complementary explanations for trends in CED over the period from 1989 to 1995.

The remainder of this chapter is structured as follows. Section 1.2 provides a very brief overview of the relationship between business and society in the context of public concerns about the state of the natural environment[6], and the specific role, which the accountancy profession plays in that relationship. Following sections provide an outline of the research problem (Section 1.3), the research questions (Section 1.4), supporting motivations for the research (Section 1.5), the research design (Section 1.6) and a definition of CED (Section 1.7). The final section (Section 1.8) provides a content outline of the remaining chapters of the thesis.

1.2 'Growing up isn't easy at any age'

It is almost impossible for anyone born before 1970 not to have noticed the enormous growth of interest in and concern for the natural environment over the last 30 years or so. Approaches to addressing these environmental concerns vary widely. Some, for example, view the depiction of an 'environmental crisis' as melodramatic, arguing that humankind has the necessary know-how, skills, determination and imagination to find a technical solution to any problem no matter how complex or difficult that problem might seem. Examples of the

more common forms of technicist 'band-aid' to have emerged since the 1970s include recycling, land-fill, energy and water efficiency, pollution and waste control, closed-looped systems of environmental management, product take-back, 'eco-friendly' products and production methods and life-cycle technology (see, for example, Bennett and James, 1998; WBCSD, 1996; Welford, 1998). However, for others the adoption of what is regarded as little more than a 'business as usual' approach to critical environmental problems is perceived as contemptibly puerile in the face of recent, emerging trends which suggest that the future of the planet and that of its inhabitants is *not* safe in the hands of its incumbent trustees (see, for example, Real World Coalition, 1996, 2001).

Whilst equally forceful arguments can, and are, made, on both sides of this divide, the present study explicitly recognises the notion of an 'environmental crisis' (Arvill, 1976) as both a rational and self-evident feature of the modern world[7]. Despite the unpalatable implications, there is a growing recognition that human development has already reached (if not passed) that point at which painful decisions have to be taken to protect and nurture what remains of the Earth's unique, essential and irreplaceable eco-systems (see, for example, Brown *et al.*, 1995, 1998, 1999; Elkington and Hailes, 1998; Meadows *et al.*, 1972; Pearce *et al.*, 1989; Porritt, 1990; UNICEF, 1995; UNWCED, 1987)[8]. The ubiquitous nature of this 'environmental revolution' (Nicholson, 1972) affects all elements of society and all societies without exception. No individual or institution is immune from the global ecological consequences of climate change, deforestation, desertification, global warming, industrial agriculture, ozone-depletion, and species and habitat loss[9]. Consequently, the changes that have been, are being and will be put in place to reverse humankind's unsustainable patterns of consumption and development will profoundly alter the fabric of human society in the twenty-first century.

Modern large, transnational corporations, by virtue of the sheer scale of their economic activities, will form a key agenda issue for the environmental revolution, irrespective of whether these organizations are seen as part of the problem, part of the solution, or both[10]. Whatever the validity of the arguments over corporate social responsibility (hereafter, CSResp) and the role of business in society, the changing socio-political climate since the late 1960s and early 1970s has raised uncomfortable questions about the social, cultural, humanitarian and environmental 'externalities' associated with the function and conduct of large business organizations in liberal economic democracies (see for example, Handy, 1998; Korton, 1995, 1999). Such concerns are far from new. Scientists have been aware for some time of the disturbing implications of global, free market industrialism for the planet and its eco-systems (see, for example, Carson, 1965; Erlich and Erlich, 1970; Friday and Laskey, 1989; Silver, 1990; Ward and Dubos, 1972). Nevertheless, it is only relatively recently that the mainstream of market-based democracies, such as business and the accountancy profession, has started to take these issues more seriously.

In the world of accountancy, Gray's (1989, 1990a, b, c, 1992) seminal work has perhaps been the main catalyst for invoking a genuine, altruistic concern for the natural environment amongst accountancy academics and professional accountancy bodies[11]. The accountancy profession's interest in the natural environment in the late 1980s and early 1990s came on the back of a considerable body of previous work in CSResp which began in the early 1970s with the publication of a number of important introductory contributions to the subject (see, for

example, Beams and Fertig, 1971; Churchman, 1971; Linowes, 1972; Mobley, 1970)[12]. Even today, amidst a veritable explosion of interest in CSResp and various forms of corporate social, ethical and environmental accounting and reporting, and the more recent developments in triple bottom line (TBL) reporting and assurance and verification services, there is a strong tendency for the 'new kids on the block' to reinvent wheels, to overplay originality and to ignore the many valuable experiments and case studies that were carried out in the early to mid-1970s (see, for example, Owen, 1996). Ironically, one key development in the late 1980s was the rebirth of interest in CSResp through the 'back door' of growing public concerns over the impact of global industrialism on the natural environment. Largely in response to these concerns, a number of key socio-political institutions, notably the United Nations (UN) and Commission of the European Communities (EC), have been active in promoting the need for a more environmentally responsible attitude amongst business organizations. In 1992, for example, the UN published a report (UN, 1992) containing a list of corporate environmental reporting recommendations. Similarly, within the European Union (EU), two initiatives in particular, the EC's fifth action programme on the environment "Towards Sustainability" (CEC, 1992) and an EU regulation, Community eco-management and audit scheme (CEC, 1993b, 2001a), commonly referred to as 'EMAS', have both contributed to greater attention on corporate environmental management and reporting issues[13]. Both initiatives have important implications for businesses in general and for the accountancy profession in particular. The latter's involvement in environmental issues since the late 1980s has been considerable (see, for example, ACCA, 1998, 2003a; Adams, 1992a; Adams *et al*., 1999; AICPA, 1996; CICA, 1992, 1993a, b, c, 1994a, b, 1997a, b; Collison *et al*., 1996; Drieënhuizen *et al*., 1998; FEE, 1993, 1995, 1999a, b, 2000, 2001, 2002; FEE/Kamp-Roelands, 1996; IAPC, 1995, 1998; ICAA, 1996, 1998; ICAEW, 1995, 1996; Macve and Carey, 1992; UNCTAD, 1998). Whilst this development may be viewed as a natural progression in the profession's services to corporate clients as the latter embrace a wider socio-political communications strategy, it stands in sharp contrast to the traditional view of the role of the accountant in society in relation to the preparation and audit of financial statements[14]. Put simply, the craft of accounting has evolved over time to become an institutionalised, abstract body of technical knowledge the primary macro-economic purpose of which is to reduce uncertainty for social actors:

> *... uncertainty breeds anxiety. Accounting information serves the social purpose of abating and objectifying anxiety in a manner similar to the process of institutionalisation, rationalization and the establishment of symbolic order. In sum, the role of the accounting profession in society is to absorb uncertainty and abate social anxiety* (Mason 1980, p.29)

The accountancy profession has long been viewed as a practical discipline rather than one which belongs to the arts or sciences[15]. The importance of accountancy in this context derives particularly (though not solely) from its *practical* contribution to the management of the modern business organization through the provision of a 'true and fair' system of financial accounting[16]. For many of those involved in the practice and education of accountancy, the perception of accountancy's importance being rooted in the provision of 'reliable', 'complete' and 'accurate' financial information to the business organization has changed little over the past 50 years or so. Professional accountancy bodies spend considerable resources on improving the quality of financial reporting (see, for example, Hoogendoorn and

Mertens, 2001)[17]. Justification for such efforts rests primarily on two fundamental, related assumptions. The first is what may be termed the *objectivity assumption*, which holds that through a system of generally-accepted principles, concepts, rules, and standards, it is possible to improve the quality of financial information such that what is reported through corporate financial statements reflects an underlying economic reality that is 'objective', i.e. free from the subjective bias of those involved in its preparation and audit. Consequently, considerable efforts are directed at socially constructing a detailed and ever increasing set of legal and technical rules for the preparation and audit of corporate financial statements, the assumption being that it is possible to arrive at a quality of financial reporting which perfectly mirrors *economic* reality. It is this basis of accounting, with its strong attachment to liberal economic theory, which led many influential figures in accounting history to argue that accounting in its present form is *socially desirable* because it provides information to investors to make the 'right' economic decisions for the benefit of a society as a whole (Paton and Littleton, 1940):

> *The social importance of accounting is clear, especially in relation to the income statement, since dependable information about earning power can be an important aid to the flow of capital into capable hands and away from unneeded industries* (p.3).

Similarly, over 60 years later, the International Accounting Standards Board (IASB)[18], the foremost international accountancy body with responsibility for the promulgation of global financial accounting principles and standards, sees its principal goal as that of providing financial information that is relevant, reliable (i.e. free from material error and bias) and comparable (IASC 1989, paragraph 24) by developing (emphasis added):

> *... **in the public interest**, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements ... to help participants in the various **capital markets** of the world and other users of the information to make **economic decisions*** (IASB, 2002, p.8)[19].

The second assumption is what may be termed the *utility assumption*. In short, financial accounting and reporting is sanctioned at an institutional level by virtue of the fact that the primary purpose which it serves, namely the *economic* measurement of the operations and position of the business organization, is a valid and vital goal for society as a whole. In other words, the system of financial accounting and reporting is a necessary and important element of the means by which a market-based economy functions in relation to its primary socio-economic objective of efficiency in the allocation of scare resources amongst alternative ends (Robbins, 1932). Much of the philosophy underlying the objectivity and utility assumptions has its roots in neo-classical[20] and positive[21] (i.e. value-free) economics, both of which have had an enormous influence on the development of the practice and education of accountancy over the last 50 years. Under a political system based on liberal economic democracy and the economic mechanism of free-market global capitalism, reliable and accurate financial information is seen as vital to the efficient running of that system. Moreover, it is assumed that by improving the quality of the system of corporate financial reporting, the efficiency of the social system as a whole can also be improved. Thus, in a corporate context, accountancy is argued to provide a valuable function not only in terms of directing economic activity and

ensuring the efficient allocation of economic resources but also in socio-economic terms in providing valuable feedback to investors, employees and other members of society. Such a perspective manifests itself through a pre-occupation with the role of accounting in facilitating responsible stewardship over the principal's (i.e. outside investors) funds and rational decision-making as socially constructed by the agent's (i.e. management) perception of reality, whether economic, sociological or technological (see for example, Cooper and Kaplan, 1991; Chandler, *et* al., 1991; Ijiri, 1967; Horngren, 1977).

Within this narrow, economic, markets-orientated perspective resides a strong pre-occupation amongst the accountancy profession with improving the quality of financial information for *economic* decision-makers. Much of contemporary financial accounting reporting theory and practice is couched within a socially constructed perception that accountancy has a primarily *economic* purpose, guided by goals of economic efficiency and wealth-creation. The primary users of this information are considered by many, including the IASB, the UK's Accounting Standards Board (ASB) and the US's Financial Accounting Standards Board (FASB), to be investors and creditors. As such, there is a widespread perception that, to be of value, financial accounting information must be *useful* to those narrow groups within society, predominantly institutional investors, venture capitalists, merchants, entrepreneurs, financiers and speculators, or their respective agents or trustees, who invest private property in enterprises for the pursuit of their own personal financial gain. Consequently, the provision of CSResp information, such as that relating to environmental issues, is not normally considered to be within the realm of accounting (Patten, 1995). However, since the late 1970s, accountancy researchers have increasingly turned their attention to the nature of accountancy as a broader, socio-political phenomenon (Burchell *et al*., 1980; Tinker *et al*., 1982, 1991), and with the historical development and consequences of accountancy practices in a broader social context (Burchell *et al*., 1985; Hopwood, 1978, 1983; Loft, 1988).

Assertions that corporate financial reporting (a) could *ever* be 'objective', 'complete' or 'accurate' and (b) *should* positively discriminate in favour of money capital at the expense of social, human, cultural and environmental capital, are highly contestable *normative* positions and have been strongly refuted by accounting literature that has been critical of the current financial reporting framework, whether this be from a 'market for excuses' perspective, which sees accounting standards more in the nature of a tradeable commodity than a symbol of quality and reliability (Watts, 1977; Watts and Zimmerman, 1978, 1979) or a 'classical' political economy perspective which sees accounting as a means of preserving existing inequalities and power asymmetries between labour and capital (see, for example, Cooper and Sherer, 1984; Tinker, 1984a, b, 1985; Neimark, 1986, 1992; Tinker and Neimark,1987). 'Neutrality' or 'objectivity' in mainstream accounting in a socio-political context i.e. as an instrument of public policy, is circumscribed within the normative argument that, by focusing on effective economic measurement, accounting is consistent with the national interest (see, for example, Elliot and Jacobson, 1994), the assumption being that the economic system (capitalism) serves the national interest. However, a broader socio-political interpretation of accounting, i.e. one which is prepared to question or which rejects the assumption that the social system is just and fair to all, permits a more diverse range of perspectives, values and beliefs to enter into debates on the role, purpose and, importantly, the socio-political consequences of corporate financial accounting and reporting. This broader perspective forms

an integral part of the present research investigation into the phenomenon of CED[22]. The nature of this investigation is described in more detail in the next section.

1.3 Problem definition

One of the principal requirements of a research investigation is a statement of the general problem to which the research pertains:

> *Such a statement should convince the reader of the theoretical or practical importance of solving such a problem relative to what is currently known and/or the benefits that might accrue from solving it* (Krippendorff 1980, p.179).

In 1993, when the research problem for this investigation had to be defined, CED was (re-) emerging as an area of interest to both accounting academics in particular and the accountancy profession in general. At that time, there already existed a sizeable body of research which explored CSResp and CSR, including CED (for an overview of this prior literature see, for example, Gray *et al*., 1996; Mathews, 1984, 1991, 1997; Ullmann, 1985). However, hitherto CED had been researched largely as a category of social disclosure, with little investigation into the specific nature and causes of environmental disclosure, either cross-sectionally or longitudinally. In addition, the phenomenon of stand-alone, dedicated corporate environment reports was still relatively embryonic. The first such reports began to appear in the latter part of the 1980s, with many of the pioneers emerging as recently as the early 1990s[23]. Importantly, the vast majority of environmental disclosure and reporting was and remains voluntary. That is, such disclosure is provided at the discretion of the management of corporations, not in compliance with any legal, statutory or contractual obligation[24]. The fact that management chooses *voluntarily* to provide environmental information has been suggested as not only one of the reasons why such disclosures became a topic of interest to many in the accounting profession (Patten, 1995) but also one of the key factors behind the current resurgence of interest in both the *practice* and *theory* of CSR (Gray *et al*., 1996).

Within the European Union (EU), current EU Accounting Directives and national legal and accounting reporting rules require corporations to make detailed disclosures to their shareholders in relation to various aspects of their financial performance and state of affairs. In this context, it has been suggested as logical to assume that *voluntary* environmental disclosure, financial or otherwise, would be made only where it is considered to be of some benefit to the management of the organization (O'Donovan, 1999a). However, just what this benefit might be and how they relate to management in terms of their pursuit of the organization's overall objectives, remain matters of conjecture[25]. According to Gray *et al*. (1996) convincing histories which explain the rise of environmental accounting, and more recently, of social accounting, have yet to be written. The absence of such convincing histories provides one important reason to support research in this field. During the 1990s, calls for researchers to take CER more seriously have come from a number of different sources, one of the earliest being Gray (1990a) who argued that (original emphasis):

> *We need to discover (i) what <u>is</u> happening in this field; (ii) the difficulties that surround articulation and implementation of environmental accounting systems (i.e. experiences with what is happening); a review of what is <u>not</u> happening and why; and, (iv) explorations of what can happen* (p.135).

Likewise, Patten (1995) argued that there was a need for further research in the area of social disclosure, noting that trends in such disclosure were not well documented as recent at the

mid-1990s, and that there was very little information on the extent and nature of social disclosure in the 1980s or early 1990s. Without this descriptive data, an understanding of the provision of and use of socially responsible information is restricted (Patten, 1995). Similarly, Stray and Ballantine (1996) argued that a serious commitment to the important prevailing issues surrounding CED at that time was paramount in order that "… environmental disclosure does not suffer a recurrence of its previous fate of the 1980s, that of being relegated towards the bottom of the hierarchy of corporate priorities and concerns" (p.3). There have also been calls for CSR research in countries other than the UK and the USA. Jönsson (1995), for example, drew attention to the possible benefits to accounting theory development from increased research efforts in the area of environmental accounting, arguing that there are also legitimate theoretical reasons for engaging in accounting research on environmental issues and that accounting is implicated in the search for solutions to environmental problems.

Whilst the search for these convincing histories is reason enough in itself to support such research, important benefits may accrue from greater knowledge and understanding of the possible motivations for CED. For example, the socio-political aspects associated with environmental issues, particularly the growing tension between global (i.e. US-led) free-market capitalism and sustainability[26] is susceptible to widely differing interpretations and outcomes, creating conditions under which the various parties involved are likely to use information as a socio-political tool. Hence, benefits are likely to accrue to society from research which highlights the extent to which CED is being used to foster sectional interests rather than merely to inform or render an account. Recognising the existence of such sectional interests, be they economic, social or political, opens up avenues of research which focus on the 'Why?' and 'So what?' aspects associated with social phenomena, including CED.

1.4 The research questions

As noted above, CED is largely a voluntary act rather than something that is required of the management of a corporation. This raises the obvious but deceptively simple question: why do something that is not required? Moreover, even when disclosure is mandatory, the disclosure rules normally specify some minimum level of disclosure. Hence, the voluntary/mandatory distinction would not help in trying to explain why one corporation discloses more or less than another over and above the minimum, or why one particular corporation's volume of CED varied during a period of time in which the disclosures rules remained unchanged. In approaching this question, there are a whole host of potential factors which may be put forward to explain variations in CED both between firms and over time. However, scientific inquiry requires the use of some form of theoretical framework or model which permits the articulation of specific, testable propositions, assumptions and accounts as to the nature and causes of observable (i.e. measurable) phenomenon:

> *[A]ll observations are governed – to a greater or lesser extent – by the (implicit) theories we use. All action is, to some extent, influenced by implicit theory and any attempt to justify and evaluate new action (e.g. accounting policy making) is guided by theory – whether or not we are aware of this (Tinker et al., 1992). Thus, if we are to make any progress in examining, evaluating and prescribing CSR in anything other than an ad hoc or*

> *instinctive way we need to establish some bones of a framework of explicit theory* (Gray *et al*. 1996, p.32).

The accountancy literature contains a relatively large number of competing, complementary and/or alternative theories, both traditional and new, that have been sourced from other disciplines (for an overview, see, for example, Schreuder, 1983; Laughlin, 1995; Broadbent and Laughlin, 1997; Parker and Roffey, 1997). Within the realm of CSResp and CSR, a substantial body of literature from a wide spectrum of theoretical positions has explored the nature and causes of corporate social and environmental disclosure. These theories include (but are not restricted to): decision-usefulness theory (Parker, 1991); economic agency theory (Belkaoui and Karpik, 1989; Ness and Mirza, 1991); managerial stakeholder theory (Roberts, R., 1992; Ullmann, 1985); organizational legitimacy theory (Dowling and Pfeffer, 1975; Guthrie and Parker, 1989; Lindblom, 1994; O'Donovan, 1999a; Patten, 1992); corporate accountability theory (Gray *et al*., 1987, 1996; Kokubu *et al*., 1994); and, political economy of accounting theory (Buhr, 1998; Gray *et al*., 1995b; Neu *et al*., 1998). These different theoretical models reflect a diversity of scientific traditions in relation to issues of ontology, epistemology and methodology. Moreover, all such models are value-laden, i.e. what researchers choose to look at and how they choose to measure phenomena, is decided *a priori* according to a set of political values and belief systems (see, for example, Hanson, 1958)[27]. Hence, it is not possible to assert with absolute authority which particular theoretical model provides the more convincing explanation. Rather, as with all research in the social sciences, including economics and accounting, 'truth' is a matter of meta-theoretical belief not empirical fact. Notwithstanding these issues, heuristics may be developed and employed which assist in negotiating and contrasting the contributions of several different theories simultaneously towards the prediction and explanation of observed phenomena. One such heuristic is the notion that CED is teleological, i.e. that CED takes place not by accident but due to the underlying purpose or design that is served by it. As such, the precise motive, purpose or design ascribed to managerial behaviour varies according to the particular theory or model being employed. However, the common thread running through each is the assertion that there is some end-state which CED is intended to serve. By means of this teleological framework, three theories have been chosen for examining the nature and causes of CED using the hypothetico-deductive method of inquiry, viz.[28]:

(i) *Economic agency theory* (EAT), which has its roots in neo-classical and positivist economics and which sees the world strictly in terms of competing self-interests where all individuals seek to maximise personal *economic* wealth;

(ii) *Managerial stakeholder theory* (MST), which has its roots in *socio-economic* theory and sees the world in terms of different conflicting interests between various sections or stakeholder groups within society and of managing those interests to achieve some form of workable consensus in the interests of the business's long term survival; and,

(iii) *Organizational legitimacy theory* (OLT) which has its roots in *socio-political* theory and sees the world in terms of an unwritten social contract between business and society and which involves business having to undertake various legitimising strategies to attain or retain a status of legitimacy within society as a whole.

These three theories employ other economic, social and political theories in developing descriptive models to explain, predict and/or explore the human agency. A 'descriptive'

model as used here refers to a theory which offers predictions, explanations and/or understandings about social behaviour, in contrast to normative (i.e. prescriptive) theories which prescribe 'what should be'[29]. To draw out the different elements of these theories more clearly, each is situated within Burrell and Morgan's (1979) seminal framework which classifies theories within different sociological paradigms. The three theories are used to address the research questions set out in Table 1.1.

Table 1.1

The research questions
(i) Why do companies provide environmental disclosure? *(ii)* Following on from (i), what implications do these explanations have for the role of corporate environmental disclosure and reporting in relation to matters of public policy?

Whilst no one theory is ever likely to be able to provide explanations for all events and all situations that take place in our highly complex, multi-faceted and ever-changing social world, the testing of these three theories may provide, on the basis of acceptable and accepted scientific evidence, an indication as to the value of such theories in explaining observed phenomena. The increasing popularity of a phenomenon such as CED provides an opportunity for researchers to test the relevance and value of theories, both old and new. Indeed, much of the CSR literature has been subjected to major criticism by critical accounting[30] scholars for its failure to theorise explicitly on the underlying organization-society relationship (see, for example, Puxty, 1986, 1991; Tinker *et al*., 1991). By applying existing theories to new and developing phenomena, such as CED, it is possible to gain a better understanding of the contemporary usefulness and applicability of these theories.

1.5 Supporting motivations

A growing body of empirical evidence shows that large corporations in almost all parts of the developed world have increased significantly the amount of CED since the late 1980s (see, for example: *Internationally* – KPMG, 1997a; KPMG/WIMM, 1999, 2002; Patten, 1992; *Australia* - Frost and Wilmhurst, 1998; Deegan and Gordon, 1996; Deegan *et al*., 2002; Gibson and O'Donovan, 1994; *Belgium* – Van Nuffel *et al*., 1994, 1995; *Canada* - Gorman, 1992; *UK* – Gray *et al*., 1995b; Harte and Owen, 1991, 1992; *USA* – Gamble *et al*., 1995). However, prior empirical research has tended to focus on corporate social and environmental reporting in a specific country, at a specific point in time. The country in which the organization is reporting and the country of ultimate ownership seems to have a significant effect on CSR practice (see, for example, Adams *et al*., 1998; Andrew *et al*., 1984; Gray *et al*., 1995b; Guthrie and Parker, 1990; Roberts, 1990). Although studies have been carried out which have looked at social disclosures across countries (see, for example, Adams *et al*., 1995b; Adams *et al*., 1998; Andrew *et* al., 1989; Belkaoui and Karpik, 1989; Cowen *et al*., 1987; Guthrie and Parker, 1989; Lynn, 1992; Nees and Mirza, 1991; Roberts, C., 1990, 1991; Trotman and Bradley, 1981), there are no prior studies which have examined the longitudinal trends in *environmental* disclosures over time for several European countries.

The vast majority of research in the CSR field has been cross-sectional in nature, focusing on social and environmental reporting at a point in time. Longitudinal studies, which look at trends in CSR over time, are rare in comparison to cross-sectional studies and even though they exist (see, for example, Guthrie and Parker, 1989; Hogner, 1982, in the case of Australian companies; Campbell, 2001; Gray *et al.*, 1995b; Unerman, 2000 in the case of UK companies; O'Dwyer 2001a; O'Dwyer and Gray, 1998 in the case of Irish companies; Ljungdahl, 1999a in the case of Swedish companies), their focus is on a single country[31]. Prior research (see, for example, Elkington, 1994; Gray *et al.*, 1995b) has highlighted significance of trends over time, suggesting that a longitudinal approach may improve the explanatory power of research in this area. Ullmann (1985), for example, has called for more longitudinal studies as a means for methodological improvement on existing CSR studies. Tsang (1998) argues that longitudinal studies of CSR provide a fruitful area of research and deserve more attention from academics. Moreover, almost all studies of CSR over the last twenty years or so have focused exclusively on the annual report and accounts (see Adams *et al.,* 1998; Belkaoui and Karpik, 1989; Cowen *et al.*, 1987; Gray *et al.*, 1995b; Hulme and Huse, 1997; O'Dwyer, 2001a; Roberts, C., 1991, 1992; Trotman and Bradley, 1981; and Van Nuffel *et al.*, 1995). Although some researchers have included other sources (see, for example, Ness and Mirza, 1991 and Ljungdahl, 1999a), these studies are the exception rather than the rule. The need to research corporate environmental disclosure issues outside the confines of the annual report and accounts was noted by Mathews (1997) in a review of 25 years of social and environmental accounting research:

> *...larger organizations are also producing environmental reports ... The reasoning behind the acceptance by some managerial groups of the need to provide additional social-orientated disclosures should be an important research area* (p.502).

The noticeable increase in the use of stand-alone corporate environment reports in the early 1990s, particularly in Europe (KPMG/WIMM, 1999), and the (re)emergence of other forms of corporate social responsibility reporting, such as social reports (ACCA, 2001), social and ethical accountability reports (ISEA, 1999) and triple bottom line (TBL) reports (GRI, 2000, 2002), adds weight to the argument that the communication strategies of large corporations are undergoing some sort of evolution. This apparent shift in corporate communications strategy arguably requires a re-examination of the position taken in previous CSR studies (see, for example, Adams *et al.*, 1998; Gray *et al.*, 1995b; O'Dwyer and Gray, 1998) that the annual report and accounts remains the *prima donna* of information on corporate activities. Hence, it seemed both apposite and timely, despite the reservations noted in the literature (see Gray *et al.*, 1995b; Ness and Mirza, 1991), to include annual environmental as well as annual social reports in the study. The present study therefore departs from much of prior CSR research by (i) including reports other than just the annual report and accounts and (ii) looking at environmental disclosure longitudinally over a seven-year period from 1989 to 1995. It is also cross-sectional, covering eight industry sectors and four countries of the European Union (EU), i.e. the Benelux countries of Belgium, Luxembourg and the Netherlands (40 companies) and Germany (50 companies). Details of these aspects of the research are set out in Chapter 8. A few studies have been carried out which look at CED by German and Benelux companies (see, for example, Adams *et al.*, 1998; Dierkes, 1979; Mélis, 1991; Roberts, C., 1991, 1992; Van Nuffel *et al.*, 1994, 1995). Notably, Mélis (1991) carried

out a cross sectional, one period study of environmental reporting by Dutch companies, and Van Nuffel *et al*. (1995) performed a cross-sectional, longitudinal study of environmental reporting by Belgian companies over the period from 1987 to 1991. However, as far as the author is aware, no prior longitudinal study has been performed of CED by German and Benelux companies which covers a number of different industry sectors and countries.

1.6 Research design

Research design refers to its overall configuration, including the methods by which data and evidence is gathered, from where, and how such data and evidence is interpreted. The research design of the present study follows the logical positivist tradition in adopting a quasi-experimental approach[32] (see, for example, Abdel-Khalik and Ajinkya, 1979; Campbell and Stanley, 1963; Cook and Campbell, 1976) to test hypotheses under the hypothetico-deductive method of research[33]. Empirical research of this kind is typically concerned with establishing putative relationships between two or more variables. Traditionally, these variables are dichotomised as independent or dependent variables, with the researcher studying how one variable (the dependent variable) behaves in response to changes in another variable (the independent variable). In experimental research, the researcher attempts to hold all other variables constant (i.e. control them) while manipulating the independent variable. In accounting, however, as with all the social sciences, direct manipulation of the independent variable is very rarely possible and thus the vast majority of accounting research cannot be described as 'experimental'. The present project thus adopts a research design that is non-experimental or quasi-experimental in nature (Ryan *et al*., 1992) and is set out in summary form in Table 1.2 below[34].

Whilst quasi-experimental research offers a number of empirical research designs, the present study employs a correlational, *ex post facto* research design which predicts that correlations exist between variables. Importantly, correlational research design does not imply causality, rather that the variables under study co-vary. In this context, the three accounting theories referred to above serve as theoretical constructs for explaining how the world works and thus offer descriptive explanations for the underlying relationship between the variables. *Ex post facto* research design refers to the fact that the variables under study are not under the direct control of the researcher, but have to be chosen after the event of interest has occurred (Ryan *et al*., 1992). As indicated above, correlations between the variables can be measured at one point in time across a set of subjects and/or over time; studies which look at correlations between variables across a set of subjects are termed cross-sectional, whereas those which look at the correlations over time are termed longitudinal. Hence, the present study is both cross-sectional and longitudinal. For these purposes, CED is treated as the dependent variable.

Stages 1 and 2 of Table 1.2 have already been described. Stages 3 to 6 provide the structure for the remaining chapters of the thesis (Section 1.8 below). After having made the logical connection (internal validity) between the three accounting theories and CED, respectively (step 3 above), various factors, i.e. 'firm characteristics' and 'external influences', which the three theories suggest as being important in the context of the research questions, are chosen to test for the existence of a putative association between variations in each factor and variations in the volume of CED (the dependent variable). For each factor, the underlying

association is expressed formally in the form of an alternative hypothesis, the null hypothesis in each case being the hypothesis of no association. Statistical techniques and computer software programmes are employed to test for the existence of a relationship (positive or negative, depending on the predicted direction of the relationship in question) between each factor and the volume of corporate environmental disclosure.

Table 1.2
The research approach by stages

Stage	Objective	Key issue(s)	Description
1	Problem definition	Research question - "why" and "so-what?"	Area of intrigue: Why do firms provide environmental disclosure? What implications do these explanations have for the role of corporate environmental disclosure and reporting in relation to matters of public policy?
2	Structure definition	Review of practical developments; Review of prior research; Frameworks, theories.	Study for a teleological explanation of managerial behaviour using 3 accounting theories set within Burrell and Morgan's (1979) model of sociological paradigms.
3	Develop a "model" and hypothesis for each factor	Building of models, based on a set of assumptions, to test the three theories.	Modelling: On the basis of certain assumptions, a logical progression of propositions is formulated which result in a series of hypotheses which are used to test each theory in terms of their ability to explain and predict CED.
4	Research design	Specification of the means for data capture, including definitions and the design and development of research instruments for the purpose of performing the research.	Defining CED – the data to be captured. Selecting a research method for capturing the phenomenon under investigation (e.g. content analysis) and developing appropriate instruments for gathering, recording and coding the attributes of the empirical data (the independent and dependent variables).
5	Empirical study	Empirical and field research - the gathering, analysis and interpretation of data.	Looking at actual behaviour and seeking to explain that behaviour using content analysis of corporate reports and mailed questionnaires to sampled companies and environmental organizations.
6	Summary evaluation and conclusions	Does the data support the theory?	Do the hypotheses accord with observed facts? What are the limitations and constraints? Are there any new findings or differences from prior research? What implications do the findings have for matters of public policy?

Analysis and interpretation (stage 4) involves the use of both formal, positivist methodology, based on putative associations between CED and other factors, and the use of interpretive research, the latter to interpret trends in CED over time. The main differences between these two approaches to research are summarised in Table 1.3 below. A detailed consideration of these issues is outside the scope of the present study (see, for example, Abdel-Khalik and Ajinkya, 1979; Burrell and Morgan, 1979; Easterby-Smith *et al*., 1991; Erlandson *et al*., 1993; Laughlin, 1995; Lee, 1991; Morey and Luthans, 1984; Ryan *et al*., 1992)[35].

Table 1.3
Contrast between positivist and interpretive approaches to research

Aspect	Positivist approach	Interpretive approach
Researcher	Independent	Involved
Samples	Large	Small
Theories/data	Testing hypotheses	Generating data/telling stories
Nature of the work	Quasi-experimental design	Field work – the study of real organizations or social settings
Preferred methodology	Hypothetico-deductive verificationism (logical positivism)	Multiple methods to establish different views of phenomena, including naturalistic enquiry, hermeneutics, ethnography, phenomenology and case studies

Table 1.3 depicts the two extremes of a spectrum, with the two traditions occupying opposite ends of that spectrum. Although at a philosophical level these two approaches are clearly different, in practice many researchers in the social sciences adopt a pragmatic view by deliberately combining research designs and methods drawn from both traditions such that the distinction between the two is often blurred (Easterby-Smith *et al*., 1991)[36]. Such an approach can be found amongst CSR researchers who use a variety of research methods in exploring the nature and causes of CSR (compare, for example, the different approaches taken by Gray *et al*., 1995b and 2001 to the same underlying data set). Organization theorists have sought to integrate both approaches to establish an integrated framework for the two (see, for example, Lee, 1991). It is not, therefore, *necessarily* strictly a choice between alternative research methods, but rather the selection of appropriate (and accepted) methods of inquiry, having regard to the phenomenon under investigation and the research questions at hand (Morgan and Smircich, 1980).

1.7 Corporate environmental disclosure (CED) defined

The research approach adopted in the present study is implicitly linked to the definition of CED, this definition itself being drawn from one particular branch of the CSR literature. Other approaches could obviously provide different definitions of CSR from those provided below but are not considered relevant to the present study. In attempting to arrive at a definition of CED that is consistent with prior CSR literature it is immediately apparent that there already exists a plethora of terms for describing this broad area of accountancy practice and academic enquiry. These include 'Social Responsibility Reporting', 'Social

Responsibility Accounting', 'Social Accounting', 'Social and Environmental Accounting', 'Corporate Social (Responsibility) Reporting', 'Corporate Environmental Accounting' and 'Corporate Environmental Reporting'[37]. The focus of the present study is on that branch of social and environmental accounting research which concerns itself with external corporate social and environmental reporting (CSR).

Various terms have been used to describe this area of academic enquiry including CSR, 'Social Responsibility Disclosures' and 'Corporate Social Reporting' (Mathews, 1984). These different terms tend to be used by researchers approaching the subject area from slightly different perspectives due to social and cultural influences, and also because of the fact that social and environmental accounting is a very broad term (Gray, 2001). There is also a lack of consistency in the research output of those working in the field of social and environmental accounting due to the fact that researchers do not focus on the same type of corporate socio-economic activity, resulting in fragmented enquiries and the lack of a common approach (Guthrie and Mathews, 1985). As a result, comparison of the results of prior studies is problematic because of differences in definition, survey methods, timing, sample size and selection criteria (Guthrie and Mathews, 1985). However, it is perhaps reasonable to suggest that, by and large, CSR researchers are talking about the same thing. As Gray *et al.* (1995b) argue, CSR and CED have many virtual synonyms and the differences in nomenclature are probably not important when environmental reporting and disclosure are viewed as merely one facet of social reporting and disclosure. Whilst it is the latter which forms the focus of the present study, it is worth noting that there is a close relationship between CSR and social accounting (SA), the distinction between the two often being blurred due to forms of SA providing one source for the practice and research of CSR[38]. Marquès (1980) refers to the two adjectives "social" and "societal", preferring to use the term "societal accounting" which he defined as a system of accounting which emphasises the relationship between a business and society as a whole rather than simply between the business and its employees. The German language also has two adjectives, "sozial" and "gesellschaftsbezogen", which have the same shade of meaning as the English "social" and "societal", respectively. Gray and Bebbington (2001), in a brief introduction to social accounting, describe it as:

> *... a diverse activity [that] has been an active area of research and practice since the early 1970s. It is principally concerned with offering, if not an alternative, then a complementary form of accounting to the dominant economic and profit-orientated emphasis of organizations* (p.274)[39].

From this perspective, the forms and subject matter of social accounting are virtually infinite, the 'universe' of all possible social accountings (Gray, 2001) being limited only by our imaginations (Gray *et al*., 1996)[40]. However, to provide some sort of structure to such a wide and burgeoning field, Gray categorises social and environmental accounting and 'audits' based upon a distinction between internal and external participants in the accounting process (Table 1.4). Of the four quadrants shown in Table 1.4, that on the bottom left (i.e. reports and non-reports prepared *internally* for *external* consumption) is the most relevant to the present study, containing the more sophisticated forms of accountings by which organizations communicate social and environmental information. This includes not just the more visible

forms, such as environmental and social reports, but also the 'silent social and environmental accounts' (Gray, 1997)[41].

Table 1.4

Categorisation of Social and Environmental Accounting and 'Audits'		
Report for the consumption of ...	*Report compiled by ....*	
	Internal participants	*External participants*
Internal Participants	Environmental audits/accounting EMS – EMAS/ISO14001 Compliance audit (e.g. SA8000) Social responsibility audit	Regulators reports – e.g. EPA Suppliers audits Duty of Care audits Environmental consultants
External Participants	Disclosure in annual reports The 'silent social accounts' Environment reports & social reports GRI/'Sustainability' reports	External 'social audits' Ethical investment Consumer & pressure group audits Trade Union reports

Source: Gray (2001). NB: These categories are not claimed by Gray to be unequivocally discrete.

Within this framework, CSR is typically seen as "… comprising information relating to a corporation's activities, aspirations and public image with regard to environmental, community, employee and consumer issues" (Gray *et al*. 2001, p.329). This definition highlights three key aspects of CSR:

(i) it involves the self-reporting of information and the communication of that information in a variety of different forms and mediums; whilst the annual report and accounts is traditionally perceived as a key source of information of a company's social and environmental activities, other forms of self-reporting used by companies in this context include stand-alone environmental reports, employee and social reports, brochures, pamphlets, company videos and material prepared for distribution at company meetings with investors, stakeholders and other sections of society;

(ii) it is concerned with more than just communication about a company's activities, but spans wider to include the company's (as specified by its top management) goals, objectives and ambitions for the future, as well as the public relations aspect of information; hence, environmental information can take a variety of different forms, including descriptive, non-monetary quantified data and monetary data; and,

(iii) the range of issues falling within 'environment' is wide, including matters relating to employment and employees, relationships with local and regional communities, consumer and customer issues and environmental issues, energy usage and efficiency, corporate governance, health and safety, etc.

Although there are many different definitions to be found in the literature, there is widespread agreement that CSR is essentially concerned with disclosure of information by corporations and other forms of business organizations about their *social* activities in financial, non-financial, quantitative and qualitative terms. 'Social' in this context has a broad meaning,

referring as it does to the interaction between such organizations and the societies and environments in which they operate, and encompassing not only economic activities but other areas of such as human resources, employee relations, environmental and ethical issues and community involvement, etc. Such a perspective arises from the recognition that "… [a]ll economic organizations operate within a larger social environment and for the purpose of serving the needs – economic, human and social – that arise therein" (Dierkes and Preston 1977, p.3). Guthrie and Parker (1989), for example, define CSR as a corporation's reporting on the social impacts of its activities, the effectiveness of its social programmes, the discharging of its social responsibilities, and the stewardship of its own social resources. From this perspective, organizations are viewed as having more than just economic or financial relationships, but also social, human and ecological relationships with all those who are affected by the activities of the organization, including employees, management, shareholders, customers and suppliers and other groups in society such as consumers and local communities. Lessem (1977), for example, argues that social reporting is about communication and should be seen as part of the process by which decision makers are informed about the social costs and benefits of their actions. Gray *et al.* (1996) cast their net even wider, viewing CSR as encompassing all possible forms of accounting[42]:

> *CSR can take a potentially infinite range of forms. It can be designed to fulfil any one or more of a wide range of objectives. It can cover a myriad of different subjects. CSR can be constructed around almost any type of information or with almost any sort of focus. It is not a systematic, regulated or well-established activity and so what is covered ... is limited (in description) only by practice and (in prescription) only by our imaginations* (p.3).

In practice, research into CSR tends to be grouped around a 'core set' of subject areas. Gray *et al*. (1996), for example, distinguish between 11 such core areas including shareholders, employees, consumers, community, environment, and dealings with other countries. In the UK, the annual survey of UK published accounts, *Financial Reporting*, published by the Institute of Chartered Accountants in England and Wales (ICAEW)[43] included for a number of years a chapter on 'social reporting', the voluntary disclosure of which was classified using the same seven categories as employed in the surveys of Ernst & Ernst (1972-1978) in the US, namely:

- *human resources* - e.g. worker health and safety, equal employment opportunity and employment practices in third world countries;
- *fair business practice* - e.g. statements in relation to doing business with repressive regimes);
- *energy* - e.g. energy conservation and efficiency;
- *community involvement* - e.g. charitable donations;
- *products* - e.g. product safety, production of dangerous or toxic substances;
- *environment* - e.g. providing data about the corporation's impact on the natural environment (pollution); and,
- *other* - e.g. general statements of social concern or other disclosures of a social responsibility nature not specifically related to the above categories.

Generally speaking 'the environment' is almost always seen as a distinct category of CSR[44]. O'Dwyer (2001a, p.9), in the specific context of his study of corporate environmental reporting in Ireland, defines the latter as "…the process of communicating externally the environmental effects of organizations' economic actions through the corporate annual report or a separate stand-alone publicly available environment report." O'Dwyer's definition probably comes closest to the subject matter of the present study. However, O'Dwyer focused mainly on the annual report and accounts whereas the present study includes other 'annualised' reports such as social and environment reports. Consequently, for the purposes of the present study, the term CED is being used in reference to both the disclosure of environmental issues in corporate reports and the reporting of environmental issues in dedicated social and environment reports. Moreover, in keeping with Gray *et al*. (1995b), CED is interpreted as including health and safety and energy usage and efficiency issues. Table 1.5 provides a definition of CED that is used in the present study. Further details of the definition of CED are given in Chapter 8.

Table 1.5

Definition of corporate environmental disclosure (CED)
The external communication of environmental, health and safety and energy issues relating to the policies, activities, undertakings and beliefs of an organization through company-wide reports which are placed in the public domain on a regular and continuing basis.

1.8 Chapter outline

The remaining chapters of this study are organized along the lines of the research approach set out in Table 1.2. above. Chapters 2 to 4 provide the *structure definition* phase. Chapter 2 reviews accounting and reporting practices associated with corporate environmental disclosure and reporting (CED) within the framework of CSR generally. In doing so, Chapter 2 seeks to place the present study in its proper historical, political and social context. The particular role played by the accountancy profession in promoting CED is explored, together with a review of some of the significant developments and trends in CED, and a typology of the main approaches by large corporations to CED, in the 1990s. Chapter 2 also includes both a review of specific European accounting and company law requirements which affect the disclosure of environmental issues in corporate annual reports and of recent international regulatory and voluntary developments concerning stand-alone environment reports. Chapter 3 provides a review of prior research into the nature and causes of CSR, locating the particular area of CSR research that is of relevance to the present study. The chapter begins by looking at some of the possible motivations, influences, pressures and firm characteristics associated with increased environmental disclosure by companies in the 1990s. These various factors are presented diagrammatically in a model which depicts the corporation as the focal point of analysis and its executive management as the human agency in the disclosure decision. The 'meat' of the chapter consists of a review of the findings of prior empirical CSR research which explores the association between CSR and 'firm characteristics' and 'socio-political influences'.

Chapter 4 builds on the analysis provided in Chapter 3 by examining prior studies which have employed theoretical frameworks to predict and explain CSR. A brief overview is given of the development of theory within the different research traditions. This issue is explored further by examining the philosophical issues involved in theory selection and acceptance using the concept of *scientific paradigms*. Burrell and Morgan's (1979) seminal work on *sociological paradigms* is employed to classify accounting theories amongst the different research traditions. Each of these paradigms is explored separately, reference being made in each case to the type of CSR research that has been carried out and the understandings that such research has brought to the study of CED. The four theories employed in the study are situated within the framework provided by Burrell and Morgan's sociological paradigms, together with a summary of the key philosophical aspects of each theory. Chapter 4 also explains the overall approach adopted in the present study for the exploration of both putative associations between CED and other variables and an interpretive exploration of trends in CED over time.

Chapters 5 to 7 represent the *model-building* phase of the research (stage 3, Table 1.2). Chapter 5 is devoted to economic agency theory (EAT). This chapter includes an overview of the *functionalist* methodology employed in *positive accounting research* (PAT), the research tradition that is most closely associated with EAT, together with some of the key theoretical constructs informing this perspective. This is followed by a review of the 'principal-agent' problem and principal-agent theory as it relates to the economic consequences of the separation of ownership from control, including Jensen and Meckling's (1976) single-period model of 'agency costs'. Prior CSR research which has used the agency costs hypothesis is reviewed and a set of testable hypothesis developed under EAT for predicting variations in the volume of CED. Chapter 6 is dedicated to the second theory, managerial stakeholder theory (MST), which provides a model to explain observed managerial behaviour based on perceived socio-economic relationships between a business and its stakeholders. Freeman's (1983, 1984) seminal 'stakeholder approach' to strategic management is examined in detail towards the development of a descriptive managerial stakeholder theory that may be employed to explain and predict managerial behaviour in relation to CED. This analysis leads to a set of hypotheses with which to empirically test for an association between variations in stakeholder importance, both within and across firms, and CED.

Chapter 7 provides an introduction to organizational legitimacy theory (OLT). OLT as employed here forms one element of a *socio-political* approach to accounting theory which views legitimacy from a bourgeois political economy perspective[45] and which seeks to explain CED by reference to the values, norms and customs of the societies within which an organization operates. Chapter 7 provides a summary of the main features of OLT and explores the concept of organizational legitimacy in detail. The latter includes an examination of some key contributions to this concept from CSR researchers, notably the notion of legitimation, and summarises various legitimation strategies which may be used by management to manage legitimacy in the specific context of CSR. An analysis of prior research which has used OLT and the notion of legitimation strategies to predict and explain variations in CSR leads to the development of a set of hypotheses with which to explain and predict managerial behaviour under OLT in relation to CED.

Chapter 8 describes the *research design* (stage 4) for the purposes of data gathering and subsequent descriptive, statistical and interpretive analysis. The research method and interrogation instruments employed are drawn primarily from those developed by Gray *et al*. (1995c), the present study being an attempt to replicate and expand on the Gray *et al*. project in the specific context of CED. The chapter describes the design of a content analysis-based interrogation instrument to capture and analyse CED, a checklist of categories of environmental disclosure items and a set of decision rules. This latter includes a discussion of which corporate reports to include in the study, the sample size and basis of selection, industry sector and country composition, and the period covered by the study. Chapter 8 also includes details of the procedures followed for the preparation and circularisation of two mail questionnaires, one to the sample companies and the other to environmental non-governmental organizations (ENGOs), for the purposes of measuring certain socio-political influences which are posited as possessing explanatory power under MST and OLT, respectively.

The *empirical study* (stage 5), including data gathering, analysis and interpretation is presented in Chapters 9 and 10. Chapter 9 is concerned with the various putative relationships hypothesised under the three accounting theories (EAT, MST and OLT) respectively, which explore associations between variations in CED and corporate characteristics and socio-political influences. Chapter 9 begins by assessing distribution problems associated with skewness and kurtosis as well as problems of outliers and non-linearity in relation to both CED and other variables, and the results of data transformation. Detailed descriptive statistics are provided in relation to both CED and various corporate characteristics. The rest of the chapter is divided into three parts, each part consisting of the results of the statistical tests in relation to a set of hypothesised associations under each theory, respectively. Chapter 10 offers a complementary analysis to the hypothetico-deductive approach as set out in Chapter 9 by providing an interpretive analysis of trends in CED practices by German and Benelux companies over the period of the study. Descriptive results of the content analysis part of the study are presented along three fronts, firstly by reference to the popularity of CED, secondly in relation to the relative quantities of these disclosures, and thirdly by reference to three testable dimensions which relate to the nature of an item of disclosure, viz.: 'auditability', 'news value' (i.e. 'good' versus 'bad') and 'compliance' (voluntary versus regulatory). An interpretive analysis is then presented towards explaining the nature and causes of CED longitudinally, four theories (i.e. EAT, MST, OLT and PEAT) each being employed to offer alternative insights into the motives and influences underlying the reported trends in CED over the period 1989 to 1995.

Chapter 11 constitutes the final phase of the study (stage 6), summarising the results and the main conclusions of the research. This includes a summary of the more important limitations of the study, an appraisal of the empirical evidence in terms of its support for each theory, the relative contribution each theory appears to offer towards explaining the nature and causes of CED and highlighting confirmations of and differences from prior research, as well as new findings. Based on these findings, the chapter provides an analysis of their implications from a public policy perspective, particularly as regards future regulatory requirements for corporate environmental reporting. These matters are considered from a normative (as opposed to a purely descriptive) point of view in the context of both the recent upsurge of interest in corporate social responsibility (CSResp) and sustainability and the role of the

accountancy profession in lending credibility to external corporate reporting in these areas. The normative theme continues with a critical commentary on current developments in corporate social and environmental reporting and a call for CSR researchers to focus more of their energies on the underlying *causes* of social injustice and ecological devastation rather than their obvious symptoms.

Notes

1. Throughout this thesis, the terms 'environmental disclosure' and 'environmental reporting' are used as virtual synonyms, referring to disclosure made by business organizations in various reports, including annual reports, social reports and environment reports. In that context, 'disclosure' refers to both the process of disclosure and reporting and the act of disclosure and reporting (see, for example, Gray *et al*., 1995b).
2. The terms 'company', 'corporation' and 'firm' are used interchangeably throughout this thesis.
3. The adoption of a teleological construction to predict and explain CED is an important assumption in the context of the research approach and is considered in more detail in Chapter 4. The assumption that human behaviour is purposive, i.e. that it has some end-game objective which benefits particular individuals or groups in society, is made primarily because of the construction given to managerial behaviour by the theories chosen for use in the present study. However, there is no reason, *a priori*, why CED should always be intended to serve some specific underlying purpose or design. As such, other, perhaps equally valid, non-teleological explanations have, by definition, been excluded from the study.
4. The terms CSR and CED are closely linked, the latter being a sub-set of the former (see Chapters 3 and 8). Throughout this thesis, reference to CSR may be presumed to apply more or less equally to CED, and vice versa, although this specific study focuses on CED and therefore certain parts emphasise the 'environmental' rather than the 'social and environmental'.
5. It should be pointed out that throughout this thesis it is not the variables themselves (e.g. political visibility) which are used but theoretically-derived proxies for these variables. These variables are not observable empirically, i.e. with our senses, although the use of proxies provides a quasi-basis for measuring them. As such, the method of research employed relies upon a loose form of empiricism which is not restricted to strictly observable phenomena.
6. The terms 'natural environment' and 'environment' are used interchangeably throughout this thesis. Following Gray *et al*. (1995a), these terms are used in the specific context of *ecology* including human experiences within that context rather than referring to the more common business use of the term 'environment' in a business strategy sense.
7. Gray *et al*. (1993), for example, depict the approach to environmental issues by researchers in terms of the *Crisis? What crisis?* question. The majority 'light green' view, particularly amongst the mainstream business, accounting and finance communities, has been and remains, sceptical towards any notion that the planet or the social system (i.e. modern global industrial capitalism) is in crisis. Conversely, the minority holds that the environmental crisis is very serious, getting worse and morally indefensible. Whether one considers the planet to be in crisis, the extent of that crisis and the appropriate response, if any, are highly contentious issues, deeply rooted in meta-theoretical assumptions about the social and natural worlds, and the role of humans in those two interrelated and interdependent worlds. The position adopted in this thesis is that the assumption of an 'environmental crisis' in a socio-political and historical context is apposite to the study of managerial behaviour in the context of corporate environmental disclosure and reporting. This assumption is instrumental in the sense that it permits images of the social world in general and the business-society relationship in particular to emerge which would otherwise remain hidden and thus excluded from analysis. The issue is contestable, and contested, of course, and others may take a different view.
8. The focus on human socio-economic development is itself a limited and closed perspective, being essentially *anthropocentric*. That is, it fails to take into account the rights, wants and needs of other species, privileging one species, our own, over all others. Such a perspective, whilst

common, is rejected by other, more holistic, inclusive perspectives such as spiritual ecology (see, for example, Kumar, 2000, 2002) which emphasise universal responsibility and reverence for all living things.

9. A number of 'facts' may help to put things into perspective concerning our 'overcrowded ark' (Kirby, 2002): (i) half of the world's rivers are seriously depleted and polluted; (ii) more than a quarter of sea fish stocks are depleted; (iii) about 15 per cent of the planet's surface land has been degraded by human activities; (iv) sea levels are set to rise for decades even in the best-case scenario. In terms of humanity's footprint on the planet, humans are currently using 120% of the Earth's carrying capacity (Kirby, 2002). In other words, we are currently using up the Earth's resources faster than the planet can replace them such that it would take 1.2 Earths to keep pace with current levels of human consumption. Whilst the science underlying the studies which have generated these facts may not be accepted by all scientists, there remains a question mark over the ability of human ingenuity to plug the gap in terms of treating the Earth as if we intended to stay.
10. Korten (1995) provides an indication of the degree to which large, global corporations are implicated, positively or negatively, in the outcomes of the environmental crisis, reporting that 70 per cent of world trade is managed by a mere 500 corporations. Moreover, of the world's 100 largest economies, 50 are corporations and of the list of centrally-planned economies, Cuba comes in 73rd place, with 70 corporations above her (Handy, 1998).
11. Any professional accountant, be they practitioner, public servant, academic, in business or values-based organizations, vaguely familiar with the field of corporate environmental accounting and reporting would be hard pressed to ignore the huge body of research work, much of it explicitly normative (rather than 'critical' or 'radical') in nature, published since the late 1980s by a relatively few number of researchers. The success, for example, of *The Centre for Social and Environmental Accounting Research* (CSEAR) in developing international networks and fostering and supporting new and continued academic interest in this field is one aspect of the growing social and environmental 'bandwagon' that has sprung out of the concerns and activities of a few stalwarts.
12. Epstein *et al*. (1976), writing over a quarter of a century ago, report that accounting researchers, management consultants and corporate executives had been attempting for several years to develop operational frameworks for the implementation and institutionalisation of corporate social accounting, a development that produced an enormous diversity in terms of models and reporting frameworks for the measurement and reporting of an organization's total impact on society. This picture seems very similar to developments that are taking place in Europe in relation to corporate 'sustainability' reporting at the present time. One is minded to suggest that the only thing that has really changed is the name.
13. The EU's *fifth environmental action programme* was elaborated in the early 1990s as a response to the perceived failure of regulatory measures to achieve the EU's environmental standards. It took as its model the Dutch National Environment Plan (NMP, 1989), which was based on a combination of regulatory, market and voluntary measures, and attempted to extrapolate this approach to the EU level. Among a range of proposals in the area of environmental protection, it provides for an EU initiative in the area of accounting (see, for example, Bebbington, 1993; Bebbington *et al*., 2001; CEC, 2001b). Adopted in 1993, the fifth environmental action plan defines strategic long-term goals for EU environmental policy from 1993 to 2000. The programme aims to achieve sustainable development through: (i) integration of the environmental dimension into all major policy areas; (ii) widening the range of policy instruments (education and information; technological development; incorporation of environmental costs in prices; financial support mechanisms, etc.); and (iii) shared responsibility among all societal actors (public and private). In 2001 the European Commission adopted a communication concerning the *sixth action programme for the environment* (CEC, 2001c). The original EMAS regulation (CEC, 1993b; see, for example, Hillary, 1993; Starkey, 1998) was repealed following the EU's adoption of a revised EMAS regulation (CEC, 2001a). See Chapter 2 for more details.
14. The terms 'financial statements', 'financial accounts' and 'accounts' are used interchangeably throughout this thesis. The term 'financial statements' refers to a statutory set of financial statements covering the balance sheet, profit and loss account or income statement, statement of changes in financial position, notes and other statements and explanatory material which are

identified as being part of the financial statements (IASC, 1983, paragraph 5). In its exposure draft to a proposed revised "Preface to International Financial Reporting Standards" the IASB states that a complete set of financial statements includes "… a balance sheet, an income statement, a statement showing either all changes in equity or changes in equity other than those arising from capital transactions with owners and distributions to owners, a cash flow statement, and accounting policies and explanatory notes" (IASB 2002, paragraph 11).

15. On the question of whether or not accounting is a 'science', Belkaoui (1992, p.516 *et seq*) asserts that although it meets with Buzzell's (1963) criteria of what constitutes a science, this question has never been adequately answered. Wells (1976), in a seminal paper, demonstrated that events in accounting did indeed appear to follow the general pattern of scientific revolutions as described by Kuhn (1970), with accounting going through periods of stability and crisis. Mattessich (1984a) argues that accounting is an applied science, a 'science' because of its methodology, and 'applied' because of its goal-orientation. Conversely, Schreuder (1984) observes that whether accounting is an 'art' or a 'science' makes no difference to the fact that research in itself is a scientific activity and thus accounting research can be judged by scientific standards, be they methodological ones or otherwise. It is the latter interpretation which seems most convincing to the present author.
16. Other contributions include management accounting, taxation, financial management and treasury functions but the focus of the present study in this context is with external financial accounting and reporting.
17. There is an obvious dilemma here, with the accountancy profession chasing two goals which arguably move in opposite directions to one another, i.e. between a serious concern for ecological issues and its traditional business-orientated, economics-led culture. Attempts to 'square the circle' can be found in concepts such as 'triple bottom line reporting' (Elkington, 1997; GRI, 2000, 2002) and developments in financial environmental accounting (ACCA/UNEP, 2002). The extent to which one is convinced by the legitimacy and validity of such attempts is fundamentally a matter of belief, depending on one's view of the degree to which ecological protection and global, industrial economics are compatible public policy goals.
18. The IASB (previously the IASC) is an independent, privately funded accounting standard-setting body based in London that is committed to developing a single set of global accounting standards which require transparent and comparable information in general purpose financial statements. The IASB has the support and co-operation of the European Union and the International Organization of Securities Commission (IOSCO). Accounting standards promulgated by the IASB have recently taken on greater significance in light of the European Union's *Financial Reporting Strategy* to harmonize the European accounting field, which requires the application of International Accounting Standards (IASs) by listed EU companies from 2005 onwards. The IASC, the IASB's predecessor, published several IASs that are of particular relevance to environmental issues (see Chapter 2).
19. According to the IASB's *Framework for the Preparation and Presentation of Financial Statements*, the objective of financial statements (and thereby financial accounting) is to "… provide information about the financial position, performance and changes in financial position of an enterprise that is *useful* to a wide range of users in making *economic* decisions" (IASC 1989, paragraph 12, emphasis added). This view on the basic purpose of financial reporting is mirrored in the US, the world's largest capitalist economy, where the FASB (1978) has described the purpose of such reporting as to provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions.
20. *Neo-classical economics* as used here refers to a school of economic thought in the tradition of classical economics which has developed since the Second World War and which is characterized by microeconomic theoretical systems constructed to explore conditions of static equilibrium (Bannock *et al*., 1992). The neo-classical approach to economics is contrasted with the Cambridge School, a system of economic ideas influenced by economists such as Alfred Marshall, Arthur C. Pigou and John Maynard Keynes at Cambridge University in the UK, which emphasized macroeconomics.
21. *Positive economics* refers to the study of economic propositions or conditional propositions which can, in principle at least, be verified by observation of events or states of the 'real' world, such as for example, 'if the economy is reflated, unemployment will fall' (Bannock *et al*., 1992). Positive

economics eschews value judgements by avoiding normative or prescriptive statements such as 'unemployment should be cut'. However, as with all statements, be they conditional or otherwise, there is a normative agenda underlying their construction (see, for example, Tinker *et al*., 1982).

22. Throughout this thesis, accounting practices and processes and the accountancy profession itself are seen as contextual, offering perspectives on the wider social *milieu* in which they operate. The recognition of accounting as contextual maintains that accounting, whether as a practice or as a profession, is a phenomenon which has social, economic and political consequences which needs to be understood in this context (Laughlin, 1999). As such, all interpretations of accounting practices and of the accounting profession itself take place within some context or other, whether that context is social, economic, political, environmental, ethical, geographical, organizational or historical. The need to research different accountings, such as CSR and CED, in their contexts is important because "… that is the only way one can begin to come near to understanding the full effects of using one accounting practice than another and, hence, determine when each approach is functionally useful" (Tomkins 1999, p.84).
23. One of the first companies in the world to publish a systematic corporate environment report was Norsk Hydro, one of Norway's largest industrial groups, which produced a special report on environmental matters in 1989 in relation to its domestic activities. In 1991, the UK subsidiary of Norsk Hydro was the first company in Europe to have its environment report audited, the latter being performed on the company's 1990 environment report by Lloyd's Register which expressed a "true and fair view" on the figures provided in the report in relation to environmental monitoring data (Kamp-Roelands, 2002).
24. Some European countries, i.e. France, Norway, the Netherlands and Spain, have recently introduced environmental disclosure and reporting requirements which affect some or all sectors of the economy (see Chapter 2). However, to date no European country has introduced a law, which requires companies to report on environmental issues at corporate level, i.e. for the company's operations as a whole. Whilst it is true that requirements now exist in the Netherlands, for example, which require some companies to produce environment reports for certain industrial sites, the present study is concerned only with corporate reports which cover the company as a whole. The reasons for doing so are set out in Chapter 8.
25. The literature on determining why corporations choose to voluntarily disclose information, how they disclose it, and when they choose to do so is already quite extensive (see, for example, Camfferman, 1996; Dye, 1985; Gibbins *et al*., 1990; Klumpes, 2000; Verrecchia, 1983). However, the present study focuses on one particular form of disclosure, i.e. environmental disclosure, and there is no reason for assuming, *a priori*, that all forms of disclosure are tarred with the same brush.
26. The term *sustainability* is used here in its traditional, long-accepted ecological context. Although there are many definitions of sustainability in circulation (see, for example, Bianchini, 1998), the concept of *sustainable yield* is considered the most meaningful and relevant in the context of the present study. Sustainable yield is defined as "… the use of living resources at levels of harvesting and in ways that allow those resources to supply products and services indefinitely. Sustainable yield means living off the interest, rather than the capital, of a resource base" (Gilpin, 1996, p.206). This concept is narrower than the more familiar concept of *sustainable development* (UNCWED, 1987), requiring as it does the maintenance of essential ecological processes and life-support systems, the preservation of genetic diversity, and the maintenance and enhancement of qualities relevant to productivity (in a corporate accounting and reporting context, see, for example, Bebbington, 2001; Gray, 1992). Whilst there are increasing attempts by the management of large global corporations to suggest that sustainability can be associated with economic goals, such as Royal Dutch/Shell's (2001) mantra 'people, planet, profits', such developments are misleading at best and destructive at worst when seen in the context of current global environmental crises in relation to population, forestry, agriculture, fisheries, soil, air and water (see, for example, Redclift, 1987).
27. Theories do not travel alone but come pre-wrapped in ideological "baggage" that contains assumptions about the world and how that world functions or should function. As a result, the theory selection process is itself values-driven, theories being selected based on a set of values which reflect the researchers own, and/or those responsible for the research process, meta-

theoretical preferences. As such, no study is 'value-free' and all theories are 'value-laden' (see, for example, Hanson, 1958; Chalmers, 1982). See also Popper (1959, 1963) on the verification/falsification argument and Laughlin (1995) on the importance of empirical research in accounting.

28. At the beginning of the project, a research proposal was presented to the supervisors which proposed the use of interpretive rather than positivist methodology, based on prior CSR studies (notably Gray *et al*., 1995b). This approach was not considered scientific by the project's supervisors in deference to their allegiance to the logical positivist tradition. A compromise arrangement was therefore adopted under which positivist research methodology forms the major part of the thesis, with interpretive methodology being used to interpret trends in CED over time. The latter approach opens the door to the inclusion of a fourth theory, political economy of accounting theory (PEAT). For epistemological reasons, PEAT is not employed in tests of association involving hypothetico-deductive methodology (Chapter 9). The latter forms the primary research method in the present study and thus the major part of this thesis is concerned only with three theories, viz.: EAT; MST; and OLT. However, for the purposes of longitudinal analysis (Chapter 10), interpretive research is employed which adopts a 'softer' approach to hypothesis formulation and which thus permits the use of theories which do not sit comfortably with 'hard' hypothesis developed under hypothetico-deductive methodology. The issue of theory closure in this context is addressed in Chapter 4.
29. In the early 1990s, a number of authors attempted to provide guidance to companies on corporate environmental disclosure and sought to indicate what environmental information *should* be disclosed to the users and readers of corporate reports (see, for example, Blokdijk *et al*., 1992; Charter, 1992; Coopers & Lybrand Deloitte, 1991; Elkington *et al*., 1992; Eckel *et al*., 1992; Gray, 1990a, 1990c; Gray *et al*., 1987; Maxwell, 1990; Newman and Breeden, 1992; Shrivastava, 1993; Welford and Gouldson, 1993). Whilst a consideration of the normative issues surrounding what environmental information companies should report is clearly important, it is not one which is addressed directly in this thesis.
30. 'Critical accounting' covers a broad church of academic inquiry and as such any definition is debatable. However, Laughlin (1999) suggests that it could be defined as: "A critical understanding of the role of accounting processes and practices and the accounting profession in the functioning of society and organizations with an intention to use that understanding to engage (where appropriate) in changing these processes, practices and the profession" (p.73). Thus, whilst critical accounting is always *contextual*, i.e. the assertion that all forms of accounting have social, political, economic and environmental consequences and needs to be understood in terms of those consequences, it is not critical just for the sake of being critical but seeks to *change* accounting in deference to the perceived unjust and indefensible aspects of those consequences. It is the latter which gives critical accounting its 'radical' edge since this represents a rejection of the status quo.
31. There are however, a number of longitudinal studies which have employed periodisation analysis to explore changes in the issues of concern and their presentation over time (see, for example, Neimark, 1992; Tinker and Neimark, 1987), the association between environmental *performance* and corporate characteristics (Stanwick and Stanwick, 1998) and, more recently, work which has used longitudinal analysis to explain changes in social and environmental reporting practices over time (see, for example, Unerman, 1999; Campbell, 2000). However, none of these longitudinal studies used hypothetico-deductive methodology to explore the relationship between corporate characteristics and social and environmental disclosures.
32. Pure so-called 'true' scientific experiments require that the researcher has complete manipulative control over the independent variables (i.e. those variables which are suggested as being associated with variations in the dependent variable, the factor or variable which the researcher seeks to understand). In situations where the independent variables (or, more usually, proxies which are assumed to be valid surrogates for those variables) can be observed but not manipulated, for example, real-life situations, such manipulation is not possible. These situations are known as quasi-experimental settings and the research is thus described as quasi-experimental (Abdel-Khalik and Ajinkya, 1979).

33. Hypothetico-deductive research refers to a research method which involves the verification or refutation of a theory by empirically testing that theory using hypotheses developed from it (Abercrombie *et al*., 1994). A hypothesis in this context thus refers to a proposition or set of propositions put forward for empirical testing. Generally speaking, accounting researchers believe in the concept of empirical testability (Chua, 1986), having widely accepted Hempel's (1965) hypothetico-deductive account of what constitutes 'scientific explanation'. The particular form of verificationism used in the present study is logical positivism, a fundamental principle of which states that the meaning of a proposition consists in the method of its verification, i.e. on the basis of whatever observations or experiences show irrespective of whether the proposition is or is not true. It follows from this that propositions which are not capable of being verified by reference to observation are neither true nor false but simply meaningless (Flew, 1983). Such an approach also leads to the search for universal regularities and causal relationships and a widespread use of large samples, survey methods, quasi-experimental research and statistical and mathematical models of analysis. According to Chua (1986), the hypothetico-deductive model of scientific explanation is the most consistent characteristic of extant accounting research, being referred to as 'the scientific method' (Abdel-Khalik and Ajinkya, 1979; Mautz and Sharaf, 1961).
34. The research approach as set out in Table 1.2 adopts what is commonly referred to in mainstream accounting research as 'the scientific method' (Gaffikin, 1988) or 'received (positivist) methodological orthodoxy' (Ryan *et al*., 1992) based on the seminal work by Abdel-Khalik and Ajinkha (1979). The latter's work is published by the American Accounting Association (AAA), probably the world's most influential international academic accounting body. According to Gaffikin (1988), the work of Abdel-Khalik and Ajinkha (1979) developed from courses given at annual and other meetings of the AAA and at US several universities and from critical comments of many important educators and researchers. Abdel-Khalik and Ajinkha (1979) suggest a sequence of eight steps which are considered as ideally suited to the development of a sound research programme. The six stages to the present study as set out in Table 1.2 more or less mirror the eight sequential steps suggested by Abdel-Khalik and Ajinkha (1979).
35. Lee (1991) offers the following in-a-nutshell summary of the main differences between the positive and interpretive approaches to science. The *positivist understanding* "… consists of theoretical propositions, manipulated according to (a) the rules of formal logic and (b) the rules of hypothetico-deductive logic" (p.364). The positivist approach in this context consists of those procedures "… associated with inferential statistics, hypothesis testing, mathematical analysis, experimental and quasi-experimental research design" (*op cit*., p.342). In contrast, the *interpretivist understanding* consists of the researcher's reading or interpretation of the *subjective understanding*, developed with the aid of research methods such as phenomenology, sociology, hermeneutics, ethnography and participant-observation. Subjective understanding in this context refers to "… the everyday meanings and everyday common sense with which the observed human subjects see themselves and the organizational world around them, …" (*op cit*. p.364). The concept of subjective understanding is discussed in more detail in Chapter 4.
36. At the present time, the predominant methodology applied in accounting research is strongly positive and follows a "… weak form of realism …" (Ryan *et al*. 1992, p.82) in that theories are seen as having utility only in terms of providing a vehicle for deriving generalizations which can be tested empirically. From this perspective, value judgments are generally seen as taboo and have no place in accounting research. However, there is no one 'right' approach to doing research in the social sciences. In their seminal work on empirical research in accounting, Abdel-Khalik and Ajinkya (1979), for example, argue against placing too much emphasis on the elegance, consistency and precision of the research method employed but rather that research work should be judged in terms of its contribution to finding solutions to problems. Drawing on the lessons of other disciplines, notably sociology, the authors identified two main types of research in this respect, the 'scientific method' (i.e. hypothetico-deductive research) and the 'naturalistic approach' (i.e. interpretive research). Although the emphasis of their work is on the former, the authors recognise the contribution which both methods can bring to understanding observed phenomenon. Moreover, they suggest that use of different research methods to explore the same phenomena, a concept known as 'triangulation', can improve the internal (i.e. extent of established causality) and external (extent of generalisability) validity of research.

37. Terms such as 'Social Accounting' have been applied to the economic and social aspects of national income at the macro-economic level as well as to individual company financial accounting and reporting issues from both an internal and external perspective. The focus of the present study is on reporting at the corporate level.
38. There are a number of definitions of social accounting (SA) to be found in the literature (see, for example, ASSC, 1975; Epstein *et al*., 1976). One of the earliest was proposed by Mobley (1970, p.762) who defined SA as "… the ordering, measuring and analysis of the social and economic consequences of governmental and entrepreneurial behavior."
39. For an introduction to social accounting and the recent resurgence in social reporting practice, see, for example, Gray *et al*., 1996; Gray and Bebbington, 2001.
40. Historically, the field of 'social accounting' has been concerned with a set number of different issues including the community (e.g. local community, local economic regeneration, involvement with local charities, etc.), employees (e.g. employment conditions, equal opportunities, redundancies, training, etc.), the consumer (e.g. access for the disabled, consumer protection, health and safety issues, product quality and value for money, etc.) and environmental issues (Gray and Bebbington, 2001). However, in contrast, conventional (especially financial) accounting is much more restricted in its construction of 'the account', being no more than a "… very severely reduced subset of that possible universe of accountings" (Gray, 2001, p.250).
41. The point being made by Gray (1997) in his reference to *silent social and environmental accounts* is that many companies already produce social and environmental data either within or accompanying their annual report and annual reporting cycles. The same point was made by the AICPA (1977) in its comprehensive review of the state of the art of social accounting in the US in the late 1970s, concluding that, although enormous gaps existed, companies do have available fairly substantial amounts of information about business actions and the nature of their social impacts (Heard and Bolce, 1981). A corollary of this is that such organizations are clearly in a position to produce basic social and environment reports should they choose to do so simply by collating all of the available, existing social and environmental data and pulling it together to form, for example, a separate, devoted subsection of the annual report (Gray, 2001).
42. For an introduction to the potential range of accountings that may be constructed within a CSR context, see for example, Gray *et al*., 1996, p.83.
43. For a brief review of early UK corporate social reporting practice based on survey evidence see, for example, Harte and Owen (1992). It is perhaps worth noting that the chapter on social reporting as published in the ICAEW's Financial Reporting was discontinued after the 1982-83 edition (Harte and Owen, 1992). However, Gray, Owen and Maunders took up the baton in their book (Gray, *et al*., 1987) for 1983/84. The findings of the latter survey pointed to a dramatic fall off in disclosure for 1983/4 in respect of all information categories with the exception of human resources (Harte and Owen, 1992). Harte and Owen suggest that this change in the trend of CSR was due to the 'anticipation of legislation' effect.
44. Differences do exist however in relation to what 'environment' means. More recently, it has become common practice for researchers to define 'environment' as including energy efficiency, health and safety and product safety issues (see, for example, Gray *et al*., 1995b). As Gray and Bebbington (2001, p.275) state: "Health and safety issues are 'environmental' in that they deal with part of the organization's effect on (particularly local) environments." However, such issues are also employee, community and customer related. Strictly speaking therefore, health and safety issues are general social issues and the distinction made in this study, though in keeping with much of the environmental reporting literature, is an artificial one.
45. In the social sciences, the term bourgeois is loosely used when referring to either the middle or ruling classes in a capitalist society. Both classes are presumed to have an interest in preserving capitalism in the context of a struggle with the working class over the distribution of surplus value arising from the production and distribution of goods and services. According to Abercrombie *et al*. (1994) the term is more appropriately applied to the urban social class made up of entrepreneurs, merchants, and industries active in the early stages of capitalist development. In the specific context of the present study, it is used to describe a framework of analysis which draws on bourgeois political economy in terms of its visualisation of conflicts which take place within society (see Chapter 7).

Chapter 2

Practical developments in corporate environmental disclosure and reporting: An introduction and overview

2.1 Introduction

This chapter, along with Chapters 3 and 4, provides the structure definition stage of the thesis (stage 2, Table 1.2 Chapter 1). The focus here is on practical and practice-based developments in the field of corporate environmental disclosure and reporting (CED) within the general ambit of CSR. In doing so, the primary purpose is to provide historical, political and social context to the present study. The argument that accounting practices (and CSR and CED are certainly that, even though they are still very much a marginalized area of accounting theory and practice) cannot be properly understood unless the context in which they have been developed is also adequately recognised, has been well documented in the accounting literature (see, for example, Burchell *et al*., 1985; Gray *et al*., 1996; Hopwood, 1983, 1987; Hoskin and Macve, 1988; Loft, 1988; Roberts and Scapens, 1985).

The rest of this chapter is structured as follows. Section 2.2 reviews general approaches to CSR as an aspect of corporate reporting practice. Section 2.3 expands this analysis further by exploring the origins and history of CSR in the context of the organization-society relationship. Section 2.4 looks at the way in which the practice of CED has developed through *mandatory* environmental disclosure under accounting and company law rules. The particular role played by the accountancy profession in promoting *voluntary* CED in the 1990s is explored separately in Section 2.5. Section 2.6 looks at significant developments in the practice of CED in the 1990s and provides a typology of the main approaches by large corporations to CED. Section 2.7 considers some of the more significant socio-political influences on the practice of CED, notably regulatory, quasi-regulatory and supra-national influences. A résumé of current mandatory environmental reporting and disclosure requirements which have emerged in Europe and other major First-world countries is provided in Section 2.8. Section 2.9 provides some concluding remarks and an introduction to the next chapter.

2.2 'Setting the scene' – a societal approach to CSR

Within the accounting literature there have been two dominant, but significantly different, approaches to CSR (Gray *et al.*, 1995b). Firstly, CSR may be treated as "… an addendum to conventional accounting activity and researched with the same assumptions and preconceptions which inform most of mainstream accounting research" (Gray *et. al*., 1995b, p.48)[1.] Secondly, an alternative approach to CSR which views corporate reporting from within a wider social context, one that moves beyond any legalistic, financial or market-based

boundaries and which has its origins in the social audit movement dating from late 1960s and early 1970s (see, for example, Geddes, 1992; Gray *et al*., 1996)[2]. Under the first approach, the assumptions and preconceptions referred to are drawn primarily from economic liberalism, a branch of economics which privileges money capital over other forms of capital (such as natural, social, cultural and human capital) in the service of modern, global capitalism (for an introduction and overview, see, for example, Gray and Bebbington, 2001; Gray *et al*., 1987, 1996; Mathews, 1984, 1993). As indicated in Chapter 1, the primary *social* purpose of financial accounting and reporting from this traditional perspective is to provide information that helps *economic* decision-makers (i.e. shareholders and providers of loan capital) make better *economic* decisions[3]. Within accountancy, a consideration of environmental issues based on this traditional view can be seen in the profession's focus on matters such as the definition, measurement and disclosure of environmental expenditures and the treatment of environmental clean-up obligations (this is explored in more detail at Section 2.4 below). While such considerations may be helpful in a strictly economic context, this approach is problematic because it imposes restricted 'world views' on the possible forms of CSR/CED and, in so doing, prevents other, alternative forms of social accountings from emerging (see, for example, Bebbington and Gray, 2001, Gray, 1992; Gray *et al*., 1995a, 1997; Lehman, 1999).

Phenomena such as CED when conceived of and practiced from the perspective of traditional financial accounting, are structured within a legalistic, economic framework where the 'usefulness' of financial, social, environmental, ethical and other reported information is determined according to its ability to meets the needs, or perceived needs, of shareholders and providers of loan capital, rather than from the perspective of society as a whole. Conversely, a societal approach places CSR "… at the heart of an examination of the role of information in organization-society dialogue" (Gray *et al*. 1995b, p.48). A detailed exploration of these issues in the context of CED is outside the scope of the present study[4]. However, any study of environmental reporting by business organizations involves also a study, whether explicit or implied, of the relationships between those organizations, the natural environment and society itself (see, for example, Lessem, 1977; Preston, 1975, 1981, 1983). The extent to which such relationships are or are not made explicit depends on the form of accounting and accountability by which a society *chooses*, normatively speaking, to socially construct them (see, for example, Hines, R., 1988a, 1991). It is difficult to overplay the significance of this choice. Put simply, to *fully* understand and appreciate these relationships requires the consideration of a whole range of issues and systems, including the political, economic, social, ethical and financial aspects of the current social system (capitalism), together with a much deeper recognition of how organizations function, of how society operates, of how the natural environment works, and of how these various elements of the whole are interrelated and impact upon each other. For example, social, human and environmental costs not reflected in market prices, known as 'externalities' are deliberately excluded from the present globalised system of financial accounting and reporting. As a result, that system is not simply a *social construction*, but is also *socially constructing* a partial, anthropocentric view of reality (Hines, 1988a).

The notion that it is possible to separate the social world from the natural world and treat the latter as a servant of the former is strongly rejected by more holistic world-views such as neo-Darwinism and Gaia theory which see the planet and all its biological and geological

occupants as a truly unified and self-regulating system (Lovelock, 1988, 2001, 2002). Our own limitations, in terms of human cognitive capacities to manage, understand and interpret complex, multifaceted human, social, non-human and ecological phenomenon also play an important part in constructing the world around us. As Gray and Bebbington (2001) state:

> *The more one tries to understand any one system – be it accounting, organizations, the environment, or whatever – the more one comes to realize that to understand any one element we really need a good grasp of the central issues in those other systems – systems which, far too often, we just leave as taken for granted* (p.273)[5].

As such, any distinction made between the economic, the social, the human, the non-human and the environmental is *artificial* given that, as human beings, we are part of and connected to the whole. What we do, how we do it and how we interact with each other and with other life- and non-life forms not only shapes our own social world but also influences and determines the state of the whole that is around us. Indeed, any consideration of the natural environment as one element of the whole involves a social dimension in the sense that we give meaning to that environment based on our anthropocentric perception of its role and purpose (Hines, R., 1988a, 1991). Furthermore, and perhaps most important of all, any consideration of environmental issues inevitably leads to a concern with 'sustainability' (Gray and Bebbington, 2001)[6]. Although not explicitly discussed in the present study, the issues are *implicitly* subsumed within the organization–society framework described above and thus inform and have a place in our overall understanding of the process by which organizations socially construct social and environmental issues via CSR, something which business organizations in particular have been doing for many years.

2.3 A brief, historical walk-through of practical developments in CSR

CSR has a long history, both as an aspect of corporate reporting practice (see, for example, Anderson, 1989; Guthrie and Parker, 1989; Hogner, 1982; Lewis *et al*., 1984) and as an aspect of academic enquiry (see, for example, Gray *et al*., 1996). However, the present study takes its cue from the end of WWII since much of what is known today as CSR has developed over that time. This is not to say that CSR issues were not considered important prior to WWII. Indeed, issues of responsibility in general and those in relation to employers, owners and organizations in particular feature strongly in the writings of such early philosophers as Plato and Aristotle (Gray *et al*., 1996). Nevertheless, what has been termed 'formal CRS' has a much more recent history and is generally associated with the rise of the modern organization during the decades since World War II (Gray *et al*., 1996).

Concern with the social and environmental consequences of business activities, particularly in relation to employment practices, pollution, health and safety and community involvement, has oscillated in a sea of changing fortunes (AAA, 1976; Parker, 1986; Tinker *et al*., 1991; Walden and Schwartz, 1997; Wood, 1991a, b; see also, in international terms, Roberts, 1990; in relation to Germany, Schreuder, 1979; the Netherlands, Huizing and Dekker 1992; the UK, Gray *et al.*, 1996; the USA, Ernst and Ernst, 1972-78; Australia, Guthrie and Parker, 1989)[7]. During those periods when concerns over CSResp increased, it appeared to do so along several different fronts. Gray *et al.* (1996), for example, suggest two distinct fronts, the first being the more radical debates engendered by what is sometimes referred to as 'extremists',

coming from both the far right (for example, Friedman, 1962, 1970) and the far left (for example, the work of Marx and Engels) as well as from the deep ecology and spiritual ecology movements. The second stream represents the more 'conventional' social and environmental movements of the 1950s and 1960s, which generated debate within the powerful 'middle ground' of society, including business, government, business schools and amongst the demos itself[8]. These 'conventional' commentaries on the social responsibility of business can be found in, for example, the seminal works of Bowen (1953), Druker (1965, 1971) and Galbraith (1969). Such writings reflected a major shift in thinking within Western business and government, being linked to and part of the whole social and environmental movements and mass demonstrations of the late 1960s and early 1970s in the United States, Europe and other parts of the world. However, it was developments in the US in the late 1950s and early 1960s that first sparked a general reassessment of the relationship between business and society (see, for example, Heald, 1957; Walters, 1977). Epstein *et al.* (1976) provide an interesting glimpse of developments in the US from the early 1960s:

> *Traditionally, a corporation was considered a good corporate citizen if it satisfied certain basic responsibilities: (1) if it provided a product or service valued by society; (2) if, in its business operations, it stayed within the confines of the law; and, (3) if it provided employment for members of the local community. However, since the early 1960s, the concept of 'good corporate citizen' has undergone fundamental changes. Satisfaction of the three criteria noted above was no longer deemed adequate to meet social responsibilities. Instead, there has been increasing concern for equal employment opportunities, the minimization of pollution, and the effective utilisation of society's resources by corporations* (p.24).

Epstein *et al*. (1976) suggest that the change in the role of corporations in US society in the 1960s arose out of a new social conscience amongst American society that led businesses to assume a wider responsibility that was largely unfulfilled by governmental institutions[9]. Ullmann (1985) argues that the growth of the idea of corporate social responsibility was closely linked to society's heightened sensitivity to the externalities of business activities, such external social costs long recognized in mainstream economics (see, for example, Kapp, 1950/1978; Pigou, 1960). In comparison to the UK and the US, Western Europe has a long history of social and environmental reporting practice (see, for example, Brockhoff, 1979; Preston *et al*., 1978; Ray, 1978; Schreuder, 1979, 1981; Theunisse, 1980a, 1980b; and UEC, 1983). Dierkes (1979), for example, refers to a growing concern in Germany, "… as in all other highly developed market economies of the Western world" (p.87) with the impact of business activities on the quality of human and social life, particularly the living environment. In Belgium, the issuance in November 1973 of a Royal Decree on Financial and Economic Information for Workers' Councils (Official Gazette, 28 November 1973, pp.13.352-66), in the wake of the student unrest of the late 1960s and public pressure on business for greater accountability, sought to protect workers' security by providing them with a 'true and fair view' of their employers' economic and financial position (Lefebvre and Flower, 1994). The perception of a much wider socio-political role on the part of business contrasts rather sharply with those of a political right wing disposition, notably Friedman (1962, 1970) who argued that the only social responsibility of business is to increase profits for their owners. The latter argument, born out of economic liberalism, is supported by a

belief that to spend money unnecessarily on social causes such as environmental protection was essentially 'bad' because it reduces the return to stockholders, reduces wages to employees and raises customer prices (Pinkston and Carroll, 1996). However, public expectations of business changed significantly over the 1960s and 1970s, such that by the early 1980s businesses were expected to assume broader social responsibilities which included attending to the human, environmental and other social consequences of business activities as they affect a broadened constituency of employees, consumers, local communities and other groups (Heard and Bolce, 1981). There is also some evidence that business executives themselves underwent some form of change in relation to the social responsibilities of the businesses which they ran. Brenner and Molander (1977), for example, in a survey of 5,000 readers of the *Harvard Business Review* report that of 1,227 executives which responded, only 28% felt that the social responsibility of business was to "stick to business". Based on their findings, Brenner and Molander refer to a new breed of executives which recognized broader, more socially-conscious objectives of the US business corporation.

The extension of societies' expectations of business corporations as described above has, perhaps quite naturally, been linked to the sudden, initial growth in the practice of corporate social reporting (CSR) in the 1970s, particularly in the US (AAA, 1976; Chastain, 1973; Dierkes and Preston, 1977; Epstein, *et al*., 1976; Heard and Bolce, 1981)[10]. Both Epstein *et al*. (1976) and Heard and Bolce (1981) provide useful summaries of developments in approaches to social accounting by US companies at that time, including those of Eastern Fuel and Gas Associates (one of the first US corporations to publish a social report, in 1973, *Toward Social Accounting*), the Norton Company's supplemental report to its 1973 annual report entitled *Accountability*, Linowes' (1972) socio-economic accounting, and Abt Associates, Inc.'s total impact approach to measuring in monetary terms the impact of an organization on society in relation to employees, customers, community and the general public. Many US companies engaged in social reporting in the late 1960s and early 1970s, providing a variety of descriptive, quantified and monetized reports and comprehensive social accounting reports[11]. Similar developments were taking place in Europe. Dierkes (1979), for example, identifies the start of discussions on CSR in Europe at around the early 1970s in Germany, influenced by developments in the US in the late 1960s. Indeed, practical developments in social accounting were already apparent in many European countries by the late 1970s, as reported by Marquès (1980):

> *A study of numerous social balance sheets emanating from Holland, England, Belgium, Germany, Switzerland, Sweden and, more recently, Spain, has shown us that it would be possible to detect certain principles of social accounting little by little* (p.38).

However, efforts in the early and mid-1970s in the US to develop sophisticated, comprehensive measures of social performance reporting soon gave way to less ambitious, more pragmatic solutions, particularly in the development of 'management tools' by consultants that met the needs of managers (Heard and Bolce, 1981). The 'process audit', for example, developed for 'corporate social audits' by Bauer and Fenn of the Harvard Business School (see, for example, Bauer and Fenn, 1973; Bauer, 1973; Bauer *et al*., 1975) became a principal management tool for many companies wanting to evaluate their social performance

(Heard and Bolce, 1981). Lessem (1977), in a critical assessment of the social reporting practices of 400 large British, American, German, French as well as some Benelux and Scandinavian companies, identifies a number of major shortfalls in CSR practice at that time, including an over-concentration on conventional wisdom, a failure to fully exploit new avenues tentatively opened up and a tendency to rationalise away inadequate social performance. Despite these perceived failures, Dierkes and Preston (1977) report increasing discussion of expanded government requirements for corporate reporting in socially relevant areas on both sides of the Atlantic, including extensive hearings held by the U.S. Securities and Exchange Commission (1975), the proposal for legally required corporate social reporting in France (Rapport Sudreau, 1975), and similar discussions in Germany (Küller, 1976), Holland (Boogerd, 1976) and the European Economic Community (EEC Study Group, 1975). General recognition of the corporate-environmental relationship was so widely recognised throughout the industrialized world by mid-1970s that most large companies and many medium-sized ones had by then already published formal environmental policy statements (Dierkes and Preston, 1977)[12].

There were also a number of attempts at developing *normative* frameworks directed specifically at corporate environmental impact analysis. Two noteworthy examples are provided by the Council on Economic Priorities (CEP, 1975) and Dierkes and Preston (1977), the latter based on the former's proposals submitted to the US Securities and Exchange Commission for comprehensive accounting and reporting of industrial pollution[13]. In mainland European countries, notably Germany and the Netherlands, CSResp issues were also the subject of public debate, although the form and result of these debates tended to differ. Both Schreuder (1979) and Brockhoff (1979) provide interesting summaries of developments in Germany in the 1970s, but from different perspectives. Schreuder (1979) focuses on the 'Sozialbilanz' (which, literally translated, means 'social balance sheet') and notes that, in comparison with other European countries, Germany had "… probably produced the largest collection of elaborate, theoretically well-grounded models of corporate social reporting" (p.109). However, this had little influence on practice, relatively few German companies having published a social report as it was *theoretically* understood[14]. Brockhoff (1979) analysed the state of the art of social reporting in Germany at that time by examining the annual reports of 300 German companies, reporting that 205 (approximately 70%) published a social report of identifiable nature within their annual reports in 1973/74. However, he notes that no general rule or consensus on social reporting had developed and there were few signs of any substantive innovations appearing in the annual reports[15].

In the Netherlands, the Dutch approach to resolving corporate reporting of social and environmental issues at this time reflected the 'political market' platform through which Dutch society seeks solutions to socio-political issues (see, for example, Huizing and Dekker, 1992; Leyer *et al.*, 1986). In the 1970s, there were frequent public debates over the social responsibilities and accountability of Dutch companies on numerous social issues (Huizing and Dekker, 1992). The Club of Rome's Report *The Limits to Growth* (Meadows *et al.*, 1972), with its gloomy predictions[16], led to the establishment of the environment as an autonomous area of Dutch public policy, which in turn introduced a series of new Dutch legislation for regulating pollution (Huizing and Dekker, 1992). However, CSR reporting did not develop either in practice or in theory in the Netherlands in the 1970s as it did in other countries such as the USA, Germany and the UK. Rather, debates in the Netherlands

concentrated on whether their should be internalisation of corporate responsibility for environmental issues (i.e. left to the companies themselves), based on the principle that companies are responsible enough to decide what is best - an approach much-favoured by Dutch employers' organizations - or whether there should be a regime of government regulation, as favoured by both Dutch environmental organizations and employees' representatives (Huizing and Dekker, 1992). The outcome of this debate is still on-going, although in the 1990s there was a noticeable shift towards regulation (see Section 2.8 below).

By the mid-1980s, European countries, notably Germany and the Netherlands, had implemented major public policy programmes to remediate and protect the environment from the effects of economic growth. However, for most of the 1970s and 1980s, the emphasis in Western Europe in a CSR context was on reporting to employees ('employee reporting') and reporting about employment ('employment reporting') (Gray *et al*., 1996). Indeed, the 1970s might well be described as the decade in which employee reporting became an established reporting practice of many organizations (for some of the reasons for this and of the forms that employee reporting took during the 1970s, see, for example, Gray *et al*., 1996 chapter 4). Nevertheless, compared to the early 1970s, the rest of that decade and most of the 1980s saw a general decline in the level of CSR (see, for example, in relation to the UK, Gray *et al*., 1996; Harte and Owen, 1992; in relation to the Netherlands, Huizing and Dekker, 1992; in relation to Germany, Schreuder, 1979; in international terms, Roberts, 1990). By the late 1980s, the emphasis given to *voluntary* reporting to and about employees, about the environment and about energy issues, had lost much of its early impetus and non-statutory reporting became a much less prominent aspect of CSR (Gray *et al*., 1996)[17]. Roberts (1990) suggests that this change reflected macro-economic developments as levels of unemployment and inflation rose and the rate of world economic growth began to slow down, such that social priorities shifted away from the social activities of companies towards concerns about economic circumstances. Other empirical evidence appears to support this perception. Pinkston and Carroll (1996), for example, studied the relative priorities of large businesses in seven developed countries (England, France, Germany, Japan, Sweden, Switzerland and the US) since the mid-1980s. They concluded that, regardless of the country of origin, *economic* orientations were still perceived to be the most important aspect of corporate social responsibility, followed by legal, ethical and philanthropic orientations[18].

However, in the late 1980s and early 1990s this situation seemed to change dramatically as issues surrounding the environment came to dominate much of the social reporting agenda and accompanying accountancy literature (see, for example, Butler *et al*., 1992; Christophe and Bebbington, 1992; Drieënhuizen *et al*., 1998; Freedman and Stagliano, 1992; Harte and Owen, 1991; Owen, 1992; Macve and Carey, 1992; Roberts, C., 1990, 1991, 1992 and Tonkin, 1991). Owen (1992) refers to a sea change in the public mood around this time, particularly in the strong surge of support for the Green Party in the 1989 European elections. Whilst the reasons for this are many, varied and complex, the explosion in world population, increasing industrialization, the widespread use of chemicals, pesticides and fertilizers, noise pollution, the contamination of air, water, land and food, soil erosion, over-fishing, the destruction of forests, over-exploitation of natural resources, evidence of global climate change and loss of biodiversity, and a string of environmental disasters, notably Bhopal, Chernobyl, Exxon Valdez etc., which received widespread international publicity in the media (see, for example, Elkington, 1997), were probably key factors in engendering such a

widespread and serious concern for the environment[19]. Other factors too are likely to have played their part, notably a shift in international politics by a number of supra-national governmental and non-governmental bodies such as the European Union, the European Commission and the United Nations (UN) through the United Nations Environmental Programme (UNEP). Whatever the causes, it is widely recognised that interest in CSR resurged in the 1990s (see, for example, Johnson, 1993; Surma, 1992; Walden and Schwartz, 1997) and that, in particular, business organizations began to increase the amount of information devoted to environmental issues (see, for example, Harte and Owen, 1991; Patten, 1992; Gamble *et al*., 1995).

By the beginning of the 1990s, the environment had become a central piece of social policy and business culture. Gray *et al*. (1996, p.ix), for example, reflecting on the changes that had taken place, record that (original emphasis): "By the late 1980s there was widespread acceptance that the natural environment *was* an issue of concern to us all; an issue which, for 20 years, had been impossible to raise on business and accounting agendas was brought back to centre stage. This concern for the natural environment, together with increasing disgust at the worst of the social consequences of the 1980s, suddenly re-opened the whole social justice, environmental concern and accountability debates". Gray *et al*.'s reference to the difficulties encountered in raising the natural environment as an agenda issue for the accountancy profession in the 1980s contrasts rather sharply with the profession's projected image and position in the 1990s. Since that time the European accounting profession has eagerly sought to promote itself as a key source of expertise in this area (see, for example, FEE, 1993, 1995, 1996, 1999b, 2000, 2002, 2003b)[20]. However, the profession has been selective in terms of how it has constructed the business–society relationship in this context. Politically, rather than challenge the fundamental way in which social and environmental issues are reflected in the financial reporting framework, the accountancy profession has used that framework as a springboard for expansion into the social and environmental arena, shying away from more holistic forms of social and environmental accounting. The consideration of environmental issues within this traditional financial reporting framework is considered in the next section.

2.4 Accounting and company law environmental reporting requirements

The annual report and accounts is seen by many CSR researchers as the primary document through which a company communicates with society, particularly its shareholders, to which a company has a fiduciary duty and is legally accountable (see, for example, DTTI, 1996; Gray *et al*., 1995b, c, 2001; Neu *et al*., 1998; O'Dwyer, 2000; Wiseman, 1982). Annual reports are also viewed as the most important document through which the business organization constructs its own social imagery (Hines, 1988a; Neimark, 1992). Hence, the annual report is commonly perceived as the principal vehicle for corporate reporting to society on a whole range of economic and social issues, including divisional and product performance, employee reporting and environmental reporting. However, in relation to the latter, it would probably be unusual to find an annual report containing an integrated environment report of ten pages or more. Much, if not most, environmental information provided in the annual report is *voluntary*[21]. Prior CSR research suggests that little voluntary environmental information is provided in the annual report relative to the report as a whole and that the level of disclosure tends to be quite superficial with very few companies

providing detailed data relating to their environmental performance (Gray and Bebbington, 2001).

Information that is *required* to be reported in the annual report and accounts is determined by company law requirements and accounting rules (see below). In addition, for those companies whose shares are traded on public stock exchanges, there may be additional disclosure requirements from the stock exchange itself. In relation to the latter, in several non-European countries (Australia, Canada, South Korea and the USA), the respective body with responsibility for the public trading of securities requires the disclosure of certain environmental information or its inclusion in financial reports. The most stringent requirements for publicly-listed companies in this context are those of the Securities and Exchange Commission (SEC) in the US. Since 1971, the SEC has issued a series of releases stipulating specific environmental pollution disclosures that are required to be included in SEC filings (see, for example, Roussey, 1992; Zuber and Berry, 1992)[22]. The SEC's current requirements in relation to pollution disclosure for US-listed companies are set out in Regulation S-K, revised in 1986 (see, for example, Collier *et al*., 1993; Fekrat *et al*., 1996; KPMG, 1997a). Item 101 of Regulation S-K requires disclosure in 10-K reports (an annual statement that US-listed companies must file, also known as Form 10-K) of the material effect that compliance with federal, state and local environmental laws may have on capital expenditures, earnings and competitive position, together with details of existing estimates of current and future environmental expenditures for environmental control facilities. Item 103 of Regulation S-K requires the disclosure of significant environmental, administrative or judicial proceedings, both contemplated by government and pending, that might have a material impact on the company. Item 103 also requires that the Management Discussion and Analysis of Financial Condition and Results of Operations (known as the MD&A) of Form 10-K includes disclosure of any environmental problems that are reasonably likely to have a material effect on the company's conditions or results of operations, unless the management can determine that a material effect is not reasonably likely to occur (SEC, 1989). However, there are doubts as to whether US-listed companies comply fully with the SEC's disclosure requirements in this context[23].

The SEC has come down hard on US-listed companies in relation to their obligations, or possible obligations, under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (i.e. PL 96-510), more commonly known as CERCLA or 'the Superfund Act'[24]. Significantly, under the Superfund liability for the cleanup of hazardous sites is joint and several, the latter provisions requiring that any party having involvement with a hazardous waste site could be held responsible for the full cost of cleanup regardless of the extent of involvement (Cahan *et al*., 1997). Moreover, these provisions were retroactive, such that firms could be liable for past actions even if such actions were not illegal at the time. An official US EPA memorandum issued in December 1983 reported in the region of 22,000 hazardous waste disposal sites in the US, of which between 1,400 and 2,400 required remedial action in the immediate future, the cost of which was estimated at between US$8 and US$16 billion (Rockness *et al*., 1986). By the early 1990s, the US EPA had designated some 1,200 locations as 'national priority sites' requiring immediate clean up, with the responsibility for the hazardous waste disposed at these sites falling primarily on large chemical companies which had been dumping on public sites for many years (Chadick *et al*., 1993; Rockness *et al*., 1986). More recent estimates for the total cleanup costs under the

Superfund, excluding US Department of Defence and Department of Energy sites, put the total bill at over US$500 billion, requiring 40 to 50 years to complete (Chadick *et al*., 1993). However, it was not until 1996 that the US accountancy profession, through the American Institute of Certified Public Accountants (AICPA), made serious efforts to address major US federal and non-federal legislation dealing with pollution control and environmental remediation laws. In response to the SEC's strong stance on the issue of environmental liabilities, the AICPA developed *Statement of Position on Environmental Remediation Liabilities, SOP 96-1*) (AICPA, 1996). SOP 96-1 provides specific guidance for the application of US accounting rules in relation to the recognition, measurement, display and disclosure of environmental liabilities (see, for example, Gill, 1995), notably the requirement for companies with environmental remediation liabilities to disclose those items, as well as other environmental cost information, in the annual report (Milne and Patten, 2002). The SEC's requirements apply only to US-listed companies. However, given that the US is the main source for equity and bond capital internationally, large European companies which seek US funds are also caught by the SEC's rules. As a result, this may influence the reporting of additional environmental information by European companies in their home country annual reports (Hackston and Milne, 1996).

In the European Union (EU), the company law requirements of the fourth (CEC, 1978) and seventh (CEC, 1983) Council Directives (referred to hereafter as "the EU accounting directives") (as amended) are adopted by all Member States into national law. These accounting directives contain provisions on both the content of the directors' report and on the form and content of the annual accounts and consolidated accounts, respectively. The directives contain no specific provisions on environmental issues other than the general measurement, valuation and disclosure rules (FEE, 1999a). However, some European countries, notably Norway, Spain and Sweden, have introduced national government regulations which sit alongside the EU accounting directives and which require companies to disclose certain environmental information in their annual accounts (see Section 2.8 below). Other European countries, such as the Netherlands, have carried out a review of their existing accounting rules and provided additional guidance to practitioners where it was considered necessary[25]. In addition, the European Commission (EC), the executive arm of the EU, has also addressed environmental issues within the framework of the accounting directives. In 1995, the (now defunct) European Commission Accounting Advisory Forum (EC AAF), a body of experts established by the Commission, published *Environmental issues in Financial Reporting* (EC AAF, 1995) on the treatment, recognition, measurement and disclosure of environmental issues in the annual report and accounts. In 1998, as a follow-up to the earlier EC Advisory Forum's paper, Directorate General XV of the EC published *Interpretative Communications* (DG XV of the EC, 1998) which addresses the application of the EU accounting directives to environmental issues. The latter document deals, *inter alia*, with accounting matters relating to the environment and their recognition and disclosure in financial statements. More recently, in June 2001, the European Commission (EC) issued a voluntary *Recommendation* (CEC, 2001b) on the recognition, measurement and disclosure of environmental expenditure, liabilities, risks and assets in annual accounts and annual reports of EU companies (see, for example, Collison, 2003). The Recommendation is based on a 'decision-usefulness' (i.e. investors) rather than an accountability (i.e. a 'right to know') perspective, clarifies existing mandatory reporting obligations laid down in the existing EU

accounting directives and seeks to improve the quality, transparency and comparability of environmental data. In some instances, the EC goes beyond the requirements of the Directives by presenting recommendations of a non-mandatory nature, including those relating to environmental policies, programmes and improvement, and environmental performance concerning energy, water and materials usage, emissions and waste disposals, which should be disclosed to the extent that they are material to the financial performance or financial position of the reporting entity[26].

The EC's attempts to improve transparency and comparability of corporate financial environmental accounting rules form part of the EU's financial reporting strategy aimed at harmonizing EU accounting rules which require the application of the IASB's International Accounting Standards by EU-listed companies with effect from 2005 (CEC, 1995). The IASB is currently embarked on developing a single set of global accounting standards that require transparent and comparable information in general purpose financial statements. The EC's recommendation (CEC, 2001b) in relation to financial accounting was itself based substantially on the UN's (UNCTAD-ISAR, 1999) report on accounting for environmental costs and liabilities, the latter itself being largely authored by the CICA with substantial input from an expert group of professional accountants from around the world (ACCA/UNEP, 2002). In practical terms, the fact that these recommendations are non-binding means that it is left to the governments of EU Member States to introduce financial accounting and reporting requirements beyond what is strictly required by the EU accounting directives (ENS, 2001). Consequently, in the absence of Member States introducing national requirements, the EC's recommendations are unlikely to have much impact[27].

To date no national government or accounting standard-setting body within or without Europe has introduced specific requirements in relation to environmental issues other than in the context of the traditional financial reporting framework[28]. Consequently, the sort of items that are *required* to be disclosed in the annual accounts in order to comply with company law, financial accounting standards and generally accepted accounting practice (GAAP)[29], if material to the financial performance or financial position of the reporting entity, reflect the legalistic and economic nature of financial statements (Table 2.1 below). A more detailed description and discussion of these issues can be found in the UN's statement of position on accounting and reporting for environmental costs and liabilities (UNCTAD-ISAR, 1998) and the European Commission's communication on the treatment of environmental issues in the statutory annual report (CEC, 2001b). Significantly, it is those areas described in Table 2.1 which have formed the focus of the international accountancy profession's attention to environmental issues since the early 1990s (see, for example, CICA, 1992; FEE, 1999a; Macve and Carey, 1992; UNCTAD-ISAR, 1999). One issue which has dominated the minds of accounting bodies in this context, particularly in North America, is that of actual, probable and potential environmental liabilities (see, for example, AICPA, 1996; CICA, 1993c, 1997a; Cormier *et al*., 1996; Gill, 1995; Newell *et al*., 1990; Roussey, 1992; Rubenstein, 1992). Against a backdrop of increasing litigation and more stringent penalties for breaches of environmental laws and regulations, accounting for the costs of past, present and future environmental activities has become increasingly more important (see, for example, the UK's Financial Reporting Standard (FRS) 12 (ASB, 1998) and the International Accounting Standard (IAS) 37 on provisions, contingent liabilities and contingent assets (IASC, 1998c), which, although not environmental accounting standards, provide appendices which draw on

environmental examples to illustrate accounting treatment of environmental issues)[30]. Hence, it is this particular issue which is most likely to give rise to *mandatory* environmental disclosure in the annual report and accounts.

Table 2.1
Examples of environmental disclosure required under existing accounting rules (subject to materiality)

Accounting item	Description
Balance sheet – Assets	Capitalisation of costs in relation to environment-related expenditure on long term assets for use in the business where such assets provide rights to future economic benefits, including the continued operation of existing assets.
Balance sheet – Liabilities	Provisions for future environmental liabilities, risks and legal, contractual and constructive obligations including provisions for future environmental costs such as those relating to clean-up obligations and long-term decommissioning costs.
Profit & Loss Account	Losses arising on the write-down of assets made obsolete or uneconomic due to stricter environmental pollution controls; expenditures relating to pollution permits and emission rights; costs relating to fines and penalties for breach of pollution permits and other environmental protection laws.
Notes to the accounts	Accounting policies in relation to any significant environmental costs and liabilities; contingent obligations in relation to possible future claims against the organization for environmental damage concerning the enterprise's past or current activities.

However, as indicated in Section 2.2 above, an important distinction needs to be drawn between the disclosure of environmental issues through the annual accounts under company law and accounting GAAP, and a serious approach to 'accounting for the environment'. Examples of the latter are provided by, *inter alia*, Bebbington *et al*., 2001; CICA, 1997b; FEEM, 1995; Howes, 1999, 2000; Rubenstein, 1992, 1994; UNCTAD, 1995; US EPA, 1995, 1996. As noted by Gray and Bebbington (2001), when examining environmental issues in the context of the annual report and accounts:

> *... we are* ***not*** *looking at the environment itself but rather at those manifestations of the environment which are affecting the financial measurement of economic events at a material level. We are* ***not*** *looking at habitat destruction but rather at what we might be fined for destroying habitat. We are not looking at contributions to climate change but rather at what we might have to spend to comply with future laws on emissions ... and so on* (p.222/3 original emphasis).

Experiments and developments in *accounting for the natural environment* have tended to take place outside the confines of the annual report and accounts, with the accountancy profession reacting to these developments on an *ad hoc* basis, depending upon the values and priorities of those with responsibility for setting the profession's agenda (see, for example, Bebbington *et al*., 2001 in relation to the European profession's response to the EC's call for the accountancy profession to take a lead in developing full cost accounting FCA)[31]. Given that

there is still no universally accepted, general accounting framework for the reporting of environmental information, other than under accounting GAAP (which as noted above is *not* about 'accounting for the environment'), and no generally accepted method of accounting for the environment, this principle applies to all forms of CED. However, the list shown in Table 2.1 above does illustrate that environmental issues are *potentially* very important to business organizations (see, for example, Collinson, 1996; Collison *et al*., 1996; Collinson and Gray, 1997). Moreover, despite the lack of detailed mandatory requirements for the environment under traditional financial accounting, it would be wrong to suggest that social and environmental issues have failed to attract the interest and concern of professional accountancy and national standard-setting bodies. On the contrary, over the years there have been a number of well-intentioned studies and reports from both the private and the public sector that have addressed aspects of accounting which *could* have led to the emergence of new forms of social and environmental accounting. These are briefly reviewed in the next section.

2.5 The accountancy profession's consideration of alternative forms of CSR

The accountancy profession has, over the years, made many excursions into the practice of CSR. These include (in chronological order): in the USA (AAA, 1973a, b, 1974, 1975b, 1976; AICPA, 1973, 1977); in the UK (ASSC, 1975; Macve and Carey, 1992; Collier *et al*., 1993; Andersen, 1994; ICAEW, 1996); in Canada (CICA, 1990, 1992, 1993c, 1994a); and, in Australia (AARF, 1992). This list, which is not intended to be exhaustive (trying to identify all reports and study in this area from all over the world over the last 30 years would be an immense task and is outside the scope of the present study), highlights the fact that there have been a number of instances where the *opportunity* existed to consider introducing alternative forms of social and environmental accounting[32]. As noted by Gray and Stone (1994):

> *The American Accounting Association, the American Institute of Certified Public Accountants and the British Accounting Standards Committee all produced stimulating, thoughtful and challenging documents which – to a greater or lesser extent – re-examined the heart of accounting practice and theory and set out proposals that would lead to a new evolution of accounting's role in the discharge of accountability* (p.582).

During the early 1970s those involved in accounting research and practice, both in Europe and the US, undertook a re-evaluation of the role and purpose of financial statements and financial reporting. At the time, the need for some form of accounting to provide information about the social costs and benefits of the operations of business enterprises was receiving increased attention (see, for example, Ronan, 1974). This included calls for corporations to provide details of the 'external' (i.e. non-market) social costs and benefits of their activities rather than just the private costs and benefits as reflected in the financial statements (see, for example, Churchill *et al*., 1972; Ronen, 1974). The accountancy profession in both North America and Europe responded to these developments by establishing study groups to address the wider social issues of financial accounting and reporting. The work of two study groups, one in the US (*The Trueblood Report*, AICPA, 1973) and the other in the UK (*The Corporate Report*, ASSC, 1975) are of particular relevance in the context of CSR.

The Trueblood Report was the result of two years' work by a study group set up by the AICPA in 1971 to refine the objectives of financial statements towards the establishment of guidelines and criteria for improving the quality of financial reporting and accounting (AICPA, 1973, p.67). As part of this refining process, the study group was asked to seek answers to a number of specific questions, including identifying the users of financial statements and their respective needs. In its final report, the study group defined the basic objective of financial statements as being "… to provide information useful for making economic decisions" (AICPA, 1973, p.13). The study group made a number of key assumptions, which have since become part of national and international accounting folklore and which were argued at the time to be supported by economic and behaviour theory, the first and most important of which was stated to be that users of financial statements seek to predict, compare, and evaluate the cash consequences of their economic decisions (AICPA, 1973, p.13). The emphasis on economic goals was adopted not because social goals were seen as less important but rather because "… our social and economic system assumes that the pursuit of private goals generally tends to full fill the social ones" (AICPA, 1973, p53). The study group took the view that, for the US at least, it is right that accounting and financial reporting should focus primarily on providing information that is useful for making *economic* decisions because the decisions taken on the basis of private economic considerations will (it was argued) generally satisfy the public's social goals. However, no evidence was presented in the report to support this hypothesis. Rather, reference was made to the benefits of private enterprise, investment and the free market in terms of advancing the 'common good' (AICPA, 1973, p.53). Importantly, whilst recognising that the goals of free enterprise may not always sit comfortably with those of society in relation to external costs, such as environmental pollution, the study group argued that these were matters for society not the accounting profession[33]:

> *Only society – through laws and regulation – can identify what it considers a cost or sacrifice. And only society can determine the extent to which it will absorb such costs or force enterprises either to modify their activities to eliminate social costs or else pay for them … [Nevertheless], some enterprises may choose to report activities that result in social costs* (AICPA, 1973, p.53)

Thus, whilst rejecting the need for accounting to reflect anything other than private costs, the study group did at least leave the door open for companies to voluntarily report on activities which result in external costs to society. Part of the reason for the latter may lie in the fact that a number of submissions were made in an attempt to persuade the study group to take a wider perspective on the objectives of financial reporting (see, for example, Herwitz, 1974; Colantoni *et al*., 1974; Ronen, 1974). Both Herwitz (1974) and Schwartz (1970), for example, argued for greater corporate accountability which went beyond legal requirements[34]. However, this view remained in the minority and did not find favour either in *The Trueblood Report* or with the US SEC.

In contrast, *The Corporate Report* (ASSC, 1975) published by the UK's accountancy profession, contained probably the most widely discussed proposals on the whole question of CSResp at the time and has continued to attract interest amongst CSR researchers, particularly in the context of a broad set of users of corporate reports. The remit of the ASSC study group was to re-examine the scope and aims of published financial reports in the light

of the needs and conditions which existed as the time, with the specific objective of identifying persons or groups of persons for whom published financial reports *should* be prepared, and the information appropriate to their respective interests[35]. At the time, very little research had been conducted into who should report to whom, why and how often (ASSC, 1975). In its report, the ASSC study group defined the users of corporate reports as being:

> *... those having a reasonable right to information in relation to the reporting entity. We consider such rights arise from the public accountability of the entity whether they are supported or not by legally enforceable powers to demand information. A reasonable right to information exists when the activities of an organization impinge or may impinge on the interest of a user group* (ASSC, 1975, p.17).

A key issue which *The Corporate Report* sought to raise in the context of CSResp is that economic entities, because of their scale of command over human, social and environmental resources, have implicit responsibilities in relation to those resources. Put simply, these entities are seen as accountable not just in terms of their economic performance but also for their performance in relation to human, social and environmental issues to the community as a whole (Harte and Owen 1992). However, following its release as a discussion paper, *The Corporate Report* failed to have any noticeable influence on the future direction of financial reporting and financial accounting in the UK. This may have been due in part to the fact that, at the time, the UK accountancy profession, under heavy pressure from the UK government, was pre-occupied with inflation accounting at a time when the UK economy was experiencing relatively high rates of inflation. The election of Margaret Thatcher's right-wing Conservative government in 1979 was undoubtedly also a contributory factor (Stray and Ballantine, 1996). Whatever the reasons, *The Corporate Report* effectively sank without trace and arguably remains to this day the UK' accountancy profession's most detailed, altruistic attempt to address the wider social responsibilities of business organizations[36].

Both *The Trueblood Report* and *The Corporate Report* have historical significance because of their influence in generating interest amongst accounting researchers, particularly CSR researchers, in the role and purpose of financial statements and reporting. In particular, both reports reflected a small but growing consensus of opinion at the time that was moving away from Paton and Littleton's (1940) "true income" model of financial reporting towards a decision usefulness approach, the latter being based on the notion that the primary purpose of financial accounting *should* be to aid users in making *economic* decisions. *The Corporate Report*, for example, highlighted the wider reporting responsibilities of companies to user groups such as employees, the government, customers, suppliers and the general public, and no doubt influenced developments in 'stakeholder accountability' (see Chapter 6). Indeed, the ASSC study group considered a proposal that would have required businesses to disclose information showing its impact on and efforts to protect society, its amenities and the natural environment. However, such a proposal was considered impractical and instead the study group simply assumed that "… individual enterprises, as hitherto, will show the way" (ASSC, 1975 p.58).

Events in the US and the UK as described above were more or less mirrored in mainland Europe. Although much was written on the subject of social accounting during the 1970s and

1980s, it had very little impact on the *practice* of accounting in Europe (see, for example, UEC, 1980). The issues were addressed, for example, by the Union Européenne des Experts Comptables Economiques et Financiers (UEC), the then representative body for the professional accountancy bodies in Europe, at its Third Study Conference in Belgrade in 1975, under the title, "The role of the accountant in relation to the social aspects of business". Social accounting issues were considered again a few years later at the Fourth Study Conference in Amsterdam in 1980, where the hosts, the Netherlands Instituut van Register Accountants (NIvRA), focused on the practical problems that had to be addressed within the context of corporate social accounting (UEC, 1980). Marquès (1980), in one of the working papers presented at the 1980 UEC conference, reports that some form of social accounting was in the process of being developed in response to a profound change in the relationship between business and society. Up to that time, the traditional view had been that the management of a company had to account for its activities only to shareholders, whilst at the same time safeguarding the assets as security for the company's creditors. However, there was a growing acceptance that this view had been replaced by a perception that:

> *because of its size, its importance in society and its potential influence on the living conditions of future generations, a company must report on its impact on society in general* (Marquès, 1980, p.30).

Similar views were expressed by Ternisien (1980), a member of the French *Ordre des Experts Comptables et des Comptables Agréés*, for example, arguing that a business enterprise can no longer justify itself solely in terms of the pursuit of profit, and that the present accounting framework only partially accounts for the role of business enterprise in society. However, these views were not widely accepted. Moreover, differences existed between the Member States of the EU about the relative importance of social accounting due to a number of factors, including the degree of social consensus and the social circumstances within a particular country as well as the attitudes of governments (Marquès, 1980). This is illustrated by *le bilan social*, a form of stand-alone social reporting which had been published in the Netherlands for more than ten years at that time but had only recently started to appear in Germany, France and Switzerland (Marquès, 1980). Although *le bilan social* became a legal requirement in France in 1977, the Netherlands failed to take a similar position despite the fact that France had less experience in their preparation compared to the Dutch (Marquès, 1980)[37].

In summary, despite the developments in the US, the UK and mainland Europe referred to above, there was no systematic attempt by national governments, the accountancy profession, its standard-setting bodies or other regulatory bodies to introduce specific requirements for companies to account for their social and environmental impacts outside of a predominantly legal and markets-orientated perspective. In seeking a pragmatic solution to various needs and wants of the difference user groups, it became primarily a matter of deciding which groups should be given preference in terms of the financial reporting obligations of companies. In making this decision, national professional accountancy bodies, led by those in the US and UK, with the full support of the regulatory agencies such as the SEC in the US and their respective national governments, chose to place the economic interests of shareholders and creditors above those of other user groups. According to Ullmann (1979), for example, today's accounting principles, developed over many centuries, "… are based not

so much on a theory as on a consensus among the parties as to what should be measured and how this should be done" (p.132). Mainland Europe and other parts of the developed world followed the same path. In the 1990s, the accountancy profession's focus was fixed firmly on serving the needs of investors, as demonstrated by the report of the Jenkins Committee (AICPA, 1994), a special committee on financial reporting set up by the AICPA, the purpose of which was "… to determine the information needs of users, to identify the types of information most useful in predicting earnings and cash flows for the purpose of valuing equity securities and assessing the prospects of repayment of debt securities and loans" (AICPA, 1994, p.4). Despite early, encouraging work (see, for example, the early 1970s reports from the AAA (1973a, b, 1974, 1975b, 1976) and CIMA (1982) on energy accounting) the accounting framework project remained largely unchanged (but not unchallenged), and social and environmental accounting was effectively 'left to the market' on the assumption that if it was a good thing then companies would continue to supply it and shareholders would continue to demand it (Gray and Stone, 1994)[38].

Whilst these developments present a rather depressing overview of a serious approach to 'accounting for the environment', it is worth recalling that the present financial reporting framework is not, nor was it ever, designed to address concepts pertaining to the protection, maintenance and restoration of the natural environment. Fundamentally, there is a limit to the extent to which this framework can be bent and twisted to meet such demands (Hibbitt, 1994). Indeed, it is highly questionable whether a serious approach to environmental issues can ever be conducted within such a limited legalistic and overtly economic framework. Ironically, whilst not disturbing the traditional financial reporting framework, a number of developments in the practice of environmental reporting and disclosure did start to take place in the early 1990s as the accountancy profession sought to promote its expertise in the fields of environmental management, accounting, reporting and auditing (see, for example, Drieënhuizen *et al*., 1998; Gray *et al*., 1993). In addition, accounting firms and representative bodies of the accountancy profession started to take environmental accounting and reporting matters much more seriously in examining the need for accounting standards on environmental issues and additional guidance on environmental reporting and auditing issues (see, for example, AICPA, 1996; CICA, 1994b; DRT, 1991; DTT, 1993; FEE, 1995, 1999a, 1998; IAPC, 1995, 1998; ICAA, 1998; ICAEW, 1996; IFAC, 1995, Kamp-Roelands, 1996, 1999; KPMG, 1993, 1994, 1996 and 1997b; SAICA, 1997). A number of organizations have been particularly influential in this respect, including ACCA, CICA, and Royal NIVRA. The CICA, for example, was particularly active in publishing a series of monographs on matters relating to environmental issues (CICA, 1992, 1993a, b, c, 1994a, b, 1997a, b). The European accountancy profession, through its representative body, FEE, has also become very active in this field (see, for example, Adams *et al*., 1999; Adams and Jackson, 1999; FEE 1999a, 1999b, 2000, 2001, 2002; Kamp-Roelands, 1996, 2002)[39].

One of the most significant developments to come out of the 1990s in this context was the ACCA's founding of the UK Environmental Reporting Awards (ERA) in 1991. The scheme was set up with the aim of raising the profile of environmental reporting in the UK and to encourage UK organizations to publicly report on the impact of their activities on the environment (ACCA, 2003b). Since its formation the ERA scheme has had a major impact on the direction, quality and reputation of corporate environmental reporting not only in the UK but also internationally as it gained in reputation as one of the world's most prestigious

awards for 'good' and 'better' environmental reporting practices. National accountancy bodies followed the lead set by the ACCA with the setting up of their own environmental reporting awards schemes – Denmark, the Netherlands and Norway in 1995; Belgium, France and Germany in 1998; Finland, Portugal and Switzerland in 1999; Austria and Sweden in 2000; Ireland in 2001[40]. These developments are mirrored at the European level with the formation of a European Environmental Reporting Awards (EERA) scheme in 1996 by accountancy bodies from three countries (Denmark, the Netherlands and the UK). The number of accountancy bodies represented in EERA has increased steadily since then and at the present time (2003) the full list is made up of 16 accountancy bodies from 16 different European countries (Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the UK) each of which submits winning reports to the panel of judges for the annual awards. In 2002, reflecting developments in corporate reporting practice, the EERA was re-named the European Sustainability Reporting Awards (ESRA)[41]. Since its inauguration in 1996, ESRA has received the public support of UNEP, the European Commission, the European Environment Agency (EEA) and the European Parliament, with high-level representatives of each being present on at least one occasion in a lead role at the annual awards ceremony in Brussels.

These developments signal considerable political support for the promotion by the accountancy profession of increased corporate activity in this area. Whilst this may well have been a reaction to, and the commercial exploitation of, the emergence of an 'audit society' and a growing sense of a need for greater levels of assurance in many aspects of society (see, for example, Power, 1991, 1994a, b, 1997a, b), there is no doubt that the accountancy profession's position on issues changed noticeably during the course of the 1990s as corporate environmental reporting became a more normalised part of the corporate reporting roadshow. An overview of some of the more significant developments and trends in this area is provided in the next section.

2.6 Developments & trends in corporate environmental reporting in the 1990s

The natural environment has been an important element of developments in CSR and CSResp in both the United States and continental Europe, especially Germany, the Netherlands and the Scandinavian countries, since the 1970s (Gray *et al*., 1996)[42]. Early interest in corporate environmental disclosure and reporting tended to focus on issues of pollution *per se* rather than with the broader issue of the relationship between business and the environment (see, for example, Owen, 1992). Following the oil crisis in 1973, for example, business became concerned with issues surrounding energy and energy efficiency, although by the early 1980s this too had become a peripheral issue in the context of CSR (Gray *et al*., 1996). However, a significant change in the general attitude of the public towards environmental issues in the 1990s coincided with a noticeable change in the way in which business organizations approached their management and reporting of environmental issues. It was during this period that experiments in new forms of 'accounting for the environment' came to the fore, many of the more well-know experiments coming in the early 1990s from companies such as Norsk Hydro (1990) in the UK and Norway, BSO/Origin (1990) in the Netherlands and the Danish Steel Works (1991) in Denmark. Such early experiments opened the door for first-timers and trailblazers to explore and experiment with a limitless array of new forms of

environmental accounting and reporting[43]. By the early 1990s, a variety of different approaches to 'accounting for the environment' meant that the latter had become a rather loosely-used term with many different meanings and connotations (Drieënhuizen *et al.*, 1998). A typology of the different approaches to corporate environmental reporting is presented in Table 2.2 below.

Table 2.2
A typology of approaches to corporate environmental reporting

Reporting type	Description
Descriptive/ performance reporting	An approach popularised in the UK in the early 1990s with many UK companies leading the way through the publication of separate stand-alone environment reports. These reports typically included a statement of policy in relation to environmental issues and performance data on emissions, recycling and energy savings. Such reports were seen as exhibiting 'best practice' and were the source material for the UK's environmental reporting awards (ERA) scheme established by the ACCA from 1991 onwards.
Quantitative reporting	Emphasises quantification of data and tends to go a step further than the environment reports described above by providing a more holistic picture of an organization's interaction with the environment. The distinguishing feature of such reports is the inclusion of a form of quantitative input-output analysis, typically referred to as a 'mass balance', or Ökobilanz, reporting all the inputs and outputs relating to a process, product, division or entity.
Financial environmental reporting	The most adventurous and least developed type of environmental reporting, involving attempts to link financial reporting with environmental impacts presently missing from mainstream financial accounting under GAAP (sometimes referred to as 'externalities').

Source: Gray et al. (1996)

The descriptive/performance approach is perhaps the most common form around today covering as it does the stand-alone environment reports at site, regional or corporate (i.e., company-wide) level. Some well-known UK corporations were at the forefront of developments in the early 1990s, including British Airways, British Gas (now BG Group), British Petroleum (BP), British Telecom (BT), ICI and the Body Shop (Gray *et al.*, 1996)[44]. Many mainland European companies were also experimenting with this form of environmental reporting in the early 1990s, notably the Swiss company Ciba, which published its first corporate environment report in 1992 (Roberts, C., 1992). In Germany, perhaps the most developed country in relation to the theory and practice of social reporting in the 1970s, stand-alone environment reports started to appear in the mid-1980s, particularly amongst the leaders of social reporting. In the 1970s, environmental reporting, as one aspect of social reporting, had already started to appear in one form or another in the various forms of social/societal reports, known as *Sozialbilanz* (Dierkes, 1979). By the late 1980s, this situation had changed and environmental reporting had become a separate form of reporting in its own right with many of the large industrial German companies publishing lengthy environment reports. A number of other key private, voluntary initiatives emerged in this particular field in the 1990s, notably:

- the *Coming Clean* report of DTTI, IISD & SustainAbility (1993) which provided a five-stage environmental reporting model, from 'green glossies' to sustainable development reporting;
- the *Company Environmental Reporting* report of UNEP IE, (1994) designed to meet emerging stakeholder expectations and widely regarded at the time as the most comprehensive set of environmental reporting guidelines to date, including a list of 40 environmental reporting ingredients; and,
- the SustainAbility/UNEP (1994, 1996a, b, 1997) series of surveys which evaluated the standard of environment reports around the world and which deliberately attempted to embarrass high profile 'non-reporters' (SustainAbility/UNEP, 1998).

One indication of the breadth of these initiatives is provided by KPMG (1997b) who list 44 organizations as having published recommendations and guidelines for corporate environmental reporting from around the world. Although this list is by no means exhaustive, is does give a flavour of the number and type of organizations involved in promoting developments in this field[45].

The quantitative approach to reporting (Table 2.2) also developed in the early 1990s with leading examples coming mainly from experiments by companies in mainland Europe. This type of reporting includes the so-called Teutonic model of disclosure which involves an attempt to capture what companies take in ('inputs') and what they produce ('outputs') to show the company's net impact on the environment (see, for example, *The Economist*, 1993b). Some of the more well-known examples include the Ökobilanz (environment report/eco-balance) developed in Germany, Austria, Denmark and Switzerland and influenced considerably by the work of the Institutes of Environmental Research in Economics (IÖW) in Germany and Austria (see, for example, FEE, 1993; Jasch, 1993). One of the best known and earliest published reports of this type of reporting was provided by the Danish Steel Works Ltd (Det Danske Stålvalseværk A/S) in its 1993 annual report which included a set of 'Green Accounts' containing a mass balance (input/output) analysis of the company's steel making operation (Bank-Jorgensen, 1993). The third type of report referred to in Table 2.2 is the least common, due perhaps to the difficulties involved as well as the sensitivities associated with internalising costs that are presently borne by society. One of the most widely reported experiments in this area in the early 1990s was by the Dutch consulting and electrical engineering firm BSO/Origin (Huizing and Dekker, 1992). In its 1991 annual report, BSO/Origin presented a set of financial statements, which, although seriously flawed (Gray *et al*., 1993), provides an estimate of the 'environmental value lost' (as opposed to value added) arising from the company's activities, which are deducted from the financial gain from economic activities (i.e. its net profit) to arrive at a figure for 'net added value'.

In addition to the three types of environmental reporting shown in Table 2.2 above, there are also other more specific types of reporting, such as compliance-based reporting and product focused reporting (ACCA, 2001). Examples of compliance-based reporting typically require reporting on the level of compliance with consent limits and pollution permits, a feature of heavily regulated sectors such as the water and electricity industries in the UK. In the US, companies are required under the US EPA's Toxic Release Inventory (TRI) regulations to publish lists detailing in physical quantities their emissions of substances listed on the TRI. Product focused reporting is rather uncommon but one example is that of Volvo (Sweden)

which produced a detailed environment report for one specific Volvo model (ACCA, 2001). In addition, developments in triple bottom line reporting (Elkington, 1997; GRI, 2000, 2002) in the late 1990s meant that a number of companies were moving towards providing detailed information on economic, environmental and social issues in a single report. The late 1990s also saw developments in social and ethical reporting (ISEA, 1999) through which companies may report environmental issues. However, in the context of the present study, the most significant development was the increase in the number of stand-alone environment reports by large European companies (see, for example, KPMG, 1992, 1993, 1996 and 1997a; KPMG/WIMM, 1999, 2002; see also Kolk *et al*., 2001 – the results of these surveys are addressed in more detail in Chapter 3). In the Netherlands, a survey of 263 Dutch companies by KPMG Environmental Consultants (1998) provides evidence of the increasing popularity of environment reports. Although not selected on any systematic basis, of the 263 companies surveyed, 108 (41%) had published an environment report in 1997 (41%), which compares with 99 (38%) reports in 1996 and approximately 65 (25%) in 1995. However, these figures are somewhat distorted by the fact that only 13 (11%) of the 108 environment reports were at corporate level (i.e. for the company's worldwide operations), the rest being reports at site, regional or European level. The largest number of reports was at subsidiary or site level (65%). These results are interesting in that they suggest that most Dutch companies are focusing on reporting at local level, which is consistent with the new Dutch regulations on environmental reporting (see Section 2.8 below) that came into force in the year 2000. Drieënhuizen (2001a, b), however, reports that a growing number of Dutch companies began publishing voluntary environment reports long before the new Dutch regulations made it compulsory. Drieënhuizen suggests a number of different reasons for this, the prime ones being legitimacy (i.e. improved public acceptance of the company), particularly in the case of the chemical industry and the growing acknowledgement of public accountability towards a broad range of stakeholders. Others (see, for example, DTTI, 1996; KMPG, 1997b) offer a similar interpretation for the rise in European corporate environment reports, suggesting it is due to a combination of stakeholder pressure and statutory requirements as well as a desire to present a positive image in an era when 'going green' is seen as a necessary adjustment to changing consumer tastes and fashions. These different influences probably partly explain the present state of affairs which is largely a 'free for all' with little sign of a dominant approach emerging. As noted by KPMG/WIMM (1999, p.9), "In spite of mounting experience with reporting, the debate continues about what should be reported and how, and whether standardisation is possible or even desirable."

2.7 Regulatory, quasi-regulatory and supra-national influences in the 1990s

The variety of reporting referred to above has been influenced by cultural factors such that particular forms of environmental reporting develop in different parts of the world. However, the source for much of the impetus which forced environmental issues to the top of the European business agenda in the 1990s is argued to have come from the activities of a variety of regulatory and quasi-regulatory bodies that sought to make environmental reporting part of mainstream, regulated company reporting practice (Gray *et al*., 1996)[46]. Supra-national influences on CSR may be classified into three broad categories (Gray *et al*., 1996):

(i) international governmental and quasi-governmental organizations (e.g. the European Union (EU), the United Nations (UN), the Organization for Economic Cooperation and Development (OEDC) and the World Trade Organization (WTO);
(ii) international business organizations (e.g. the International Chamber of Commerce (ICC)); and,
(iii) international non-governmental organizations (e.g. Amnesty International, Friends of the Earth (FoE), Greenpeace and Oxfam).

The influence of international governmental organizations on CSR is inseparable from the *raison d'être* of that organization. The World Trade Organization (WTO), for example, whose primary goal is to ensure that trade flows as 'freely' as possible between nations at a global level, has a more focused agenda compared to that of the EU, the EC and the UN which have generally been more concerned with social issues such as conditions of employment, consumer protection and the state of the natural environment[47]. International business organizations and international NGOs clearly have a more focused agenda, being more in the nature of lobby organizations and social activist groups. Lobbying in this context has been defined as any attempt by individuals, public agencies or private interest groups to influence the decisions of government (Gilpin, 1996). Lobbying of this kind is an inevitable part of any political system and indeed, when it exists in the form of formal presentations to members of parliament and government ministers, may be considered a valuable aspect of democracy. However, problems arise where lobbying is reinforced by the support of funds, threats, whether direct or indirect, bribery, or the offer of other forms of financial assistance. In these circumstances, the absence of a level playing field, particularly where funding from 'big' business is involved, can lead to highly undesirable social and political consequences. This issue is returned to in later chapters of this thesis, particularly Chapter 7.

International influences on CSR from international governmental organizations can be both positive and negative, depending on where economic interests are placed in relation to issues of human welfare, social justice and environmental protection. The EU, through the EC, and in deference to the Treaty of Rome (1957), has played a key socio-political role in this context through its concern with improving social policy and environmental protection (Gray *et al*., 1996)[48]. Two important EU-led initiatives in this area are: (i) the Fifth Action Programme on the Environment *Towards sustainability: A European Community Programme of Policy and Action in relation to the Environment and Sustainable Development* (CEC, 1992, Vol. II); and, (ii) the EU's voluntary regulation, the *Community eco-management and audit scheme*, commonly known as 'the EMAS regulation' (CEC, 2001a). The EU began its environmental action programme with the *Fifth Action Programme on the Environment* (see, for example, Bebbington, 1993). The *Fifth Action Programme* had important implications for the accountancy profession, proposing as it did, *inter alia*, a redefinition of accounting concepts, rules, conventions and methodology in 'getting the prices right', a goal which involved ensuring that the full cost of the consumption of goods and services and the use of environmental resources was fully reflected in market prices (see, for example, in an accounting context, Bebbington *et al*., 2001; FEE, 1993, 1995). In addition, the *Fifth Action Programme* included specific proposals for business enterprises to disclose: (a) in the annual report, the organization's environmental policy and activities, and the effects thereof; and (b) in the financial statements, (i) the organization's expenses on environmental programmes, including a clear definition of such expenses; and (ii) provisions for environmental risks and

future environmental expenses. The EMAS regulation, which first came into effect in July 1995, has as its principal aim the promotion of environmental performance improvements in industrial and other activities (see, for example, FEE, 1993, 1995; Gray *et al*., 1996; Starkey, 1998)[49]. The EMAS Regulation's importance in an accounting context lies in its requirements, *inter alia*, for participating companies to establish environmental protection goals, to report on their environmental performance in terms of these goals and for this report ('environmental statement') to be examined and externally verified by an 'accredited environmental verifier'[50].

One other supra-national, quasi-governmental organization that has perhaps had considerable *positive* influence on international trends in CSR, and environmental reporting in particular, is the United Nations (UN), notably through the UN Environment Programme (UNEP). As early as June 1972, the UN organised the first First-World international conference on the environment in Stockholm, Sweden (*UN Conference on the Human Environment*) which resulted in a declaration on the human environment, the establishment of an extensive programme of international action and UNEP, the latter being charged with implementing the recommendations of UN environmental conferences (Gilpin, 1996). This has been followed by other important initiatives under the UN, including the publication by the *World Commission on Environment and Development (the Brundtland Commission)* of its report *Our Common Future* (UNWCED, 1987), the Third-World *Environment Conference on Environment and Development* held in Rio de Janeiro, Brazil in June 1992, known as the 1992 Rio de Janeiro Earth Summit, which resulted in *The Rio Declaration on Environment and Development*, the adoption of *Agenda 21*, the creation of a *Commission for Sustainable Development* and the adoption of the *Convention on Protecting Species and Habitat* (known as the *Convention on Biological Diversity*) and the *Convention on Climate Change* (Gilpin, 1996)[51].

In the context of corporations and their impact on the environment, the UN has been particularly concerned with encouraging transnational corporations (TNCs) to give greater attention to regulatory and disclosure aspects of reporting on environmental performance (see, for example, Bebbington and Gray, 1995). Such concerns have appeared through the work of UNEP and the United Nations Centre on Transnational Corporations (UNCTC), which has maintained constant pressure on national governments and TNCs to take environmental regulation and disclosure issues more seriously[52]. The UNCTC's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (UN CTC ISAR)[53], a committee of the UN's Economic and Social Council turned its attention to the disclosure of environmental issues in annual reports in 1990. UN CTC ISAR produced two noteworthy reports, the first in 1990 and a second in 1991. The report in 1990 (UN CTC, 1990) included a recommendation that enterprises should disclose their environmental policies and programmes in their annual reports. All but one of the governments that responded agreed to ISAR's recommendation but comments from industry were far from supportive (Collier *et al*., 1993). In relation to the second report by ISAR in 1991 (UN CTC, 1991), an agenda paper of that time (reference E/C.10/AC.3/1991/5) contained a review of regulations concerning environmental disclosures in ten countries (Brazil, Canada, the Federal republic of Germany, India, the Netherlands, Norway, Sweden, Switzerland, the UK and the USA). As part of its review, ISAR produced a detailed set of

recommendations for accounting and reporting of environmental measures by business enterprises (Table 2.3).

Table 2.3
ISAR recommendations for accounting and reporting of environmental measures

Companies should disclose the following:
► A discussion about the type of environmental issues that are relevant to the business and its industry
► A statement as to what formal environmental policies and programmes had been adopted by the firm and what improvements had been achieved
► Information about emission targets and performance and the extent to which measures are being taken as a result of government legislation and how far the requirements are being achieved
► Any material legal proceedings and known potentially significant environmental problems
► The financial or operational effect of environmental protection measures on the capital expenditure programmes and earnings of the business for the current period as well as future periods (e.g. in relation to clean-up and restoration costs)
► Where material, amounts charged to operations in the current period and the current and accumulated capitalised relating to environmental protection
► The company's policies for accounting for environmental protection measures in relation to matters such as the recording of liabilities and provisions, setting up catastrophe reserves out of retained earnings and disclosing contingent liabilities

Source: UN CTC ISAR (1991).

More recently, the UN, through UNCTAD, has also been at the forefront of developments in relation to the question of how to regulate the reporting of environmental issues. In 1997 the UN published *Environmental Financial Accounting and Reporting at the Corporate Level* (UNCTAD-ISAR, 1997), a position paper which contained draft accounting guidelines on accounting and reporting of environmental costs and liabilities in the financial statements, written to assist enterprises, regulators and standard-setting bodies in determining best practice in this field. The 1997 report includes recommendations for the reporting of non-financial performance data via the annual report to shareholders and reviews best practice in relation to the measurement and communication of environmental performance via environmental performance indicators (EPIs). The 1997 report was synthesised from two background papers, *Accounting and Reporting for Environmental Liabilities and Costs within the existing Financial Reporting Framework* (CICA, 1997a) and *Linking Environmental and Financial Performance: A Survey of Best Practice Techniques* (UNCTAD, 1998). More recently, in February 1998, ACCA (1998) delivered a report to the UN recommending that company annual reports and accounts should contain a separate environmental review section, detailing a company's environmental policies, a summary of their legal compliance status and a review of their actual environmental performance.

However, despite these inititiatives, efforts by international governmental organizations to increase corporate accountability in relation to social and environmental issues have been described as "… desultory, scarce and fairly ineffectual…" due to the activities of international business in preventing their development (Gray *et al*., 1996, p.133)[54]. Ironically,

at the same time, international business organizations have been active in promoting their own initiatives in the area of corporate environmental reporting. These initiatives are, generally speaking, a combination of voluntary guidelines on issues relating to matters such as environmental management and environmental reporting and normally emanate from lobby organizations representing a particular industry or employers as a whole. Proposals from industry which deal specifically with environmental reporting have come from a number of private sector bodies, notably[55]:

(i) *The International Chamber of Commerce (ICC)*, which launched a 16-point charter *Business Charter for Sustainable Development* in 1991. Signatories to the charter, which comprise over 1,200 companies and organizations, are required to commit themselves to examine and reduce their environmental impacts. Principle 16 of the charter refers to reporting but contains no stipulations either as to the form or content of such reporting, only that the company should provide appropriate information to the board, shareholders, employees, the authorities and the general public periodically;

(ii) *The World Industry Council for the Environment* (WICE) which published an environmental reporting matrix in *Environmental Reporting, A Manager's Guide* (WICE, 1994) which was intended to encourage companies to become more open in relation to their environmental policies, practices and performance. WICE was initiated by the ICC (see above) in 1993;

(iii) *The World Business Council for Sustainable Development (WBCSD)* - WICE (see above) merged with the Business Council for Sustainable Development to form WBCSD. WICE's proposals on environment reports (see above) were superseded by the WBCSD's Sustainable Development Reporting project[56]. In 2000, the WBCSD published *Measuring Eco-efficiency – A Guide to Reporting Company Performance* (WBCSD, 2000) which provides a framework for measuring and reporting on eco-efficiency (i.e. the linking of environmental and economic goals) and includes a set of definitions, principles and indicators;

(iv) *The European Chemical Industry Council (CEFIC)*, the representative body for the European Chemical Industry, which published its *Guidelines for Environmental Reporting* in 1993 (updated in 1998) as part of the international chemical industry's *Responsible Care* programme, an industry-based voluntary code which provides principles and guidance to companies in the chemical industry for behaving 'responsibly' in relation to employees, neighbours, the environment and other industries[57]. The updated (1998) publication provides a more detailed set of environmental, health and safety (EH&S) performance reporting guidelines, including 16 'core parameters' for environmental, health and safety performance measurement designed to enable a comparable, quantified assessment of performance by the chemical industry at national and European levels; and,

(v) *The Public Environmental Reporting Initiative* (PERI, 1993), an organization established in 1993 by nine North American multinational corporations (Amoco, Dow Chemical, DuPont, IBM, Northern Telecom, Phillips Petroleum, Polaroid, Rockwell and United Technologies). In 1994, PERI published a set guidelines on environmental reporting comprising a set of nine core components, although organizations are free to choose the format and style and to provide as much detail as they wish[58].

The motivations for these initiatives are complex and varied but there does appear to have been a concern with promoting self-interest. For example, KPMG (1994) report that in the UK many of the trade and industry associations were already active in defining the environmental information which should be reported for that industry. In one case, the WICE guide on environmental reporting (WICE, 1994) states (as quoted in Gray *et al*. 1996, p.134) that "… it is up to individual enterprises to determine which of these suggestions are in *their best interests*" (emphasis added). Gray *et al*. (1996) suggest that initiatives from international business are primarily motivated by a concern with improving profitability, legitimisation of business activities and avoidance of mandatory reporting requirements. Nevertheless, the PERI guidelines on environmental reporting do indicate a wider agenda, encouraging companies not only to recognise the importance of reporting on employees' education and reward programmes but also to involve stakeholders on environmental issues. To date, however, *The CERES Principles* (CERES, 1992), developed by the Coalition for Environmentally Responsible Economies (CERES), an independent non-governmental organization formed to promote environmentally responsible corporate behaviour in the US following the Exxon Valdez disaster in 1989, probably represent the toughest set of environmental reporting guidelines. The CERES Principles were developed by CERES on behalf of the Social Investment Forum, a group of 325 socially-concerned bankers, brokers, analysts and others. The CERES Principles have since been renamed *The Valdez Principles*.

More recently, there has been the emergence of a new form of international organization representing a hybrid of the three categories described above, drawing its membership from business and their advisers (i.e. consultants), government, NGOs and other sections of society. Two such organizations in particular, the Global Reporting Initiative (GRI) and the Institute of Social and Ethical Accountability (ISEA)[59], may come to have a significant socio-political impact upon the future direction of both CSResp and CSR in Europe and beyond[60]. Another likely source of significant influence in this area are mandatory corporate environmental reporting requirements. These are reviewed in the following section.

2.8 International mandatory corporate environmental reporting requirements

From the early 1990s, mainly as a result of both the EC's Fifth Action Programme and the EU's EMAS regulation (see Section 2.7 above), European business and the European accountancy profession, through its representative body FEE, began to take notice of the implications of the EU's environmental agenda. This agenda has important implications for accountants given that it "…placed accounting and accountants at the very heart of the environmental debate" (Gray, *et al*. 1996, p.167). More significant in the context of regulation, the EC's agenda dovetailed national policies of the governments of EU Member States. As Gray *et al*. (1996) state:

> *By the mid-1990s, regulations requiring corporate disclosure of both financial and non-financial details about the environment were emerging from Denmark, the Netherlands and the Scandinavian countries. This was providing an inexorable impetus to the inevitability of company environmental reporting* (p.169).

Regulatory developments are particularly important in the context of the present study, for a number of reasons. Firstly, this study looks, *inter alia*, at trends in CED from 1989 to 1995, a

period during which the EU's proposals in relation to environmental protection really began to take hold. Secondly, the companies included in the study are from Member States of the EU and were thus directly affected by these developments. Moreover, although most CED requirements came into force only in the latter part of the 1990s, a period of due process began much earlier and thus European companies, such as those domiciled or who had operations in the EU, were clearly 'on notice' as to the intentions of the EC and some EU Member States. Thirdly, environmental reporting is a key constituent of companies with operating sites registered under EMAS (see, for example, FEE, 1993, 1995). Given that some Member States, particularly Austria and Germany (see Appendix 1), have sought to promote the EMAS regulation, it is to be expected that this will drive the form and content of environmental reporting in these countries[61]. However, as indicated in Section 2.6 above, alternative forms of environmental reporting have developed in other Member States and in other parts of the world, leading to a variety of corporate reporting practices. Apart from the EMAS regulation (CEC, 2001a - see Section 2.7 above), which is entirely voluntary and primarily a quality management standard, the EC has issued no specific recommendations or guidelines on how EU companies should report externally to society on environmental issues through separate stand-alone environment reports[62]. The closest it has come in this respect is to publicly endorse a pilot study by the Centre for Environmental Informatics at the University of Sunderland, UK into environmental reporting by a cross-section of 88 primarily US and European companies to identify best practice and to evaluate the relevance and comparability of published environmental information (Jones, 2000). Although Jones adopted a restricted approach to CSR, the study concluded (not surprisingly) that (a) environmental reporting practices varied widely across companies and (b) the information provided in the annual report was of limited value to stakeholders because of a lack of useful, reliable and comparable information[63]. However, developments have been and are taking place in a number of individual countries which suggest that the European Commission may take a more active interest in seeking to standardize corporate external environmental reporting in the future. An overview of current national mandatory reporting requirements and voluntary initiatives in European and other major First-world countries at the present time (autumn 2003) is summarised in Table 2.4 below. More detailed information on these requirements is provided in Appendix 1.

A number of observations can be made on the basis of the information presented in Table 2.4. Firstly, there are currently no mandatory requirements for companies to provide stand-alone environment reports at *corporate* level, i.e. for the business organization as a whole. Three countries, viz. Denmark, the Netherlands and Sweden (see Appendix 1 for details) have introduced mandatory requirements for corporate environmental accountability at local (i.e. site) level. However, one of the main defects of environmental reporting at site or local level is that it fails to provide a proper context in which to be able to assess a corporation's *overall* environmental impacts and its efforts to counter those impacts. In much the same way as individual company financial statements are insufficient to appreciate the overall group performance and position as provided by consolidated financial statements, site-based environment reports are inadequate for a proper assessment of managerial competence and performance in relation to policies, procedures and controls for the corporate entity as a

Table 2.4
International corporate environmental disclosure and reporting requirements (as at August 2003)

Country	Annual report and accounts	Source	Environmental reports: Site-based	Environmental reports: Corporate	Source
Europe:					
Austria			○	○	EMAS
Belgium			●○	○	Article decree
Denmark	●	Financial Statements Act (Section 99) (2001)	●○	○	Green
Finland			○	○	EMAS
France	●	Government Decree no. 2002-221 (2003)	○	○	EMAS
Germany			○	○	EMAS
Greece			○	○	EMAS
Ireland			○	○	EMAS
Italy			○	○	EMAS
Luxembourg			○	○	EMAS
The Netherlands	○	Sections 400.117-123 Dutch annual reporting guidelines (2003)	●○	○	Enviro amende
Norway	●	Enterprise Act, 1989; Accounting Act 1998	○		NS 944 (NSF, 2
Portugal			○	○	EMAS
Spain	●	Accounting Standard (2003); Environmental Disclosure Standard 437/98 (elec. utilities) (1998)	○	○	EMAS
Sweden	●	Environmental Protection Act 1969 (as amended)	●○	○	Annual
The UK	●	Combined Code (listed companies only)	○	○	DEFRA Reporti
Rest of the world:					
Australia	●○	Corporations Act Section 299(1)(f); AASB UIG 4 (1995)			
Canada	●	Canadian Securities Commission			
Japan				○	Ministr
USA	●	Securities and Exchange Commission (SEC) reg. S-K Items 101 and 103 (revised 1986); SEC Staff Accounting Bulletin 92 (1993); SFAS 5; SOP 96-1.			

Key: ● = Mandatory; ○ = Non-mandatory (i.e. voluntary or recommendation); EMAS = EMAS Regulation (CEC, 2001a).

whole (see, for example, Adams *et al*., 1998; Hibbitt and Kamp-Roelands, 2001, 2002a). Secondly, there is a strong predisposition towards voluntary environmental reporting via stand-alone reports at site and corporate level, notably through EMAS but also in certain countries such as Denmark, the Netherlands, Japan and the UK. The latter development is particularly important when seeking to understand why some national governments choose to go down the voluntary rather than the mandatory disclosure route (see, for example, Adams *et al*., 1998). Thirdly, five European countries, viz. Denmark, France, Norway, Spain and Sweden, have recently introduced specific environmental disclosure requirements in relation to the annual report and accounts. This financial environmental reporting development suggests that EU-wide changes to the provisions of the EU accounting directives may be necessary in order to fill a perceived disclosure gap. Fourthly, in the context of the present study's focus on CED by Benelux and German companies over the period 1989 to 1995, this review suggests that, with the exception of disclosures made in the statutory annual report in compliance with general accounting and company law provisions (see Table 2.1 above), relatively little, if any, environmental disclosure will be classified as 'mandatory'. Lastly, from a global perspective, European countries are not out of step with developments in other parts of the developed world. On the contrary, steps taken by countries such as Denmark, France, the Netherlands, Norway, Spain and Sweden place Europe at the head of the pack in terms of standards of required corporate environmental disclosure. However, in overall terms, this 'state of the world' review suggests that, for the time being at least, there is little political will or determination to *require* companies to be accountable to society for their composite environmental impacts outside the limited, economic confines of the statutory annual report. Movements towards mandatory environmental disclosure and reporting in relation to environmental performance issues and reporting at *corporate*– rather than site–level still appear to be some way off.

Recent experience in the Netherlands in this context provides a salient reminder of the socio-political nature of moves towards greater corporate environmental responsibility and accountability. The Dutch site-based environmental reporting regulations, referred to in Section 2.8 above and detailed in Appendix 1, were introduced on the back of an existing, extensive system of Dutch environmental regulations. However, following some major ecological disasters in the Netherlands in the early 1980s, the Dutch government came to regard the system as insufficient to protect the environment and started in the late 1980s to intervene in the market through new legislation on matters such as groundwater, hazardous materials and the 'polluter pays principle' which placed the onus of proof of innocence on the defendant (Huizing and Dekker, 1992). In 1988, the first national environmental investigation in the Netherlands led to the release of the *Nationaal Milieubeleidsplan* (National Environmental Plan, NMP, 1989) in 1989. The NMP was a significant document, containing many objectives, scenarios and instruments in relation to major environmental issues such as greenhouse gases. The NMP also stipulated the introduction of 'company-wide environmental control' (CWEC), a concept which had been developed following close cooperation between the Dutch government and industry. In the late 1980s and early 1990s, the Netherlands became involved in a serious debate on the exigencies of CWEC and other aspects of corporate environmental issues. These debates took place largely between the Dutch Government and three highly organized parties, i.e. the employers' confederations (representing the interests of employers), employees' federations (representing the interests

of employees) and environmental organizations (Huizing and Dekker, 1992)[64]. The debates were mostly about the extent to which government regulations should be introduced to control the activities of organizations, the employers' confederations stressing their own responsibilities for adequate environmental care, and the employee federations and environmental organizations arguing the need for government regulations (Huizing and Dekker, 1992). The employers' confederations were, perhaps not surprisingly, strongly opposed to the introduction of regulations, suggesting the voluntary inclusion of a separate environmental section in the directors' report or in the annual employee report (VNO/NCW, 1988, as referred to in Huizing and Dekker, 1992). There were also suggestions from the employers' organizations that relatively heavily polluting companies could also voluntarily publish a separate green report (VNO/NCW, 1990). Both sides took the same position in relation to the introduction of 'materials registration', a form of 'green accounting' which, similar to the Danish and German/Austrian approaches to mass balances, involved a materials balance sheet, a materials inflows and outflows statement, and the registration of particular materials. The environmental and employees' organizations argued for the legal introduction of compulsory materials registration for heavily polluting companies, with these registrations being audited by an accountant (VMD/SNM, 1988; FNV, 1990). The employers' organizations were against the idea on the grounds that materials registration was both impractical and superfluous (VNO/NCW, 1985).

The Dutch government although unconvinced about the benefits of green accounting, did adopt a proposal of the environmental and employees' organizations in relation to the external auditing on CWEC information (Kik and Janssen, 1989). As a result, CWEC remained a central plank of Dutch public environmental policy throughout the 1980s. The employers' organizations continued to lobby the Dutch government on the benefits (to business) of the internalisation of their responsibility for environmental issues, which included improved public image, commercial profitability from attracting customers who preferred environmentally-friendly products, and the avoidance of unilateral imposition of regulation by government. The end result of all this was the indefinite postponement of legislation on CWEC and thus what might be considered a successful lobbying campaign by the employers' organizations[65]. In contrast, the environmental and employees' organizations were against legislation on CWEC preferring greater accountability of corporate information on environmental issues and legislation only in relation to the CWEC-elements which dealt with external reporting, materials registration, green accounting and external auditing (Huizing and Dekker, 1992). This tension remained unresolved with the Dutch environment ministry (VROM) funding various research and experimental projects in the experimental period up to 1995 aimed at clarifying more clearly which CWEC-elements could and needed to be legislated for (Huizing and Dekker, 1992).

Huizing and Dekker (1992) suggested three possible options for the adoption of a formalised approach to CED in the Netherlands at the time: (i) a mandatory requirement for companies to publish an annual 'green' (i.e. environmental) report, on the basis that voluntary initiatives result only in the disclosure of information which serves the public relations and strategic interests of business; (ii) allowing companies to continue with their voluntary disclosure of environmental information; and, (iii) a series of initiatives from the Dutch employers' confederations in cooperation with the employees' and environmental organizations. Evidence of Dutch reporting practice at that time seemed to support the first option. Knoops

and Pupping (1990), for example, report that of their content analysis of environmental disclosures in the directors' report of the statutory annual report of 116 companies listed on the Amsterdam Stock Exchange, such disclosures generally referred only to the positive impact of these companies' activities on the environment. Other research suggested that Dutch companies were slow to implement CWEC and that most Dutch companies had still to introduce an environmental policy (Moret Ernst and Young, 1990). However, Huizing and Dekker (1992) concluded that legislation was premature, preferring the third option, which was also favoured by the Dutch government, of private voluntary inititiatives on the grounds that, *inter alia*, this approach had proved successful in the case of employee reporting.

The CWEC-experiment ran until 1995, at which time the Dutch government decided to adopt a new law on environmental reporting for certain Dutch companies (as described in Section 2.8 above and Appendix 1). The Dutch government reasoned that a targeted approach to mandatory, site-based environmental reporting involving a number of basic requirements for certain companies was the most appropriate towards achieving a minimum quality standard of corporate environment reports (EAAR, 1996). However, the opportunity to require mandatory environmental reporting at *corporate* level was lost under strong lobbying from the corporate sector. One problem with a site-based approach, such as that adopted in the Netherlands (and under the first EMAS Regulation and ISO 14001), is that reporting on measures taken to reduce environmental impacts in one line of business or geographical area may obscure more serious negative environmental impacts in another line of business or geographical area, which go unreported (Adams *et al*., 1998). As a consequence, the overall quality of environmental reporting by Dutch companies under the new regulations is likely to be limited, lacking genuine transparency or accountability to the wider society. One possible countervailing factor in this scenario is the influence of the Dutch Environmental (recently re-named 'Sustainability') Reporting Awards Scheme (ERAS), which may encourage more Dutch companies to report on the environmental impacts in relation to their global operations rather than just for one region or operating site. Developments such as ERAS are likely to lead to a degree of convergence within Europe towards some form of standardised environmental reporting in response to stakeholder pressure for global 'benchmarks' of corporate governance and accountability (see for example, Cadbury, 2000; Commissie Corporate Governance, 1997; Frederick, 1999; OECD, 1999a, 1999b; Short *et al*., 1999; Tricker, 2000; Turnbull, 1997; Witherell, 1999).

Recent estimates put the total number of stand-alone environment reports produced world-wide at around 2,000 with reports known to have been published in 29 different countries (ACCA, 2001)[66]. The future thus seems to be one in which corporate environmental reporting and environmental accounting throughout the world, but particularly in Europe, will be a key component of corporate external communications. More recently, reporting awards schemes such as ERAS have been extended into the area of social and ethical accountability and triple bottom line (TBL) reporting. In the UK, a social reporting awards (SRA) scheme was launched in 1999 by the ACCA and the Institute of Social and Ethical AccountAbility (ISEA) with the aim of encouraging good practice in reporting the social issues that face all organizations and to encourage non-reporters to start the process of measuring, managing and communicating their social effects. In 2001, the ACCA launched the first 'sustainability' reporting awards scheme, 'The ACCA Awards for Sustainability Reporting' (SusRA), to reward companies who report on their environmental, social and economic impacts on

society. In 2002, following the ACCA's lead, the European Reporting Environmental Reporting Awards (EERA) scheme was re-named the European Sustainability Reporting Awards (ESRA, 2003) in recognition of the shift in corporate reporting away from purely environmental issues towards triple bottom line (TBL) reporting on economic, environmental and social issues[67].

However, despite these laudable developments, any perception that companies are embracing with open arms the opportunities for pioneering developments in corporate environmental reporting is perhaps misplaced. Environmental reporting was, and still is, a relatively minor activity for the corporate sector as a whole. Moreover, the vast majority of such reporting is highly selective and tends to be self-laudatory, being largely 'public relations' driven with a virtually universal reluctance to disclose the more prickly and disturbing aspects of the impact of industrialism on the environment (see, for example, Deegan, 2002; Deegan and Gordon, 1996; Harte and Owen, 1992; KPMG/WIMM, 2002). Environmental reporting has also tended to be fragmentary and *ad hoc*, with most disclosures being partial, lacking integration into a composite whole (Adams *et al*., 1998). The extent to which corporations are *required* to be publicly accountable for their environmental impacts is still very minimal, such that the vast majority of CED remains voluntary.

2.9 Summary and conclusions

This chapter has provided a brief overview of some of the more recent practical and practice-based developments in CSR in general and CED in particular. A number of conclusions may be drawn from this review. Firstly, the *practice* of CSR is not new but has a long history, dotted along the way with examples which have come to represent 'milestones' in the development of CSR through to the present day. Secondly, the period covered by the present study (1989 to 1995) is one in which CED came of age, particularly through voluntary, stand-alone, dedicated environment reports. However, such reporting has been and remains mainly a phenomenon of large corporations (ACCA, 1998; Cowen *et al*., 1987; KPMG/WIMM, 2002; Ljungdahl, 1999a; Trotman and Bradley, 1981). In its report on the 1997 UK ERA scheme (ACCA, 1998), for example, the panel of judges concludes that it is still the very largest companies which are setting the pace for environmental reporting at the 'blue-chip' level (for a study of environmental reporting by medium-sized companies, see for example, Jackson and Owen, 2000). Thirdly, there is a growing, though not particularly pronounced, trend within a number of European countries towards mandatory environmental disclosure both within the statutory annual report and in the form of site-based, stand-alone environment reports. Fourthly, there is also a growing trend amongst the larger companies in voluntary stand-alone environment reports which cover the firm's entire operations and activities.

The latter trend is perhaps one of the more significant developments in corporate environmental reporting in Europe since the end of the 1980s. The intriguing question is why companies bothered to publish these reports at all, especially given the fact that there is a lack of any obvious demand for environment reports from major stakeholders (see, for example, Danish Environmental Protection Agency, 2000; Ljungdahl, 1999b) The ACCA (2001) identify a number of tangible benefits which support the 'business case' for environmental reporting, including: (i) strengthening stakeholder relations; (ii) demonstrating an holistic approach to environmental responsibility to stakeholders; (iii) competitive advantage from

being the market leader and from informing supply chains of environmental credentials; and, (iv) public recognition for corporate accountability and responsibility. However, whilst instrumentalist arguments may exist for doing *something*, these do not necessarily explain management behaviour. The *potential* motives for and influences on environmental disclosure and reporting are many, varied and complex. Attempts to understand the motives underlying CED are examined in the next chapter which explores prior research that has been concerned with providing insights into the nature and causes of CSR/CED.

Notes

1. For examples of this conventional approach to both the practice and research of environmental accounting and reporting see Schaltegger (1996) and Schaltegger and Burritt (2000).
2. The 'social audits' referred to here are what Gray (2001, p.9) describes as "… those public analyses of accountable entities undertaken (more or less systematically) by bodies independent of the entity, and typically without the approval of the entity concerned." Such third-party audits, the standard for which was set by Social Audit Ltd. in the 1970s, are seen as providing a valuable, democratic means by which to hold an entity to account, perhaps more so in cases where the entity concerned does not want to be held to account (see, for example, Bauer and Fenn, 1973; Geddes, 1992; Gray, 2001; Henriques, 2001; Medawar, 1976).
3. The latter perception is itself based on the belief that the prime responsibility of business executives under the social system (capitalism) is to make profits for their shareholders (for an eloquent exposition of this view, see Freedman, 1962 and 1970), supported by the trickle-down theory which (though *unproven* in practice) argues that (in John F. Kennedy's words) 'a rising tide raises all boats', i.e. that all sections of society benefit.
4. For more details on the relationship between business and society in the context of social accounting and accountability, see, for example, Gray, 1990a, b; Gray *et al*., 1996, 1997; Gray and Bebbington, 2001; Mathews, 1993; Medawar, 1976.
5. The central issues being referred to here, which, notwithstanding their enormous importance, are outside the scope of the present study, include political democracy, accountability, ecological sustainability, economic power, the distribution of wealth, etc. Traditional accounting and finance largely ignore such issues ostensibly because modern capitalism based on a system of 'free markets' and the workings of the 'invisible hand' when subsisting within a political system based on liberal democracy, is seen as the 'best available'. As William Churchill stated in a speech to the British House of Commons on 11 November, 1947: "No one pretends that [liberal] democracy is perfect or all-wise. Indeed, it has been said that democracy is the worst kind of Government except all those other forms that have been tried from time to time" (OUP, 1979, p.150). Similarly, John Maynard Keynes remarked: "I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself is in very many ways extremely objectionable" (OUP, 1979, p.295). Whilst capitalism has certainly delivered on its promise in terms of what Lord Robbins (1932) defined as the *efficient* allocation of [money] resources amongst alternative ends, the rub lies in relation to issues of ecological sustainability, social justice, accountability and democracy. In short, capitalism delivers efficiency, not democracy (Handy, 1998). In capitalist societies, one of the main protectors and enforcers of democracy and accountability are the laws governing how a society treats its people, the peoples of other nations and the natural environment. However, the extent to which national governments are able and willing to introduce and enforce laws to protect democracy and to protect the planet may be severely compromised by its economic objectives, particularly those objectives which are in direct opposition to democracy and ecological sustainability. Hence, although economic development and the pursuit of economic growth may deliver certain desirable ends such as market price efficiency, technical innovation and product development, it is no guarantee of social justice or of environmental protection and *cannot* deliver sustainability (see, Hibbitt, 2001).

6. Sustainability (i.e. *ecological* sustainability) is an enormously wide-ranging, complex and difficult subject to grasp, so much so that it is unlikely that any one person fully understands it. Those wanting to gain a basic understanding of some of the issues in a business and accounting context are referred to Bebbington and Thomson (1996). Those wishing to explore the debate concerning the sustainability (or otherwise) of business are referred to the following list of selected references which provide a useful, but necessarily partial, introduction to an extremely complex and challenging issue: Bebbington and Gray, 1996, 2001; Beder, 1997; Bucholz, 1991; Elkington, 1997; Elkington & Hailes, 1998; Gray, 1990b, 1991c, 1992; Gray and Bebbington, 1998, 2000; Gray *et al*., 1996, 1997; Handy, 1998; Hawken, 1993; Hawken *et al*., 1999; Hibbitt, 1999, 2001; Howes, 1999; Rubenstein, 1994; Stone, 1995; Welford, 1997.
7. However, it would be wrong to internationalise this 'waxing and waning' of corporate voluntary reporting of social responsibility issues as not all societies experienced the same highs and lows in relation to CSResp. For example, whilst the patterns were broadly similar in the case of the United States, the United Kingdom and Australasia (having similar political and economic ideologies), this is not the case with many of the northern European and Scandinavian countries, where social responsibility was never 'off' the political agenda (Gray, *et al*., 1996). Moreover, as Gray *et al*. (1996) point out, anyone who attempts to find some kind of "… neat and tidy history which systematically chronicles the developments of the organization-society relationship, the emergence and development of CSR and the accounting profession's response, will be disappointed" (p.81). In addition other cultures, such as those to be found in China, Africa and India, provide a salient reminder that 'Western capitalism' as a social system is but one amongst many. What 'we' in the 'developed' Western world perceive of as CSR, may be viewed, developed and articulated quite differently in other cultures.
8. Environmental laws and regulations may be seen as one outcome of these debates. In a political context, most developed (and many developing) nations have a long history of environmental regulation, beginning in some cases as long ago as the early 1900s. For a useful overview of the evolution of state environmental policy in individual countries, see, for example, Gilpin, 1996. Many European countries also operate various national pollutant release and transfer registers which, in some cases, require companies covered by environmental permit requirements to submit regular information on their environmental performance to the appropriate regulator (KPMG, 1997a). However, unlike in the US, much of this information is not publicly available under a statutory right of public access to information.
9. Public concern with the social and environmental impact of business activities in the US led to the passing of over 100 pieces of social and environmental legislation in the 1960s and 1970s including the Clear Air Act, the Federal Water Pollution Control Act, the Equal Opportunity Act and the Occupational Health and Safety Act (Heard and Bolce, 1981). These legislative programmes enjoyed cross-sectional support from a broad section of US society, reflecting increased environmental awareness and social expectations amongst citizens and consumers (see, for example, Never, 1971).
10. Guthrie and Parker's (1989) study of the social disclosure practices of BHP, one of Australia's largest corporations principally involved in the mining and steel industries, over the period from 1885 to 1985 provides an interesting analysis of how these practices changed over time. Prior to the 1950s, they found that environmental disclosures were totally absent from the corporation's annual reports. Around 1950, environmental disclosures started to appear in BHP's annual reports, after which time they disappeared before returning again in the early 1970s and 1980s but remained at a relatively low level, peaking in the 1970s. Guthrie and Parker (1989) suggested that this peak coincided with the time during which the Australian mining, steel and oil industries came under attack from conservationists.
11. Comprehensive social accounting reports were, as their name suggests, the most ambitious form of social accounting, attempting to measure the *full* impact of the organization on society in terms of economic, social and environmental aspects. The most comprehensive report of this kind in the US in the early 1970s was provided by Abt Associates, Inc, which appeared for the first time in 1971 as part of the company's annual report (Epstein *et al*., 1976). It is interesting to note the similarities between this approach and that of the Global Reporting Initiative (GRI, 2000, 2002) to 'triple bottom line reporting' almost 30 years later.

12. However, according to Dierkes and Preston (1977) most environmental policy statements were more in the nature of public relations documents being "… highly generalized and imprecise [containing] highly selective and incomplete data" (p.10). Dierkes and Preston (1977) refer to a few notable examples of formal corporate policy statements with respect to the environment, including that of Honeywell Corporation (a large US manufacturer of computers), Philips N.V. (the Dutch electronics firm which had by 1974 already established a 'Concern Pollution Control Committee') and Deutsche Shell AG (which, in its 1975 Annual Report/Social Report, provided an exact rank ordering of the company's objectives, as perceived by management, the profit objective being in third place).
13. Dierkes and Preston (1977) produced a detailed framework for environmental impact analysis for reporting various environmental impacts to stakeholders, including energy, air pollution, water pollution, solid waste disposal, noise, packaging and transport. Their proposed framework for systematic environmental impact analysis *avoided* the use of a single performance measurement, preferring to use a variety of measures (including absolute quantities, cost, percentages, description, time, weight, etc.) as befitted each impact, reflecting their view that "… we see no way at present, nor for the foreseeable future, to define a common denominator integrating the diverse measurements that are available and appropriate for the various environmental impacts to be covered" (p.15/16). This approach contrasts sharply with the GRI's (2000, 2002) a 'one size fits all' approach to triple bottom line (TBL) reporting.
14. Schreuder (1979) comments that, whilst a number of German companies had published social reports, they soon arrived at a consensus as regards their contents "… thereby seemingly concluding a very short period of experimentation" (p.109).
15. Practical developments in CSR by German companies tended to follow a middle course between the US and most other European countries in relation to the orientation of its social reports, stressing employee matters much more heavily than their US counterparts (Schreuder, 1979). However, unlike in France and the Netherlands, German companies also recognised other constituent groups in their social reports, such that the popularised term 'Sozialbilanz' was felt by some to be unfortunate, preferring the term 'socially relevant corporate report' (Schreuder, 1979). Many German companies have a long tradition of social reporting in the narrow sense of reporting on matters of personnel policy, such that the annual report often contains a separate section commonly titled "Sozialbericht" (social report). However, in the early 1970s, new forms of sozialbericht began to emerge which attempted to address a wider audience beyond those merely interested in financial information (Schreuder, 1979). The first social report to appear in Germany was published by STEAG A.G. in 1972, with STEAG A.G. and Saarbergwerke A.G. being the pioneers of the Sozialbilanz (Dierkes, 1979). STEAG A. G., an energy company, published a "Sozialbilanz" in 1971/72 which provided an account of the firm's performances and results for the total societal environment (Schreuder, 1979). Another German company, Deutsche Shell A.G., had published an 'annual and social report' since 1975, based on the goal-accounting approach which included the company's performance in relation to established goals and a set of social accounts which dealt with the company's relations with its personnel (Schreuder, 1979). The French experience with CSR was somewhat different, with Vogelpoth (1980) - as referred to in Huizing and Dekker (1992) - reporting that pre-law experiments were much more informative and much more promising that post-law practice, the latter being compliance-orientated with companies treating the minimum as required by law as the maximum.
16. The Club of Rome's first report *Limits to Growth* (Meadows *et al*., 1972) predicted the complete exhaustion of a number of scarce raw materials and a marked deterioration in the quality of the biosphere by the end of the 20th century as a result of the prolonged growth patterns in consumption and population in western and developing countries (see also, in this context, the Club of Rome's second report, *Mankind at the Turning Point*, Mesarovic and Pestel, 1975; *Beyond the Limits*, Meadows *et al*., 1992; *Blueprint for Survival*, The Ecologist, 1972). These predictions had a significant impact on the Dutch political market (Huizing and Dekker, 1992). However, the publication of the Brundtland Report *Our Common Future* (UNWCED, 1987), with its much more up-beat predictions as to the compatibility of economic growth with environmental protection and social justice ('sustainable development') led to a more optimistic Dutch

perspective, as set out in the *Nationaal Milieubeleidsplan* (National Environmental Plan, NMP, 1989) (Huizing and Dekker, 1992).

17. A classic example of this in the context of employee-related areas of CSR is the value added statement (see, for example, Burchell, *et al*., 1985; Meek and Gray, 1988), popular in the 1970s and 1980s but much less prominent today.
18. Pinkston and Carroll (1996) suggest that under a barrage of so many new laws and regulations, executives not only have to devote more attention to following the law, but also committing more financial resources to ensuring compliance with the law. As a result, they suggest executives' efforts are expended on their economic, legal and ethical social responsibilities with nothing left over for philanthropic activities. Pinkston and Carroll conclude that economic and legal corporate social responsibilities are 'required' of business, whereas ethical responsibilities are 'expected', with philanthropic responsibilities being merely 'desired' of business, noting "… what society 'desires' of business has become increasingly less of a priority for business" (p.205).
19. Union Carbide's chemical accident on 1 December 1984 at its pesticide plant on the outskirts of Bhopal, India, led to the release of a poisonous cloud of methyl isocyanate. The accidence resulted in approximately 4,000 deaths and 200,000 injuries (Feder, 1992). Accidents on this scale are rare but their long-term affect on the public image of the industry concerned can have significant implications in terms of regulatory costs and changes in firm value (see, for example, Blacconiere and Patten, 1994).
20. The Fédération des Experts Comptables Européens (FEE) is the representative body organization for the accountancy profession in Europe, grouping together 41 professional bodies from 29 countries (which include all 15 Member States of the EU, nine EU candidate countries and three member countries of EFTA) having a combined membership of 500,000 individuals (FEE, 2003a).
21. The fact that most CSR is still voluntary is an important political issue. It means, in effect, that the discharge of accountability by organizations to the demos is left to market forces, the implication being that 'the market knows best'. The problem with this approach is that power, and thus control, over what gets reported, and to whom, is left in the hands of those controlling the information and as such there is power asymmetry over that information within society. The fact that the accountancy profession, as one of the actors in society charged with 'serving the public interest', has yet to take CSR seriously, is an indication of its continued alliance with the interests of business, the premise being that by serving business it serves society.
22. The SEC's involvement in this area came about as a result of the US National Environmental Policy Act of 1969, which required that the SEC consider environmental effects in its disclosure requirements for US-listed companies (Jaggi and Freedman, 1986). However, it was not until April 1973 that the SEC issued SEC Release No. 33-5366, Compliance with Environmental Requirements, which required US-listed companies to disclose any material effects which compliance with environmental laws (requiring pollution abatement expenditure) may have on capital expenditure, earnings and the company's competitive situation (SEC, 1973). Unhappy with the SEC's position on this issue, US environmental groups brought a suit against the SEC demanding more extensive mandatory pollution disclosures. As a result, the SEC held public hearings which led to the SEC adopting a more aggressive stance in enforcing pollution disclosure requirements.
23. According to a 1998 study by the US Environmental Protection Agency (US EPA) (as reported in ENS, 2001), 74 percent of US-listed companies failed to adequately disclose the existence of environmental legal proceedings in their 10-K registration requirements. Recent empirical evidence provided by Chan and Milne (1999) suggests that company accountants adopt a short-term, avoidance strategy when it comes to the disclosure of negative environmental information on the grounds that it would increase exposure to environmental liabilities and future expenditures.
24. The Superfund Act, which became law on December 11, 1980, was passed by the US federal legislature as a means of cleaning up large chunks of contaminated industrial land in the US. The dumping of hazardous waste by US companies had been going on for several decades prior to the 1980s but the magnitude of the problem was only officially recognized through the US EPA's hazardous waste site designation and clean-up programme following the passing of the Superfund

Act (Rockness *et al*., 1986). The passing of the Superfund led to the US Federal Government having authority and responsibility to remediate spilled or dumped chemicals that were a hazard to public health or the environment (for more details of the provisions of the Superfund see, for example, Cahan *et al*., 1997; Weinberg *et al*., 1983). However, despite the sheer magnitude of the clean-up costs under the Superfund Act, for much of the 1980s US-listed companies were not reflecting these as provisions for future liabilities in their balance sheets but as contingent liabilities in the notes (and thus had no impact on reported profits or the balance sheet) where it was reasonably possible that a material liability had been incurred (Rockness *et al*., 1986). In 1989, the SEC issued additional regulatory guidance to potentially responsible parties (PRPs) liable for clean-up costs under the Superfund Act of 1980 - PRPs are defined as those parties jointly and severally liable under the Superfund Act for all costs necessary for evaluating and for cleaning up hazardous waste sites (Roussey, 1992). Under SEC *Financial Reporting Release No. 36* (SEC 1989, Section III.B) PRPs are required to indicate the effects of PRP status in the MD&A, with the effects to be quantified wherever possible (Roussey, 1992; Milne and Patten, 2002). In 1990, the SEC reached agreement with the US EPA under which the latter would release details to the SEC on PRPs so that the SEC could target environmental matters for disclosure enforcement (Gill, 1995; Roussey, 1992). Following its review and approval of routine filings in the mid-1990s, the SEC gave clear signals to the effect that it regarded the adequate disclosure of environmental risks and liabilities as being of fundamental importance to US investors (KPMG, 1996). The SEC took the unusual decision of sending out letters to US-listed companies informing them that their disclosures were not adequate and issuing a bulletin on the standard of disclosure it expected (SEC Staff Accounting Bulletin (SAB) No. 92 - SEC, 1993) requiring management to disclose any environmental problem of known significance unless it is able to conclude objectively that the problem is not reasonably likely to occur or that its consequences would not be material if it did (Fekrat *et al*., 1996).

25. In the Netherlands, the Raad voor de Jaarverslaggeving (The Dutch Council for Annual Reporting - CAR) issued recommendations (Section 400.117-123 of the Dutch annual reporting guidelines, revised 2003) on what companies should report on ethical and environmental issues in the annual report. Although not mandatory, recommendations issued by the CAR are expected to be followed and would be taken into account by a Dutch court of law when considering whether a company's annual accounts complied with company law.
26. The Recommendation (CEC, 2001b) has recently been underpinned by a new Directive (CEC, 2003) which inserts an amendment to the EU accounting directives as follows: "The annual report and the consolidated annual report are important elements of financial reporting … The information should not be restricted to the financial aspects of the company's business. It is expected that, where appropriate, this should lead to an analysis of *environmental and social aspects* necessary for an understanding of the company's development, performance and position" (CEC, 2003, Preamble 9, emphasis added). Articles 1.14 and 2.10 of the new Directive (CEC, 2003) stipulate the inclusion of environmental matters in the company's annual and annual consolidated reports, respectively. These mirror the Commissions' recommendations (CEC, 2001b) in relation to the disclosure of environmental matters in the statutory annual report which recommends, *inter alia*, the inclusion of disclosures concerning the reporting entity's policies and programmes, improvements made and protection measures taken in relation environmental issues where such issues are "… relevant to the financial performance and position of the undertaking or its development …" and which must provide "… a fair review of the development of the undertaking's business and position to the extent that environmental issues can directly affect it" (Annex, 4. Disclosures, paragraph 2).
27. At the present time (autumn 2003), implementation of the EC's Recommendation (CEC, 2001b) in Member States of the EU has been less than encouraging with only six countries (Denmark, Finland, France, Portugal, Spain and Sweden) taking steps to implement the provisions either in full or in part, of which only two (France and Finland) appear to be heading for full implementation.
28. In New Zealand, for example, the New Zealand Society of Accountants Accounting Research and Standards Board's Proposed Framework for Financial Reporting in New Zealand published in 1993, explicitly stated that the objectives of financial reporting are accountability, compliance and

decision-usefulness (Pratt and Allen, 1993). The framework gives implicit commitment to the principles of social accountability by recognising that financial reports are intended to meet the information needs common to a wide range of users who are unable to require or contract for the preparation of reports which meet their specific needs. However, ED-60 completely omits any mention of environmental accounting, adopting a conventional economic framework which effectively treats water and air as 'free goods' in the absence of any private costs (Pratt and Allen, 1993).

29. For the purposes of this study, accounting 'GAAP' refers to accounting 'practice', reflecting the author's preferred use of this term, and not accounting 'principles', the latter being more common to North America.
30. Several international accounting standards (IASs) are of specific relevance to environmental issues, notably IAS 36 on impairment of assets (IASC, 1998a), IAS 37 on provisions, contingent liabilities and contingent assets (IASC, 1998b) and IAS 38 on intangible assets (IASC, 1998c). IAS 37, for example, includes several environmental scenarios, such as de-commissioning costs, to illustrate the practical accounting for contingent liabilities and provisions. However, although the IASC has published several international accounting standards that lay down provisions and accounting principles that are relevant when dealing with environmental issues, little guidance is given which directly relates to such matters (CEC, 2001b). Moreover, there are currently no specific international financial reporting or auditing standards which deal explicitly with social, environmental or 'sustainability' accounting, reporting or auditing issues (ACCA/UNEP, 2002; Drieënhuizen *et al*., 1998).
31. Current and historical prices as recorded in corporate financial statements do not reflect the 'ecological truth', the use of natural resources and the environment (land use, clean air and water, etc.) being excluded from economic prices with the result that the environment is seen as 'cheap' and 'free' (Van Dieren and Van Swigchem, 1995). Until new forms of accounting are generated, company financial reporting remains a partial construction of reality, potentially sending the 'wrong' messages to those it is intended to inform.
32. In April 1975, for example, the US SEC, under court order, began hearing testimony on the possibility of broadening corporate disclosures by US listed companies to include matters of primarily social as well as financial concern (Epstein *et al*. (1976). Such disclosures were seen as reporting on corporate performance in relation to issues such as equal employment opportunity, environmental policy and other socially significant matters. This led to a number of studies in the US and elsewhere which proposed new systems for the measurement and reporting of social and environmental issues by companies (see, for example, CEP, 1975; Dierkes and Preston, 1977; Nikolai *et al*., 1976).
33. Nevertheless, in a later report published by the American Accounting Association (AAA, 1975b), its Committee on Social Costs suggested that the development of social accounting could involve three levels of measurement, ranging from the simplest (Level I, where an activity is identified and described, e.g. the identification of pollution materials being released into the atmosphere) to the most sophisticated (Level III, where an attempt is made to evaluate in financial terms the total costs and benefits of an activity to all stakeholders, including the general public) (AAA, 1975b, p55).
34. Herwitz (1974) refers to Schoenbaum's (1972) concern for disclosures to address civil liberties, environmental, health and safety issues, and consumer rights issues: "… disclosure has a role in regulating corporations as major centres in our society. Acceptance of this wider role of disclosure to any degree is to say that there is a direct relationship between corporate disclosure under the [US] securities laws and corporate responsibility. … The heart of the problem is getting at the impact of corporate behaviour on society, not only as to its financial affairs, but also in the area of civil liberties, the environment, health, safety and consumer rights" (Schoenbaum, 1972, as cited by Herwitz, 1974, p.63).
35. The ASSC's (1975) report was published amidst a series of attempts by UK Governments to require and encourage companies to report on their roles and responsibilities to the environment and the wider community. For a useful review of these attempts, see, for example, Derwent, 1989; Gray *et al*., 1987; Stray and Ballantine, 1996.

36. Prior to the publication of Gray's (1990a) seminal work, the environment slipped down the UK accounting profession's order of priorities. There were other reports in the intervening period but none which could be considered as potentially 'ground-breaking'. *Making Corporate Reports Valuable* (McMonnies, 1988), published under the auspices of the Research Committee of the Institute of Chartered Accountants of Scotland (ICAS), did raise the issue of environmental disclosure more widely, particularly within the accountancy profession. However, the report reduced the seven stakeholders in *The Corporate Report* (ASSC, 1975) to just four groups (equity investors; loan creditors; employees; and, the business contact group), thus excluding the general public and thereby a large section of the demos. More importantly, the proposals in the ICAS report were largely designed to provide information on how management discharged its stewardship responsibility to owners, this assessment being largely based on earnings information and entity performance rather than on environmental issues (Stray and Ballantine, 1996).
37. The French *bilan social*, enacted into French law in 1977, requires all firms with more than 750 employees to publish a social report. This report is required to include 94 indicators, many of which relate to environmental issues in the workplace (Dierkes and Coppock, 1978). For a review of the French *bilan social* from an environmental accounting perspective, see, for example, Christophe and Bebbington (1992).
38. It is interesting to note the parallels between current discussions surrounding environmental and 'sustainability' reporting and the social accounting debate in the 1970s. Then, as now, the opportunity for a re-appraisal of the organization of economic activity and the values underlying such activity presented itself to the accountancy profession. However, whether the accountancy profession is willing to 'grasp the nettle' and address the fundamental challenges presented by society's concern for the natural environment remains doubtful. As Houldin (2001) notes: "There still seems little likelihood of much in the way of introduction of specific environmental accounting standards …. Most accounting bodies believe that existing accounting standards, together with current exposure drafts, are generally adequate for the job" (p.199). See also, for example, Bebbington *et al*., 2001; Hibbitt, 1999.
39. For a review of current initiatives for international standard-setting in the fields of environmental reporting and the provision of assurance services, particularly in relation to the GRI Guidelines on triple bottom line reporting and the deliberations of the IAPC on assurance engagements in connection with corporate environment reports, see, for example, Drieënhuizen (2001a, b).
40. Although the ACCA ERA scheme has since been adopted in many other countries, it is not the only award scheme of its kind. A complete list of award schemes for environmental reporting is outside the scope of the present study but see, for example, KPMG/WIMM (1999, Appendix 1) for an illustration of some of the other award schemes around the world.
41. These developments follow in the footsteps of the ACCA's strategy in the UK. Following its founding of the UK Environmental Reporting Awards in 1991, the ACCA has introduced other reporting award schemes, notably the UK Social Reporting Awards in association with ISEA in 1999 and the UK Sustainability Reporting Awards in 2001. For a review of results of the ACCA's most recent reporting awards for environmental, social, environmental and sustainability reporting see ACCA (2003b).
42. North America was a particularly fertile ground for early experiments in environmental reporting. This has been suggested as being the result of regulatory and governmental pressures (Gray, 1990a; Gray *et al*., 1996). Indeed, comparisons between the USA and other parts of the world in relation to trends in corporate environmental reporting need to be seen in the context of a shift in the USA from voluntary environmental reporting in the 1970s towards an increasing emphasis on mandatory environmental disclosures in the late 1980s and early 1990s.
43. Developments in corporate environmental reporting in the 1990s left unanswered the many conceptual and technical difficulties that were troubling researchers and practitioners in the 1970s and 1980s in their quest for a generally accepted framework for social reporting. One possible reason for this might have been that an enormous amount of work was still required to overcome these difficulties and that such work would only have been fruitful if a social or legal consensus on corporate social responsibility had emerged (Brockhoff, 1979). The focus on environmental issues, rather than the full ambit of social issues, increases perhaps the chances of reaching some form of consensus.

44. Harte and Owen (1992) note that in the early 1990s UK companies were starting to use other, separate reports for disclosing social and environmental information. They also report that a handful of UK companies, notably BP and RTZ, had produced separate social reports and both British Steel and the UK subsidiary of Norsk Hydro had published separate stand-alone environment reports. However, at that time, the only example of a regular annual report of which they were aware was the annual Health and Safety Report of British Nuclear Fuels Ltd (Harte and Owen, 1992). The UK's annual Environmental Reporting Awards (ERA) scheme, established by the ACCA in 1991, provides an excellent source of material in relation to both developments in UK environment reports generally as well as examples of best practice during the 1990s.
45. Of the 44 organizations listed by KPMG (1997b), 25 are from business/industry, four are intergovernmental organizations, six are NGOs and not-for-profit organizations, four relate to government initiatives, three are accountancy bodies (FEE, IFAC, CICA) and one a representative of the investment community (the European Federation of Financial Analysts' Societies (EFFAS)).
46. The identification of international influences on CSR and the effects that such influences have on business organizations is far from simple. Moreover, there is no way of knowing for certain whether some of the more important and subtle influences at an international level have, to date, been identified. As Gray *et al*. (1996) state (original emphasis): "[M]any of the most important global influences on CSR may have arisen from very broad pan-national trends such as the relatively recent growth of international capitalism, international business and international capital markets" (p.128). Interestingly perhaps, the concerns of the financial community over possible economic risk issues do not appear to have been an influential factor in the escalation of corporate environmental reporting in the early 1990s. Although the financial community recognises environmental issues as affecting the financial value of companies and their abilities to meet obligations and to make profits (see, for example, EFFAS, 1994, 1996), they appear to have little interest in environment reports. DTTI (1996), for example, report that a number of surveys have concluded that the financial community, in particular brokers and stockbrokers, do not use corporate environment reports in their decision-making partly because of the fact that (a) they do not know how to 'price' that information and (b) they do not seem to know what information they need.
47. In connection with the WTO, it is perhaps interesting to speculate on the extent to which multinational businesses perceive the 'New World Order'. Dame Anita Roddick, founder of the Body Shop International Plc, in a BBC television interview on 11 October 2001 referred to Royal Dutch/Shell's alleged statement made at the EARTH SUMMIT+5 (more commonly referred to as 'Rio+5', a Special Session of the General Assembly of the UN to review and appraise the implementation of Agenda 21, held in New York on 23-27 June 1997) that the company is not worried about the regulations as it controls them (through the WTO). Nor is Shell allegedly concerned about governments (as it controls them too through the WTO). However, according to Roddick, what really concerns Shell is its customers and how those customers react to the activities of pressure groups (see, for example, Roddick, 2000).
48. The origins of the EU and EC's involvement in and concern for environmental issues are to be found in The Treaty of Rome (1957) ('the Treaty'), a cornerstone of the EU. The Treaty provides the basis for establishing a common social policy law within the EU Member States and the European Free Trade Association (EFTA) countries of Iceland, Liechtenstein and Norway. In the early 1990s, significant developments took place within the EU and EFTA countries in relation to future regulations concerning environmental reporting with the adoption of an environmental policy in the Agreement on the European Economic Area (1992) ('the Agreement'). Article 73 of the Agreement requires the Member States of the EU and EFTA countries to preserve, protect and improve the quality of the environment, to contribute towards protecting human health and to ensure a prudent and rational utilisation of resources. Although the Agreement contained no specific requirements concerning individual companies, it contained three important principles which had potentially serious implications for society, business and individuals. These three principles were as follows (Gray *et al*., 1996): that preventative action should be taken; that environmental damage should as a priority be rectified at source; and, that the polluter should pay (the latter became known as 'the polluter pays' principle).

49. The original EMAS regulation (CEC, 1993b) focused on industrial sites although Article 14 provided Member States with the option of extending it to other economic sectors. A revised EMAS regulation was adopted by the Commission on 30 October 1998, the main elements of which were the extension of EMAS to all economic sectors, the integration of ISO 14001 as the required environmental management system and the strengthening of the role of the environmental statement to improve transparency and accountability to stakeholders. On 28 February 2000, a revised EMAS scheme, more commonly known as EMAS II, was formally adopted and entered into force on 6 July 2000 following its second reading in the European Parliament (CEC, 2001a). The essential elements of EMAS II are much the same as its predecessor, with two notable exceptions: (a) the new regulation applies to all organizations rather than just to companies in the industrial sector; and, (b) the regulation is no longer site-based but can be extended to include all activities or parts of the activities of an organization.
50. To date, the EMAS regulation has been popular in certain EU Member States, particularly Germany, although its take-up by companies in many Member States remains patchy primarily due to its perceived lack of credibility. As at July 2003, a total of 3,718 sites are officially registered under EMAS, of which 2,364 (64 per cent) are registered in Germany (source: http://europa.eu.int/comm/environment/emas/index). The verification of EMAS reports is no longer a new phenomenon, coming as it does within the general ambit of what the accountancy profession likes to call 'assurance services'. However, in 1993, when the EMAS regulation was adopted, the situation was quite different. At that time the ICAEW, one of Europe's leading professional accountancy bodies, was initially uninterested in EMAS, regarding it as outside the role of accountants despite strenuous efforts by the present author to convince them otherwise (see FEE, 1993 (researched and written by the present author) and Hibbitt, 1994). It was only later, when practitioners of the 'Big Five' accountancy firms realised the significance of this area in terms of new business opportunities and the threat to that new business posed by other service providers such as environmental engineers and environmental consultants, that the accountancy profession began to take EMAS seriously.
51. The 1992 Rio de Janeiro Earth Summit was particularly significant because it led to the adoption by national governments of The Rio Declaration on Environment and Development, a proclamation by some 167 nation States of their commitment to 27 Principles, Principle 8 of which states: "To achieve sustainable development and a higher quality of life for all people, States should reduce and eliminate unsustainable patterns of production and consumption and promote appropriate demographic policies" (Gilpin, 1996, p.218).
52. In a more general context, the UN has long been engaged in efforts to regulate the activities of large business organizations, particularly the regulation of international accounting by transnational corporations (TNCs). For an insight into the history and structure of the UN's (failed) initiatives in relation to the latter since the 1970s, see, for example, Newell, 2000; Rahman, 1998.
53. Now disbanded, having become part of the United Nations Conference on Trade and Development (UNCTAD).
54. Gray *et al*. (1996) suggest that the reason why international governmental organizations such as the UN have been so ineffectual in increasing corporate accountability on environmental issues is the power of the big corporations to influence governments. Documentary evidence to support such claims is not widespread but there is a growing body of literature which does seem to support the contention that the executives of large corporations have used their huge financial resource base to influence the perceptions of governments and society generally (see, for example, Beder, 1997; Korten, 1995, 1999; Krut and Gleckman, 1998; Mayhew, 1997; Welford, 1997).
55. For a more detailed analysis of selected examples of environmental charters and codes of practice, see, for example, CICA, 1993a; KPMG, 1997b.
56. Details of the WBCSD's Sustainable Development project can be found on the WBCSD's web site at: http://www.wbcsd.org/projects/pr_sustreport.htm
57. Details of the CEFIC guidelines on environmental reporting can be found in Appendix B in *Environmental Reporting* (KPMG, 1997b).
58. Further details of the PERI Guidelines can be found on the web site of IBM Inc. at: http://www.ibm.com/ibm/environment/initiatives/peri.phtm

59. The Global Reporting Initiative (GRI) was initiated in late-1997 by the Coalition for Environmentally Responsible Economies (CERES) in partnership with the United Nations Environment Programme (UNEP), with the active participation of business, NGOs, accountancy bodies, business associations, and other stakeholders. Its original purpose was to develop a generally-accepted framework for *environmental* reporting (ACCA/UNEP, 2002). In early 1998, the sponsors unilaterally expanded the scope of their work to encompass economic and social issues. In a highly controversial move, and for reasons best known to the sponsors, this 'triple bottom line' (TBL) reporting (Elkington, 1997, 2001) on environmental, social and economic issues somehow acquired the misleading title of 'sustainability reporting'. In 2000, GRI released the *Sustainability Reporting Guidelines* (GRI, 2000), a voluntary framework for 'triple bottom line' reporting on economic, environmental, and social issues. These guidelines were subsequently updated in 2002 (GRI, 2002). More information is provided on the GRI website at: http://www.globalreporting.org/index.htm. The Institute of Social and Ethical Accountability (ISEA) was founded in 1996 as an international membership organization with the mission of improving the accountability and performance of organizations in relation to social and ethical accounting, auditing and reporting. ISEA's membership is made up of corporations, academics, NGOs, and business consultants. As part of its goal of facilitating a convergence of best practice, ISEA launched its accountability standard *Accountability 1000* (AA1000) in 1999. The AA 1000 standard provides both a framework that organizations can use to understand and improve their ethical performance and a means for others to judge the validity of ethical claims made. More information can be found at ISEA's website at: http://www.accountability.org.uk/.
60. The European Commission has also recently entered into the corporate social responsibility arena with the issue of both a Green paper in 2001 (CEC, 2001d) and its recent communication *Corporate Social Responsibility: A Business Contribution to Sustainable Development* (CEC, 2002). (Green Papers are official consultation documents which, before the preparation of formal proposals, set out the Commission's ideas and present possible measures. In effect, they provide an indication of the Commission's internal thinking on a particular topic, laying down the foundations for a framework in which interest groups can present their viewpoints in terms of time limits, importance of presenting views in writing, the possibility of organising hearings, etc.) The communication (CEC, 2002) constitutes a follow-up to the Green paper and presents an EU strategy to promote CSResp following the consultation process. The communication includes a definition of the concept of CSResp in the context of sustainable development and its impact on business and society.
61. Various national standards for environmental management have been recognised by the European Commission as satisfying the criteria of the EMAS Regulation (Article 12), including those in the UK (British Standard BS 7750), Ireland (Irish Standard IS 310) and Spain (UNE 77/801/94). As in the case of some other countries, the UK's standard (BS 7750) has since been formally superseded by the International Standard Organization's ISO 14001, the latter being also a quality management standard rather than addressing issues of transparency and accountability to society. ISO 14001 is currently under review with a revised version expected to be released in 2005 or later.
62. Despite their growing popularity, it is important to remember that both the EMAS regulation (CEC, 2001a) and its international counterpart ISO 14001 (European Committee for Standardization (CEN), 1996; ISO, 1996) are essentially internal quality management standards, being based on the principles of total quality management (TQM) (Netherhood, 1998). For example, the introduction to ISO 14001 (ISO, 1996) states that it shares common management system principles with the ISO 9000 series of quality system standards and that organizations may elect to use an existing management system consistent with the ISO 9000 series as a basis for its EMS. Similarly, the revised EMAS regulation's Annex 1, Part A, *Environmental management system requirements* is reproduced entirely from the text of section 4 of ISO 14001. Partly for this reason, both EMAS and ISO 14001 have been criticised for not going far enough, for being defensive and bureaucratic, and, more important perhaps, for failing to provide an adequate framework with which to tackle the challenges of sustainability (see, for example, Kamp-Roelands and Bouma, 1998; Krut and Gleckman, 1998; Netherhood, 1998; Starkey, 1998). However, such criticisms may be symptomatic not of the instruments themselves but of the

institutions involved and of the standardisation process, both EMAS and ISO 14001 being products of an institutionalised shift towards market-based, voluntary instruments and the systematic standardisation of environmental management systems (Hibbitt and Kamp-Rolands, 2001).

63. The study by Jones (2000) makes a number of recommendations, based on her findings, to improve the comparability, reliability and usefulness of environmental information appearing in the annual report. Whilst such an approach may find support with certain sections of the population, it is not necessarily democratic or socially desirable in a neo-pluralist society. Jones' (2000) suggestion, for example, that "… environmental information … should present a 'true and fair' view …" (p.ii) is nonsensical *unless* we are talking about a very restricted construction of CSResp and CSR such as is found in traditional financial reporting.
64. In the case of employers and employees, Dutch labour relations are highly centralised and heavily institutionalised with legal recognition and based fundamentally on consensus rather than conflict (Huizing and Dekker, 1992), a central feature of Dutch culture. The employees' federations did not enter the debate on CWEC until rather late due to problems in being able to reconcile their concern with full employment with environmental issues (Federatie Nederlandse Vakbeweging (FNV) (Federation of Dutch Trade Unions), 1988) as referred to in Huizing and Dekker, 1992). However, from 1988 onwards they have co-operated closely with the environmental organizations.
65. For a discussion of the role of the accountancy profession in this debate, see Huizing and Dekker, 1992 (pp.439-444). What is interesting is that the accountancy profession was invited by the Dutch government to express its view on issues related to the CWEC-system at the outset of the CWEC debate. However, at the time there was no general consensus across the accountancy profession (i.e. NIVRA had not issued a statement on CWEC) although individual accountants were contributing substantially to the debate (Huizing and Dekker, 1992).
66. These 29 countries are: *North America*: Canada, USA; *South America*: Argentina, Brazil, Columbia; *Africa*: South Africa; *Asia*: Honk Kong; India; Japan; *Australasia*: Australia; New Zealand; and *Europe*: Austria; Belgium; Czech Republic; Denmark; Finland; France; Germany; Hungary; Ireland; Italy; the Netherlands; Norway; Portugal; Russia; Spain; Sweden; Switzerland; and the UK (ACCA, 2001).
67. FEE (2001), in stating that "… the concept of **People - Planet - Profit** reflects the responsibility of corporations and other institutions towards external stakeholder groups" (p.7, original emphasis), has publicly acknowledged triple bottom line reporting as part of the social responsibility of business. Whilst Royal Dutch/Shell's (2001) concept of 'people, planet and profits' has all the elements of a 'business case' marketing strategy, the fact that the European accountancy profession asserts publicly that business corporations have a responsibility towards the environment evidences a re-appraisal of both CSResp and CSR.

Chapter 3

Prior corporate social and environmental reporting research

3.1 Introduction

The purpose of this chapter is three-fold. Firstly, to provide a review of prior research into the nature and causes of corporate social and environmental reporting (CSR). This is done by examining various associations advanced by CSR researchers for predicting and explaining variations in the popularity and volume of CSR both cross-sectionally and over time. Secondly, to provide an overall model which serves to present these associations within a coherent framework of analysis. Thirdly, to identify any discernable patterns or trends from a review of this prior research towards the selection of certain observable, measurable phenomena that are suggested as being associated with variations in the popularity and volume of CSR.

In Chapter 2, the concept of corporate social accounting was presented as a broad church of activities, overarching a number of different areas of research and practice, including corporate social and environmental reporting (CSR), total impact accounting, social indicators accounting and socio-economic accounting (Mathews, 1984). Of these four areas, CSR is the most widely researched and practiced since the early 1970s (Gray *et al.*, 1995b; Neu *et al.*, 1998). Within CSR, the growth in corporate environmental disclosure and reporting in the 1990s was undoubtedly influenced by a variety of factors, and initiatives and developments from many different quarters. The fact that today more of the world's largest companies are reporting more information on environmental issues is not contestable (see, for example, KPMG/WIMM, 1999, 2002). What is perhaps remarkable about the growth of environmental reporting throughout the 1990s is the fact that, generally speaking, such reporting was a *voluntary* activity. This raises the very obvious question: why? What was motivating corporations to issue environmental information voluntarily, particularly in the form of stand-alone, dedicated environment reports? From a business perspective, there are clear economic benefits to be gained from environmental disclosure. KPMG (1996, 1997a), for example, highlighted a number of direct business benefits, based on a survey of the *Financial Times Stock Exchange (FTSE) Top 100* UK companies, from reporting on environmental performance in annual and environment reports, including:

- it leads to a stronger internal commitment to improved environmental performance;
- it provides an opportunity to address financial stakeholders' (investors and lenders) concerns about the impact on the business of environmental risks and uncertainties and to demonstrate (good) progress in environmental management to stakeholders;
- preparing an environment report helps to identify deficiencies in internal environmental reporting, management and accounting systems which, if left unchecked, can lead to poor management of risks;

- linking environmental and financial data allows quantification of environmental costs, highlighting areas where cost savings can be made;
- it can improve public relations; and
- it leads to increased employee awareness of the company's environmental policies and goals.

Similarly there are *economic* benefits to the organization from a higher level of transparency which may in themselves be an important motivation, including (ACCA, 2001): increased numbers of customers who share the same values; access to preferred suppliers' listings of businesses that take responsibility for environmental issues downstream to their own operations; strengthening the organization's relationship with its stakeholders by involving them in the reporting process; and, reduced reputational risk as a result of general public approval. Reputational risk is seen as increasingly important to business organizations. Browne (2000), for example, argues that there is a growing belief that 'corporate reputation' will replace product innovation and design, quality and service as the most important competitive differentiator over the next 50 years. Companies looking to create, protect and enhance shareholder value will, it is argued, have to build solid reputations of real substance through 'reputational management', the strength of which depends on such things as corporate legitimacy, stakeholder engagement and corporate communication initiatives (Brown, 2000). Similarly, KPMG/WIMM (2002, p.25) refer to 'enhancement and maintenance of reputation' and 'risk reduction' as two of the main quoted business drivers for companies to engage in 'sustainable' (i.e. in the context of TBL) programmes and reporting. However, the *economic* benefits of improved focus on environmental issues tell little about the socio-political pressures on a company. In the UK, a series of roundtable discussions with senior industrialists organised by KPMG in 1995 identified a number of pressures faced by industry to report on its environmental performance (KPMG, 1996). These 'driving forces' included: pressures from stock exchanges, particularly those with a US listing; peer pressure through industry awards such as the ACCA's ERAS; customer and consumer pressure which leads to companies assessing the environmental performance of their suppliers; and the introduction of environmental management systems, particularly the EU's Eco-management and audit scheme (EMAS) (CEC, 2001a).

Other factors, such as public awareness and concern for environmental issues, pressure from 'first-timers', developments in mass communication, the need for a pro-active approach to environmental risk management and developments in mandatory reporting in some countries are creating socio-political pressures on companies to report on environmental issues (KPMG/WIMM, 1999). However, an important distinction needs to be drawn between 'motives' and 'influences' (Gray and Bebbington, 2001). 'Motives' in this sense refers to the reason(s) *why* the executive management of an organization chooses to disclose environmental or any other information to the public[1]. 'Influences' on the other hand, refers to factors that may (but not necessarily) bring about a change in the behaviour of the management of companies in response to the latter's changes in *perceptions or beliefs*. Thus, for example, environmental campaigns by NGOs represent a potential source of *influence* on the executive management of multinational business organizations and may (or may not) result in a response from those organizations. However, management may be *motivated* to disclose carefully selected environmental information in the hope of being able to assuage or deflect such pressures if, for example, they feel their organizational legitimacy is under threat

(Dowling and Pfeffer, 1975). Motives may exist for both the reporting and the non-reporting of *voluntary* information and the motives underlying a decision *not* to disclose are perhaps just as important as the motives for disclosing. Table 3.1 below summarises some of the main ones to be found in the literature in relation to CED (although many also apply in the case of CSR generally).

Table 3.1
Possible 'motives' for voluntary environmental disclosure and non-disclosure

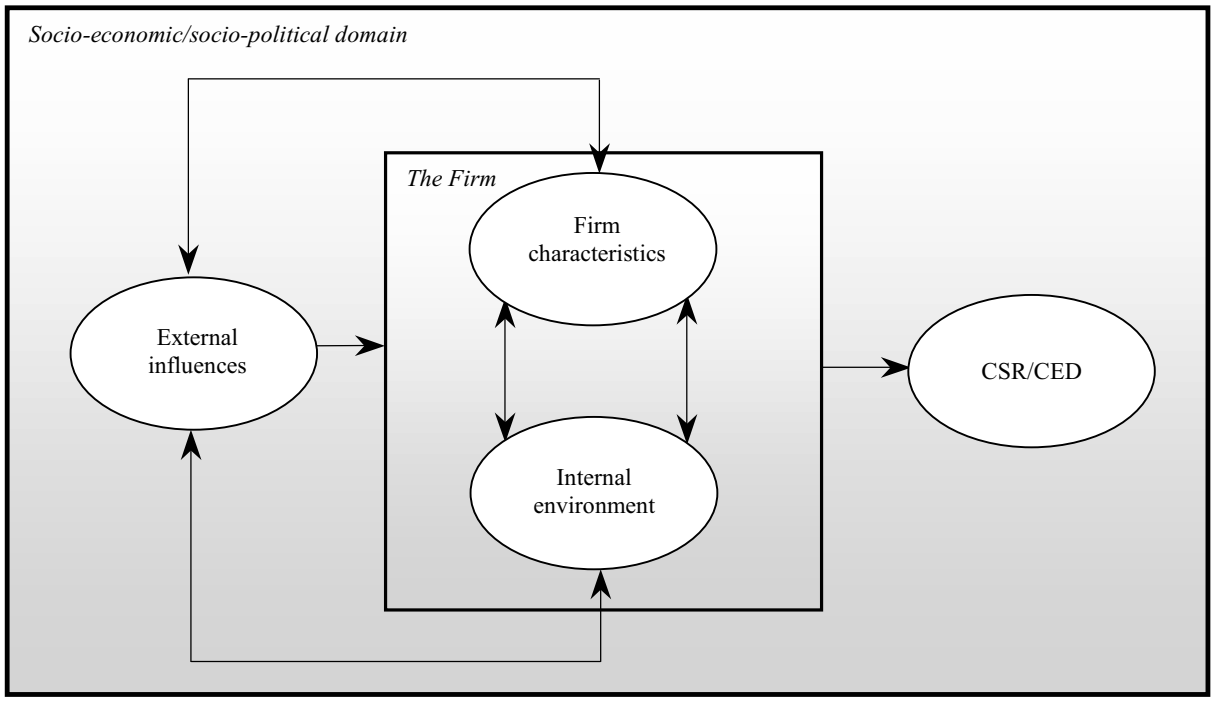
Disclosure	Non-disclosure
► Compliance (e.g. with EPA and EU guidelines)	► No need/motivation to do so
► Positive impact on share price	► Wait and see
► Brand management	► Cost
► Financial, legal, and reputational risk management	► Data availability
► Satisfy 'green' and ethical investors	► Secrecy
► Ethics (of the firm or its top management)	► (Perceived) absence of demand
► Individual commitment (e.g. top management)	► No legal requirement to do so
► Accountability to stakeholders	► Not previously considered
► Build up expertise in advance of regulation	► Priority given to other areas of disclosure
► If not done voluntarily will become mandatory	
► Legitimise activities, influence perceptions, forestall regulation and or legislation	
► Stimulate internal developments	
► Maintain position of power/stay ahead of competitors	
► Experimentation	
► Forestall disclosure by other parties	

Adapted from Gray et al. (1996), Gray and Bebbington (2001) and O'Dwyer (2001a)

The list of motives in Table 3.1 is not intended to be exhaustive but rather to indicate the very diverse range of potential motives driving business organizations to disclose environmental information. The one motivation not included in this table is of course the motivation to comply with the law and regulations, this being associated with information that *must* be reported, for example, in compliance with financial reporting requirements, rather than voluntary reporting. Although there are a complex array of potential socio-political influences on an organization's decision to disclose (or not to disclose) social and environmental information to the general public, it is possible to categorise them into four primary areas (Gray and Bebbington, 2001): (i) industry and voluntary initiatives (see Section 2.7 of Chapter 2); (ii) market pressures - from, e.g., customers, consumers, competitors, employee concerns, public relations; (iii) legislation and regulatory pressures – e.g. legislation in relation to the 'freedom of access to information', the 'polluter pays' principle, environmental impact assessments, environmental protection (through environmental protection agencies), and specific legislation in relation to the disclosure of environmental information; and (iv) social pressures - from, e.g., stakeholders such as non-governmental organizations (NGOs), pressure groups, the media, personal and family beliefs, etc. In addition, CSR researchers, in

seeking to explain, predict and explore the nature and causes of CSR, have focused on a number of 'firm characteristics' such as size, profitability, industry sector and the country of ultimate ownership of the reporting entity, all which are perceived, based on certain putative associations drawn from a number of different theoretical models, to be correlated with variations in both the popularity and volume of CSR across companies and over time (these are discussed in more detail below). However, whilst it may be tempting to suggest that certain firm characteristics, influences on and motives for the reporting (and non-reporting) of information have general applicability, the overall picture is a complex one when seen in the context of an organization-society relationship that is continually in a state of flux as the various parties constantly negotiate and re-negotiate their respective agendas, goals and positions. Hence, any attempt to provide a formal, rigid, representational structure of the various influences on CSR/CED is problematic because this will unavoidably involve a degree of reductionism, abstraction and oversimplification compared to what takes place in the 'real' world. Nevertheless, in order to investigate these influences scientifically it is necessary to introduce some form of workable framework or model to guide the research. A suggested schema to assist in navigating the CSR/CED landscape in this context is set out in Figure 3.1 below.

Figure 3.1
Diagrammatical representation of the relationship between the firm and CSR/CED



Note: Arrows indicate assumed direction of influence

A basic premise underlying this schema is that CSR/CED is teleological, i.e. that it occurs not by accident but due to the underlying purpose or design that is served by it (see Chapter 1, Section 1.1), CSR/CED being seen as the end-product of a complicated, complex and multi-faceted interplay of economic, social and political relationships. For the purposes of analysis, the various factors influencing CSR/CED have been classified into three categories: (i) firm characteristics; (ii) the internal environment; and (iii) external (socio-economic and socio-political) influences. Firm characteristics in this context refer to aspects or features of an

organization that can be identified, measured and related to that organization such as size, profitability, industry affiliation, capital structure, cost of capital, management style and decision horizon. The internal environment refers to the internal *milieu* within the firm and includes primarily social, political and ideological factors such as the values, attitudes and beliefs of its senior management, the firm's reporting strategy, internal culture (e.g. values, principles and ethics), perceptions of and attitudes towards stakeholders, and the firm's corporate reporting strategy. External influences refer to the general economic, social and political *milieu* in which the firm operates and includes factors such as the activities of NGOs and other pressure groups, media interest, customer attitudes and pressures, reporting practices of competitors, industry best practice, shareholder activism, attitudes, values and beliefs of the general public and geo-political developments such as industrial 'globalisation'. For practical reasons, the present study is restricted to an investigation of the association between CED and a limited number of these various economic, social and political influences which the three theoretical frameworks (i.e. EAT, MST and OLT) suggest as having explanatory power in this context[2]. These influences are described in more detail in this and subsequent chapters.

The remaining sections are structured as follows. Section 3.2 provides a general overview of prior CSR research, the aim of which is to locate the particular area of CSR research that is of relevance to the present study. Section 3.3 provides an introduction to the main areas of empirical CSR research. Section 3.4 provides the main focus of the chapter in reviewing the findings of prior empirical CSR research which have attempted to assess the association between corporate social and environmental disclosures and firm characteristics and socio-political influences. Section 3.5 provides a summary and conclusions.

3.2 A general overview of prior CSR research

In contrast to the long history of the *practice* of CSR (see Chapter 2), academic interest in social responsibility research has a more recent past (for a complete review of some of the early social accounting literature, see, for example, Jensen, 1977; Mathews, 1997; for an overview of developments in Europe since the early 1970s, see, for example, Owen, 1996)[3]. Since the mid-1970s, however, CSR has been the focus of much research attention, such that today there exists a large and burgeoning body of research in CSR in many developed (i.e. industrialized) and developing countries (see, for example, Carrasco and Larrinaga, 1994; Choi, 1998; De Villiers and Barnard, 2000; Gibson and O'Donovan, 2000; Gray, 1993; Gray *et al*., 1993; Gray and Bebbington, 2001; Jupe, 1997; Kokubu *et al*., 1994; Niskala, 1994; O'Dwyer and Gray, 1998; Rahaman, 1999; Savage, 1994; Van Nuffel *et al*., 1994, 1995). This body of research is far from homogeneous and any classification of the literature is necessarily an arbitrary affair. Part of the reason for this lies in the fact that, despite numerous studies into CSR practices in the 1970s and early 1980s, only a few researchers attempted to *explain* the phenomenon (Patten, 1995). Gray *et al*. (1995b) also highlight a number of factors which have contributed to this state of affairs:

- the literature lacks an overall coherence (see, for example, Ullmann, 1985);
- there has been a lack of any agreed theoretical perspective to drive systematic research (see, for example, Preston, 1983);

- CSR continues to face opposition in terms of its legitimacy as a valid area of accounting research enquiry (see, for example, Parker, 1986, 1991); and,
- the contested and contestable nature of CSR, together with the breadth of possibilities which may constitute CSR, have given the subject a more explicitly political edge than either is customarily the case or which accounting researchers are sufficiently equipped to perform (see, for example, Puxty, 1986, 1991; Tinker *et al*., 1991).

Whilst not wishing to over-simplify what is a broad, diverse and complex research domain, academic interest in CSResp and CSR may be said to comprise seven broad streams (Guthrie and Mathews, 1985 and Mathews, 1997) as shown in Table 3.2.

Table 3.2
Broad streams of CSResp and CSR research

Stream	Examples
Normative/philosophical	Ackerman, 1975; Acherman and Bauer, 1976; Benston, 1982; Davis, 1973, 1976; Elias and Epstein, 1975; Estes, 1973, 1976; Evans, 1991; Fiedler & Lehman, 1995; Frederick, 1987, 1994; Gambling, 1985; Geno, 1995; Gray and Laughlin, 1991; Gray, *et al*., 1987, 1988, 1996; Linowes, 1972a, b; Logsdon, 1985; Mobley, 1970; Perks, 1993; Ramanathan, 1976; Ronen, 1974; Swanson, 1995; Tinker, 1984a; Tinker and Lowe, 1980; Wildavsky, 1994.
Descriptive/non-empirical (e.g. of CSR practice)	Brockhoff, 1979, 1995; Gray, 2000, 2001; Most, 1977; Rey, 1978; Schreuder, 1979; Van den Bergh , 1976.
Attitudes (e.g. of management, accountants, etc.)	Anderson, 1980; Bebbington *et al*., 1994; BiE, 1994; Deegan *et al*., 1995; Filios, 1985.
Regulatory	AARF, 1992; ASSC, 1975; AAA, 1974, 1976; AICPA, 1973, 1977; UEC, 1983.
Classificatory	Guthrie and Mathews, 1985; Mathews, 1984, 1987a, 1991, 1997; Ullmann, 1985.
Empirical	Adams *et al*., 1995b; Belkaoui & Karpik, 1989; Deegan & Gordon, 1996; Dilley and Weygandt, 1973; Ernst & Ernst, 1972-1978; Gray, 1990d, 1991a; Gray *et al*., 1995b; Harte and Owen, 1991; Kirkman & Hope, 1992; Ness and Mirza, 1991; Neu *et al*., 1998; Ng, 1985; O'Dwyer & Gray, 1998; Patten, 1990, 1991, 1992; Roberts, C., 1991; Roberts, R., 1992; Tilt, 1994; Trotman, 1979; Trotman and Bradley, 1981; Ullmann, 1985; Unerman, 2000; Zéghal, and Ahmed, 1990.
Critical/radical	Cooper and Sherer, 1984; Hines, R., 1988a, 1991; Lehman, C., 1988, 1992; Lehman, G., 1995, 1999; Maunders and Burritt, 1991; Puxty, 1986, 1991; Tinker, 1984b, 1985; Tinker and Neimark, 1987; Tinker *et al*., 1982, 1991; Willmott, 1990.

Source: Based on Guthrie and Mathews (1985) and Mathews (1997)

The classification provided in Table 3.2 is intended to serve as an aid in structuring prior research in the field of social responsibility research and as such should not be seen as a rigid

classification system. In practice, many items of published research could be allocated to more than one of the seven categories shown. Nevertheless, although simplistic in its representation, Table 3.2 symbolises those areas where most of the academic interest in CSR has focused over the last 40 years or so. In particular, it is evident from a review of published CSR research during the period from the early 1970s to the mid-1990s that much of the research interest in the early years was directed towards philosophical and normative discussions, whereas since the late 1980s, the focus has been on empirical studies (Mathews, 1997)[4].

The 1970s was a period during which researchers explored the 'how' aspect of CSResp and CSR, focusing on the development of normative models. However, despite the fact that there have been quite a number of studies which may be classed as philosophical and/or normative in nature, there are in fact only a few which addressed conceptual operational frameworks that could be used to guide and evaluate CSR. Some early, seminal work undertaken by accounting researchers in the 1970s included that of Dierkes and Preston (1977), Estes (1973), Medawar (1976), Mobley (1970), Ramanathan (1976), Ronen (1974) and Ullmann (1976). However, these ideas were not taken up by business, which continued up to the early 1990s to focus on specific issues, particularly on levels of pollution (Gray *et al*., 1996)[5]. In a later development, Ramanathan and Schreuder (1982) proposed a normative approach to social accounting using a system of linked macro and micro indicators under which the costs to society of neutralising the 'hidden' costs of corporate activities (what we now refer to as 'externalities' or public costs) could be located back to the firms responsible for such costs. Ramanathan and Schreuder's (1982) basic premise was that these externalities should be incorporated into private sector costs rather than being borne by societies, a process which they contended would not weaken the market system but make it stronger by being more inclusive. Much earlier, Colantoni (1974), for example, had argued that social accounting and social reporting should be regarded as being concerned with phenomena that are not adequately reflected in market prices and be directed at audiences that extend beyond those customarily concerned with company reports. Viewed from this perspective, CSR takes on a social dimension in extending the scope of corporate reporting into areas outside its traditional sphere in an attempt to serve sections of society other than those users who are traditionally served by annual reports. Benston (1982), however, took a quite different philosophical position on social accounting and social responsibility, arguing that management's only responsibility is to the shareholders as the owners of the business. The market system, in Benston's view, acts as an effective regulatory mechanism for maintaining pressure on, and ensures that there is no misuse of corporate resources by, management. Benston's classical free market stance is in the same vein as Friedman's (1962, 1970) famous dictum that the only social responsibility of business is to make profits for its shareholders:

> *Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. This is a fundamentally subversive doctrine* (Friedman, 1962, p.133)[6].

In essence, Friedman's view (see, also, Hayek, 1969) was that managers of business enterprises should not be concerned with the social costs and benefits of their activities but with maximising profitability, provided that they stay within the law, the assertion being that

by so doing managers will be acting in a socially responsible manner by creating wealth for their shareholders, employment for their employees and paying taxes to governments to fund social welfare programmes.

During the 1980s, social disclosure studies paid more attention to methodological issues, reducing subjectivity and increasing the replicability of content analysis (Mathews, 1997)[7]. In particular, social disclosure studies attempted to explain the source, direction and type of disclosures (see, for example, Belkaoui and Karpik, 1989; Bradley, 1978; Freedman and Jaggi, 1982a, 1988; Rockness, 1985; Trotman and Bradley, 1981; and Ullmann, 1985). Attempts to offer reasons motivating the disclosure of social information, however, did not advance very far. Studies in this period were, by and large, looking at associations between firm characteristics and CSR, without explicitly theorising those associations. Nevertheless, there was an early attempt at using organizational legitimacy theory to explain corporate disclosures (Guthrie and Parker, 1989). Guthrie and Parker's study represented a significant shift in approach to surveys of CSR. Up to that time, most of these surveys were concerned with finding out whether companies did or did not disclose certain categories of information. However, this tells very little about either the quantity or the nature of such disclosures. The Guthrie and Parker study also introduced greater rigour to CSR surveys through the use of content analysis as a research method. Using content analysis, Guthrie and Parker classified the CSR content of annual reports according to theme (environment, energy, human resources, community involvement and other), evidence (monetary, non-monetary and declarative), amount of disclosure (in terms of the proportion of a page), news value (good, bad or neutral) and location in the annual report. Later studies, notably that of Gray *et al.* (1995b) and O'Dwyer and Gray (1998), adopted broadly the same approach.

In the 1990s, the focus of CSR research interest shifted away from social accounting in general towards environmental accounting research. Mathews (1997, p.496) refers to "… the advancement of environmental issues within accounting on a broad front characterised by the almost complete domination of environmental accounting over social accounting." This is particularly noticeable in the period from 1991 to 1995 and is commensurate with the comments in Chapters 1 and 2 above in relation to the significant increase in CED. The 1990s was also a period during which those involved in empirical studies of environmental disclosure started to make a genuine attempt at including theory in their work (see, for example, Deegan and Gordon, 1996; Gray 1995b; Gray *et al.*, 1995b, c)[8].

3.3 Empirical research into CSR

Empirical studies of corporate social reporting may be categorised as falling within one or more of the following sub-streams: (i) surveys of trends and patterns in the popularity and volume of social and environmental disclosures; and, (ii) studies of associations between social and environmental disclosures and firm characteristics and external socio-political influences. Generally speaking, surveys under item (i) are concerned with describing the incidence, and in some cases, the nature of CSR/CED, whereas those which fall under (ii) are concerned with establishing putative associations between CSR/CED and other explanatory variables. Both categories provide a variety of research studies, including longitudinal studies of individual companies over long periods of time (for example, Guthrie and Parker, 1989; Hogner, 1982; Neimark, 1992), longitudinal studies of the CSR practices of companies

within a particular country (for example, Gray *et al*., 1995b; O'Dwyer and Gray, 1998; Van Nuffel *et al*., 1995) and studies of CSR practices across countries (for example, Adams *et al*., 1998; Cowen *et al*., 1987; Guthrie and Parker, 1990; Roberts, C., 1990, 1992; Trotman and Bradley, 1981)[9].

One particular early empirical study worthy of note was that of the US public accounting firm Ernst & Ernst which carried out a series of social disclosure studies analysing the annual reports of the US *Fortune 500* companies[10] over the period from 1972 to 1978, using the annual reports for the years 1971 to 1977 (Ernst & Ernst, 1972-78). Under the direction of Dennis Beresford, later chairman of the US FASB, the Ernst & Ernst surveys reported on the extent of social and environmental disclosure by companies included in the yearly *Fortune 500* industrial rankings (Patten, 1995). These surveys give a page count of social disclosures made in annual reports including the social topics discussed and the amount of space devoted to each, providing researchers with a wealth of data with which to subsequently investigate and identify patterns of and trends in CSR. One of the most interesting results to come out of these surveys was their revealing of a dramatic increase in corporate social disclosure during the 1970s amongst top US companies. For example, whereas only 51.4 per cent of the companies surveyed in 1972 disclosed social information in their 1971 annual reports, 91.3 per cent of companies surveyed in 1978 disclosed social information in their 1977 annual reports (Patten, 1995). Similarly, the mean number of pages devoted to social responsibility issues increased from 0.39 pages in relation to 1973 annual reports to 0.56 pages in the 1977 annual reports (Patten, 1995)[11]. It was from the Ernst & Ernst database that most of the key early inferences about trends in and patterns of CSR, notably its association with the larger companies, the influence of industry sector and the waxing and waning of issues of voluntary disclosure, were drawn (Gray *et al*., 1996)[12]. Given that the subject matter of the present study is CED by large European companies, the focus here is on trends in the (so-called) developed Western world[13]. In doing so, however, it should be borne in mind that the history of comparative social and environmental reporting is much shorter than, say, comparative studies in international financial reporting (Gray *et al*., 1996). Consequently, any attempt to provide an international context for CSR must remain tentative. A number of other points are worth noting about empirical surveys of CSR in general:

(i) such surveys have tended to focus almost exclusively on the nature and frequency of CSR in the major First-World economies of Australia and New Zealand, Canada, mainland Europe and the UK and the USA with studies of CSR practices in Japan appearing in the 1990s (see, for example, Kokobu *et al*., 1994; Yamagami and Kokobu, 1991), and on the larger companies within these countries[14]. However, a limited number of studies have been done on CSR practices in the developing countries such as India, Malaysia and Singapore (see, for example, Andrew *et al*., 1989; Foo and Tan, 1988; Singh and Ahuja, 1983; Teoh and Thong, 1984; Tsang, 1998; Vasal, 1997)[15];

(ii) surveys are almost always based on an analysis of the annual reports of reporting companies, with little focus on other reports (this issue is explored in more detail in Chapter 8); and,

(iii) surveys in Australia, New Zealand, the USA and the UK suggest that, of the three main strands of CSR (i.e. human resources, community involvement and the environment), companies have so far placed the greatest emphasis on the disclosure of human resource

issues (Hackston and Milne, 1996; Guthrie and Parker, 1989, 1990; O'Dwyer and Gray, 1998).

The pre-dominance of human resource reporting (item (iii) above) is due primarily to the fact that much of the disclosure is *mandatory* rather than *voluntary*, in contrast to environmental reporting, for which, as discussed in Chapter 2, the volume of legal reporting requirements is much lower. However, since the late 1980s, there has been an increasing focus on CED (see, for example, Gray *et al.*, 1996; Mathews, 1997; O'Dwyer and Gray, 1998). As interest in the environment as an aspect of CSResp increased in the late 1980s and early 1990s, the focus on survey data of trends in CED has also increased. Such surveys included:

(i) *international studies* which provided valuable data on trends in *global* CED as disclosed in the annual reports of large companies across developed countries (see, for example, Adams *et al*. 1995b; Roberts, C., 1990, 1991; United Nations (UN CTC ISAR) 1991, 1992, 1994, 1995); and,

(ii) *single country* studies which provided valuable data on trends in CED in annual reports of large European companies, (see, for example, Gray *et al*., 1995b; Harte and Owen 1991; Jupe, 1994; Kirkman and Hope, 1992; KPMG, 1994, 1996; Mohamed and Hill, 1996; Roberts, C., 1991, 1992).

These surveys have produced varying estimates of the amount of social and environmental information disclosed by companies. This is due to a number of factors, including differences in the sample composition[16], differences in the definitions of CSR and in the measurements instruments, with very little (if any) attempts to replicate prior studies (Hackston and Milne, 1996). Notwithstanding such differences, these studies, on the whole, suggest that there has been a noticeable increase in both the popularity and quantity of environmental disclosure by large international and European companies since the late 1980s. KPMG (1997a, p.13), for example, in an international review of voluntary CED refer to "…a marked increase in enterprises' interest in reporting on their environmental policies, practices and performance to the public" in the early 1990s. In the case of international studies (item (i) above), Roberts (1990), for example, drew a sample of 200 large companies with headquarters located in 28 countries (North America: 40; Australasia, 15; Africa, 11; Japan, 19; Asia, 15; and Europe, 100) and covering a wide range of industries. Based on the 1987 English language annual reports only, Roberts reports that 13 per cent of her sample provided at least one item of environmental disclosure, with the average number of pages devoted to environmental protection measures being 1.10 pages (the maximum number of pages of CED disclosed by any one company was 4.0 pages and the minimum 0.25 pages). Roberts, C. (1991) also used complete English language versions of the 1988/89 annual reports of 110 mainland European companies from France (25), Germany (40), the Netherlands (15), Sweden (15) and Switzerland (15). Based on this sample, Roberts reports that 68 per cent of companies disclosed at least one item of CED. This higher percentage suggests that, in an international context, CED is more popular amongst European companies compared to other regions of the world. In a later study, Adams *et al*. (1995b) also focused on European companies, their sample of 150 companies being comprised of the 25 largest companies (ranked by turnover) in France, Germany, the Netherlands, Sweden, Switzerland and the UK, respectively, as provided by the *Financial European Times 500* (1991) for which the complete English language version of the corporate annual report was available for 1992/93. Based on this

sample, Adams *et al*. report that 77 per cent of companies disclosed at least one item of CED in their 1992/93 annual report. This percentage is in the same ballpark as that of Roberts, C. (1991), although slightly higher suggesting that the popularity of CED in annual reports was increasing amongst European countries in the early 1990s.

The UN's 1994 study (UN CTC ISAR, 1994) of 203 annual reports relating to 1992 and 1993 selected from *Fortune* magazine's 'Global 500' indicated some important international trends, notably: (i) the percentage of companies disclosing some environmental information varied from one industry to another, with the chemicals, petroleum and pharmaceuticals sectors having the highest percentage of disclosers (100 per cent in all cases); and (ii) the percentage variation between industries is much more pronounced when looking at individual areas of disclosure. For example, whilst 92 per cent of chemical companies provided some information on environmental policy, only 40 per cent of companies in the industrial equipment sector provided such information. The accounting firm Deloitte Touche Tomatsu International (DTTI, 1996), in their study on the extent of corporate environmental reporting amongst 677 mostly large listed Scandinavian companies (from Denmark, Finland, Norway and Sweden), found that about half of the companies included some information on environmental issues in their annual or environment report. However, the majority of these companies were found to report on environmental matters in limited detail, DTTI (1996) concluding that CED was increasing although it appeared to be still only a minority of businesses who report to the public about their environmental impact, management practice and performance.

Single country studies in the 1990s (item (ii) above) have tended to confirm a rising trend in CED amongst large companies. Table 3.3 below provides a summary of the empirical evidence among the larger companies across Europe based on surveys carried out in the early to mid-1990s, showing (where possible) the source documents, sample size, incidence and amount of CED in the respective countries[17]. Some of these studies were surveys of CSR, whereas the data shown relates only to CED. The amount of CED is given in terms of the average number of pages devoted to environmental issues in the annual report, per company. Most of the studies selected the largest companies according to some measurement of size rather than being drawn from random samples and thus the sampling technique, sample size and the industry-make up of each sample will influence the resultant figures of incidence and average amount of CED.

Table 3.3 provides some interesting insights into the state of the art of CED amongst European countries during the early 1990s. What is most noticeable are the considerable differences in both the number of companies disclosing environmental information and the average volume of information disclosed. German companies appear to devote much more of their annual reports to environmental issues (an average of 1.61 pages) compared to Irish (0.27) and Dutch (0.45) companies. Generally speaking, surveys of CED by large European companies during this period suggest that German and Swedish companies were the market leaders in terms of both the popularity of CED and the variety of information disclosed, with the lowest incidence of CED being provided by companies in France and the Netherlands (see, for example, Adams *et al.,* 1995b; Ljungdahl, 1993, 1994; Roberts, C., 1991). Some of these variations will be attributable to differences in the industry compositions of each sample, with those samples having a higher proportion of companies from heavy industries

Table 3.3
European surveys of corporate environmental disclosure

Country	B	NL	D	F	IRE	FIN	S	CH
Study	Nuffel *et al*. 1994	Adams *et al*. 1995b	Adams *et al*. 1995b	Adams *et al*. 1995b	O' Dwyer & Gray 1998	Niskala & Pretes 1995	Adams *et al*. 1995b	Adams *et al*. 1995b
Source documents	Annual Reports	Annual Reports	Annual Reports	Annual Reports	Annual Reports	Annual Reports	Annual Reports	Annual Reports
Data year	1991	1992/3	1992/3	1992/3	1995	1992	1992/3	1992/3
Sample size	39	25	25	25	50	75	25	25
Sample criteria	Largest	Largest	Largest	Largest	Largest	Largest	Largest	Largest
Percentage which disclose	80	64	100	56	20	48	88	76
Av. pages disclosed	N/A	0.45	1.61	0.71	0.27	N/A	0.85	0.60

Notes: Where: B = Belgium; NL = the Netherlands; D = Germany; F = France; IRE = Ireland; FIN = Finland; S = Sw
Kingdom. Adams et al., (1995b) data is based on the latest available English version of the annual report as at June 19
AR for 1992. Figures for O' Dwyer and Gray (1998) are for last year of their study (1995). The Gray et al. (1995b) st
1979 to 1987, being a random sample of 444 companies from which samples were selected in each year, the second, 1
of the largest UK companies. The figures are estimates based on the line graphs included in the study (O' Dwyer and G

likely to focus on environmental industries than lighter industries. Both Adams *et al*. (1995a) and Mohamed and Hill (1996) excluded financial institutions (banks, finance and holding companies) from their sample, whereas O' Dwyer and Gray (1998) did not. Niskala and Pretes (1995) selected companies from the nine most environmentally-sensitive industrial sectors in Finland and then selected the top 100 companies (ranked by turnover) across these sectors. Van Nuffel *et al*. (1994) selected their sample using the five largest industrial sectors in Belgium (according to turnover figures) and then requested information from the 20 largest companies (by turnover) from each sector. However, industry differences are unlikely to explain all the variations and it seems reasonable to suggest that there *is* a country effect.

A second key feature of the data presented in Table 3.3 is in relation to discernable trends in the popularity and volume of CED over time. A comparison of two surveys (that of Adams *et al*. (1995b), who took as their basis years 1988 or 1989, and Roberts, C. (1991) who took 1992), for example, shows an increase in the number of companies reporting environmental information in Germany, Sweden, France, Switzerland and the Netherlands[18]. Roberts, C. (1992) suggests that corporations across Europe were becoming more aware of increasing public and governmental concerns about the environment and that many were responding to such concerns by producing clearly defined environmental information sections in the annual report. However, the trend of increased reporting of environmental issues is not universal O'Dwyer and Gray (1998), for example, report that 80 per cent of Irish companies in their sample made no environmental disclosures (the basis year being 1995), suggesting that this reflected "… the low relative importance attached to the environment in Ireland" (p.24). Gray *et al*. (1996), in a comparison of several UK surveys of CED with those of mainland Western Europe suggest two things. Firstly, that at the beginning of the 1990s, the incidence of environmental reporting was more common amongst UK companies than it was across the rest of Western mainland Europe. Secondly, however, if one looks at the *volume* of CED, UK companies lagged behind countries such as Germany, France, Sweden and Switzerland, the exception being the Netherlands. Evidence in support of the latter trend is provided by Adams *et al*. (1998) in their survey of social and environmental reporting across European companies based on a sample of the largest (by turnover) 25 companies in each of six Western European countries (viz.: France, Germany, the Netherlands, Sweden, Switzerland and the UK) for which the English language version of the 1992/93 annual reports and accounts were available. These researchers report that the mean length of environmental disclosure was greatest amongst German companies (1.60 pages), with the least amount of such disclosure being provided by Dutch companies (0.29 pages). Roberts, C. (1992) describes the beginning of the 1990s as a period of generally increasing levels of disclosure but noted that:

> *… there are still instances of corporations disclosing no information in this area. Even when disclosures are fairly extensive problems still remain. In particular, the disclosure of environmental information is generally entirely voluntary. This means that corporations have almost complete discretion in deciding what information to provide and the form that the disclosures should take. This gives them the opportunity to present their activities in the best possible light by the judicious choice of what information to disclose and the reporting format used* (p.165).

Developments in CED at this time appear to have taken place without specific reference to or linkage with the financial accounts. European surveys of developments in environmental accounting and auditing in the EU and EFTA countries (FEE, 1993, 1995) concluded that in most cases of company reporting of environmental issues there was either no measurement in financial terms or no linkage with the financial statements. Harte and Owen (1992), in their review of green reporting practice in the UK at the beginning of the 1990s note a clear trend towards giving more exposure to green issues, discerning two clear trends: firstly, a marked tendency to devote increased coverage to environmental issues in the unaudited 'Review of Activities' section of the annual report and, secondly, the introduction of specific comments on environmental issues within the chairman's statement. Harte and Owen also refer to the fact that very little detailed environmental information was being provided by the 'better' disclosers at this time, with much of the disclosures linked to the development of public image rather than representing a commitment to the concept of public accountability.

A third key aspect of the data reported in Table 3.3 is the fact that the source documents are, in all cases, the annual reports and accounts. The focus on the annual report is normally justified by CSR researchers on the basis that it represents the primary document through which a company communicates to society. Whilst this argument may be valid in the context of certain aspects of CSResp and CSR, whether it is defensible in the relation to CED is questionable (this issue is addressed in more detail in Chapter 8 in relation to the selection of source documents). It is possible, for example, that a different picture would have emerged from international and national studies had account been taken of CED reported via other media such as social and environment reports. Studies which consider these other sources of CSR are relatively rare (notably exceptions include DTTI, 1996).

One of the best indicators of international trends in CED during the 1990s which includes reporting via environment reports is the series of international surveys carried out by the accounting firm KPMG (1992, 1993, 1996 and 1997a, KPMG/WIMM, 1999, 2002; see also Kolk *et al*., 2001). The results of the KPMG studies are summarized in Table 3.4 below, together with the results of a similar study by DTTI (1996). As show in Table 3.4, whereas only 15% of participating companies surveyed by KPMG in 1993 had prepared a corporate environmental or HSE report, this figure had increased to 25% of companies surveyed in 1999. The comparative figure of 17% for the 2002 survey is based on a larger sample of 19 countries which included the 'emerging' states of Greece, Hungary, Slovenia and South Africa. A fairer comparison with the 1999 survey, based on the 11 countries represented in both the 1999 and 2002 surveys, shows that 28% of companies published an environmental or health, safety and environmental (HSE) report in 2000/2001. This suggests that the trend in terms of the number of companies publishing such reports is still upwards.

The KPG/WIMM 2002 survey was also expanded to include social and community reports, 'sustainability reports' and combinations of these reports[19]. Of the 1,900 companies surveyed in 2002: 65% produced environmental or HSE reports; 12% produced social/community reports; 11% produced combined environmental and social reports; and 12% produced 'sustainability reports'. KPMG/WIMM (1999) report that 47% of the 1,100 sample companies published environmental information in corporate reports (including the statutory annual report and accounts, environmental/HSE reports, social reports and 'sustainability reports'). In comparison, the 2002 survey found that for the 1,900 sample companies, 49%

disclosed environmental information in the equivalent corporate reports (KPMG/WIMM, 2002). This suggests that the level of corporate environmental disclosure is increasing internationally.

Table 3.4
International surveys of corporate environmental reporting

Region	International	Scandinavia	nternational	International	International
Study	KPMG 1993	DTTI 1996	KPMG 1997a	KPMG/WIMM 1999	KPMG/WIMM 2002
Source documents	Annual Reports and Environment reports	Annual Reports and/or Environment reports	Annual Reports and Environmen t reports	Annual Reports and Environment reports	Annual Reports, Environment reports, Social Reports and 'Sustainability Reports'
Data year	1991/2	1994/5	1995/6	1997/8	2000/2001
Number of countries	10	4	13	11	19
Sample size	810	773	1,300	1,100	1,900
Sample criteria	Leading companies in 10 countries	Largest listed and non-listed plus others	Top 100 listed in 13 countries	Top 100 listed in 11 countries	Top 100 listed in 19 countries
Response (No.)	690	677	885	1080	1803
Response (%)	(85%)	(88%)	(68%)	(98%)	(97%)
Percentage which publish ER/HSE reports (based on response rate)	15%	12%	24%	25%	17% (28%)

Notes: The DTTI study was of 677 companies, of which 511 were the largest listed companies in each of the four Scandinavian countries (Denmark, Finland, Norway and Sweden), 124 were large non-listed companies and 42 were selected on the basis of being signatories to the ICC Business Charter for Sustainable Development in Denmark and Sweden. Figures for the KPMG surveys are based on information as reported in the respective surveys. Figures in parentheses in the bottom row for the KPMG/WIMM 2002 survey are adjusted for comparative purposes to comprise only the equivalent 11 counties included in the 1999 survey.

For the middle and latter parts of 1990s, other studies provided further evidence of a worldwide increase in the number of large companies reporting on environmental issues through stand-alone environment reports (see, for example, Davis-Walling and Batterman, 1997; KPMG, 1997b; Krut and Moretz, 2000). A survey of the *Fortune Global 100* (excluding companies from the financial services sector), for example, found that 60% of these companies had published a global environment report (Krut and Moretz, 2000). Another interesting trend revealed by the KPMG studies is the recent shift in the dominance of stand-alone environment reports from North America to Europe. In their 1996 survey

KPMG (1997a) report that the USA and Canada provided the greatest number of separate environment reports, followed by a number of European countries. However, this situation appears to have reversed with KPMG/WIMM (1999) reporting that companies in Germany published most environmental/HSE reports, followed by Sweden, the UK and Norway, with the USA being the only country not to show an increase between the 1996 and1999 with 30% of US companies producing an environmental or HSE report in the 1999 survey compared to 44% in the 1996 survey. The country showing the highest increase was Denmark, increasing from 8% of companies in the 1996 survey to 29% in the 1999 survey. Latest trends, as revealed by the KPMG/WIMM (2002) survey, indicate that the highest rate of corporate reporting (i.e. reporting via environmental/HSE, social and community reports and/or 'sustainability reports') is found amongst Japanese companies (72% of those sampled by KPMG/WIMM, 2002), followed by the UK (49%), the Netherlands (35%), Germany (32%) and Finland (32%). Compared with 1999, the KPMG/WIMM (2002) survey reports that the countries showing the largest increase in the number of companies reporting via these reports were the UK (from 32% to 49%), Finland (15% to 32%) and France (4% to 21%), with the reporting rate actually falling in Sweden, Belgium, Denmark, Germany and Norway[20].

The growth in the number of European companies providing stand-alone environment reports in the 1990s is a key issue in the context of the present study. However, the vast majority of prior CSResp and CSR research has tended to ignore these and other similar reports outside of the traditional, statutory annual financial reporting framework. Rather, in seeking to explain the causes of variations in the popularity and volume of CED across firms and over time, CSR researchers have focused almost exclusively on the statutory annual report and accounts. Such studies have generally been structured in the context of exploring putative associations between CED and other explanatory variables. These other variables, as formally proposed and researched within the CSResp and CSR literature, are considered in the next section.

3.4 Associations between CSR and other explanatory variables

Empirical studies exploring putative associations between CSR and other explanatory variables which are perceived as potential influences on CSR may generally be categorised as falling into three sub-streams: (i) social performance and economic performance; (ii) firm characteristics and (iii) external socio-political influences. The focus of the present study is on (ii) and (iii) which are discussed in detail below. However, a brief mention is made here of studies falling under (i). Many early empirical CSR studies into the determinants of the corporate decision to disclose social information tended to focus on the potential relationships between social (and environmental) disclosures of a firm and its social performance and/or economic performance[21]. Ullmann (1985) and, later, Belkaoui and Karpik (1989), classify these studies into three types:

(a) studies which looked into the relationship between social (and environmental) disclosure (SD) and social (and environmental) performance (SP) (see, for example, Abbott and Monson, 1979; Belkaoui and Karpik, 1989; Bowman and Haire, 1975; Fekrat *et al*., 1996; Freedman and Jaggi, 1982a; Fry and Hock, 1976; Ingram and Frazier, 1980; Preston, 1978; Wiseman, 1982);

(b) studies which looked into the relationship between social performance (SP) and economic performance (EP) (for example, Alexander and Buchholz, 1978; Bowman

and Haire, 1975; Chen and Metcalf, 1980; Cochran and Wood, 1984; Fogler and Nutt, 1975; Kedia and Kuntz, 1981; Moskowitz, 1975; Parket and Eilbirt, 1975; Ruf *et al.*, 2001; Spicer, 1978a, 1978b; Sturdivant and Ginter, 1977; Vance, 1975); and,

(c) studies which looked into the relationship between social disclosure (SD) and economic performance (EP) (for example, Abbott and Monson, 1979; Anderson and Frankle, 1980; Belkaoui, 1976; Belkaoui and Karpik, 1989; Bowman, 1978; Bowman and Haire, 1975; Freedman and Jaggi, 1982a; Haire, 1975; Ingram, 1978; Ingram and Frazier, 1983; Jaggi and Freedman, 1986; Preston, 1978; Shane and Spicer, 1983).

Social performance (SP) here refers to an organization's responses to anticipated or existing social demands (Strand, 1983). Hence, studies which fall into this category were generally interested in discovering whether those companies which reported more (or less) social information performed better (or worse) from a societal perspective, the basic hypothesis being that the quantity and quality of SD is positively correlated with SP (Ullmann, 1985). There have also been some studies which have explored the relation between social performance and economic returns to shareholders or return ratios covering different time periods ranging from seven months to ten years (Ullmann, 1985). The link between a company's social performance and the market value of its securities is based on a number of different lines of argument. Spicer (1978a), for example, posits that knowledgeable investors, when considering whether to invest in a company or not, would be influenced by a corporation's social performance and therefore that such performance would have a bearing on a company's share price. This is similar to the argument of Alexander and Buchholz (1978) who ventured that socially responsive firms are also more profitable because of a crossover of the management skills required for both economic and social performance. However, Ullmann (1985) suggests that the relationship between social and economic performance is problematic because of the existence of other variables that may have to be included or controlled for, such as the social beliefs of the firm's key decision makers, the visibility of the firm and the investor's ability to interpret the firm's social performance and to relate it to investment decisions. Moreover, the findings of Hines (1982) suggest that shareholders are likely to differ in relation to both their expectations of future returns and their interpretative skills. Hence, some investors may well share Friedman's (1962, 1970) view on a firm's social responsibilities and react negatively to an excessive or over-zealous managerial concern with social performance, leading to a negative or an inverted U-shaped correlation between SP and EP.

Studies which looked at the relationship between social disclosure (SD) and economic performance (EP) also include so-called 'information content' studies which explore the extent to which social disclosure reduces investors' information uncertainty, using *market variables* as a proxy for economic performance (see, for example, Anderson and Frankle, 1980; Belkaoui, 1976; Dierkes and Antal, 1985; Epstein and Freedman, 1994; Ingram, 1978; Jaggi and Freedman, 1985; Shane and Spicer, 1983)[22]. 'Information content' attracted a lot of interest from researchers, especially in North America, in the 1970s and early 1980s (for a review of the early literature, see Gonedes and Dopuch, 1974). Prior to the 1970s, the users of corporate reports were seen predominantly as being the providers of long term and short-term finance (i.e. shareholders, bondholders and other creditors) and thus much of the literature focused on stock market reaction to the publication of social and environmental *performance*

information. The attitude of investors, who represent a major constituency to which a company is legally accountable, towards social and environmental performance and reporting was seen as being a potentially key issue for the management of companies whose shares are publicly traded on stock exchanges. Social disclosures are said to have 'information content' if they reduce investors' uncertainty as to the economic risk of a firm. From this perspective, it is normally assumed that companies disclosing social responsibility information on a voluntary basis are working on the principle that the value of this information to investors is not zero (Ullmann, 1985). Hence, higher levels of social disclosure are normally posited as being positively correlated with economic performance as measured by stock market returns. However, research evidence on the 'information content' of social responsibility disclosures and economic performance is far from clear, with some studies concluding that the stock market reacts to CSR (see, for example, Belkaoui, 1976; Anderson and Frankle, 1980) and others finding no evidence of a relationship (see, for example, Abbott and Monson, 1979).

In the context of CSResp and CSR generally, the perspective that social and environmental disclosures may contain information that is relevant to the needs of *investors* is a controversial one. This is because such a perspective tends to be researched from within an efficient markets hypothesis (EMH) framework whereby social and environmental disclosure in annual reports is viewed as providing information which is of value to shareholders in their investment and risk appraisal decisions. The assumption underlying this approach, particularly in North America, is that if the reporting of social and environmental information elicits a reaction from the stock market, then investors must be utilizing the information in some way or other to adjust their expectations and, if so, the information must be useful (Epstein and Freedman, 1994). However, although the EMH has been well researched (Fama, 1970, 1976), its application to CSR has raised doubts in the minds of many researchers. Ullmann (1985), for example, raises two specific qualifications:

- that social disclosures are likely to depend on a variety of other factors, including firm size, industry and company visibility, external pressures and executive values; and,
- it is not clear whether the models (e.g. EMH) and empirical findings in relation to financial disclosures can be applied to social disclosures, noting that shareholders' ability to interpret this information would be even more difficult than with financial information (see, for example, Hines, 1982).

In relation to the last issue, some researchers have been critical of the underlying utility of 'information content' studies, their main argument being that CSR is motivated not from a concern with the information needs of shareholders and the behaviour of the capital markets, but by other considerations, such as the moral and social responsibilities of business to society (Donaldson, 1982; Gray *et al*., 1996; Mathews, 1987b; Owen *et al*., 1987). Such researchers claim that CSR can be better understood not from within an efficient capital markets framework but in terms of a *social contract* between organizations and society under which CSR is intended to fulfil an organization's *moral* obligations to report to a wider audience other than just shareholders and stock markets, such as employees, local communities, consumers and the general public. Moreover, recent empirical research casts doubt on the view that social and environmental issues are of interest to the financial community. Business in the Environment (BiE) (1994), in a study of the attitudes of 85

investment analysts in the city of London on environmental issues, found that environmental issues rank relatively very low in analysts' priorities in the context of investment analysis. Rather, their report concluded that analysts' assessments were made on the basis of 'rational' financial criteria with other issues not being seen as part of their assessments except insofar as such issues have financial consequences. Indeed, BiE (1994) report that the majority of analysts considered environmental issues as being *irrelevant*. Deegan and Rankin's (1997) study into the materiality of environmental information to users of annual reports found that stockbrokers and analysts gave greater weight to financial indicators and lower weight to environmental performance. Murray *et al.*'s (2001) empirical investigation into the relationship between share returns and the extent of social and environmental disclosures for large UK companies failed to establish either a linear or non-linear association between these two variables, either within single time periods or over time. These results suggest that the stock markets do not distinguish between companies on the basis of the amount of social and environmental information disclosed. In other words, financial markets do not seem to care about CSR.

Moreover, and this is equally important in the context of environmental disclosures, there is an inherent assumption in studies which focus on the information content of CSR that such disclosures are in some way a surrogate for real social activity or reliable measures of social and environmental performance (Owen *et al.*, 1987). There is some evidence to support the view that CSR is an *inappropriate* surrogate for a company's social or environmental performance. Rockness (1985) for example, analysed the ability of various user groups to evaluate the environmental performance of US companies based on the contents of the annual reports but found no association between the user groups' perceptions of environmental performance and those of the Council for Economic Priorities (CEP), with a negative association in some cases. Researchers (and perhaps even the stock markets) may be guilty of associating CSR/CED with social and environmental performance on the naïve assumption that non-traditional disclosures in relation to social and environmental issues in the annual report can perform the same function as financial disclosures in serving the economic needs of investors. This issue becomes all the more significant when recognising that most social and environmental disclosure is made voluntarily by management and is mostly unaudited, leading some to suggest that management discloses information which it arbitrarily considers to be 'socially relevant' subject to cost-benefit considerations (Guthrie and Parker, 1989; Puxty, 1986; Yamagami and Kokobu, 1991). This is a far from trivial issue and one which is returned to later when exploring organizational legitimacy theory in Chapter 7.

The overall results of the various studies on the interrelationships between social disclosure, social performance and economic performance are, at best, inconclusive with no clear overall picture emerging. Ullmann (1985), in an extensive review of the literature at the time, described the overall situation as 'data in search of a theory', concluding that there does not appear to be a *single* reason why firms choose to disclose social information[23]. Belkaoui and Karpik (1989), in another extensive review, concluded that "… depending on the type of conceptualisation and operationalization of key variables, the results range from strong correlation to no correlation …" (p.36), suggesting that the diversity of results was down to the failure to analyse the relationship among social disclosure, social performance and economic performance within a single conceptual framework. However, perhaps the most important finding to come out of all these studies is that the relationship between CSR and

another variable is contingent on many other endogenous and extraneous variables (see, for example, Ingram and Frazier, 1983; Trotman and Bradley, 1981). In particular, these other variables are likely to reflect a host of socio-economic and socio-political values, influences and pressures reflecting firm characteristics, political constraints, agency relationships (between managers and outside shareholders), contractual relationships with other "inputs" to the firm, and the regulatory environment. Amidst this complex array of variables, recent studies (see, for example, Gray *et al*., 1995b; Hackston and Milne, 1996) have attempted to distil from the CSR literature over the last thirty years or so an overall picture of the relationship between firm characteristics and CSR. Generally speaking, such studies have demonstrated the existence of associations between social disclosures and some firm characteristics such as size, industry and country, although any overall conclusions must remain tentative due to a lack of comparability, an absence of replication and inconsistent results. However, as represented in Figure 3.1 above, two particular categories of variables are generally perceived as providing much promise as regards explanations for variations in the popularity and volume of CSR/CED. These variables are explored in the next two sections.

3.5 Firm characteristics and CSR

This section provides a review of prior CSR research which has been concerned with putative associations between firm characteristics and CSR disclosures. Firm characteristics in this context refer to an aspect or feature of an organization which can be identified, measured and related to that organization. Most empirical CSR studies carried out over the last 30 years or so generally involve (i) identifying a firm characteristic which, based on prior research or informed assumptions, is predicated to be related in some way or other to CSR, and (ii) testing for the existence of an association between the chosen characteristic(s) and the popularity and/or volume of CSR. Ljungdahl (1999b) suggests that, as an example of voluntary disclosure, CED practice may, to some extent, be affected by the same factors that are associated with the disclosure of other voluntary information. Various studies have been made in this area which suggest that it is firm characteristics such as size and company disclosure strategy or position which are associated with the voluntary disclosure of information (see, for example, Cook, 1989; Gibbins *et al.*, 1990; and, Meek *et al*., 1995)[24]. In the specific context of CSR and CED, the type of firm characteristics chosen for study normally include one or more of the following (see, for example, Abbott and Monson, 1979; Anderson, 1980; Belkaoui, 1980; Cowen *et al*., 1987; Bowman and Haire, 1975; Ernst and Ernst, 1972-1978; Trotman, 1979; Trotman and Bradley, 1981): profit; size; industry affiliation; country of ultimate ownership; capital structure, cost of capital and systematic risk; dual stock market listings; management style; management's decision horizon; and, the existence of a social responsibility committee. Table 3.5 below provides a summary of selected studies of associations between firm characteristics and CSR/CED in chronological order. Studies which focus specifically on CED are highlighted in italics. Whilst not intended to serve as a complete, exhaustive picture, Table 3.5 is arguably representative of prior CSR studies in this field and provides an indication of the nature, focus and results of studies concerned specifically with tests of association. A more detailed discussion of the results of these studies as they relate to individual firm characteristics is provided below.

Table 3.5
Empirical (statistical) studies of CSR/CED and corporate characteristics (in chronological order)

Study	Subject, sample size, source documents and year(s)[a]	Dependent variable and basis of measurement	Statistical tests performed	Independent varia
Bowman and Haire (1975)	CSR in ARs of 82 firms in food processing (1973)	Social responsibility prose in AR	Linear regression	Profitability (ROI
Bowman (1978)	CSR in ARs of 46 firms in electronic computing (1973)	Social responsibility prose in AR	Linear regression	Profitability (ROI
Preston (1978)	CSR in ARs of Fortune 500 Firms (1975)	Quantity of social disclosures in 2 years between 1971-75	Linear regression	Profitability (ROI
Abbott & Monson (1979)	450 firms based on Ernst & Ernst study results of CSR in ARs of Fortune top 500 companies (1974)	Number and type of CSR (7 categories)	Linear regression	Profitability (ROI
Spicer (1978a)	18 US firms in pulp and paper industry (1968-73)	CEP pollution performance index	Linear regression	Profitability, size, risk, systematic ri ratio
Ingram and Frazier (1980)	40 US firms subjected to CEP performance indices, 1970 to 1974	Extensiveness of type and nature of environmental disclosures in AR	Linear regression	Environmental performance usin index scores

Study	Subject, sample size, source documents and year(s)	Dependent variable and basis of measurement	Statistical tests performed	Independent varia
Trotman & Bradley (1981)	207 ARs of 100 Australian largest listed companies (1978)	Extensiveness of CSR in AR	Non-parametric tests	Size, systematic r management's de horizon, social co
Cowen *et al*. (1987)	134 firms based on Ernst & Ernst study results of CSR in ARs of Fortune top 500 companies (1978)	Number and type of CSR (7 categories)	Linear regression	Industry, profitab social responsibil committee
Freedman & Jaggi (1988)	115 US firms materially affected by SEC pollution regulations for disclosures in 10Ks in 1973 & 1974	Extensiveness of pollution disclosures	Pearson product moment correlation co-efficients	Economic perforn (using 6 proxies i return on assets a on equity)
Belkaoui & Karpik (1989)	23 large US firms based on the first Ernst & Ernst study (1973)	Number of social programmes disclosed	Linear regression.	Size, profitability performance and contracting costs
Patten (1991)	CSR in the ARs of 128 Fortune 500 companies (1985)	Volume of social disclosure (2 groups, high disclosure and low disclosure)	Linear (OLS) regression.	Industry, profitab

Study	Subject, sample size, source documents and year(s)	Dependent variable and basis of measurement	Statistical tests performed	Independent varia
Patten (1992)	CSR in ARs of 21 firms in petroleum industry (1988, 1989)	Increase in environmental disclosures following Exxon Valdez incident	Linear regression	Size (turnover) ar involvement in 'A consortium
Roberts, C. (1991)[b]	CSR in the ARs of 110 companies covering 5 European countries[b]	Number of reported CSR categories (9 categories, 7 env; 1 H&S; 1 employment)	Linear regression (ANOVA)	Country
Ness & Mirza (1991)	CSR in the ARs of 131 largest UK industrial companies (1984)	Number and type of CSR (4 categories)	Non-parametric tests (Pearson's chi-Square)	Industry (oil secto environmental dis
Roberts, R. (1992)	Results of CEP's study of social resp. activities reported in ARs of 130 large Fortune 500 USA companies (1984 to 1986)	CEP's rating of corporate social disclosure performance (poor, good, excellent)	Logistic regression.	Stakeholder powe strategic posture, economic perforn size & industry
Hackston & Milne (1996)	CSR in ARs of top 50 listed New Zealand companies (1992)	Amount of reported CSR in terms of sentences and quantity (7 themes)	Linear regression	Size, profitability industry, overseas

Study	Subject, sample size, source documents and year(s)	Dependent variable and basis of measurement	Statistical tests performed	Independent varia
Mohamed and Hill (1996)	*CED in ARs of 124 large UK companies (1993/94)*	*Incidence and amount of CED disclosures (10 categories)*	*Chi-squares test on incidence; multiple regression non-parametric tests on quantity*	*Industry (environ sensitivity), size*
Al Najjar (1997)	CSR in the ARs of 451 US Fortune 500 companies (1990)	Number and type of CSR (4 categories)	Linear regression	Size, profitability
Halme & Huse (1997)	*CED in ARs of 140 large companies from 4 countries (1992)*	*Quantity of CED (2 groups)*	*Logistic regression*	*Industry, size, cou ownership concer board size*
Adams *et al*. (1998)[b]	CSR in ARs of 150 large companies from 6 countries (1992)[b]	Quantity & type of CSR (3 groups: environmental, employee and ethical)	Linear regression (ANOVA tests)	Industry, size, cou
O'Dwyer and Gray (1998)	Study of CSR in ARs of 50 largest Irish listed companies (1991 to 1995)	Quantity and type of CSR (3 groups, HR, environment and community)	Non-parametric tests (Spearman Rank Correlation Coefficients (size) & Kruksal-Wallis (Chi squares) test (industry)	Industry, size (ma capitalisation)

Study	Subject, sample size, source documents and year(s)	Dependent variable and basis of measurement	Statistical tests performed	Independent varia
Ljungdahl (1999a)	*Study of CED in ARs & stand-alone ERs of 94 listed Swedish companies (1990 - 1996)*	*Quantity of CED*	*Linear regression. Quantity of CED (number of pages)*	*Industry, profitab ownership, levera*
Gray *et al*. (2001)	Study of CSR in ARs of top 100 UK listed companies (1988 to 1995) (although the actual number employed in each regression varied from 66 to 95)	Quantity and type of CSR (3 groups: environmental, employee and community)	Linear (OLS) regression. Quantity of CED (number of pages)	Size (turnover, ca employed, no. of employees), profi and industry

Notes:

a. Abbreviations: AR = Annual Reports; ER = Environment reports; CSR = Corporate Social Reporting; CED = Corp Council on Economic Priorities (USA); CA = content analysis; (+) & (-) direction of association, where a plus si minus sign a negative association.

b. The five European countries included in the Roberts, C. (1991) study were France, Germany, the Netherlands, Sw countries included in the Adams *et al*. (1998) study were: France, Germany, the Netherlands, Sweden, Switzerlan

(i) Size

Company size is perhaps the most common firm characteristic in the CSR literature and has consistently been found to be significantly associated with voluntary social responsibility disclosures (see, for example, Adams *et al*., 1995, 1998; Brockhoff, 1979; Cowen *et al*., 1987; Deegan and Gordon, 1996; Dierkes and Coppock, 1978; Eilbirt and Parket, 1973; Gray *et al*., 2001; Hackston and Milne, 1996; O'Dwyer and Gray, 1998; Patten, 1991, 1992; Trotman and Bradley, 1981). However, Cowen *et al*. (1987) found that the association existed only in the case of certain areas of disclosure (mainly environmental and community-based) and one study (Singh and Ahuja, 1983 – not shown in Table 3.5) found no relationship. Previous studies have used one or more of the following surrogates for size (see, for example, Belkaoui and Karpik, 1989; Gray *et al*., 2001; Kimberly, 1976; Newbould and Wilson, 1977; Patten, 1990, 1991, 1992; Roberts, R., 1992): number of employees; total book value of assets; reported earnings (book profits); sales turnover; log of net sales; capital employed; market capitalisation; and, an index rank (e.g. *Fortune 500*). Whilst no theoretical reasons exist for the choice of a particular measure of size (Hackston and Milne, 1996), in the case of large banks and other financial institutions, their total assets tend to be much greater than the total assets of industrial and other service companies (see, for example, Barrow, 1997). Moreover, the term 'turnover' does not have the same meaning for banks and other similar financial institutions as it does in the case of industrial and other service companies.

Research by Cowen *et al*. (1987), Dierkes and Coppock (1978) and Trotman and Bradley (1981) indicated that size was the decisive characteristic for CSR disclosures. Moreover, it has been shown that the association between size and CSR holds true both across European countries and across different types of social disclosure (such as employee, ethical and environmental information) (Adams *et al*., 1998). Cowen *et al*. (1987), for example, concluded that in the case of CED, size appears to have a significant impact upon whether environmental disclosures are made, larger companies making a greater number of such disclosures. Al Najjar (1997) in a study of CSR of the 1990 annual reports of 451 US *Fortune 500* companies, tested for the significance of size, industry and profitability amongst total CSR as well as for each category of CSR (community involvement, product safety, human resources and environmental protection). Size appeared to hold the most explanatory power for all types of disclosures. When testing for each category of CSR, environmental protection disclosures were found to be significantly associated with size only, whereas community involvement and product safety disclosures were found to be significantly associated with both size and industry, with human resources disclosures significantly associated with profitability and size. These results indicate that the association between firm characteristics and CSR may also be a function of the type of disclosure, suggesting that any discussion of CSR in aggregate may provide only a partial picture of the underlying associations.

In a recent *longitudinal* study of larger Irish companies, O'Dwyer and Gray (1998) found a significant association between size and the average volume of a company's total social disclosure for all five years of their study (1991 to 1995, inclusive). However, when looking at individual disclosure streams (i.e. by type) the results were less significant. In particular, in the case of environmental disclosure, only one year (1992) out of five produced a statistically significant association (at the 10 per cent level) between total CED and size (based on market capitalisation) and in the case of 1995, the association was negative. Moreover, if the

mandatory CSR disclosures are excluded the results were less convincing, O'Dwyer and Gray (1998) reporting no significant association between company size and *voluntary* CSR in the latter years (1994 and 1995) of their study. Similarly, Gray *et al*. (2001) in their longitudinal study of social and environmental disclosure by UK companies over the period 1988 to 1995 used three surrogates for size – turnover, capital employed and number of employees. Of the 24 regressions run against total CSR only 12 (i.e. 50 per cent) provided statistically significant results at the five per cent level. Similarly, for the 24 regressions run against CED only, 50 per cent provided statistically significant results. The inconsistent nature of these results suggests that the relationship between size and CSR/CED may not be stable over time but varies from one year to another. Moreover, not all studies have found as association between company size and CSR (see, for example Davey, 1985 and Ng 1985, as reported in Hackston and Milne, 1996; Halme and Huse, 1997; O'Dwyer and Gray, 1998; Roberts, R., 1992). The Davey (1985) and Ng (1985) studies involved random samples that included smaller companies. One possible explanation suggested (but not substantiated) by Hackston and Milne (1996) for the failure to find an association between size and CSR in both studies is that the size-disclosure association exists only for the largest of companies, i.e. it does not hold for smaller companies. Given that CSR studies are overwhelmingly focused on the largest companies (see Tables 3.3, 3.4 and 3.5 above), it may be that by focusing on these larger companies, researchers have neglected to consider whether the association also holds true for small and medium-sized companies (see, for example, Jackson and Owen, 2000; Mohamed and Hill, 1996).

Theoretical explanations as to *why* CSR might be associated with the size of a firm are largely absent from most CSR studies in the 1970s and 1980s. However, both Trotman and Bradley (1981) and Dierkes and Coppock (1978) used a shareholder-utility perspective in suggesting that in the case of listed companies, larger companies have more shareholders who might also be concerned with social programmes undertaken by the company. Trotman and Bradley (1981) also suggested that larger companies are more visible because they undertake more activities and hence have a greater impact on society. Consequently, larger firms are suggested as receiving more attention from the general public and therefore are under greater social pressure to exhibit social responsible behaviour, including CSR. More recent CSR studies have sought to situate the size-disclosure hypothesis within different economic, social and political theories. These studies, where relevant, are explored in more detail in Chapters 5, 6 and 7.

(ii) Profit

As shown Table 3.5 above, the relationship between CSR/CED and profit measures is inconclusive at best. A number of studies have found *no* association (for example, Abbott and Monson, 1979; Belkaoui and Karpik, 1989; Cowen *et al*., 1987; Hackston and Milne, 1996; Patten, 1991), whilst others find either an U-shaped or an inverse relationship (Bowman and Haire, 1975; Ainajjar, 1997). Conversely, both Bowman (1978) and Preston (1978) report a positive association, although in the latter's case the association was weak. Moreover, the two studies that specifically looked at an association between environmental disclosure and profit suggest no association (Freedman and Jaggi, 1988; Ljungdahl, 1999a). Gray *et al*. (2001), report a significant association (at 5 per cent) between profit and social and environmental disclosure in four years out of eight (i.e. in 50 per cent of cases), suggesting that this

relationship is not consistent over time. This fact may in itself help to explain the inconclusive nature of other studies which look at particular years in isolation

(iii) Industry classification

Along with size, the industry characteristic of a firm has been found to be associated with CSR (see, for example, Adams *et al*., 1998; Brockhoff, 1979; Cowen *et al*., 1987; Dierkes and Preston, 1977; Fekrat *et al*., 1996; Hackston and Milne, 1996; Halme and Huse, 1997; Ljungdahl, 1999a; Mohamed and Hill, 1996; Patten, 1991; Roberts, R., 1992). Underlying these studies is an assumption that some industries feel greater social pressure for certain areas of corporate social responsibility, which leads to higher levels of reporting on social and environmental issues. Dierkes and Preston (1977), for example, argue that companies whose economic activities modify the natural environment, e.g. the extractive industry, are more likely to disclose social information about their environmental impacts than are companies in other industries. Patten (1991) took a slightly different perspective, suggesting that industry, like size, is related to political visibility and social disclosures may be used to deflect political pressures from certain sections of society such as social activists. Empirical research tends to support this hypothesis. Hackston and Milne (1996), for example, found that large New Zealand companies operating in 'high-profile' industries disclosed significantly more social and environmental information than those operating in 'low-profile' industries. These findings were consistent with those of Patten (1991) and Roberts, R. (1992).

However, not all studies found industry to be associated with CSR (see, for example, Cowen *et al*. (1987) in relation to US companies; Davey (1985) and Ng (1985), as reported in Hackston and Milne (1996), in relation to New Zealand companies; and Kirkman and Hope (1992) in relation to UK companies). Others found only partial support (see, for example, Al Najjar, 1997). Cowen *et al.* (1987) found that industries were associated with different *types* of CSR but did not find a significant association between environmental disclosure and industry type. Similarly, when testing for significant differences between *sectors* in relation to the average volume of disclosure, for total CSR disclosure O'Dwyer and Gray's (1998) results were significant for three years out of five (but only in one case were the results significant at the five per cent level). When looking at individual CSR streams, in the case of CED O'Dwyer and Gray's results were significant for *only* two years out of five, only one of which (1992) was significance at the five per cent level. Hackston and Milne (1996), in their study of large New Zealand companies, reported both size and industry as being significantly associated with the amount of disclosure. In addition, by including a further variable (i.e. dual and multiple overseas stock exchange listings, see below), they increased the explained variation from 46 per cent (Adjusted *R-squared* = 0.467) to 76 per cent (Adjusted *R-squared* = 0.767). Hackston and Milne argue that size and industry on their own may not be enough to explain CSR. They suggest looking at size *within* environmentally sensitive industries on the premise that large companies in sensitive industries may be attempting to use CSR as a political device for mitigating the effects of large and noticeable impacts on the environment and society.

International surveys also tend to suggest that environmental reporting seems to be more widely practised in certain industries, such as forestry, than others (UN, 1992). Similarly, studies of environmental reporting by firms operating in the more environmentally-sensitive sectors, such as energy utilities, chemicals, oil and gas, and forestry, suggest that these

industries, on the whole, appear to report more environmental information than companies operating in less environmentally sensitive sectors. Niskala and Pretes (1995), for example, in their longitudinal study of environmental reporting by 75 of the largest Finnish companies between 1987 and 1992, found the sectors with the highest percentage of companies reporting environmental information in their annual reports in 1992 to be energy production, forestry and forest products and oil trading (100% in each case). The only sector to show a fall in the percentage of companies disclosing environmental information was the construction industry, which, due to the active discussion on safety and working conditions in Finland in the 1980s, was seen as the main factor prompting many firms to report on workplace safety (Niskala and Pretes, 1995). DTTI (1996) in their study of 677 annual and environment reports of Scandinavian firms report that companies within the forestry, pulp and paper and oil and chemicals sectors practised the most extensive corporate environmental reporting, whereas companies in the trade and services, property and investment and banking and insurance sectors practiced the least extensive. The various empirical studies referred to above suggest that the social, political and environmental aspects of a particular industry may influence the extent of CSR/CED by companies in that industry. Moreover, within the more environmentally sensitive industries, it may be that size matters, larger companies have a greater propensity to disclose and/or disclose more CSR than smaller companies.

(iv) Country of ultimate ownership

Prior research suggests that the nature and extent of CSR varies between different countries (Adams *et al*., 1998; Brockhoff, 1979; Fekrat *et al*., 1996; Gray *et al*. 1995b; Guthrie and Parker, 1989, 1990; Halme and Huse, 1997; KPMG, 1993; Roberts, C., 1991, 1992; Schreuder, 1979; Trotman and Bradley, 1981), which could imply that the country in which an organization is based is an influencing factor. Gray *et al*. (1995b) also suggest (based on a review of prior research) that country of ultimate ownership and the country of reporting appear to be associated with social disclosure, either because they are mandated by regulation (through legislation and the stock exchange: see, for example, Guthrie and Parker, 1990) or because the reporting culture demands it with companies in the more regulated countries (particularly the USA, Canada and the UK) making higher social disclosures. Hackston and Milne (1996) suggest that Gray *et al*.'s (1995b) review of a number of studies indicates that the country in which an organization is reporting may affect the *theme* of CSR, if not the *amount* of disclosure. It may also be the case that the country in which a company is operating is relevant in the context activities which are politically or environmentally sensitive, such as in the cases of BPAmoco in Columbia, Royal Dutch/Shell in Nigeria and Heineken in Burma. There have also been some studies that have looked specifically at CSR *across countries* (see, for example, Adams *et al*., 1995b; Andrew *et al*., 1989; Belkaoui and Karpik, 1989; Cowen *et. al*., 1987; Guthrie and Parker, 1990; Lynn, 1992; Ness and Mirza, 1991; Niskala and Pretes, 1995; Roberts, C., 1990, 1991; Trotman and Bradley, 1981; UN, 1992, 1994). On a general level, these studies provide evidence which suggests that there are differences in terms of both the quantity and types of disclosures across countries. Roberts, C. (1991), for example, in studying social and environmental disclosure in the annual reports of 110 companies across five different European countries, found a significant association between country and CED, but the results were mixed when looking at categories of CED. Other European studies (Adams *et al*., 1995b and Adams *et al*., 1998) report that German companies tend to disclose the most environmental information, whereas Dutch companies

disclose the least. However, the generality of these differences is difficult to determine due to differences in the composition of the companies (for example, in size and industry) that make up the sample from each country.

(v) Capital structure and cost of capital

Capital structure has been perceived as another firm characteristic which influences CSR. Lenders of loan finance such as debentures often impose restrictive covenants on the firm and its management to restrict wealth transfers (see, for example, Dhaliwal, 1980; Felton, 1982; Jensen and Meckling, 1976). Given that these covenants are often related to accounting income, the management of firms with high financial leverage (that is, a high ratio of debt finance relative to equity finance) are argued to adopt policies which increase reported earnings, for example, by reducing discretionary social and environmental programmes or by not carrying out any programmes which would reduce reported earnings in the short term (Dhaliwal, 1980; Felton, 1982). In turn, this is said to influence the level of CSR (see, for example, Belkaoui and Karpik, 1989). Similarly, a high cost of capital due to the perception, on the part of investors, of a high economic risk, has also been argued to be associated with higher levels of CSR (see, for example, Elliot and Jacobson, 1994; Sweeney, 1994; Dhaliwal, 1978; Conover and Wallace, 1994; EFFAS, 1994, 1996). A company that is currently experiencing a high cost of capital may resort to the use of disclosures of more information, including environmental disclosure, in an effort to improve transparency as to the firm's economic risk, thereby seeking to reduce the company's cost of capital. Empirical evidence to support the cost of capital/CSR association is sparse although anecdotal evidence suggests that the executive management of many companies realise institutional investors prefer to invest in firms which provide detailed information, including CSR, and that good investor relations can help their share price (Sweeney, 1994). It can be argued, for example, that financial participants and the stock markets actually need and want to be informed of the impact in terms of the social and environmental costs which the reporting organization has on society (see, for example, Cooper, 1988; Owen *et al*., 1987). Moreover, there have been a number of studies (see, for example, Belkaoui, 1984; Benjamin and Stanga, 1977; Chenall and Juchau, 1977; Firth, 1978, 1979, 1984) which have suggested that the financial community find CSR information at least moderately important. However, the cash flow consequences of any CSResp-related expenditure appear to be important in this context. Mintzberg (1983), for example, in a review of studies which have investigated the 'information content' of social disclosures (see Section 3.4 above), tentatively concluded that stock market participants reacted favourably, although there was a clear expectation that companies could take social responsibility only so far before investors' concerns with the cost implications became an issue. Similarly, Mahapatra (1984), in an empirical investigation of investor reaction to CSR, argued that the 'rational economic investor' views pollution control expenditure as a drain on the organization's resources which could be invested profitably in other areas, and thus investors do not 'reward' companies which undertake such socially-responsible behaviour.

(vi) Management style and decision horizon

CSR disclosures have been argued by some to be indicative of a particular style of management, with certain management styles likely to produce more CSR disclosures than others (Browne and Haire, 1975; Cowen *et al*., 1987; Heinze, 1976). Cowen *et al*. (1987), for

example, suggest that CSR disclosures may reflect an adaptive management approach to dealing with a dynamic, multidimensional, external environment and an ability to meet social pressures and thus respond to societal needs. Browne and Haire (1975) suggest that a more adaptive management style would be revealed through management instituting various programmes designed to respond to societal needs. Disclosure of these programmes is a means of demonstrating management's willingness to develop long range strategic planning necessary for surviving in an ever-changing corporate environment. Management's decision horizon has also been seen as a firm characteristic associated with CSR. Studies have provided evidence which suggests that companies disclosing social information placed stronger emphasis on the long term compared to companies that did not disclose this information (Trotman and Bradley, 1981; Parker, 1977). Trotman and Bradley (1981) employed a cost/benefit analysis in theorising that the explanation for this lies in the fact that there are economic benefits in the long term (although not always in the short term) which outweigh the costs of corporate social responsibility programmes. By disclosing these programmes, the firm might improve its public image and increase its long run prospects for survival and growth. Empirical evidence to support the specific association between CED and certain styles of management is more commonly interpreted in the context of management attitudes towards environmental issues (see, for example, Campbell, 2000; Freedman and Jaggi, 1988; Hackston and Milne, 1996; Roberts, R., 1992; Ullmann, 1985), the views of management being seen as a key factor in determining the level of CSR (Gray and Bebbington, 2001).

The numerous empirical studies and resulting evidence referred to above provide a rather mixed, confusing and evasive picture of what is a complex economic and socio-political phenomenon. Whilst firm characteristics such as size, industry, capital structure and country appear to be associated with CSR, the overall evidence is, at best, inconclusive and contradictory. This confusing situation is aggravated by the fact that empirical studies into CSR are not strictly comparable, having been conducted at different periods in time, employ different definitions, research methods and sample criteria, use different sample sizes and are performed by researchers operating from within different research traditions. Gray *et al.* (2001) suggest that there are a number of other reasons why these prior studies produce such contradictory and inconsistent results, such as the fact that most studies fail to distinguish adequately between mandatory (i.e. legally-required) and voluntary disclosures. Nevertheless, some researchers have offered interpretations as to the overall state of play. Neu *et al.* (1998), for example, conclude that firm size, systematic risk, industry, and managerial decision horizon are associated with social disclosures. Gray *et al.* (1996) conclude that CSR varies over time, between countries and tends to be related to both company size and industry. Similarly, taking into account the results of longitudinal studies, Gray *et al.* (1995b) suggest that it is possible to draw a number of tentative conclusions as to the *nature* and *causes* of CSR:

(i) CSR does not appear to be a systematic activity but rather, to the extent that it is a *voluntary* activity, goes through cycles of ups and downs in terms of popularity, the subjects addressed and the organizations which engage in CSR;

(ii) CSR does appear to be related to company size, although the results are not so reliable if no allowance is made for the presence of other influencing factors (Andrew *et al*., 1989; Belkaoui and Karpik, 1989; Cowen *et al*., 1987; Trotman and Bradley, 1981);

(iii) the country in which the organization is reporting and the country of ultimate ownership do seem to have a significant effect (Guthrie and Parker, 1990; Freedman and Jaggi, 1988; Roberts, 1990; Teoh and Thong, 1984);

(iv) there is some evidence of an industry effect, but prior studies are not clear or consistent enough to assess exactly what, if any, these effects may be (Beresford and Cowen, 1979; Cowen *et al*., 1987; Freedman and Jaggi, 1988; Roberts, 1990; Zéghal and Ahmed, 1990); and,

(v) CSR does *not* appear to be related to profitability in the same period although there is some evidence to suggest that it may be related to lagged profits (Abbott and Monson, 1979; Belkaoui and Karpik, 1989; Cowen *et al*., 1987; Freedman and Jaggi, 1988; Ingram, 1978; Roberts, R., 1992).

In addition, certain factors appear to make it more likely that a company will make social and environmental disclosures, including capital intensity, senior executives' values and attitudes, and the existence of social responsibility committees (see, for example, Belkaoui and Karpik, 1989; Campbell, 2000; Cowen *et al*., 1987; Roberts, R., 1992; Trotman and Bradley, 1981). However, Gray *et al.* (1995b) emphasise that these conclusions are necessarily tentative because of the dearth of systematic theorising in the literature, concluding that prior studies "… are not clear or consistent enough to assess exactly what, if any, these effects might be" (pp.49-50). Adams *et al*. (1998), in a cross sectional, single period study of the 1992 annual reports of 150 large companies across six European countries, report significant differences in the amount of CSR between countries. However, such differences could *not* be associated with either size or industry, leading the researchers to conclude that, in attempting to explain differences across countries, the situation is much more complex and that other factors are clearly involved but which they were unable to identify in their study. Adams *et al*. (1998), suggest that cultural and political factors are at work in the case of German and UK companies which provide more social disclosures than companies in France, the Netherlands, Sweden and Switzerland. However, the authors offer no explanation as to why German companies report more social responsibility information than Dutch companies, even though, generally speaking, the Dutch have closer social, political, economic and cultural ties with Germany than with France or the UK.

One final point to be made here concerns Gray *et al*.'s (1995b) observation that CSR goes through cycles of ups and downs. This may be more significant than most empirical studies have hitherto acknowledged (a reflection perhaps of relatively sparse number of longitudinal, cross sectional studies). In particular, these cyclical movements suggest that multi-period studies of trends in CSR over time (i.e. longitudinal studies) may be of considerable value in terms of understanding the nature and causes of CSR. Moreover, cyclical fluctuations in CSR over time (see, for example, Gray *et al*., 2001; Unerman, 2000) may suggest the presence of other external socio-political influences which have still to be properly explored from within various socio-political theoretical frameworks. These other social and political influences are considered in more detail below.

3.6 Socio-political influences on CSR

Previously, at various junctures in this and the previous chapter, reference has been made to external influences (see Figure 3.1 above) which, potentially at least, could affect management's decision to disclose/not to disclose social and environmental information. Although there is a complex array of such influences, they have been categorised into four primary areas (Gray and Bebbington, 2001): industry and voluntary initiatives; market pressures; legislation and regulatory pressures; and, social pressures. In a socio-political context, each of these areas represents a potential source of external influence on the firm's management as the latter seeks to manage the firm's relationship with the societies within which it operates. Roberts, C. (1991), for example, in exploring the question as to why business executives choose to voluntarily disclose information, notes that prior studies have indicated that this varies both across countries (see, for example, Gray *et al.*, 1990) and across companies (see, for example, Ronen and Livnat, 1981; Wong, 1988). Possible reasons for these variations include (Roberts, C., 1991) stock market considerations in the case of listed companies and political considerations, such as to reassure the public or governments at both local and national levels, or to alter their perceptions and so reduce any potential political costs (see, for example, Watts and Zimmerman, 1986).

The influence of the stock market is predominantly orientated towards economic considerations given that the primary concern of investors and potential investors is the accumulation of monetary wealth. A brief reference was made to prior CSR research in this area in Section 3.4 above in the context of 'information content' studies which explore the association between social and environmental disclosure and economic performance. Whilst economic considerations clearly play an important role in the running of any business, it is less obvious, based on prior CSR studies, that such considerations are uppermost in the minds of business executives when deciding whether or not to make social and environmental disclosure (see, for example, Ljungdahl, 1999a, b). Some argue, for example, that disclosure decisions are always *political* decisions (see, for example, Cooper and Sherer, 1984; Hunt and Hogler, 1990; O'Leary, 1985). 'Legislative and regulatory pressures', for example, are one form of socio-political pressures on an organization (Trotman and Bradley, 1981) and organizations are known to develop their disclosure practices ahead of the introduction of legislation so as to give themselves time to implement the necessary management and information systems and to build up, or acquire from outside, the required expertise in a new area of disclosure (Gray and Bebbington, 2001). In an environmental context, forthcoming laws and regulations are suggested as having influenced the level of environmental reporting in both Denmark (see, for example, KPMG, 1999) and the Netherlands (see, for example, KPMG Environmental Consultants, 1998), although this evidence is largely anecdotal.

'Social pressures' refers to the socio-political pressures which the different social groups within a society may bring to bear on institutions to achieve ends that they favour. Such groups include shareholders, employees and their representatives, customers, consumers and local communities as well as external social pressure groups. The notion that pressure groups play a significant role in society is related to the concept of *pluralism* (pluralism is discussed in more detail in chapters 4 and 6) since the political process is seen to result from a large number of often competing pressures (Abercrombie *et al.*, 1994). Since the late 1960s, there has been a noticeable shift within Western societies in terms of the number of sources from

which political pressures on business organizations have sprung, as well as the degree and level of sophistication of such pressures. Notably, non-governmental organizations (NGOs) such as Amnesty International, Greenpeace and Friends of the Earth (FoE) became increasingly more adept at using the mass media (e.g. television and the press) to help them gain public approval and support for their campaigns. The idea that social pressures are associated with, and may influence, the level of social and environmental disclosure by business organizations has attracted a lot of interest from CSR researchers (see, for example, Deegan and Gordon, 1996; Deegan and Rankin, 1996; Dowling, and Pfeffer, 1975; Gray *et al.*, 1995b; Neu *et al.*, 1998; Roberts, R., 1992; Tilt, 1994; Trotman, 1979; Trotman and Bradley, 1981; Walden and Schwartz, 1997). Trotman (1979), for example, suggested that legislation is often prompted because of community pressures from sections of society such as environmentalists and other groups who apply pressure on government bodies to control the effects of corporate actions on society. Trotman and Bradley (1981) reported a positive relationship between the degree to which a company's management perceives the organization to be operating under social pressures (they used the term 'social constraints') and the extent of its CSR. Felton (1982) noted that any disclosure process is highly complex and is likely to be influenced by numerous factors of a financial or non-financial nature. Non-financial factors suggested by Freedman and Jaggi (1988) in the context of environmental pollution disclosures included pressures from outside groups such as shareholders and customers and fear of altercations with regulatory authorities.

In the specific context of environmental disclosure, Ljungdahl (1999b) notes that major stakeholders in companies rarely request copies of corporate environment reports. This raises the obvious question of why, in the absence of any legal requirements and obvious demand from the stock market, should corporate environmental reporting have grown so rapidly during the 1990s (as noted in Chapter 2, legislation requiring environmental disclosure and reporting was only recently introduced in EU member States such as Denmark, Norway, Spain, Sweden and the Netherlands). Ljungdahl (1999a, b) carried out a series of 20 interviews with representatives of Swedish companies which had a relatively well developed corporate environmental reporting history to identify factors, internal and external, affecting the decision to disclose environmental information. Based on the results of his interviews, Ljungdahl concluded that both the internal firm environment and external socio-political factors are important in explaining companies' environmental disclosure behaviour. More significantly perhaps, Ljungdahl notes that these factors are only partially captured in the firm characteristics used in the various regression analyses of CSR (see Table 3.5 above). Ljungdahl did not test the strength of these various factors and recognises that, in the absence of such testing, it is difficult to gauge the relative importance of each. Testing of the association between socio-political factors and CSR is problematic because of the difficulties in identifying appropriate proxies for these factors which are capable of measurement and which thus lend themselves to statistical analysis. Gray *et al.* (2001), for example, whilst recognising that these factors may well significantly improve the modelling of associations with CSR, raise doubts over whether it is possible to capture them by observable surrogates such that they could be used in statistical modelling.

Nevertheless, external influences, particularly pressures from consumers, regulatory bodies and other social and political pressure groups, are perceived as possessing considerable potential in aiding our understanding of the nature and causes of CSR. Moreover, researchers

have begun to explicitly *theorize* CSR disclosures from within differing socio-political frameworks, including stakeholder (Roberts, R., 1992; Tilt, 1994; Ullmann, 1985) and legitimacy (Deegan and Gordon, 1996; Guthrie and Parker, 1989; Neu *et al*., 1998; Patten, 1991) perspectives. Neu *et al* (1998, p.267), for example, argue "… an unpacking of 'public pressure' provides insights into the differential responses of organizational managers to the demands of the various 'relevant publics'".

3.7 Summary and conclusions

There have been many empirical studies into CSR over the last 30 years or so. These studies have provided insights into: (i) the proportion of companies disclosing CSR; (ii) the type of information disclosed; (iii) the trend in overall disclosure over time; (iv) the general association between CSR and firm characteristics such as size and industry; and (v) the propensity of large firms to indulge in CSR. Although the evidence seems to suggest that there are many factors which influence the extent and nature of CSR, these studies have raised as many questions as they have answered. At the present time, there are still many unresolved issues and issues over which the empirical evidence is either inconclusive or contradictory (Adams *et al*., 1998)[25]. Some have questioned whether any stable relationships between CSR and firm characteristics have been proven (Hackston and Milne, 1996), noting the lack of standardization in the research techniques employed with regard to sampling and measurement techniques, this being one reason why it is difficult to draw any firm conclusions on these relationships (Lindsay, 1995). Despite these justifiable concerns, it seems fair to conclude that some relationships have been established. Gray *et al.* (1993, p.206), for example, were able to identify several themes in voluntary corporate reporting of social and environmental issues that were apparent in the early 1990s based on their review of prior published research:

(i) the *proportion* of companies disclosing voluntary information and the *extent* of that disclosure are small;
(ii) the *quality* of such disclosures (such as, for example, the verifiability or specificity of the data) is low;
(iii) disclosure varies over time, both across companies and between countries, with environmental disclosure in particular reflecting the changing social, political and economic climate in which they occur;
(iv) the *total* amount of voluntary disclosures stays fairly constant over time, with changes occurring in the subject matter of such disclosures;
(v) there is a very clear *size* effect with larger companies being more likely to disclose than smaller companies; and,
(vi) very little disclosure would be considered 'information' in the normal sense of the word, the vast majority lacking any quantitative support, financial or otherwise, with an emphasis on public relations rather than transparency.

Notwithstanding these general themes, there nevertheless remains a lack of consensus within the CSR literature as to *why* companies disclose social and environmental information. It is only relatively recently that CSR researchers have begun to explicitly theorise as to the reasons *why* companies voluntarily report social and environmental information (Gray *et al.* (1995b). Trotman and Bradley's (1981) study, for example, whilst comprehensive in terms of

the 'shopping list' of variables which were synthesised from the CSR literature, lacked a cohesive theoretical framework, such that the testing of this shopping list required the adoption of various (and potentially conflicting) theoretical perspectives (Deegan and Gordon, 1996). The absence of systematic theorising of CSR has been suggested as one of the principal reasons for the present lack of any substantive conclusions about CSR. Moreover, although there have been a number of studies that have researched CSR over time (see for example, Campbell, 2001; Deegan and Gordon, 1996; Gray *et al*., 1995b; Guthrie and Parker, 1989; Hogner, 1982; O'Dwyer and Gray, 1998) and across countries (see, for example, Adams *et al*., 1995b; Adams *et al*., 1998; Andrew *et al*., 1989; Belkaoui and Karpik, 1989; Cowen *et. al*., 1987; Guthrie and Parker, 1990; Lynn, 1992; Ness and Mirza, 1991; Niskala and Pretes, 1995; Roberts, C., 1990, 1991; Trotman and Bradley, 1981; UN, 1992, 1994) which have provided evidence of trends in and amounts and types of CSR, these studies have not filled the void which exists in relation to the extent to which CSR practices have been influenced by culture, regulations and social pressure groups (Adams *et al*., 1998).

The extent to which cultural differences or the particular socio-political characteristics of a country are the dominant influences on CSR practices in the 1990s is open to debate. Lewis and Unerman (1999), for example, suggest that the practice of CSR may be culturally relative. The influence of both culture and national customs in accounting practices amongst the Member States of the European Union and EFTA countries has been well documented (see, for example, Haire *et al*., 1966; Hofstede, 1980, 1991; S. Gray, 1988). There are also known to be strong influences from the particular social and political structures which exist within a particular country as well as those which become established as a result of accidents of history (Hopwood, 1983, 1987; Puxty *et al*., 1987; Loft, 1988; Adams and Harte, 1998). Adams *et al*. (1998) argue that when looking at the largest (i.e. global) corporations, corporations which are economic giants with operations and activities all over the world, the importance of country- and culture-specific factors may be outweighed by other factors, such as industry- and corporate-characteristics. The rise of economic globalisation in the latter part of the 20th century, together with the increasing internationalisation of accounting and reporting practices under the IASB, may indeed, as suggested by Adams *et al*. (1998), increase the potential influence of firm characteristics such as size and industry in explaining CSR practices. However, the potential political, social, environmental and cultural influence of global corporations, by virtue of their sheer economic power, particularly in terms of their relationship with national governments through such institutions as the World Trade Organization (WTO) and the World Economic Forum, may also generate increased concerns amongst societies whose agenda is not completely dominated by concerns with economic growth, consumerism and self-interest. Consequently, the relevance of socio-political pressures and other external influences on large corporations in aiding our understanding of the nature and causes of CSR is arguably just as, if not *more*, important. Hence, the position adopted in the present study is to explore the contribution of both 'firm characteristics' and 'socio-political influences' from within several different theoretical frameworks, employing traditional positivist methodology in each case. These different theoretical frameworks are explored in the next chapter.

Notes

1. Motive is *very* difficult to assess for those not directly involved in the decision-making process. Consequently, care needs to be exercised when assuming the motivations underlying a disclosure decision of any kind, environmental or otherwise. Socio-political pressures on organizations are known to exist and can be observed in practice. However, this is not the same as being able to say that these pressures succeed in changing the behaviour of organizations. Moreover, although we can identify the many potential forces for change, particularly in relation to environmental issues, the process by which such forces succeed in bringing about change and the form that such change takes is still not fully understood (Gray and Bebbington, 2001). For an introduction to the external and internal influences for 'environmental change' within organizations, see Bebbington *et al*., 1994; Gray and Bebbington, 2001; Gray *et al*. 1995a. For a general introduction to issues of organizational change, see, for example, Laughlin, 1991.
2. It is impractical in a single study to investigate all the internal factors, external factors and firm characteristics which may have an influence on CSR/CED. Rather, as with all prior research of this nature, the aims of the present project are much more modest, being essentially to explore the influence of a number of factors which, *a priori*, are suggested as having explanatory power in the context of the three chosen theoretical frameworks. The extent to which these factors are shown to explain variations in the volume of CED across firms is discussed at the conclusion of the study in Chapter 11.
3. An in-depth review of the complete domain of social responsibility research is outside the scope of the present study. For different attempts at providing such an overview, see, for example, Belkaoui and Karpik, 1989; Gray, 2002; Gray *et al*, 1995b; Mathews, 1997; Ullmann, 1985. Mathews (1997) provides a systematic examination of the published research literature in social and environmental accounting over the 25-year period from 1971 to 1995.
4. Interestingly, these developments mirror the trend in mainstream accounting research which, prior to the 1970s, was dominated by 'normative' thinking and theorizing (Mattessich, 1980). However, since the 1970s, empirical research has become the dominant focus of the mainstream accounting academic research community. Laughlin (1995) suggests that this was due to firstly, a 'tissue rejection' of normative ideas in accounting practice and secondly, pressure from both the 'economics' and 'behavioural' schools for greater empirical understanding of accounting. As is discussed later in this chapter, early interest in developing normative models of social accounting eventually gave way to an emphasis on empirical understanding. The failure of business to take up many of the early, exploratory models of social accounting may have played a part in this shift.
5. Gray *et al*. (1996) provide (chapter 4, p.122) of one of the earliest examples of a company reporting specifically on environmental issues in the annual report, a "pollution audit" (compliance with standard report) extracted from the 1973 annual report of Phillips Screw Co., a US company. Such early reports provide much in the way of experience and knowledge that is perhaps often ignored by the many researchers, companies, consultants and other so-called 'experts' now so heavily involved in the corporate environmental and TBL reporting bandwagon. CSR is *not* a recent phenomenon and businesses, researchers and consultants who assume otherwise run the risk of wasting valuable time and money in re-inventing 'tried and tested' wheels.
6. Friedman continued, even as recently as the late 1980s, to hold on to the view that executives would be violating their fiduciary duty to their principals if they did not pursue goals which maximised the return on the latter's investment (Johnson, 1989).
7. Content analysis is discussed in more detail in Chapter 8.
8. It was during this period that professional and academic accountancy journals started to give emphasis to social and environmental accounting and reporting. Since that time, a number of accounting journals have produced special issues on social and environmental accounting including *Accounting, Auditing & Accountability Journal* (AAAJ) in 1991 (Volume 4 no. 3), 1997 (Vol. 10 no. 4) and 2002 (Vol. 15 no. 3); *Accounting, Organizations & Society* (AOS) in 1992 (Vol. 17 no. 5); *Accounting Forum* in 1995 (Vol. 19 nos. 2/3) and 2000 (Vol. 24 no. 1); *European Accounting Review* (EAR) in 2000 (Vol. 9 no. 1); and, *Asia Pacific Journal of Accounting* in 1997 (Vol. 4 no. 2).

9. Most CSR studies have privileged cross-sectionality (whether geographic or economic) over longitudinality (Campbell, 2000). In-depth case studies over time are quite rare, although they are becoming more common in relation to studies which apply legitimacy theory in explaining CSR (see Chapter 7 for more details).
10. The *Fortune 500* is an annual list of the top 500 publicly traded US companies ranked by market capitalisation.
11. Trotman (1979), in a similar survey of the annual reports of the 100 largest Australian listed companies, reported an increase in the percentage of companies disclosing some social responsibility information from 48% in 1972 to 69% in 1977. In a later study, Patten (1995) sought to repeat the Ernst & Ernst study using the 1985 annual reports of a sample of 288 *Fortune 500* firms. Patten reports a decline in the percentage of US companies disclosing social information from 93% in 1977 (Ernst and Ernst, 1978) to 63% in 1985 (Patten, 1985). Patten argues that this decline reflects a shift in the public policy agenda of US governments in the 1980s under the Reagan administrations.
12. Other studies from the 1970s onwards have generally confirmed a willingness of corporations to report on social and environmental issues (Brockhoff, 1979; Dierkes, 1979; Gray *et al*., 1987; Gray *et a*l., 1995b; Guthrie and Mathews, 1985; Guthrie and Parker, 1990; Lessem, 1977; Niskala and Pretes, 1995; Patten, 1995; Rey, 1978; Schreuder, 1979, 1981; Singh and Ahuja, 1983; Teoh and Thong, 1984; Ternisien, 1980; Theunisse, 1980; Yamagami and Kokobu, 1991). However, despite the considerable amount of research carried out in the USA in the 1970s, many of the early inferences remain tentative even today owing to the fact that such patterns rarely proved to be clear cut (Gray *et al*., 1996).
13. The perception of a 'developed' nation is culturally and ideologically dependent. Whilst many Western nations may perceive of themselves as being developed in a *material* sense, the same may not be true when such nations are considered in terms of their *spiritual* development. Thus, Mahatma Gandhi, when asked by a journalist what he thought of Western civilization, is reputed to have replied, "I think it would be a good idea" (*Resurgence*, September/October, 2001).
14. Outside of North America and Western Europe, studies indicate relatively low levels of environmental reporting in other parts of the world such as Australia (Deegan and Gordon, 1996; Guthrie and Parker, 1990), New Zealand (Hackston and Milne, 1996), Japan (Kokobu *et al*., 1994; Yamagami and Kokobu, 1991) and South Africa (Savage, 1994). Nevertheless, in the main these studies suggest that CED was on the increase in these countries in the early 1990s (O'Dwyer and Gray, 1998).
15. As noted by Tsang (1998), it is dangerous to generalize the results of empirical studies in the 'developed world' to less-developed countries not least because these countries are at different stages of economic development, the latter being potentially an important factor influencing CSR practices. For a review of trends and experiences in non-western European countries and parts of the less developed and newly industrialized countries, see, for example, Gray *et al*., 1996, chapter 5.
16. For example, the DTTI (1996) survey of corporate environmental reporting in Scandinavian countries reports that approximately 30% and 20%, respectively, of the listed companies included from Denmark and Sweden are in the banking and insurance or property and investment sectors which provided only limited levels of information on environmental matters.
17. The data presented in Table 3.3 also includes data from international studies referred to previously, given that some of these studies also provide data in relation to individual countries.
18. This trend of increasing numbers of companies reporting on environmental issues in the early 1990s was also mirrored in the UK. The *Company Reporting* survey of UK financial reporting reports that 27% of UK companies made some mention of the environment somewhere in their annual reports, with 10% of companies providing environmental information in a separate section of the report (Company Reporting, 1994). This compares with figures of 26% and 6%, respectively, for 1993 (Company Reporting, 1993) 23% and 6%, respectively, for 1992 (Company Reporting, 1992) and 10% and 3%, respectively, for 1991 (Company Reporting, 1991).
19. The term 'sustainability reports' refers to a *form* of reporting known as triple bottom line (TBL) reporting rather than to providing an actual *account* of the extent to which an organization is (un)sustainable ecologically. For an introduction to triple bottom line reporting see, for example,

Elkington (1997). Consistent with the GRI guidelines (GRI, 2002) KMPG/WIMM (2002) define 'sustainability reports' as, "… reports that include quantitative and qualitative information on their financial/economic, social/ethical and environmental performance in a balanced way" (p.7). Whilst TBL reporting may provide an indication of *selected* aspects of social, economic and environmental performance, it is nonsense to suggest that such reporting is 'balanced' given the enormous complexities, differences of opinion and uncertainties surrounding the concept of sustainability. For an introduction to accounting for some form of organizational sustainability, see, for example, Bebbington and Gray, 2001; Bebbington and Thomson, 1996; Gray, 1992; Rubenstein, 1994.

20. Various factors are likely to have influenced these trends, including legal, regulatory and government-backed developments (see Chapter 2, Section 2.8), the growth in socially responsible investment (SRI) and SRI funds (such as the 'Dow Jones Sustainability Group Index' and the 'FTSE4Good Index') and shifts towards more integrated, 'one-stop shopping' forms of reporting
21. All of the studies referred to below used some form of content analysis as the primary method of measuring the volume of social and environmental disclosures.
22. 'Information content' is a term most commonly associated with security price research, i.e. research which explores the relationship between accounting information and the reactions of the stock markets which determines the shares prices for companies whose securities are traded in these markets. Security price research is itself closely tied to the efficient market hypothesis (EMH) which, basically, in its semi-strong form, asserts that the stock market instantaneously, and without bias, compounds into an organization's share price all *relevant* publicly available information, including accounting and all other externally available information. Thus, the underlying rational is that for any form of information published by a company, the *economic* value of that information can be ascertained by reference to any change in the disclosing organization's share price (assumption of causality). If there is such a change, then the information is said to have information value or content to those dealing in the shares. For a more detailed review of the EMH and its implications and ramifications, see, for example, Beaver, 1981; Hines, 1984.
23. Of the 33 studies reviewed by Ullmann (1985) on the interrelationships between social disclosure, social performance and economic performance, 16 provided evidence of a positive correlation, five a negative correlation, two no correlation, one a U-shaped correlation and the other reported no correlation with some variables and a negative correlation with other variables.
24. Studies into the association between firm characteristics and voluntary disclosures generally, as opposed to specific forms of social and environmental disclosure, belong to a separate field of research in their own right and are outside the scope of the present study. However, recent studies (see, for example, Meek *et al.*, 1995) into the voluntary disclosures of multi-national corporations (MNCs) provide evidence which suggests that factors such as size, country, listing status, and, to a lesser extent, industry are the most important factors explaining such disclosures, although the importance of factors varies according to information type. Studies of voluntary disclosure issues in general have also considered the cost benefit hypothesis (for example, Gray *et al.*, 1990), under which an organization will assess the relative costs and benefits of disclosing information. In this context, disclosure creates data collection, processing and auditing costs, and could also give rise to losses in competitive advantage or negative impacts on share prices and unfavourable political perceptions (Van Nuffel *et al.*, 1994).
25. The fact that some empirical studies have 'failed' should not in itself be a matter of regret or over-concern. The publication of 'failed' empirical studies is to be applauded given that (i) we can learn much from studies that do not work and (ii) that their publication reduces the temptation for others to try and produce 'successful' results at all costs.

Chapter 4

Paradigms, theories and theory closure

4.1 Introduction

The purpose of this chapter is to examine various different approaches to the study of CSR that have explicitly theorised, and thus offered predictions, explanations and/or interpretations, as to *why* companies voluntarily disclose social and environmental information. Accounting researchers have, over the years, offered a variety of different theoretical insights into the nature and causes of CSR (see, for example, Adams, *et al*., 1998; Guthrie and Parker, 1989; Gray, *et al*., 1996; Kokobu *et al*., 1994; Lehman, 1995, 1999; Lewis and Unerman, 1999; O'Donovan, 1999a, b; Neu *et al*., 1998; Power, 1994a; Puxty, 1986, 1991; Roberts, R., 1992; Tilt, 1994; Tinker, 1984a, b; Tinker and Neimark, 1987; Tinker *et al*., 1991). Whilst there a number of different theories which, potentially, could be employed in a study of CED[1], as indicated in Chapter 1, for the purposes of the hypothetico-deductive method of research, three have been selected for use in the present study (economic agency theory (EAT), managerial stakeholder theory (MST) and organizational legitimacy theory (OLT)). The previous chapter reviewed prior empirical research for tests of association between CSR and other variables. Whilst such research undoubtedly has value in terms of shedding light on these putative associations, by itself a test of association fails to answer the important question as to *why*, in the absence of regulatory requirements, companies *voluntarily* disclose environmental information. Thus, whilst it may be useful to know that, for example, firm characteristic A (e.g. size) is positively correlated with another variable B (e.g. the volume of CED), to understand the possible nature and causes of CED requires explicit *a priori* theorising as to *why* A may be positively correlated with B.

In the natural and social sciences, much research effort is directed towards discovering the 'why' aspects of natural and social phenomena. This reflects not only our inquisitive nature but also a concern to harness new knowledge to improve the quality of our lives as well as to make visible some of the less obvious and taken-for-granted aspects and impacts of the social and natural systems[2] within which we live. In the social sciences, including economics and accountancy, the search for new knowledge and insights is assisted by the use of theories or models each of which offers a different 'lens' which, though viewing the same total social 'reality', focuses on *chosen* aspects of that reality which are judged to be important in the context of the 'world-view' which the theory socially-constructs for the purpose of scientific analysis and investigation[3]. As such, theories do not 'travel alone'. Every theory comes 'wrapped' in a set of assumptions concerning such things as the nature of the world, what constitutes new knowledge and how to go about the process of acquiring that new knowledge (see, for example, Boulding, 1956; Morgan, 1980). These ontological, epistemological and methodological assumptions give particular meaning to an otherwise complex, confusing and kaleidoscopic social world:

> *Like individuals in everyday life, scientists and social scientists shape knowledge through means of constructs which help them organize and make sense of the complex and ambiguous experiences they encounter. ... In this way, research builds on a network of assumptions that are often taken for granted, yet which exert a decisive influence on what is seen as studied* (Davis *et al.* 1982, p.307).

All science is predicated, to some degree or other, on a set of assumptions, some of which have long been the subject of intense and often acrimonious debate amongst scientists and philosophers. Researchers using theories automatically, whether explicitly or by implication, adopt various meta-theoretical assumptions, thereby accepting the 'world-view' offered by the theory being used[4]. In practice most published research within mainstream or 'normal' science generally eschews a discussion of ontological, epistemological and methodological assumptions. Laughlin (1995, p.77), however, asserts that "… all would-be accounting researchers need to be able to argue not only the merits of their chosen perspective, but also to be able to defend their position and be equally prepared to be contradicted." Where phenomena are researched using a single theory, the relevance of the underlying meta-theoretical assumptions may be less crucial, though not less important, given that there is only one 'world-view' informing the research. However, where several different theories belonging to different world-views are employed, as in the case of the present study, complications can arise due to the conflicting nature of the meta-theoretical assumptions underlying each theory. In effect, in these circumstances, the researcher is exploring the same social phenomena but operating, simultaneously, from within different, parallel universes. As a consequence, it becomes all the more necessary for the researcher to properly understand the meta-theoretical assumptions informing each theory, not least to avoid incorrectly interpreting the results and implications of the 'story' as told by each theory. For these reasons, the present chapter provides an overview of the ontological, epistemological, methodological as well as human nature assumptions of EAT, MST and OLT as the foundations or 'building blocks' to subsequent chapters (5, 6 and 7) which explore each theory, respectively, towards the development of hypotheses for modelling of relationships between CED and specified variables.

The rest of this chapter is structured as follows. Section 4.2 provides a definition of theory as used in science and considers, briefly, the development of theory within the different research traditions which exist within accountancy research. Section 4.3 develops this further by highlighting the philosophical issues involved in theory selection and acceptance, using the concept of *scientific paradigms*. This includes a brief review of how the concept of paradigms has been interpreted within accountancy for the classification of accounting theories. Section 4.4 provides an overview of Burrell and Morgan's seminal concept of *sociological paradigms* and how this concept can be used for the classification of accounting theories amongst different paradigms. These different paradigms are explored separately in sections 4.5 (the functionalist paradigm), 4.6 (the interpretive paradigm) and 4.7 (the radical paradigms), respectively. In each case, reference is made to the type of CSR research that has been carried out within that paradigm and the understandings that such research has brought to the study of CED. Section 4.8 considers some of the criticisms that have been levelled at Burrell and Morgan's framework, particular those by accounting researchers, together with the arguments used to justify its use in the present study. Section 4.9 situates the theories

chosen for use in the present study within Burrell and Morgan's *sociological paradigms* and provides an overall summary of the key philosophical aspects of each theory. Section 4.10 addresses some of the key methodological issues which arise when employing theories which belong to different sociological paradigms, a concept known as *multi-paradigm research*. Section 4.10 also explains the overall approach adopted in the present study for the exploration of both putative associations between CED and other variables and an interpretive exploration of trends in CED over time. A brief summary and conclusions section (4.11) is presented at the end.

4.2 Theory and theory acceptance

Attempts to *explain* social phenomena in a scientific sense require the adoption or construction of a model or theory which contains one or more propositions as to the underlying relationship between two or more variables. At its simplest, a *theory* may be defined as the expression or conception of a relationship (usually causal) between phenomenon, facts, observations or 'things'. The *Concise Oxford Dictionary* defines a theory as a supposition or system of ideas explaining something, especially one based on general principles independent of the facts (Sykes, 1976). Kerlinger (1964) provides a fuller description of theory, defining it as:

> *... a set of interrelated constructs (concepts), definitions, and propositions that present a systematic view of phenomena by specifying relations among variables with the purpose of explaining and predicting the phenomena* (p.11, as quoted in Mathews and Perera 1991, p.57).

This definition highlights the fact that theories can be used to predict as well as to explain phenomena. Generally speaking, the more complex our perception of how the world works, the more complex will be the theories we use to explain that world. Moreover, when researchers study 'abstract' phenomena (i.e. phenomena the existence of which is solely dependent on human construction, such as economics and accounting) they are more likely to find many different theories, some more complex than others. This is true of accounting as well as many of the other scientific disciplines from which accounting theories have been developed, such as economics, sociology and social and organization theory. In addition, certain theories, particularly their underlying meta-theoretical assumptions, may come to dominate a particular science at a certain point in time. Accounting, for example, has, for most of its relatively short history[5], been dominated by a concern firstly with normative (i.e. prescriptive) theorising, as in the case of *a priori* or 'postulational' research in the 'golden age of accounting' in the 1960s and early 1970s (Gaffikin, 1988; Nelson, 1973), and then later with descriptive theories of what accountants and business managers 'do' in practice, as in the case of positive accounting theory (PAT), which belongs to the research tradition known as 'positivism' (not to be confused with 'positivist methodology') since the early 1980s (see, for example, Jensen, 1976; Mouck, 1992)[6]. A descriptive theory is normally interpreted in the 'positivist' sense of being concerned with describing reality, i.e. how it is in the 'real' world, using theories and methods that are free of moral, political and ethical 'values'. As described in Chapter 1, such a view is itself predicated on certain assumptions about the relationship between the researcher and the object under investigation. Others (for example, Hanson, 1953; Kuhn, 1970; Lakatos, 1970) have a different perspective, arguing

that it is our belief systems which inform our perceptions in explaining socio-political phenomena and, as a result, explanations are not, nor can they be, made independent of those belief systems[7].

At about the same time as PAT came to dominate accounting research, other accounting scholars began to give more consideration to the assumptions underlying accounting theories. At the heart of this development was a growing awareness among accounting researchers of the complex nature of empirical knowledge about accounting, about how accounting knowledge is generated and how its validity is evaluated in a wider socio-political context (Schreuder, 1984). Such understanding includes being aware of the rationale underlying a particular research approach. Gray *et al.* (1995b), for example, observe that the existence of two different research schools (i.e. the economics and the behavioural schools) has led to two quite distinct approaches to CSR research. These two schools involve very different assumptions about reality (ontology), about the basis of knowledge (epistemology) and about research methodology (these terms are discussed in more detail below). The economics school, for example, is used by researchers following the 'positive accounting' research tradition which approaches CSR using the same set of assumptions and preconceptions which inform much of mainstream accounting research. The second, the behavioural school, is used by researchers working within a socio-political economy framework which studies CSR as part of an examination of the role of information in the context of an organization-society dialogue (Gray *et al.*, 1995b). Thus, although the 'why' issue may, *prima facie*, seem relatively straightforward, in practice it is a complex matter, involving a number important philosophical issues. These issues are explored below, beginning with the concept of scientific paradigms.

4.3 Paradigms and multi-paradigm science

In the philosophy of science, the term 'paradigm' may be said to refer to a central, overall way of perceiving phenomena, within which a scientist normally works and through which is dictated the type of scientific explanations that are acceptable (Flew, 1983). This overall way of 'seeing' is not, however, immutable, and science may exchange one paradigm for another (Kuhn, 1970). Unfortunately, in this context, the term 'paradigm' is both ambiguous and vague, such that, across the different sciences, it has acquired slightly different interpretations[8]. In its original, sociological use, 'paradigm', is generally used in the context of Thomas Kuhn's (1970) work on *The Structure of Scientific Revolutions*[9]. Kuhn (1970, p.viii) defines a paradigm as "… universally recognised scientific achievements that for a time provide model problems and solutions to a community of practitioners." Kuhn's basic thesis is that scientists work within paradigms which dictate the nature and role of science in terms of what kind of scientific work should be performed, how it should be performed and what kinds of theory are permitted. Kuhn argued that, at any point in time, science is dominated by one particular paradigm, what he refers to as 'normal science'. With the passage of time, however, Kuhn observed that normal science produces a series of anomalies which cannot be resolved within the current paradigm, leading to a state of crisis and the eventual replacement of the old paradigm with a new one. Kuhn's thesis was not just that science exchanged one paradigm for another in a period of crisis, but also that different paradigms existed at the same moments in time. In other words, competing paradigms are

continually present in science, but one paradigm, the 'normal science' dominates to such an extent that, for those working within that paradigm, it is possible not to be aware of other ways of perceiving phenomena[10].

Kuhn's original definition of a 'paradigm' has been criticised for being both vague and lacking consistency (see, for example, Masterman, 1970; Philips, 1973; Ritzer, 1975). Masterman (1970) concludes that Kuhn uses the term 'paradigm' in the first edition of *Scientific Revolutions* with at least 21 different meanings, which Masterman categorised into three different groups (philosophical/metatheoretical, sociological and artefact; see, also, Morgan, 1980). Ritzer (1975) attempted to overcome some of these criticisms of Kuhn's definition by providing a more operational definition:

> *A Paradigm is a fundamental image of the subject matter within a science. It serves to define what should be studied, what questions should be asked, how they should be asked, what rules should be followed in interpreting the answers obtained. The paradigm is the broadest unit of consensus within a science and serves to differentiate one scientific community (or subcommunity) from another. It assumes, defines, and interrelates the exemplars, theories, methods, and instruments that exist within it* (Ritzer 1975, p.15, as quoted in Belkaoui 1992, p.161).

The ensuing debate following the publication of the first edition of *The Structure of Scientific Revolutions* probably helped draw out some of the more important political elements of 'paradigms' in terms of the competition which existed between rival research schools within science (Belkaoui, 1992). However, perhaps the greater value of Kuhn's work in this context lies in the fact that it stimulated scientists to consider the existence of, and thus 'uncover', the different 'paradigms' within their own fields of science. Certainly, within sociology, for example, Kuhn's work resulted in number of attempts to characterize paradigms employed in social and organization theory (see, for example, Burrell and Morgan, 1979; Pondy and Boje, 1981; Zey-Ferrell and Aiken, 1981). The same may be said of accountancy, where the opportunity to classify different developments in accounting thought was first taken up the American Accounting Association with the publication of The Committee on Concepts and Standards for External Financial Reports' *Statement on Accounting Theory and Theory Acceptance (SOATATA*) (AAA, 1977). Using Kuhn's 'philosophy of science' perspective, the AAA reviewed a variety of theories and approaches to accounting that existed at that time[11]. The Committee (AAA, 1977) defined paradigms as conceptual and institutional frameworks that provide models from which spring particular coherent traditions of scientific research and proceeded to identify three dominant theoretical approaches in accounting: the 'classical' i.e. data-orientated approach; the 'decision usefulness' approach; and, the 'information economics' approach. Similar suggestions for the classification of accounting theories have been made elsewhere (see, for example, Belkaoui, 1992; Gray *et al*., 1995b; Mangos and Lewis, 1995; Laughlin, 1995)[12]. *SOATATA*'s (AAA, 1977) acceptance that accounting is home to several competing 'paradigms' had important implications in a Kuhnian sense given that, if accounting was a *science*, then, on the basis of the AAA's analysis, it also had to be accepted that accounting was a *multi-paradigm science*. Accounting has since come to be generally recognised as a multi-paradigm science (see, for example, Belkaoui, 1992; Boland, 1989; Chua, 1986; Hines, 1989; Knoops, 1988, 1990, 1995; Laughlin, 1995; Laughlin and

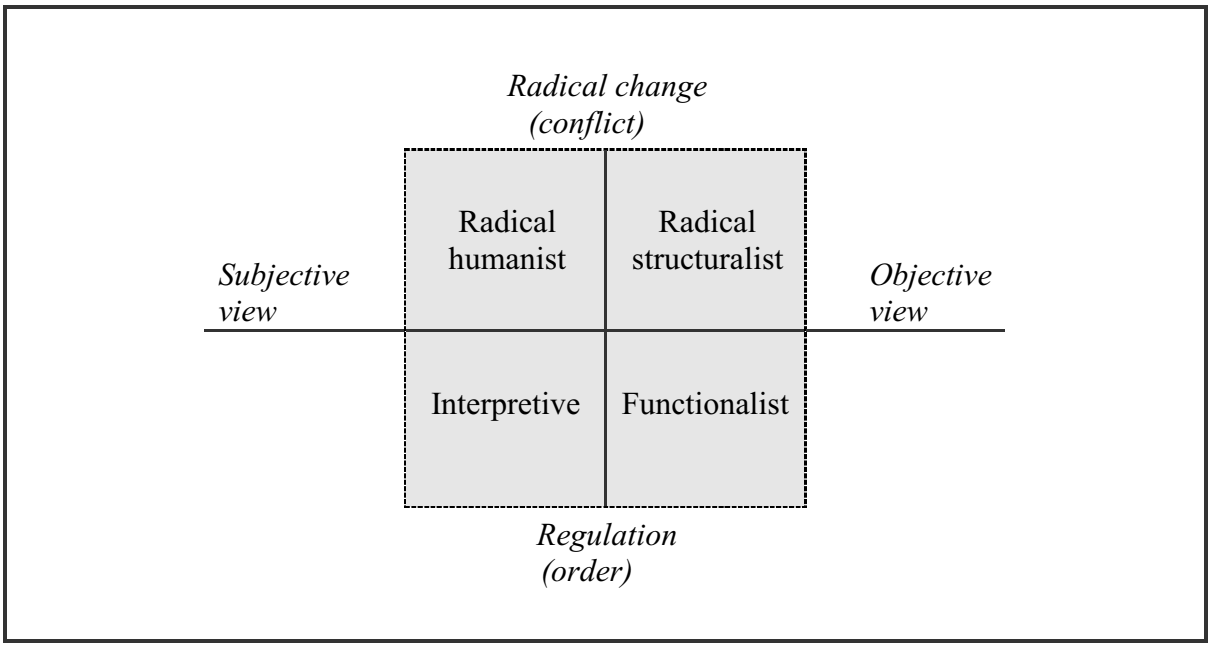
Lowe, 1990; Mangos and Lewis, 1995; Mathews, 1987a; Richardson, 1987; Wells, 1976; Watts and Zimmerman, 1990).

Today, within accounting the term 'paradigm' has acquired an ambiguous usage, denoting the simultaneous existence of different research schools or traditions, each of which is relatively self-contained and quite impervious to the methods and theories of other schools. Lewis and Grimes (1999), for example, refer to a paradigm as being the assumptions, practices and agreements among a scholarly community. *SOATATA*'s (AAA, 1977) focus was on the conceptual and institutional frameworks that provide models for addressing accounting theories, not the wider socio-political issues in the context of the organization-society relationship. Thus, whilst SOATATA's suggestions have been used by others (see, for example, Belkaoui, 1992) to identify the basic *accounting* paradigms, this does not serve as a valid framework when researching the behavioural aspects of accounting in the context of the organization-society relationship. To do so requires a broader socio-political framework which permits the researcher to locate and contrast the different research traditions that are present in the study of accounting-related phenomena. These include economics (for example, Coase, 1937; Demski, 1972), psychology (for example, Argyris, 1952) and the behavioural school (for example, Cyert and March, 1962) but also politics (for example, Markus and Pfeffer, 1983) and sociology (for example, Chua, 1995). In this regard, there have been a number of attempts within accounting since *SOATATA* to provide what Chua (1986, p.603) describes as "… commonality amidst theoretical diversity …" by examining the meta-theoretical assumptions that theories share (see for example, Gioia and Pitre, 1990; Hines, 1989; Hooper and Powell, 1985; Jensen, 1976; Laughlin, 1995, 1999; Morgan, 1988; Parker and Roffey, 1997). For the purposes of the present study, the framework provided by Burrell and Morgan's seminal *Sociological Paradigms and Organizational Analysis* (1979) will be employed to compare the accounting theories used in the present study to predict, explore and understand the nature and causes of CED.

4.4 A sociological framework for the analysis of accounting theories

Since its publication in 1979, Burrell and Morgan's *Sociological Paradigms* has acquired seminal importance. Not only did their work stimulate others to characterize paradigms within the social sciences, these effort have themselves sensitised theorists to the notion of paradigms, legitimising less mainstream alternative assumptions, practices and agreements amongst the scholarly community (Lewis and Grimes, 1999). Despite its shortcomings (see Section 4.8 below), Burrell and Morgan's framework has been widely employed within the accounting literature (see, for example, Cooper, 1983; Hopper and Powell, 1985; Tilt, 1994), providing researchers with a means of seeing the 'big picture' in terms of the meta-theoretical assumptions underlying different approaches to the same subject–matter. Burrell and Morgan's basic thesis is that all *social* theories, including those within economics and accountancy, can be conceived of as being based upon two main sets of meta-theoretical assumptions, one about the nature of social science and the other about the nature of society[13]. Burrell and Morgan present these two sets of assumptions in the form of a 2x2 matrix (Figure 4.1), each 'box' representing a quite distinct view (i.e. paradigm) of the social world[14].

Figure 4.1
Framework for analysis of accounting theories



Source: Burrell and Morgan (1979)

Although presented as a matrix, the two axes, representing the two main sets of assumptions, are more properly seen as bi-polar continuums (Laughlin, 1995), providing a set of grid references, the intersection of which allows the location of different research traditions. These two main sets of assumptions are described below.

(i) Assumptions about the nature of science: the subjectivist–objectivist dimension

The subjective–objective horizontal continuum in the model (Figure 4.1) represents the meta-theoretical assumptions underlying the different approaches to social science. Burrell and Morgan (1979) define these in terms of four sets of assumptions related to ontology, epistemology, human nature and methodology, with each set of assumptions containing a range of different perspectives along a continuum, the extremes of which represent diametrically opposed positions. A detailed review of these different assumptions is outside the scope of the present study (in the context of accounting and finance, see, for example, Arrington and Francis, 1989; Christenson, 1983; Gambling, 1985; Gaffikin, 1988; Jensen, 1983; Laughlin, 1981, 1995; Ryan *et al*., 1992; Easterby-Smith *et al*., 1991). Nevertheless, some overall points can be made to help locate the particular approach adopted in the present study:

(a) Ontology – this assumption concerns the nature of reality and whether the external world is 'real' and 'external' to the researcher or not. In philosophical terms this is conceptualised as the nominalism–realism debate. Nominalists see the world as possessing no real structure, consisting only of nomenclatures (a system of names and labels) used by people to negotiate the external world, a world that is socially-constructed and has no existence independent of the observer. Conversely, realism refers to a material, objective, social world that is perceived of as mind independent i.e. external to the observer, a world made up of hard, tangible and relatively immutable structures that can be discovered through formal and defined investigatory methods (Burrell and Morgan, 1979; Laughlin, 1995; Ryan

et al, 1992). Within economics and accounting, most researchers treat the social world as if it were the same as the natural world, seeing it as hard, real and external to the researcher, whereas others perceive the social world as soft, personal and subjective[15].

(b) Epistemology – i.e. the assumptions as to basis and nature of knowledge. This is presented by Burrell and Morgan as the positivism–anti-positivism debate. 'Positivist'[16] epistemology argues that knowledge must be based on experience through the senses (rejecting the metaphysics) and places emphasis on observation (empiricism) and seeks to "…explain and predict what happens in the social world by searching for regularities and causal relationships" (Burrell and Morgan, 1979, p.5). Positivism supports this search, contending that there is an objective, single, determinable reality which exists independent of the researcher (realism) and that all metaphysical statements (statements of value or non-observable reality) are meaningless. Anti-positivism[17] rejects this approach, holding that the world is essentially relativistic and can only be understood from the perspective of the personal experiences of those directly involved in the activities being studied.

(c) Methodology – i.e. the study of methods by which we acquire knowledge about the world[18]. This is normally perceived of in terms of the nomothetic–ideographic debate. A nomothetic approach to social science places methodological emphasis on systematic protocol, standardised research instruments and techniques, as employed in the natural sciences, in the search for general laws. This has been described as a "… process of testing hypotheses in accordance with scientific rigour [being] pre-occupied with the construction of scientific tests and the use of quantitative techniques for the analysis of data" (Burrell and Morgan, 1979, p.6/7)[19]. Conversely, ideographic (or idiographic) methods assume that understanding can only be achieved through first-hand knowledge or subjective, personal experience to 'get inside' situations, persons, events or things. Examples of the latter include the phenomenological and hermeneutic schools of research.

(d) Human nature - Burrell and Morgan depict assumptions about human nature (i.e. the model of man that is reflected in any theory or model of society, particularly relationships between humans and their environment) along a continuum of extremes from 'determinism', in which people and their activities are seen as being determined completely by their *milieu*, to 'voluntarism', in which people are perceived of as being completely autonomous and possessing free-will.

The key to understanding the importance of the four philosophical positions described above lies in the fact that *all* scientific research makes certain assumptions about ontology, epistemology, human nature and methodology, although in most cases these assumptions are implicit rather than explicit. Smircich (1983) argues that researchers not only rarely state their paradigm assumptions but also quite often make such choices unconsciously. Research traditions, including those in accountancy, tend to adopt a set of consistent assumptions relating to ontology, epistemology, human nature and methodology. Thus, for example, mainstream (i.e. 'normal science') research in accounting and finance at present is dominated by empirical studies which can be characterised as realist, positivist, nomothetic and determinist[20].

(ii) Assumptions about the nature of society: the 'order–conflict debate'

Burrell and Morgan (1979) argue that a researcher's assumptions about the way in which society is structured may be located somewhere along the order–conflict continuum, the extremes of which represent, at one end, the perception that society is *orderly* and, at the other, the perception that society is in *conflict*. This is often referred to as the 'order–conflict debate'. Social order theory (also known as systems theory) was the dominant paradigm in sociology in the 1950s and 1960s (Abercrombie *et al*., 1994). Social theorists, notably a group of sociologists at Harvard University, attempted to establish parallels between physiological systems in medical science and social systems in the social sciences. Parsons (1951, 1971), for example, sought to integrate social order theory into other disciplines, including economics and political theory (Abercrombie *et al*., 1994). In particular, Parsons developed a general theory of social systems, whereby such systems were seen as problem-solving entities, emphasising the 'functional imperatives' of social systems (adaptation, goal-attainment, integration and pattern maintenance) which came to be known as 'functionalism'[21]. This view of society led to the development of positivist (structural-functionalist) methodologies which treat the social world as if it were the same as the natural world, seeing it as hard, real and external to the researcher[22].

In the late 1950s and early 1960s, critics of functionalism and systems theory argued in favour of an alternative perspective based on 'conflict theory'. Social conflict, in this context, comes in many forms, from the non-violent regulation of competition between companies for control of resources, to revolution, wars, military conflicts and violent clashes between different sections. However, not all social theorists saw conflict as a negative phenomenon. Coser (1956), for example, viewed conflict as usually functioning in pluralist, complex societies and argued that, rather than pulling society apart, different conflicts cut *across* social classes, providing a balancing, integrating mechanism that prevented instability, thus giving rise to a different meaning to the term 'functional conflict'. This view contrasts particularly with that of Karl Marx. Marxian approaches to conflict regard the whole of society as being divided down the middle along class lines, with the two basic classes representing the interests of capital and labour, respectively. Conflict theories are seen as dynamic, being concerned not only with explaining "… the process and nature of deep-seated structural change in society as opposed to change of a more superficial and ephemeral kind …" (Burrell and Morgan 1979, p.14) but also with "… radical transformations of society …" (*op cit*., p.16). However, Burrell and Morgan modified the 'order–conflict' distinction to differentiate more clearly between the two models, and to highlight the radical element, by substituting the notions of 'regulation' and 'radical change' and introduced the terms 'sociology of regulation' and 'sociology of radical change'. The various aspects with which these two concepts are concerned are shown in Table 4.1. The sociology of regulation refers to a perspective of society which emphasises stability and cooperation, and the need to hold society together through the *regulation* of human affairs. Thus, 'need satisfaction' under the sociology of regulation refers to the satisfaction of the needs of individuals (or of the system as a whole), needs which are presumed can be satisfied *without* changing existing social systems (such as capitalism). By contrast, the sociology of radical change is concerned with the need to seek explanations for the radical, deep-seated conflicts and divisions which are perceived to be characteristics of modern society and with seeking alternatives to the *status quo*. Reference to 'deprivation' (see Table 4.1 below), for example, is intended to highlight

the fact that the social system prevents individuals from becoming fulfilled, deprivation being a *consequence* of the status quo (Burrell and Morgan, 1979).

Table 4.1
The regulation–radical change dimension

The sociology of REGULATION is concerned with:	The sociology of RADICAL CHANGE is concerned with:
► The status quo	► Radical change
► Social order	► Structural conflict
► Integration and cohesion	► Modes of domination
► Consensus	► Contradiction
► Solidarity	► Emancipation
► Need satisfaction	► Deprivation
► Actuality	► Potentiality

Source: Burrell and Morgan, 1979

In summary, Burrell and Morgan's typology can be described as parsing:

> *... four paradigms by polarizing assumptions regarding the nature of social science (objective-subjective) and the nature of society (regulation-radical) change. Objectivity presumes an external reality of deterministic and predictable relationships, whereas subjectivity presumes contextually bound and fluid social constructions. Regulation assumes harmonious and orderly social relations, whereas radical change assumes conflict and power asymmetries* (Lewis and Grimes 1999, p.674).

These two bi-polar dimensions provide a framework for distinguishing between the four sociological paradigms shown in Figure 4.1 above. Burrell and Morgan argue that all social theory can be conveniently understood in terms of the co-existence of these four distinct paradigms. In essence, each paradigm offers a different 'lens' through which social scientists view their own science and the social world around them. These lenses vary both in terms of their level of resolution (i.e. the degree to which phenomena are specified and specifiable) and their field of vision (i.e. the panoramic scope of phenomena which are viewed and viewable). The four sociological paradigms also provide a framework for understanding accounting theory and practice (Morgan, 1983a). Each of these four paradigms is described briefly below, together with its application in an accounting context.

4.5 The functionalist paradigm

The functionalist paradigm (see Figure 4.1 above) represents the dominant paradigm in the social sciences (including economics and accounting) at the present time. Thus, in Kuhnian terms, science performed within this paradigm is considered 'normal science'. Research carried out within the functionalist paradigm (or structural functionalist paradigm as it is sometimes called) assumes a sociology of regulation perspective (see Table 4.1 above) and thus tends to be concerned primarily with providing explanations of the status quo, consensus, etc. Consequently, the problematic tends to be researched from a standpoint which

is 'realist', 'positivist', 'nomothetic' and 'determininst'. Burrell and Morgan (1979) define it thus:

> *It is a perspective which is highly pragmatic in orientation, concerned to understand society in a way which generates knowledge which can be put to use. It is often problem-orientated in approach, concerned to provide practical solutions to practical problems. .... It is concerned with the effective 'regulation' and control of social affairs* (p.26).

Rooted in the 'positivist' tradition (ontologically, epistemologically and methodologically), science from within the functionalist paradigm is heavily influenced by the natural sciences, adopting the same models and methods in the study of human affairs. As such, the social world is seen as highly structured, "… composed of relatively concrete empirical artefacts and relationships which can be identified, studied and measured through approaches derived from the natural sciences" (Burrell and Morgan 1979, p.26). Science researched from within this paradigm is thus primarily regulative and pragmatic, with a concern for understanding society in a way which generates 'useful' empirical knowledge. Similarly, human behaviour is seen as structured and functional, characterised by traits such as adaptation, goal-attainment, integration and pattern maintenance. Mainstream accounting research adopts this perspective, making two important assumptions about the social world (Chua, 1986): (i) that human behaviour is purposive (i.e. action is predicated on producing beneficial results to the actor in question); and (ii) that social order is seen as controllable. These assumptions are important in the context of the present study and hence are considered in more detail below.

(i) Human behaviour as purposive

In sociology, purposeful behaviour refers to the assumption that all social action is intended to produce beneficial results to the actor or actors concerned. This assumption has its roots in economics and forms one of a broader class or models of human behaviour belonging to the 'rational choice' approach to social theory. Rational choice behaviour in this context refers to a *metatheoretical assumption* as opposed to an *empirical generalization* (Abercrombie *et al*., 1994). Thus in the field of management, the 'traditional' purpose of decision-making is to optimise the economic function of the firm, with management acting as the visible hand to coordinate the activities of the firm 'rationally' by making 'rational' decisions (Chandler, 1977). In mainstream economics and accounting, people are seen as possessing bounded rationality (Simon, 1976), although they are also capable of 'rational' goal setting (Chambers, 1966). This is particularly the case with economic agency theory (see Chapter 5) where the agent is presumed to prefer less effort to more (Baiman, 1982), where individuals are perceived as resourceful, evaluative, maximizing men (Zimmerman, 1979) and each individual is not only assumed to act in his or her own interest but also expects all other individuals to act solely to maximize their own best interests (Baiman, 1982). These perspectives on the nature of man and thus society have given rise to frequently-used terms within the mainstream management accounting and finance literature, including 'bonding', 'opportunistic behaviour', 'moral hazard', 'shirking' and 'monitoring'. These terms are explored further in Chapter 5 when looking at the assumptions underlying economic agency theory. The important issue to note here is that a researcher's social construction of those things which exist in the social world, i.e. things that simply would not exist without people, depends upon assumptions made about that world[23].

In accounting, assumptions about human behaviour having some underlying purpose are crucial because information is assumed to serve a pragmatic, technical function through the provision of 'useful', 'reliable', 'relevant' and 'objective' information for the making of economic decisions (see, for example, Paton and Littleton, 1940; AICPA, 1973; FASB, 1978; see also FEE (1999b, 2000) in the context of corporate environmental reporting). Concepts such as 'usefulness', and 'relevance' are consistent with the functionalist paradigm in that they assume some prior objective or need. The existence of a 'means–ends' belief (Chua, 1986), whereby accounting specifies 'the means' (i.e. the how) rather than getting involved in discussions on the desirability, in a socio-political context, of 'the ends' (e.g. utility maximisation, the pursuit of profit, social justice, ecological restoration, etc.), permits researchers to take as given and natural the current institutional framework of governments, markets, prices and organizational forms (Tinker, 1984b). However, the 'means–ends' belief is itself a value position in that it effectively judges the status quo as being in some way ideal or superior (Chua, 1986).

(ii) Social order is seen as controllable

Given that human behaviour is perceived as purposeful, there is an implicit assumption of a controllable social order. In mainstream accounting, for example, while conflicts may be recognised as existing between investors and managers, these conflicts are conceptualised as 'manageable' and do not lead to calls for a change in the social system (i.e. capitalism). However, in terms of the 'order–conflict debate' described above, conflict is seen as dysfunctional if it interferes with the main goal of the organization, whatever that may be. Thus the 'order–conflict debate' is, for the most part, entirely absent from mainstream accounting (Chua, 1986). Rather, society and organizations are presumed to be, and perceived of as being, essentially functional, purposive and stable, with any dysfunctional conflict being managed through the use of appropriate accounting controls such as budgets and divisional performance criteria (see, for example, Demski and Feltham, 1978; Hopwood, 1974).

The functionalist paradigm is home to many of the conventional finance and economic theories, including neo-classical economic theory, economic theories of the firm such as economic agency theory, as well as conventional accounting theories (Cooper, 1988; Mathews, 1987a). Studies conducted within this framework also include those which focus on the usefulness of social and environmental information to investors (see, for example, Epstein and Freedman, 1994). From a functionalist perspective, social accounting is considered important only if it enhances the company (Gray *et al.*, 1988). Whilst a detailed discussion of this issue is outside the domain of the present study, it is helpful to consider the potential links between CSR and conventional accounting theories. A number of worthy attempts have been made to codify conventional accounting theories (see, for example, AAA, 1977; Belkaoui, 1992; Davis *et al.*, 1982; Gray *et al.*, 1987, 1996; Klaassen, 1976; Laughlin and Puxty, 1981). One alternative, as suggested by Gray *et al.* (1996), classifies conventional accounting theories into four broad (but overlapping) groups: the 'classical' inductive approach; the 'classical' true income/deductive approach; the decision usefulness approach; and, the information economics/agency theories (commodity-based)approach[24]. Each of these four groups is considered, briefly, below.

(a) Classical inductive theories represent attempts to formulate accounting postulates and principles based on observations of accounting practice, leading to the development of general accounting principles and conventions such as matching (accruals), consistency and prudence. Such attempts are 'inductive' because the construction of theory begins with detailed observations and measurements of existing (best) accounting practice, which are then developed into generalised models (see, for example, Flew, 1983; Hendriksen, 1982; Ijiri, 1975). This approach was particular influential in the US in the 1920s and 1930s, culminating in the American Accounting Association's (AAA, 1936a) "Accounting Principles and Underlying Corporate Financial Statements"[25]. Whilst this method has a descriptive element, it is essentially prescriptive (i.e. normative) in that attempts to develop accounting theories in this way are usually based on beliefs in the value of accounting practices, or some notion of 'best accounting practice' (see, for example, Gordon, 1964; Littleton, 1953; Paton and Littleton, 1940, 1953; Sanders *et al*., 1938; Sprouse and Moonitz, 1962). One weakness of this approach is that it fosters 'theory closure' by preventing the consideration or emergence of other forms of normative accounting and reporting, such as CSR, which are not based on observed practice. Hence, the classical inductive school is claimed to exclude CSR without being able to offer any justifiable reason for doing so (Gray *et al*., 1996).

(b) Classical 'true' income/deductive theories are concerned with developing a 'best' model of accounting which provides an 'objective' and 'truthful' account of business profit[26]. The deductive method of reasoning involves starting with specific objectives and postulates out of which logical principles are derived that provide the basis for concrete and practical solutions (Hendriksen, 1982). This approach is also known as the *postulational approach* (Mattessich, 1984b) or *a priori research* (Nelson, 1973). In the context of 'true' income models, there is a perception as to the existence of a 'correct' profit figure and that the role of accounting, as a measurement system, is seen as being to provide the basis for arriving at this figure. Proponents of the 'true income' model took a normative/deductive approach to the construction of accounting theory, with the development of general propositions about what accounting 'should be' (i.e. the objectives of financial statements) and then moving on to specify accounting postulates, principles and accounting techniques for their practical application (see for example, Canning, 1929; Chambers, 1955, 1966; Edwards and Bell, 1961; Ijiri, 1967, 1975; Moonitz 1961; Paton, 1922; Sterling, 1970)[27]. The development of objectives and postulates formed at the outset is also known as 'a priori' research, which was particularly popular within accounting in the 1960s (Gaffikin, 1988). This approach, also referred to as the 'data orientated approach' (Laughlin and Gray, 1988), is essentially tautological given that accounting, as a man-made artefact, has no existence independent of the human agency. Thus, the notion that there exists a 'true' measure of accounting profit has meaning only to the extent to which we choose, ideologically speaking, to give it meaning. Since 'accounting profit' is the result of whatever measurement system we choose to construct to derive measures of profit and financial position, this circular reasoning cannot, logically, be the basis for arriving at any 'objective' truth about an organization (Gray *et al*., 1996). Defining what is to be accounted for by reference to market transactions and events, for example, implies that commodities which have no market price (i.e. 'free goods', being goods which are not (currently) scarce or which do not require the use of factors of production to create them) are not accounted for. This therefore excludes everything which has no 'price tag', such as the quality of the 'free' natural environment (rivers, seas, lakes,

land and air). Consequently, income theories based on market transactions and events effectively exclude the very things which CSR is concerned with, the corollary being that social and environmental issues are not important in the context of business accounting and reporting (Gray *et al*., 1996)[28].

(c) Decision usefulness theories currently dominate mainstream accounting thought and make important assumptions about human behaviour, particularly that all such behaviour is 'rational' and 'purposeful'. Thus, the 'user decision model', for example, is based on the view that the primary purpose of financial accounting is to provide information that meets the needs or wants of parties other than the reporting organization (Laughlin and Gray, 1988)[29]. This approach to accounting theory has been particularly influential since the 1970s following the rise in the interest in needs of the users of annual accounts. The work of Edwards and Bell (1961) was particularly influential in this context because it highlighted the fact that different models of determining income may be needed for different decision purposes. In the 1970s, the realisation of the possibility of a 'horses for courses' approach to income determination had the effect of shifting the focus of accounting research away from determining a single 'true' measure of economic income towards a concern for the needs of the various decision makers, heralding the rise of decision-usefulness research. Influenced by the conclusions of the Trueblood Report (AICPA, 1973) in the US and the Corporate Report (ASSC, 1975) in the UK (see Chapter 2), a widespread debate took place in the 1970s into the process of accounting standard-setting and the way in which the needs of the various users identified in these reports could be accommodated within the standard-setting process. Controversially, faced with the very real practical dilemma of trying to solve this intractable problem, standards-setters and researchers came down in favour of focusing on the needs of shareholders and investors in general for no other reason than that, from a legal perspective, the financial statements are addressed to shareholders (Ryan *et al*., 1992). Having made this choice, it logically followed to focus research efforts on the needs of the shareholder and investors.

Much of the research performed in this context was influenced by research which took as its model the neo-classical economists' view of the world in which investment decisions are determined on the basis of the net present value (NPV) of future cash flows, i.e. dividends (Ryan *et al*., 1992). Using this model, the natural choice of shareholders, if given that choice, would be for companies to publish forecasts of future cash flows. For various reasons, this was generally viewed as impractical and so researchers concentrated on the predictive ability of financial statements as a surrogate for future cash flow forecasts from the perspective of the shareholder and investor. Although there has been some empirical research into the information needs of the users of financial statements (see, for example, AICPA, 1994; Epstein and Pava, 1993; Lee and Tweedie, 1975, 1977), theorists within the 'user decision model' school of thought have tended to follow a 'one size fits all' approach. Thus Sterling (1972), for example, in recognizing the practical and economic (cost/benefit) constraints involved in trying to provide all of the information which all decision makers might need, argued that an accounting system should be designed to supply 'relevant' information for 'rational decision models', where 'rational' in this context refers to those decision models that are most likely to assist decision makers in achieving their goals. In this context, the decision makers are seen primarily as *economic* decision makers and hence the 'rational decision models' to which these theorists refer are normally those of shareholders and other

financial investors. As indicated above, accounting standard-setting bodies have tended to adopt the same approach by asserting that (i) the primary users of financial statements are shareholders and creditors (see, for example, AICPA, 1994) and (ii) 'needs' are more important than 'wants' (see, for example, FASB, 1978). Within this world-view, the principle objective of financial statements is to provide information that is 'useful' to investors and creditors for making *economic* decisions, what Watts and Zimmerman (1979) refer to as the 'information objective' (see, for example, AAA, 1936b; AICPA, 1973, 1994; Bruns, 1968; Dierkes and Antal, 1985; FASB, 1976, 1978; Macdonald, 1995; Sterling, 1972; Storey, 1964)[30]. However, this approach failed to provide a logical basis for accounting choices that had been hoped for by its advocates (Ryan *et al*., 1992). Such choices, according to Watts and Zimmerman's (1978, 1978, 1986) positive theory of accounting (PAT), are made, not on the basis of providing the capital markets with a measure of 'true income' but on the basis of their *economic consequences* to managers and shareholders. PAT is explored in more detail in Chapter 5.

A second decision usefulness theory widely recognised in the accounting literature focuses on aggregate-market-behaviour and is based largely on the works of Gonedes (1972) and Gonedes and Dopuch (1974). Put simply, the basic (*normative)* argument underlying this model is that the selection of accounting numbers, and by implication, the information systems and procedures for producing those numbers, should be evaluated in the context of aggregate stock market behaviour, the latter being regarded as a basis for judging what is important. This view is based on the premise that accounting numbers have 'informational content' (Gonedes, 1972), the value of which can be measured according to stock markets' reactions to the publication of that information. The added assumption of an efficient capital market, i.e. the efficient market hypothesis (EMH), is a key building block in the construction of the securities markets' ability to react 'efficiently' to accounting numbers[31]. Researchers working within this particular domain, often referred to as 'market-based accounting research', normally conduct their research by employing some model of the behaviour of individuals and markets drawn mainly from existing finance theories, such as the capital asset pricing model (CAPM), which contains a number of assumptions relating to risk diversification, portfolio theory and the relationship between risk and return (see, for example, Ball and Brown, 1968; Lintner, 1965; Mossin, 1966). Such research methods are rooted in neo-classical economics and the underlying assumptions about human nature ('rational') and the structure of markets (perfect competition and freedom of information) that are embedded therein (Ryan *et al*., 1992).

Both sets of decision usefulness theories described above are *prescriptive* in that they involve value judgements in privileging one section of society (shareholders or stock markets, which, in the case of large, publicly listed companies is essentially the same thing) over others. The justification for such privileging is to be found in the metatheoretical underpinnings of conventional accounting and the related assumptions of neo-classical economics (see Chapters 1 and 2)[32]. Even if it is accepted that investors or stock markets should be the prime audience for financial statements, this does not preclude the provision of information that is relevant to assessing the social and environmental impacts which the reporting organization has on society. However, decision-usefulness theory pre-supposes that what gets reported is defined *ex ante*, based on some taken-for-granted understanding or agreement (Kokubu *et al*., 1994). As such, decision-usefulness theory does not explore the dynamic nature of the

relationship between the agent (the information provider) and principal (the information receiver) in the context of existing power inequalities and information asymmetries. Thus the application of decision-usefulness theory towards explaining the nature and causes of CSR remains problematic because the generally-accepted concept of principal-agent relationship has so far not been established in regard to social reporting (Kokubu *et al*., 1994). Nevertheless, in the context of CSR, the prime case for decision-usefulness theories lies in their potential, in a *normative* rather than a descriptive sense, to give voice to other factions and interest groups and dialogues which are traditionally excluded from accounting research and practice (see, for example, Arrington, 1990; Cooper and Shearer, 1984; Gray *et al*., 1987, 1996; Mathews, 1985, 1993; Owen, 1992).

(d) Information economics/agency theories see accounting information as a type of 'organizational resource' or commodity, which is demanded and supplied in much the same way as traditional economic goods and services (Laughlin and Gray, 1988). In this context, financial accounting information takes on an 'exchange' function in that, as a tradeable commodity, the nature and amount of that information is negotiated between a willing buyer and a willing seller in the market place just like the traditional commodities of coffee, tea and corn. The underlying values of such an approach reflect a strong belief in the free market system (Adam Smith's 'invisible hand'), as found in some of the more radical 'right wing' theorists in economics (for example, Friedman, 1962, 1970) who adopt a liberal economic democracy philosophy. Under this philosophy, which espouses a strong belief in the disciplines and self-regulatory forces of the 'market', emphasis is placed on minimizing legal and political interference ('red tape') in the activities of business. Hence, mandatory CSR, to the extent that it does not serve the economic objectives of wealth maximisation, is viewed as a 'nuisance' because it interferes with liberty (see, for example, Benston, 1982)[33].

This supply/demand model of accounting is an extension of the basic neo-classical economic model of goods and services. Thus, the 'price' that someone is willing to pay for accounting information (the buyer, typically investors) will depend on supply and demand considerations, such as the production costs, transaction costs, opportunity costs, the availability of complementary goods or substitutes, the actors' utility functions, scarcity, etc. In this context, information economics theories privilege 'the economic' over all other forms of capital, such as social, human or environmental. Moreover, this view of the social world is dominated by a concern with economic wealth and economic wealth creation, and of serving those who are presumed to 'create' wealth[34]. In essence, the value of information is viewed in the context of economic choice, i.e. in terms of a cost-benefit consideration as set within the formal structure of economic theory (see, for example, Beaver, 1981; Beaver and Demski, 1979). In the context of external financial accounting and reporting, accounting information is thus evaluated in terms of its ability to improve the quality of the optimal choice in a basic choice problem (Belkaoui, 1992). Set within this context, it is assumed that if investors want certain information, such as that relating to social or environmental issues, the supplier (the organization) will provide it (see, for example, in the context of CSR, Epstein and Freedman, 1994) if the price is right. Whereas under the decision usefulness model, information is provided on the basis of the needs of the investor, under the information economics approach accounting information is negotiated between buyer and seller, the underlying assumption being that such bargaining is best done in 'the market place' on the basis of rational economic choice[35]. Hence, under the 'information economics' argument, CSR is viewed as a response

to the information needs of investors where social disclosures are assumed to have 'information content' (see Section 3.4, Chapter 3). Whilst 'information economics' theories are *normative*, in that they prescribe a basis for evaluating information in the context of rational economic choice, the underlying assumptions within this model have led other researchers to develop 'descriptive' accounting theories for predicting and explaining management behaviour patterns associated with accounting choice in the context of the 'principal agent' relationship. In the latter context, management's self-interested behaviour is argued to influence the use of accounting and other information (see, for example, Thornton, 1984, 1985). In turn, this has led to the use of economic agency theory in explaining CSR (see, for example, Belkaoui and Karpik, 1989; Ness and Mirza, 1991; Shane and Spicer, 1983). These studies are reviewed in more detail in Chapter 5.

Although this brief overview of conventional accounting theories is necessarily simplistic, each of the four groups of theories described above can be linked to CSR in one way or another (see, for example, Gray *et al.*, 1996). However, given that the present study is concerned with descriptive theories, as opposed to normative (i.e. prescriptive) theories, it is only information economics/agency theory which seems to offer possible descriptive models for managerial behaviour in relation to CSR (see Chapter 5). Nevertheless, these theories offer very little in the way of 'accounting for the environment' (see Chapter 2)[36]. With the benefit of the analysis provided above, it is possible to understand why. Essentially, mainstream accounting theory and practice accords with Burrell and Morgan's depiction of a social world-view that is highly pragmatic in orientation, problem-orientated in approach and concerned with the effective regulation and control of the status quo. Hence, although there are references to conflicting interest groups (e.g. principal and agent), such conflicts are defined as being 'rational' (and thus 'healthy') in terms of each party's *economic* interests, rather than in terms of any structural, socio-political contradictions within the system as a whole. Within this world-view, accounting phenomena are perceived as concrete, real world objects possessing regularities and causal relationships that may be subjected to scientific explanation and prediction[37]. In the absence of any obvious need or demand for social and environmental information towards the primary social goal of economic wealth creation, CSR is left to 'market forces' and thus simply falls by the wayside. However, since the 1970s a growing interest in empirical research in *understanding* and *explaining*, rather than just *predicting*, the nature of accounting within organizations and society has generated a range of different 'behavioural' schools of accounting thought, much of which has been 'borrowed' from social and political theorists (Laughlin, 1995). These social and political schools of thought are considered below in exploring the interpretive and radical paradigms[38].

4.6 The interpretive paradigm

The interpretivist approach to CSR research has been gaining increasing attention in recent years (see, for example, Dey, 2000, 2002; Dey *et al.*, 1995; Rovira, 2002) as an alternative to the more traditional positivist approach. Whereas the positivist approach claims that its methods – i.e. the methods of the natural sciences – are the *only* true scientific ones, the interpretivist approach counterclaims by arguing that the study of people and their institutions calls for research methods that are radically different from and altogether foreign to those of the natural sciences (Schutz, 1972). Habermas (1978), for example, argues that people cannot be treated as natural scientific objects because they are self-interpretive beings that create

institutional structures around them. Hence, the interpretivist approach takes the position that people, and the physical and social artifacts that they create, including all forms of economics, accounting, management and control, are fundamentally different from the physical reality examined by natural scientists (Lee, 1991). The main meta-theoretical differences between the interpretive and functionalist paradigms are summarised in Table 4.2.

Table 4.2
Dominant meta-theoretical assumptions: functionalist and interpretive paradigms

Meta-theoretical Assumptions	Functionalist Paradigm	Interpretive Paradigm
Beliefs about knowledge	Theory separate from observations. Hypothetico-deductive account of scientific assertions accepted	Search for understanding of human action. Adequacy of explanation assessed via logical consistency, subjective interpretation and agreement with actors' common-sense interpretation
Beliefs about the social and natural worlds	Empirical reality is objective and external to the individual. People are passive objects, not creators of social reality. Single goal of utility maximisation assumed for individuals and firms. Assumption of means-ends rationality.	Social reality is emergent, subjectively created and objectified through human interaction. All actions have meaning and intention that are retrospectively endowed and that are grounded in social and historical practices. Social order is assumed. Conflict mediated through common schemes of social meanings.
Relationship between accounting theory and practice	Accounting specifies 'means' not 'ends'. Acceptance of extant institutional structures	Theory seeks only to explain action and to understand how social order is produced and reproduced.

Source: Chua (1986)

Critics of the application of positivist methodology to the social sciences base much of their argument on what is known as the *Hermeneutic Circle* (derived from hermeneutics, a theological term concerning the spiritual truth of religious writings) which transported hermeneutics into the interpretation of intentional human behaviour, language and institutions (Ryan *et al*., 1992)[39]. Habermas (1978), amongst others, argues that the problem of the Hermeneutic Circle arises particularly in the social sciences but is much less of an issue in the natural sciences. Essentially, in the natural world the observed world may be viewed as 'objective'. Interplay between the world of observed reality (the objective world) and the world of meaning (the subjective world) is said to take place *only* in relation to the observer of 'reality' not the observed reality itself. However, in the case of the social world, this interplay is two-sided. Human beliefs and values not only form part of the world of meaning (the subjective world) but are also present in the reality being observed (the objective world) in relation to human action (i.e. behaviour), which is observable. According to Schutz (1972), for example, unlike atoms, molecules, and electrons, people create and attach their own

meanings to the world around them and to the behaviour that they manifest in the world around them. In other words, "… the same physical artifact, the same institution, or the same human action, can have different meanings for different human subjects, *as well as for the observing social scientist*" (Lee 1991, p.347, emphasis added). Critical social theorists such as Habermas argue that the distinction between 'facts' and 'values' is untenable in the social sciences given that society is itself a reflection of (purposive) human behaviour. Rather, facts and values are seen as inextricably intertwined (Schreuder, 1984), such that impassive observation is simply not possible (Habermas, 1984, 1988).

An obvious problem with hermeneutic analysis is how to validate interpretation of human action given that one interpretation of the meaning of an action is as good as another. The solution offered is the 'Hermeneutic Circle' which emphasizes the need to understand the part in terms of the whole and the whole in terms of the part (Abercrombie *et al*., 1994). In other words, the social analyst seeks to interpret manifestations of human action by trying to understand the 'world-view' perspective within which that action takes place. However, there can never be a completely 'correct' or 'true' understanding of human action and thus all interpretations are always tentative and subject to revision in the hermeneutic circle (Abercrombie *et al*., 1994). As such, contrary to prevailing assumptions under 'normal science', the interpretivist approach denies the existence of a single, objective reality but rather perceives reality as a result of human construction, giving rise to the existence of multiple realities which diverge away from each other rather than converge into a single reality (Erlandson *et al*., 1993)[40]. In the context of organizations, for example, the interpretivist approach has highlighted the different realities which are constructed by the various groups and individuals which make up the organization and which form the boundaries of their respective understanding of the organization and which provide the framework for the way they behave in it.

Researchers working within the interpretive paradigm are chiefly concerned with gaining an *understanding* of the *processes* which take place within the social world rather than focusing mechanistically on explanation or prediction. As such, they tend to have more sympathy with a subjectivist approach to the analysis of the social world, allowing different rather than uni-dimensional views of phenomena to emerge:

> *The interpretive paradigm is informed by a concern to understand the world as it is, to understand the fundamental nature of the social world at the level of subjective experience. It seeks explanation within the realm of individual consciousness* (Burrell and Morgan 1979, p.28).

This concern with understanding the world as it is was highlighted by Chua (1986) who, drawing on Fey (1975), stated:

> *… interpretive knowledge reveals to people what they and others are doing when they act and speak as they do. It does so by highlighting the symbolic structures and taken-for-granted themes which pattern the world in distinct ways. Interpretive science does not seek to control empirical phenomena, it has no technical application. Instead, the aim of the interpretive scientist is to enrich people's understanding of the meanings of their actions, thus increasing the possibility of mutual communication and influence. By showing*

> *what people are doing, it makes it possible for us to apprehend a new language and form of life* (p.615).

Working within this paradigm, social scientists seek to gain a *subjective understanding* of the everyday meanings and the everyday common sense with which humans see themselves and the world around them (Lee, 1991)[41]. This is achieved through the researcher's own interpretation of that subjective understanding, aided by qualitative research methods[42] such as phenomenology, hermeneutics, ethnography and participant-observation (for a review of these methods see, for example, Chua, 1986; Hopper and Powell, 1985). An *interpretative understanding* thus involves the observation of aspects reality and interpreting that empirical reality in terms of its subjective meaning to the observed human subjects (Lee, 1991). This subjective understanding is central to interpretive analysis, dictating that social scientists accept the intersubjectively-created meanings ascribed by humans to the social world as an integral part of the subject matter under investigation[43].

From an interpretive perspective, "… the social scientist must collect facts and data describing not only purely objective, publicly observable aspects of human behaviour, but also the subjective meaning this behaviour has for the human subjects themselves" (Lee 1991, p.347). In an accounting context, for example, this would be reflected in a focus on understanding the subjective experience of those individuals involved in the preparation, communication and use of accounting (and other) information. Consequently, researchers working in this paradigm focus on *interpretation* rather than 'prediction' and hence it is the intuitive and interpretive skills of the researchers which are seen as important in studying organizations (Laughlin, 1987). Researchers operating within the interpretive paradigm view the social world as an "… emergent social process" (Burrell and Morgan 1979, p.28) which is created by the individuals themselves through a process of social construction. In this sense, accounting and economics are seen as both social constructed and social constructing, having no meaning other than the meaning ascribed to it by humans. In short,

> *This perspective denies the existence of a single, objective, concrete reality. Although each participant interprets the organizational world in their own way, there is a shared, created meaning which is continuously re-negotiated and re-adapted by webs of relationships* (Buhr 1998, p.165).

Interpretivist study of accounting practice rejects the traditional view of accountants and researchers who see themselves as engaged in an "objective", "value-free", technical discipline representing reality "as is" (Morgan, 1988). Rather, accountants are perceived as being "… enmeshed in a process of reality construction. They grasp and articulate complex realities in partial ways, and these graspings and articulations help sustain the realities as *perceived*" (Morgan 1988 p.484, original emphasis). In other words, accounting is seen as a metaphorical enterprise, with accountants trying to represent organizations and their activities in terms of numbers which succeeds in providing only a partial and incomplete representation of reality to which the accounting numbers relate:

> *The idea that accountants represent reality "as is" through the means of numbers that are objective and value free, has clouded the much more important insight that accountants are always engaged in* ***interpreting*** *a complex reality, partially, and in a way that is heavily weighted in favour of what the accountant is* ***able*** *to measure and* ***chooses*** *to measure, through*

> *particular schemes of accounting to be adopted* (Morgan 1988, p.480, original emphasis).

The interpretist argument being debated here is that our understanding of organizations, and the human agency at work within these organizations, is aided by the use of metaphors which provide no more than partial, incomplete insights into the holistic whole. These different metaphors, be they historical, social, economic, rhetorical, political or ideological, each provide a different lens through which to view, isolated and forcibly separated aspects of the organization, but which, inevitably and unavoidably, distort and squeeze out others (Morgan, 1988). Significantly, the limitations imposed by any one perspective are seen as fundamental in an epistemological sense in relation to the construction of knowledge, such that our understanding of the world is always partial: "Our lot as human beings dealing with a complex, multi-dimensional and paradoxical world, is that our knowledge can do no more than create a weak and rather uni-dimensional representation of that world" (Morgan 1988, p.480). An epistemology, such as positivism, for example, which restricts the study of phenomena to that which can be measured, is seen by those working within the interpretive paradigm as denying the existence of other aspects of the same complex reality which cannot be measured but which nonetheless form part of the holistic whole[44]. Consequently, researchers working within the interpretive paradigm argue that the models and methods borrowed by accounting researchers from the natural sciences, which underlie the positivist tradition and which continue to dominate contemporary accounting research, have long been recognized as either inappropriate or deficient for the study of social phenomena (Morgan, 1983a). The crux of the argument employed by Burrell and Morgan (1979) and Morgan and Smircich (1980) is that different ontological assumptions (i.e. perceptions of reality) favour different approaches to the study of 'reality'. The positivist tradition, with its assumption that all scientific knowledge must be positivist knowledge, produces only one kind of knowledge, whereas other research models and methods can be used to generate other kinds of knowledge which are argued to be equally important in understanding how users of (accounting) information construct and interpret reality (Morgan, 1983a). In the specific context of CSR, for example, interpretivist attempts to understand how the social world functions have made use of non-positivistic methods of research to explore factors such as organizational culture, the influence of social pressure groups and the media (see, for example, Buhr, 1998; Harvey, 1984; Jones, 1990; O'Donovan, 1999a; O'Dwyer, 2000; Tilt, 1994).

The interpretive paradigm is also concerned with issues of pluralism and democracy, particularly with way the in which power is distributed between the various factions in society. In the context of CSR, the recognition of society as pluralist is a key issue because this opens the way to recognising a pluralistic set of users, or stakeholders. Unlike a functionalist approach, which would see such rights and needs in terms of the primary goal of the existing social system as a whole (i.e. economic wealth accumulation) or as part of a rational economic process, the interpretive approach seeks to understand the wants and needs of each stakeholder group and the extent to which those needs and wants are being met (or not met, as the case may be) by the present system[45]. Although not seeking to radically change the present social system, an interpretive approach favours adaptations to the system on issues such as social responsibility, accountability, social justice and democracy in order that it should more fairly serve the rights, needs and wants of the various actors within a

pluralist society. In an organization-society context, this has led to developments in the 'evolution without revolution' perspective to CSResp and CSR (Gray *et al*., 1987, 1996). Such a perspective neither rejects nor reinforces the status quo, but seeks to increase our understanding of social and environmental accounting. Laughlin (1995) refers to social responsibility researchers working within this perspective as adopting a strategic attitude to change by being "… open to maintaining certain aspects of current functioning but also open to challenging the status quo" (p.68). Thus, such researchers accept the basic *institutional* structures (i.e. the capitalist structures) in their existing form and leave them unchallenged. This does not mean they do not seek change; they do, but the essential nature of that change is 'gentle' (Gray, 1992) rather than radical (see, for example, Bebbington *et al*., 2001; Gray, 2000, 2001; Owen, 1996; Owen and Swift, 2001; Owen et al., 2001; Swift, 2001). Within accountancy, a number of theories have been employed in the interpretive tradition, each of which offers a different lens through which to view CSR. Two of these, managerial stakeholder theory (MST) and organizational legitimacy theory (OLT), have been used by accounting researchers in empirical studies of the behaviour of management from an interpretivist perspective (albeit not in a monopolistic sense – see Section 4.9 below). Both theories are suggested as being useful heuristics in seeking to explain and explore CSR practice and hence were selected for use in the present study. These two theories are explored in more detail Chapters 6 and 7, respectively.

4.7 The radical paradigms

Theories which sit within the radical humanist and radical structuralist paradigms in the Burrell and Morgan typology (see Figure 4.1 above) fall outside the scope of the main empirical part of the present study. However, as noted previously, an analysis of trends in CED over time (see Chapter 10) provided the opportunity to explore these trends through the lens of political economy of accounting theory (PEAT). Given that the latter falls within the radical structuralist paradigm, it is apposite to make a brief mention of the two radical paradigms here. The intellectual origins of the two radical traditions can be traced back to the German idealist tradition, especially Immanuel Kant's writings ('transcendental idealism') and the work of Friedrich Hegel and (the young) Karl Marx. Developments in this field have also been influenced by the Frankfurt School[46] and the existentialist philosophy of Jean-Paul Sartre. The word 'radical' is used in both cases to symbolise the fact that individuals operating from within these two paradigms essentially reject the present social order and argue for *fundamental* change:

> *The primary concern of all critical theorists was, and still is, with an historically grounded social theory of the way societies and the institutions which make them up, have emerged and can be understood. Interpretation is never for its own sake but forms part of the important understanding which can allow some desired "transformation" of societies and their institutions so that a "true, free and just life" can be assured* (Laughlin 1987, p.482).

Radicalism in this context is often equated with *critical theory*, the latter itself a branch of social analysis which has come to be associated with the Frankfurt School of critical sociology. However, critical social theory[47] has a longer history and has been influenced by a number of philosophers, particularly George Hegel, a German idealist philosopher of the late

eighteenth/early nineteenth century, and the collaborative efforts of Karl Marx and Friedrich Engels. Marx and Engels produced a body of doctrines which became known as Marxism or 'classical Marxism' in the second half of the nineteenth century (Flew, 1979). In Hegelian philosophy, the role of intellectual criticism acquired a new, positive role in terms of detecting and unmasking hidden assumptions within existing belief systems and of debunking claims to authority to further the emancipation of people (Abercrombie *et al*., 1994). Similarly, classical Marxist philosophical criticism was regarded not simply as an intellectual exercise but, more importantly, as an instrument for bringing about social change (i.e. social revolution).

In the latter part of the 20th century, the critical theorists of the Frankfurt School, perceiving that capitalism had changed fundamentally such that the classical Marxist critique of Marx and Engels had lost much of its potency, focused their attention on the foundations and assumptions of science and capitalism, particularly the claims of 'institutional rationality' as being the only form of genuine knowledge. Writers such as Habermas (1971, 1976a, 1978) and Marcuse (1955, 1964, 1969) were representative of various attempts to transcend the perceived weaknesses of both the functionalist and interpretive perspectives. The radical perspective, whilst sharing some of the same ontological beliefs and assumptions as to the nature of man as the interpretive perspective, makes several major criticisms of the interpretive approach (for more detail see Bernstein, 1976; Habermas, 1978; Held, 1980). For example, in relation to assumptions about the social world, radical theorists argue that interpretation *per se* is not sufficient "… because it cannot appreciate that the world is not only symbolically mediated, but is also shaped by material conditions of domination. Language itself may be a medium for repression and social power" (Chua 1986, p.621). From within this perspective of the social world, conflict is seen as both institutionalised and endemic. Hence, human potential is perceived as being repressed both by their own level of personal consciousness (i.e. self-awareness) and by the institutional structures of modern society which act as systems of domination, alienating people from self-realization (Held, 1980).

The radical humanist paradigm radicalises the phenomenological (or naturalistic) approach to research by focusing on the *power* dimension that underlies the process of reality construction (Morgan, 1983a). Specifically, this paradigm emphasises the importance of transcending the limitations of the status quo, of releasing the individual from the chains and constraints of the social world in order to achieve higher states of consciousness and experience. Thus, there is a concern with discovering how humans can link thought and action as a means of transcending their alienation. In the context of accounting, the radical humanist view focuses on explaining the social order from a nominalist, anti-positivist, voluntarist and idiographic perspective. Accountants, accountors and the accountee are seen as prisoners of reflections of 'world-views' which are socially constructed to shape and control their lives[48]. The accountant, for example, is seen as shaping much of the language and practice of organizational life and thereby contributing in large measure to the construction of 'power traps' from which organizational members have difficulty in escaping (Morgan, 1983a). The focus is therefore placed on understanding the 'pathology of consciousness' (Burrell and Morgan, 1979) by which humans use accounting to construct modes of social organization within which to trap themselves and be trapped, and of discovering ways in which human consciousness may be set free from these traps to facilitate

personal growth towards higher states of consciousness. Thus, a radical humanist theory of accounting is seen as potentially providing the basis for a critical understanding of the process by which accounting restricts the lives of an organization's individuals which, in turn, could have important consequences for re-shaping organizational life (Morgan, 1983a).

The radical structuralist paradigm, on the other hand, whilst sharing an approach to society which has similarities with the radical humanists, concentrates on structural relationships within a realist social world, providing a re-interpretation of the traditional approach to accounting within a Marxian and Weberian framework (Burrell and Morgan, 1979; Morgan, 1983a). The radical critique of society as offered by these theorists focuses upon structural conflict, modes of domination and social exclusion and of challenging the existing social order. Thus, reality is predicated upon a view of society as a potentially controlling and potentially dominating force. Excluded from this paradigm, however, are concerns with individuals' interpretations of reality, since these are understood to provide an unreliable basis for the purpose of understanding the nature and dynamics of society (Willmott, 1993a). In an organization-society context, radical structuralists consider society as being a reflection of the basic political, social and institutional structures within it (i.e. the capitalist structures) and, although the existence of the social world and a pluralistic set of users are recognised, these various recipients are seen to be in constant conflict with each other due to the uneven distribution of power within society. Thus, a radical structuralist view of the world sees a social and organizational structure that is oppressive in nature, arising out of dysfunctional structural relationships (Richardson, 1987). These relationships are seen as creating a power élite which has control over resources (Buhr, 1998). From this perspective, organizations, particularly large business organizations which have control over huge economic and financial resources, are viewed as instruments of social forces concerned with maintaining the present inequalities in the distribution of wealth and power within society (see, for example, Cooper, 1983 and Cooper, 1992). Such inequalities are seen as giving rise to structural and intrinsic tensions and contradictions between opposing elements. From this perspective, accounting methods and systems are seen as mechanisms or 'contextual determinants' (Morgan, 1983a) which are used to create, distribute and mystify power by the power élite for the purpose of setting an agenda which preserves existing power asymmetries. Thus, critical (i.e. radical) accounting theory has been described as a school of accounting theory which perceives accounting information as being used to advance political agendas, rationalise previous decisions and legitimise the economic and political status quo of the ruling élite (Stiner, 1994). Similarly, the discipline of accounting is not seen as value free, objective or based on fact, since such concepts are regarded as illusory, but as socially constituted, "… a social practice embedded in a socio-historical context" (Lehman 1992, p.53). In short, accounting, both as field of academic inquiry and as a practice-based craft, are seen as contextually defined, epistemologically, socially and historically.

Within accounting, the principal theory which can be located within the radical structuralist paradigm is the political economy of accounting theory (hereafter PEAT). PEAT (see, for example, Cooper, 1992; Cooper and Sherer, 1984; Miller, 1994; Stiner, 1994; Tinker, 1980, 1984a, b; Tinker and Neimark, 1987) attempts to draw attention to the conflicting political, social and economic interests at stake in accounting and reporting. The latter are depicted as a partial, interested language, or 'ideological weapons', that further the interests of particular classes and organizational groups over other sections of society. PEAT focuses on exploring

and assessing the ways in which social protagonists use accounting information and corporate reporting to mediate, suppress, mystify and transform social conflict. By placing class relations at the forefront of analysis, PEAT is concerned with the effects of accounting methods and systems on the distribution of income, wealth and power within society, particularly how the ruling élite (i.e. the shareholder and managerial classes) use accounting and reporting for the purposes controlling an agenda which legitimises the economic and political status quo thereby preserving existing privileges and power asymmetries. Thus, a radical 'classical' (Marxian) political economy perspective, such as that offered by Tinker *et al.* (1982, 1991) and Puxty (1986), views accounting (theory and practice) discourse not as a neutral device but as part of the means by which social control is exercised in the interest of the dominant classes and for managing the conflicts which take place between the different classes. Puxty (1986), for example, adopting a radical structuralist perspective on the accounting profession's response to the social accounting debate in the 1970s and 1980s, argues that accounting, as an institution, sought to protect its legitimacy "… by providing the required extension to its concepts while at the same time suggesting an extension had to be limited in its scope" (p.106).

Within this paradigm, most forms of accounting are seen as supporting capitalistic production rather than making social injustices visible and are thus perceived of as part of the problem rather than part of the solution. Such a radical view rejects the socially related 'evolution without revolution' arguments of Gray *et al*. (1996) and Elkington's (1994, 1997, 2001) vision of 'sustainable capitalism' because these are seen as based on a plurality of approach (neo-pluralism), the regulation of the market mechanism and the acceptance of much of the capitalist-based modes of production and distribution of wealth. Moreover, radical theorists regard research which seeks merely to *understand* the nature of society as effectively accepting and reinforcing existing institutional structures. Hence whereas CSR researchers such as Gray *et al.* (1997) are concerned with understanding and advancing the theory and practice of stakeholder accountability in a neo-pluralist context, radical theorists see such practices as merely suppressing the problematic conflicts which exist between organizations and society. Radical theorists such as Puxty (1986) argue that, irrespective of what form CSR takes, in terms of the 'big picture' it amounts to nothing more than the crumbs of legitimation that are permitted to fall from the table of capitalism. In other words, CSR is perceived simply as a blunt instrument to preserve existing asymmetries and inequalities between the different classes within society, rendering any analysis of the detail largely irrelevant. Hence, the radical theorists argue that the focus of CSR analysis should be on the institutional structures within society and the means by which those structures are kept in place, rather than on the amount, form or content of CSR. This analysis can be used for example, in relation to the role of the State vis-à-vis requirements by national Governments in countries like the Netherlands and Denmark to introduce mandatory environmental reporting requirements at *site* level rather than at *corporate* level (see Chapter 2). Such requirements, whilst, superficially at least, appearing to introduce greater corporate accountability and CSResp, leave the way open for companies to effectively 'export' environmental damage to countries which have no such regulations or to mask more serious negative environmental impacts in other lines of businesses which go unreported (Adams *et al*., 1998). This situation could be interpreted as evidence of the State acting *as if* to appease society's concerns whilst leaving the capitalist system as a whole largely unchanged and unthreatened by the

'environmental crisis' (see Chapter 1). Similarly, in relation to environmental pollution, a political economy of accounting theory approach would focus on the tension which manifests itself in the form of structural conflict between corporate profits and a clean, pristine natural environment, and in particular, how a 'technology argument' may be exploited by management for their own political advantage (see, for example, Buhr, 1998).

The radical approaches as outlined above are likely to appeal only to those who themselves are prepared to question the basis of societal organization in Western capitalist economies, and thus will likely not only represent a considerable challenge to mainstream accounting researchers and practitioners but also be ineffective in convincing most accountants and managers of the need for social and environmental accounting (Chua, 1986; Mathews and Perera, 1991). Nevertheless, the radical perspectives arguably offer insights worthy of consideration, not just in terms of understanding the wider socio-political role played by accounting and accountants, but also of the wider, more complex institutional roles of business organizations in society.

4.8 Criticisms of the Burrell and Morgan framework

Since its publication in 1979, the Burrell and Morgan framework has come in for a good deal of criticism, notably from accounting and organizational theorists (see, for example, Kasanen *et al*., 1993; Laughlin and Lowe, 1990; Laughlin, 1995; Lewis and Grimes, 1999; Willmott, 1990a, b, 1993a, b). Kasanen *et al.* (1993), for example, argue that accounting researchers have looked too much to the natural and social sciences for methodological models and, as a consequence, too little discussion is given within accounting to the research approaches used in other practical/applied disciplines such as engineering and medicine. They argue for the adoption of a classification system based on methodological discussions in Finland (Neilimo and Nâsi, 1980; see also Lukka, 1986; Lukka *et al*., 1984). The latter classification system is also based on a 2x2 matrix, consisting of four approaches (nomothetical, decision-orientated, action-orientated and conceptual) which are located within two axes, theoretical-empirical and descriptive-normative. However, whilst this model may indeed give greater recognition to other methodologies, the emphasis on 'practical/applied' disciplines such as engineering and medicine suggests a desire to view accounting more as a technical, problem-solving and practical discipline rather than a economic/socio-political phenomenon, something which critical theorists such as Habermas (1963/1973, 1976b) have been at pains to prevent. In addition, the simple bi-polar, dualistic classification system suggested by Neilimo and Nâsi (1980) is just as simplistic as that of Burrell and Morgan.

A further aspect which has come in for strong criticism, particularly from Chua (1986) and Willmott (1990a, b, 1993a, b), is the mutual exclusiveness of the four paradigms (what Kuhn (1970) refers to as 'incommensurability'). The dualism between the 'subjectivist' and 'objectivist' world-views has also been criticised for its simplistic nature (Boland, 1989; Willmott. 1993a). Boland (1989) argues, with some justification, that whilst the recognition of the 'subjective' and 'objective' traditions is a positive development in accounting research, it is incorrect to present it in terms of a simple dichotomy between the two or to suggest that there are two different kinds of researchers (objectivist and subjectivist) focusing on one realm of experience or the other. Chua (1986), who drew extensively on the Burrell and Morgan framework in developing her own approach to the classification of accounting

theories, is critical of Burrell and Morgan's assertion that the 2x2 matrix (see Figure 4.1 above) presents mutually exclusive dichotomies which are claimed to cover all social perspectives in a *permanent* (i.e. immutable) classification[49]. Chua rejects this approach, arguing that the meta-theoretical assumptions made by researchers are not immutable but historically specific, reflecting the dominant themes currently being debated within the social sciences and different research traditions already existing in accounting research. Chua suggests that other, new important assumptions about the nature of the social world may emerge as more and more research outside of 'normal science' is carried out. This criticism seems to hold water given that it is impossible to predict with any certainty that new 'world views' will not emerge in the future. Willmott (1993a) is also critical of Burrell and Morgan's assumption of incommensurability, claiming that although paradigm clashes may exist in relation to their different sets of assumptions, the boundaries which divide one from another are not clear cut but fuzzy and not immutable but potentially permeable. Willmott (1993a) expresses concern over the fact that by dividing social and organizational analysis into four, mutually exclusive enclaves, Burrell and Morgan's model achieves their stated aim of paradigmatic 'closure' in that it unnecessarily constrains the process of theory development within polarized sets of assumptions about science and society:

> *By representing methodological diversity as a dualism – as an either/or – a tendency for social and organizational theory to gravitate to one or other of these poles is effectively cast into a metaphysical principle, thereby promoting a new form of closure because the coherence of all attempts to resist this tendency is denied* (Willmott 1993a, p.683).

Willmott (1993a) provides an illustration of the weakness of Burrell and Morgan's bipolar dualism using labour process theory, the latter being an area of organization theory where researchers have sought to incorporate both an appreciation of the 'subjective' dimension without letting go of a commitment to radical, structural analysis, something which the Burrell and Morgan model suggests as being impossible. Laughlin (1995) also argues that the simple bi-polar dualism used by Burrell and Morgan is too simplistic and develops his own, three dimensional model of the choice processes involved in empirical research, grouping these into three broad bands which he describes as 'theory', 'methodology' and 'change' choices. However, although this model is more sophisticated that than of Burrell and Morgan, it also suffers from reductionism and, as Laughlin himself admits, his own 'high, medium and low' descriptors, used to identify different levels of commitment to methodology, theory and change, are "… not precise, definable or measurable" (Laughlin 1995, p.68).

Despite the (valid) criticisms referred to above, the overriding contribution of Burrell and Morgan's simplistic bi-polar classification of social theories is that it has isolated many, if not most, of the key domains for choice and the assumptions relating to ontology, epistemology, human nature and methodology that are implicit in the various approaches to empirical accounting research (Laughlin, 1995). Whilst the model may indeed suffer from imperfections, it highlights the growing array of 'choices' in accounting theory construction and acceptance, choices which, whether stated or implied, empirical accounting researchers are making all the time:

> *...the inevitable truth [is] that all empirical research is partial and incomplete and that theoretical and methodological choices are inevitably made whether appreciated or not* (Laughlin, 1995, p.65).

Hence, whilst there may be valid arguments which can be used to justify the use (or non-use) of one particular framework or classification in preference to another (see, for example, Lowe *et al*., 1983), there is no such thing as a value-free, independent, rational process by which we can produce a permanent, static, neutral framework within which competing paradigms can be evaluated (Bernstein, 1983; Chua, 1986; Feyerabend, 1975; Kuhn, 1970; Popper, 1963; Rorty, 1979). Hence, whatever framework is employed, will, to some degree or other, be historically and culturally specific and reflect certain ideological beliefs, resulting in some form of closure and some degree of reductionism. Consequently, whilst recognizing the simplistic and rigid nature of the Burrell and Morgan framework, it is perhaps as good as any other in providing an analytical tool which serves as an heuristic, intellectual map within which to locate different theories according to their respective source, tradition and problematic. Belkaoui (1992), for example, argues that to be able to tell the difference between a theory and a paradigm, an adequate definition of the latter must (a) categorize theories as mere components of paradigms and (b) differentiate between competing paradigms. The Burrell and Morgan framework arguably does that.

4.9 Paradigmatic comparison of chosen accounting theories

One of the principal benefits to have emerged from Burrell and Morgan's sociological analysis of theories and paradigms is that is has encouraged others to develop their own frameworks, particularly in accounting, where various attempts have since been made to classify the different ontological, epistemological and methodological approaches to the study and practice of accounting (see, for example, Belkaoui, 1987; Chua, 1986; Cooper, 1983; Hopper and Powell, 1985; Laughlin, 1995). An important issue in this respect is that it has prevented any form of 'theory closure' by which new, alternative theories might otherwise have been denied recognition in accounting (AAA, 1977; Davis *et al*., 1982; Gray *et al*., 1996; Laughlin and Gray, 1988; Laughlin and Puxty, 1981). CSR research, in particular, has not suffered from theory closure in the same way that befell mainstream accounting with postulational research in the 1950s and 1960s and PAT in the 1970s and 1980s. As such, CSR research remains open to emerging and new world-views (see, for example, Lehman, 1999) as well as to different research methodologies. A complete review of the whole range of theories which, *potentially*, could be used to understand, explain or predict the nature and causes of CSR from within these different research traditions is beyond the scope of the present study. Rather, this study is limited to providing an overview of the key meta-theoretical aspects of each of the main theories employed (i.e. EAT, MST, OLT), together with that of the auxiliary theory (PEAT). Explicit recognition of the theoretical and methodological 'choices' which researchers continuously make is currently not an essential part of the research process for the majority of accounting researchers. Whilst a theory, and attempts to explore and understand the value of that theory, represents the 'visible part', most of the underlying meta-theoretical assumptions tend to remain implicit rather than explicit. These 'choices' are important in any context but arguably become much more important when employing multiple theories to explore the same social phenomena, as in the case of the present study. In such situations, an understanding of the underlying assumptions of each

Table 4.3
Some key meta-theoretical and theoretical aspects of four accounting theories

Theory	Paradigm (dominant world-view)	Theoretical 'roots'	Human nature and social order	Principal actors	Nature of relationship(s)	Role and function of (accounting) information	T re w w in
Economic agency theory (EAT)	Functionalist	Neo-classical and 'positive' economics	'Rational economic behaviour', opportunistic and goal-orientated (the moral hazard problem'). Social order negotiated through the pursuit of economic short term self-interests (selfish, greedy, gambling)	Shareholders (principal) and management (agent)	Economic – 'nexus of contracts' between principal and agent (bonding, monitoring, etc.)	A negotiated and tradeable commodity which may be used to influence the perceptions of shareholders, bondholders and regulators	T p m c a c m a s
Managerial stakeholder theory (MST)	Interpretive	Bourgeois political economy, organization theory, sociology and systems theory	Subjective and personal, divergent social goals (but manageable and controllable). Social order negotiated through social interaction and communication (goal congruence)	Stakeholders and management within a neo-pluralist vision of society	Socio-economic management of stakeholders from the perspective of the firm	Mediation of stakeholders interests and concerns whilst keeping to the long-term strategic goals of the organization	T fi re st gr co re C w d fi o

Table 4.3 (continued)

Theory	Paradigm (dominant world-view)	Theoretical 'roots'	Human nature and social order	Principal actors	Nature of relationship(s)	Role and function of (accounting) information	T re w w in
Organizational legitimacy theory (OLT)	Interpretive	Bourgeois political economy, social theory, political philosophy	Subjective and personal, highly complex, socio-political interests. Social order negotiated through the management of society's perceptions and impressions	Management and 'relevant publics' within a neo-pluralist vision of society	Socio-political, pluralist, divergent and competing interests, but these interests can be manipulated	Source of socio-political power to legitimise particular forms of organizational behaviour	L o o e c re in p th p
Political economy of accounting theory (PEAT)	Radical structuralist	Classical political economy (Marxian), political philosophy	Subjective and personal. Deep-seated and endemic conflicts borne out of repression. Social order structured through suppression and exploitation	Capital (shareholding and managerial classes, supported by the State) and labour	Socio-political, irreconcilable, inequitable, being the source of deep-seated conflict	Source of political power used to preserve existing social divisions and power and wealth asymmetries	D e d m su m a o

theory is a *sine qua non* for empirical research. Table 4.3 above summarises these key characteristics. A more detailed exploration in the context of EAT, MST and OLT is set out in Chapters 5 through to 7, respectively (an overview of PEAT is provided in Chapter 10). A short overview of these four theories is given below in the specific context of CED[50]:

- *Economic agency theory (functionalist paradigm – economic theories)* - management is argued to use CED to minimize political costs, minimize the agency costs of debt and equity capital and maximize their own self-interest (Blacconiere and Patten, 1994; Cormier and Magnan, 1996; Ness and Mirza, 1991; Parker, 1986; Watts and Zimmerman, 1978);
- *Managerial stakeholder theory (interpretive paradigm – socio-economic theory)* - management is argued to use CED to *manage* a broad range of different factions (or stakeholders) which are mediated through a process of stakeholder management whilst maintaining the firm's pursuit of its own long-term strategic goals (Freeman, 1983, 1984; Gray *et al*., 1997; Roberts, R., 1992; Tilt; Ullmann, 1985);
- *Organizational legitimacy theory (interpretive paradigm – socio-political theory)* - management is argued to use CED politically as a *reaction* to a perceived actual or potential threat to the firm's organizational legitimacy (Dowling and Pfeffer, 1975; Guthrie and Parker, 1989; Lindblom, 1994; O'Donovan, 1999a, b);
- *Political economy of accounting theory (radical structuralist paradigm – socio-political theory)* - CED is seen as being used politically by 'capitalists' (shareholding and managerial classes, supported by the State and other economic institutions) to dominate, exploit, deprive, manipulate, suppress and mystify labour for the purposes of maintaining existing power inequalities and information asymmetries (see, for example, Cooper, 1992; Cooper and Sherer, 1984; Guthrie and Parker, 1990; Neimark, 1992; Puxty, 1986, Tinker *et al*., 1991).

Using the Burrell and Morgan framework as described above, each of these theories may be situated within its paradigmatic 'home'. The economic theory of agency, with its roots in neo-classical economics and based on a structured view of the world, belongs to the functionalist paradigm, representing what Kuhn described as 'normal science' within both economics and accounting and finance at the present time. Studies which have used this theory to explain CSR/CED do so along two fronts (see Chapter 5), the first being the use of CSR in relation to CSResp programmes, policies and performance to avoid regulatory interference under the 'political costs' hypothesis, and the second under the 'information content' hypothesis in connection with the costs of equity and debt capital (see, for example, Belkaoui and Karpik, 1989; Ness and Mirza, 1991; Zéghal, and Ahmed, 1990). The other two theories, MST and OLT (see Chapters 6 and 7, respectively) are presented as belonging to the interpretive paradigm. Both theories have their roots in social and political theory, emphasising a socio-political, neo-pluralist world and a pluralistic set of users of CSR (Mathews, 1987a), and have been used to explore the use of CSR from the perspective of managing stakeholder groups (see, for example, Roberts, R. 1992) or reacting to perceived threats to the firms' organizational legitimacy within society (see, for example, Deegan and Rankin, 1996).

In recent times, a growing body of CSR literature has used MST and OLT which may be classified as interpretive (see, for example, Adler and Milne, 1997; Deegan and Gordon, 1996; Gibson and Guthrie, 1995; Gray *et al*., 1995b; O'Dwyer, 2000; O'Dwyer and Gray, 1998; Tilt, 1994; Yamagami and Kokubu, 1991). Political economy of accounting theory belongs to the radical structuralist paradigm and has its roots in 'classical' (i.e. Marxian) political economic theory. Although recognising the existence of a pluralist society, 'classical' political economy theory focuses on the institutional structures which are seen as supporting existing inequalities and power asymmetries within society. Specific contributions to CSR from within this paradigm include those of Puxty (1986, 1991), Tinker (1984a), Tinker *et al.* (1991) and Tinker and Lowe (1980). These studies emphasise the use of language, images and rhetoric for immanent legitimation and social construction of perceptions to hide, mystify and mediate crises between money capital and other forms of capital including human, social and environmental.

The relationship between MST and OLT, on the one hand, and 'classical' political economy theory, on the other, is somewhat ambiguous, reflecting perhaps, their relatively youthful state of development within the accounting literature generally and the CSR literature in particular. Some perceive all three theories as focusing on the organizational-environmental nexus, albeit at different levels of analysis and with different levels of 'theoretical commitments' (Neu *et al*., 1998). Others present these theories within a more systems-orientated approach to the organization-society relationship, focusing on the role of information and disclosure in the relationships between organizations, the State, individuals and groups (Gray *et al*., 1996). The most considered analysis in this context is that provided by Gray *et al.* (1995b, 1996). Gray *et al.* (1995b, p.52) argue that, rather being seen as competing theories, stakeholder theory and legitimacy theory are "… better seen as two (overlapping) perspectives on the issue which are set within a framework of assumptions about 'political economy …", with any differences being "… differences in levels of resolution of perception rather than arguments for and against competing theories as such". Similarly, Gray *et al.* (1996) suggest that variations on both legitimacy theory (of the organization and of the system) and stakeholder theory (accountability and organization-centred) can be seen as broadly similar to one another given that each is concerned with (a) the power of groups within society, or society as a whole, to pressurise organizations into disclosure and (b) the deliberate use of disclosure, particularly social and environmental disclosure, to legitimate, to deflect criticism and to control the main socio-political agenda vis-à-vis the wider community. In the absence of any clear, definitive position on this issue, the approach adopted in the present study is more or less in line with that presented by Gray *et al*. (1995b, 1996). However, a subtle distinction is made between MST and OLT, with the former being described as a *socio-economic* theory and the latter as a *socio-political* theory (see Chapters 6 and 7, respectively). The inclusion of EAT within the same study is problematic because this theory, which is essentially an *economic* theory, clearly belongs to a different sociological paradigm, implying that the present study has a multi-paradigm dimension.

4.10 Multi-paradigm research

Multi-paradigm research refers to research which employs multiple theories belonging to more than one sociological paradigm[51]. With the increased recognition of the existence of multiple paradigms within the social sciences, researchers are being encouraged to search out and 'play with' the theoretical tensions or oppositions to stimulate the development of more encompassing theories (Poole and Van de Ven, 1989) and to build theories which straddle across paradigms, a concept known as metaparadigm theory building' or 'metatriangulation' (Gioia and Pitre, 1990 - see, also for example, Bradshaw-Camball and Murray, 1991; Denzin, 1978; Hassard, 1991; Reed, 1997; Willmott, 1993a). However, multi-paradigm enquiry remains controversial (Lewis and Grimes, 1999). On the one hand, some functionalists are strongly against paradigm proliferation (see, for example, Donaldson, 1985; Pfeffer, 1997), whilst postmodernists are critics of the hegemony of paradigms, suggesting alternative approaches to research strategies (see, for example, Deetz, 1996; Feyerabend, 1975; Reed, 1985). In the middle of these opposing extremes, there are those who view multi-paradigm enquiry as a compromise between dogmatism and relativism (Scherer, 1998), providing theorists with heuristics which offer unrealized theory building potential (Lewis and Grimes, 1999). In this context, multi-paradigm research involves the use of divergent paradigm or analytic 'lenses' empirically, to collect and analyze data and 'play' with the data, drawing out the diverse representations and 'stories' therein of organizational phenomena. Such studies are claimed to preserve theoretical conflicts by depicting the "… organizational voices, images and interests magnified by opposing lenses" (Lewis and Grimes 1999, p.695).

However, such a process is fraught with difficulties given that it involves respecting the different assumptions under alternative, competing paradigms and attempting to draw out the different insights offered by each source. As noted by Lewis and Grimes (1999), multi-paradigm enquiry can be used to identify opposing research issues and reveal varied interpretations of the data but conflicting assumptions may preclude the use of a common analytical approach, requiring researchers to apply respective paradigm *methods*. These bounded constraints create a practical problem with multi-paradigm science because the researcher has to adopt one particular paradigm model with which to construct 'reality' empirically and then use different 'lenses' through which to view the same data (Morgan, 1983b). This approach has been rarely employed by accounting researchers and is even rarer in the context of CSR research. However, there are exemplars to be found in the literature, notably Gray *et al.*, (1995b, 2001) where the same CSR data set was employed in exploring both interpretive and functionalist methodology for observed, empirical trends in social reporting by UK companies over time, although in this case the results were published separately at different times and in two quite different journals. Whether the same data set can be applied within a single study using multiple theories which belong to more than one sociological paradigm is questionable. On the one hand, "… observational data can take on radically different interpretations from different theoretical standpoints even though different scientists with those different standpoints may well agree on the fundamental veracity of the data itself" (Ryan *et al.* 1992, p.22). On the other, critics challenge the very possibility of embracing other perspectives, suggesting that researchers employing multi-paradigm research are prone to contaminating different paradigm perspectives (see, for example, Deetz, 1996).

In multi-paradigm research, the researcher is not just using different 'lenses' to view the same world, but viewing the same phenomena from different 'world-views', giving rise to a 'clash of paradigms'. Consequently, multi-paradigm research presents the researcher with a set of challenges not encountered in uni-paradigm research. In this situation, the key challenge is the epistemological relationship between the theories one is interested in exploring and the research methods that are used to explore those theories[52]. If the researcher is concerned with *understanding* (as opposed to *explaining* or *predicting*), s/he is more likely to focus on interpretive methods of research and design the research approach accordingly. Conversely, if the researcher is more interested in examining specific (usually *causal*) relationships, then s/he is more likely to employ positivist methodology. Thus, for example, social science researchers working with interpretive (e.g., managerial stakeholder or organizational legitimacy) theories or radical structuralist theories (e.g. political economy of accounting) theories normally view the world through a social-constructionist lens, a world which is nominal and subjective, and hence would employ ideographic research methods such as in-depth interviews, action research, ethnography, ethnomethodology and case studies to gain an understanding of social phenomena (see, for example, Scapens, 1990). Conversely, those working with functionalist (e.g. economic agency) theories normally perceive the world as 'structured', 'real' or 'objective' and thus employ hypothetico-deductive methodologies such as logical positivism to investigate, empirically, specific relationships under the theory.

In practice, however, there is a blurring of epistemological and methodological traditions. In the CSR literature, for example, there are no hard and fast rules as to whether a particular theory belongs to one paradigm or another. Thus, legitimacy theory has been used both in a 'hard' hypothetico-deductive sense (see, for example, Adams *et al*, 1998; Deegan and Gordon, 1996; Neu *et al*., 1998; O'Dwyer and Gray, 1998) and in a 'soft' hypothesis sense (Gray *et al*., 1995b) to explore the nature and causes of CSR[53]. Part of the reason for this may be that the theories in question are still relatively new (to accounting) and under-specified. If it is possible, for example, to use interpretive research (e.g. a case study to *understand* one company's experiences in relation to the preparation of its first corporate environment report) and functionalist research (e.g. to test empirically the influence of changing social norms and values on environmental disclosures based on a large sample of companies, which are found to have *explanatory* power) using the *same* theory, then the theory itself may not be so well defined as to belong exclusively to one research paradigm or another. This would seem to apply to some of the 'middle range' theories such as MST and OLT, but much less so in the case of 'radical' theories, such as classical political economy and deep ecology. In other words, some theories are more 'closed' than others in terms of the research traditions employed in exploring their respective contributions in specific areas of inquiry. Thus, a particular theory's susceptibility to paradigm closure may be a function of the theory in terms of its specificity and stage of development (see, for example, Kuhn, 1970). A further reason may the fact that some accounting academics, being more sympathetic to 'behavioural' persuasions, have expended considerable energy since the mid 1980s in generating a great diversity of approaches on both theoretical and methodological issues (Laughlin, 1995). As a result, this had led to the adoption and adaptation of theoretical and methodological approaches from both social and political theorists, using a range of different approaches to improve our knowledge and understanding of accounting practice. Moreover, although this broad range of approaches has strained relations between the 'behavioural' and 'economics'

schools, there has also been a growing use of 'behavioural' approaches to empirical research, shading some of the more distinct differences between these two schools (Laughlin, 1995).

In the present study, there is a desire to avoid the two extreme positions of objectivity (realism) and subjectivity (nominalism), and adopt some sort of 'middle way' approach, perhaps in a similar vein to Laughlin's (1995) call for 'middle-range' thinking, which he argues:

> *... takes aspects of [both] approaches on the theory and methodology dimensions while taking a less dismissive perspective to critique and change. This approach recognizes a material reality distinct from our interpretations while at the same time does not dismiss the inevitable perception bias in models of understanding. It also recognises that generalizations about reality are possible, even though not guaranteed to exist, yet maintains that these will always be 'skeletal' requiring empirical detail to make them meaningful* (p.81).

Hypothetico-deductive methodology, such as logical positivism, results in both paradigm and theory closure because it is permits only the use of 'facts' which can be established as existing empirically, implying that phenomena which are not capable of being 'measured' do not exist[54]. As such, any research project which is based on and restricted to this method of research is not multi-paradigm research in a methodological sense. The key issue, here, in the context of the present study is whether, given this methodological closure, it is possible to employ the three chosen theories as a basis for explaining variations in CSR/CED between companies. Prior empirical research suggests that it *can* (see, for example, Belkaoui and Karpik, 1989, in the case of EAT; Roberts, R., 1992, in the case of MST; Deegan and Gordon, 1996 in the case of OLT), although to what extent remains unclear pending more research in this area. Gray *et al*. (2001), for example, argue that socio-political factors may well significantly improve the modelling of associations with CSR but raise doubts over whether it is possible to capture them by observable surrogates such that they could be used in statistical modelling. Notwithstanding this concern, there seems to be no reason, *a priori*, why different theories cannot be used to explore the same data set if there is acceptance as to the underlying veracity of that data. Moreover, where that underlying data set is both cross-sectional and longitudinal, it can be used (a) to test putative associations between CED and other measured variables using hypothetico-deductive methodology and (b) to interpret trends in CED *over time* using 'soft' hypothesis following Gray *et al*. (1995b). This is the approach adopted in the present study[55].

4.11 Summary and conclusions

As a result of many different approaches to the study of social and environmental accounting and reporting, CSR research is neither structured nor representative of a particular sociological paradigm. Consequently, CSR research has yet to experience paradigm or theory closure and, as such, remains open to a number of different world-views as to the nature and causes of CED. However, respecting the different meta-theoretical assumptions under alternative, competing paradigms and attempting to draw out the different insights offered by each source is problematic, such that some form of closure is a practical necessity within individual pieces of research. The present study thus adopts a methodological framework

which reflects a strong functionalist-positivist tradition in the development of theoretical models or theories as convenient artefacts for the generation of observable (and thus verifiable) predictions, the validity of which are tested through the formulation of conjectural empirical propositions (i.e. hypotheses). In this context, each of the three theories formally employed in the present study (i.e. EAT, MST and OLT) may be seen as providing different 'lenses' through which to view the socially-constructed and socially-constructing phenomena that is CED. These lenses vary both in terms of their level of resolution (i.e. the degree to which phenomena are specified and specifiable) and their field of vision (i.e. the panoramic scope of phenomena which are viewed and viewable) but are consistent at a level of analysis which views CED as a teleological instrument of management. That is, the executive management of business organizations use CED to assuage criticism from outside investors, pressure groups, governments and others, so that they can be left in peace to carry on doing the job they have been hired to do. Paraphrasing Gray *et al.* (1996, p.49), at a simple level, these theories are attempting to recognise that executive management is primarily concerned with the control of their organizations and use CED to the extent that this aids them to achieve and maintain that control.

Whether this is indeed the case is, arguably, one of the more important contributions which researchers can make to understanding CED practice. To date, research which has *explicitly* theorised as to the nature and causes of CSR, including CED, has so far made only a limited contribution to our understanding of CSR (Gray *et al.*, 1996). The present study seeks to add to that understanding by employing different theories as a set of analytical tools through which to explore, interpret and explain both variations in CED between firms (i.e. cross-sectionally) and trends in CED over time (i.e. longitudinally). With this goal in mind, each of three principal theories chosen for use in the present study are described in more detail in the following three chapters, respectively, beginning with economic agency theory. A brief overview of the supplementary theory (PEAT) is included in as part of the longitudinal analysis at Chapter 10.

Notes

1. A 'shopping list' of theories which potentially could serve to offer explanations as to the nature and causes of CSR include, amongst others: cost-benefit theory, rational choice theory, transaction cost theory, utility theory, contingency theory, diffusion theory, institutional theory, corporate governance theory, decision usefulness theory, social contracting theory, accountability theory, stakeholder theory, legitimacy theory and political economy of accounting theory.
2. A system may be defined as any collection of interrelated parts, objects, things or organisms (Abercrombie *et al.*, 1994). Thus, the human body is a system with many interrelated parts which allow it to function normally. A system is also often seen to be purposeful or functional, i.e. it cooperates together for the achievement of some purpose or goal. The concept of 'social system' refers to the analysis of groups, institutions and inter-social entities as well as interpersonal interaction between actors and has been used most explicitly in modern functionalism (Abercrombie *et al.*, 1994). In this context, 'society' may be perceived of as a social system – a system which includes the economic and which interacts with other systems including the natural, ethical and metaphysical systems – which is determined by a whole complex of social relationships, rights and responsibilities which organise, define and structure the way in which a society functions (Gray *et al.*, 1996)
3. A discussion of these different world-views is outside the scope of the present study. However, those wishing to explore quite different 'realities' to give context to their own may find the anthropological works of Castaneda (1970, 1973, 1993) challenging.

4. Meta-theoretical assumptions as used here refers to the general background of philosophical assumptions (i.e. belief systems) which provide the rules for the construction of theories and the use of particular research methods (Abercrombie *et al*., 1994). This includes assumptions about the relationship between the researcher and the world outside and the nature and structure of society. At the outset, it should be understood that the meta-theoretical issues addressed in this chapter are much too complex and comprehensive to be covered in any depth here. At best, the present chapter merely skims the surface. References are, however, provided to assist the interested reader in exploring these issues further. This is not intended as an indication of their importance. On the contrary, all professional researchers should be properly trained in acquiring an understanding of these issues as an integral part of any formal programme of research. Sadly, this rarely happens in mainstream accountancy, with the result that few researchers in this field have either the level of knowledge or understanding required for a critical, holistic understanding of what they are doing or why.
5. Both accounting and finance are relatively new academic disciplines, as evidenced by the fact that until the end of the nineteenth century there were *no* accounting researchers in the universities of either the US or the UK (Lowe *et al*., 1983). However, certain aspects of accounting, such as double entry bookkeeping, have been around for several centuries. Accounting has been taught at European universities since the fourteenth century and was an integral part of the mathematics tripos at the Universities of Oxford and Cambridge, England, until the nineteenth century (Ryan *et al*., 1992). In more recent times, finance developed into a strong academic discipline in the US, notably at the University of Chicago Graduate School of Business, and in the UK, principally at the London Business School.
6. The terms 'normative' and 'prescriptive' are used interchangeably throughout this and the remaining chapters.
7. Essentially, from this perspective, all theories are value-laden (Hanson, 1958). Consequently, the way in which data is 'captured' and the way in which an assertion is 'proved' or 'disproved' vary according to belief systems which accompany theories. Moreover, as Tinker *et al*. (1982) demonstrate, the 'normative' approach ('where should we be?') and the descriptive approach ('where are we?') are closely associated with one another. See also Klaassen (1976) who categorises descriptive theories into two types, those which have a *rational aprioristic* approach and those which use an empirical approach. Although both are descriptive in that they study accounting practice 'as it is', in the case of the former the 'discovery' of regularities based on observed accounting practices leads to theories which are made plausible by rational reasoning rather than through rigorous empirical testing, as in the case of the latter – hence, Klaassen's description of *rational aprioristic* descriptive theories, which are essentially the same as normative *a priori* theories.
8. Within the social sciences generally, the term 'paradigm' has become a rather overused and much misunderstood term. For an insight into why 'paradigms' are not the neat and tidy concepts they are often assumed to be, see, for example, Kuhn (1970), Lakatos (1970), Lakatos and Musgrave (1970), Feyerabend (1975) and Gutting (1980). More direct applications of the concept of paradigms in the social sciences can be found in Barnes (1982) and Mohr (1982). Within the corporate management literature, McCaskey (1982), for example, uses the concept of 'conceptual maps' which comes close to the meaning of 'paradigms' as used in the present study.
9. Kuhn's (1970) work is almost entirely based on the earlier work of Fleck (1935). Kuhn, Lakatos (1970) and Feyerabend (1975) are generally recognised as the founders of the 'post empiricist' school of scientific philosophy, all three adopting a more or less relativist perspective, with both Kuhn and Lakatos rejecting the notion that any directly observable phenomenon could refute or confirm any given theory (Ryan *et al*., 1992).
10. The importance of Kuhn's work in this respect is its challenge to Popper's (1959) thesis that knowledge is a cumulative process which moves ever closer towards 'the truth'. Kuhn rejected this notion, arguing that knowledge accumulation, as a social process, is best characterized by a dichotomization of scientific activity between, on the one hand, 'normal science', and, on the other, 'extraordinary' or 'revolutionary science' (Lehman, 1992). Importantly, Kuhn's explanation of knowledge accumulation emphasises sociological factors, such as resistance to change, persuasion, authority, hierarchy and reference groups, as being the real determinants of

scientific behaviour, refuting Popper's (1959) perception of science as a systematic, logical, and rational process by which new theories become accepted (Blaug, 1980; see also, for example, Rose and Rose, 1977). Although Kuhn's conception of the scientific community as predominantly consensus-orientated is refuted by numerous theorists in sociology and related disciplines (see Lehman 1992, pp.44 *et seq*.), it has nevertheless proved highly valuable in terms of challenging the notion that scientific inquiry is value-free, particularly in terms of its contribution to a growing recognition that "… all researchers, implicitly or explicitly, approach their inquiry with an epistemological affiliation, set of beliefs and values which have historical and social foundations" (Lehman 1992, p.49).

11. SOATATA was the result of the AAA's Committee on Concepts and Standards for External Financial Reports decision to update the AAA's *A Statement of Basic Accounting Theory* (ASOBAT) (AAA, 1966). Faced with a bewildering array of research perspectives on accounting matters and finding so many competing accounting theories, the committee felt compelled to broaden the focus of its enquiry to include theory acceptance (Schreuder, 1984). Although financial accounting contains a large number of different and often competing theories (see, for example, Edwards and Bell, 1961; Hendriksen, 1982; Sterling, 1970), the focus of the present study is on theories which are used to explain the behaviour of business organizations is relation to the (voluntary) environmental disclosure.
12. Mangos and Lewis (1995) call for a socio-economic approach to understanding managers' selection of accounting practices, arguing that the economic paradigm can be modified into a socio-economic paradigm that has the potential to be more explanatory and predictive than the economic paradigm alone. Gray *et al.* (1995b) in attempting to place empirical investigation of CSR in some sort of theoretical context, offer the following classification of broad groups of theories concerning organization-society information flows: (i) decision usefulness theory (overlapping with); (ii) (neo-classical) economic theory; and, (iii) social and political theory.
13. The reference to social theory is intended in its wider socio-political context, covering a variety of social science disciplines, including economics and accounting and extending to all aspects of organizations. The present study is concerned with the behaviour of the management of organizations in relation to the disclosure of environmental information in an organization-society context. Thus, the analytical framework offered by Burrell and Morgan (1979) may be applied to such a study.
14. As Burrell and Morgan point out (1979, p.24) the four paradigms also provide a map for locating one's own personal preferences and values in relation to the nature of science and of society, including why certain theories and perspectives have more personal appeal than others. This highlights an important issue, noted earlier in the present study, that our individual perspectives as to the nature of science and of society are governed as much by our own personal values and beliefs as by anything else.
15. The positivists' concept of 'objectivity' is entirely absent from the anti-positivist way of thinking. Arrington (1990), for example, states, "… for at least 50 years the consensus view [in the philosophy of science] has been that science is primarily an act of a rhetorical community, a linguistic practice. Scientists tell stories; they agree upon a set of semiotic rules; they establish conventions of civil discourse. … Thus, the validity of the "truthfulness" of scientific discourse is not objectively determined (as through confirmation by a reality apart from the scientific community); but, rather, through the linguistic and sociological practices of the scientific community as it constructs its own "local rationality" (p.6).
16. '*Positivism'*, a term first used by Auguste Compte (1853) a French social philosopher, has been described as the direct heir of empiricism (Ryan *et al*., 1992). Compte drew on both 'rationalist' and 'empiricist' traditions, arguing that sociology should be scientific and therefore should deal only with propositions that were testable according to the same procedures and techniques used in the natural sciences (Abercrombie *et al*., 1994). Hence, positivism, as an epistemological doctrine, assumes that knowledge can *only* be based on *observations*, being a development out of *rationalism* and *empiricism*, the latter holding that the only source of knowledge is that which comes to us via our senses, a rationale which implied that the truth of any statement, other than those of pure logic, could be tested only through personal *experience* (Laughlin, 1995). This lead to a preference for measurement and quantification, the use of which would allow *only* absolute,

objective and value-free descriptions of the empirical world and which Compte called "positivism' (Laughlin, 1995). Positivism has three core beliefs (Easterby-Smith *et al*. 1991 pp.22-4): (i) there is a single, objective, *external reality*, the properties of which can and should be measured through objective scientific methods rather than subjectively inferred in a metaphysical sense (such as through guessing, intuition or belief); (ii) the *observer is independent* of that external reality and thus of what is being measured ('the fly on the wall'); and (iii) *science is value-free*, i.e. the choice of what and how to study phenomenon can be determined by objective criteria rather than by subjective beliefs and interests. Whilst positivists may disagree over the details, the essence of positivism in epistemological terms is that "… the growth of knowledge is essentially a cumulative process in which new insights are added to the existing stock of knowledge and false hypotheses eliminated" (Burrell and Morgan, 1979, p.5). Thus, some positivists belong to the 'verificationists' school which claim, "… hypothesised regularities can be verified by an adequate experimental research programme" (Burrell and Morgan, 1979, p.5). Within this school of thought we also find 'logical positivism', a branch of verificationism which argues that the scientific worth of a proposition is to be judged by its verifiability to observed 'reality', the corollary being that if something cannot be verified by observation then the proposition is meaningless (see, for example, Ayer, 1936; Ryan *et al*., 1992). Conversely, the 'falsificationists' (Popper, 1959, 1963) argue that (a) theories can never be 'proven' with finality, only well-corroborated by experiment or fatally 'refuted', but that they can be *falsified* with finality and (b) a theory which is not capable, in principle, of being refuted is *useless*.

17. *Anti-positivism*, the antithesis of positivism, is a doctrine of philosophy which focuses on *understanding* rather than *explaining* or *predicting* observations of the social world, rejecting concepts such as objectivity and independence and is influenced particularly by Max Weber (1922/1968). Weber, for many the founder of modern sociology, took a completely different view to Compte (see above), arguing that our understanding of human behaviour could not be informed using methodology borrowed from the natural sciences as human behaviour was, in Weber's view, not subject to the same universal laws (Abercrombie *et al*., 1994). Hence, anti-positivists, particularly neo-Kantians such as Simmel (1955), view the social world as being very different from the natural world. The anti-positivists' central critique of positivism, and of Comptean thought in general, is of their claim to absolute truth (see, for example, Bernstein, 1976, 1983 and Habermas, 1976a, 1978). The fact that these criticisms have had little impact upon the continuing public esteem with which the positivist school continues to be held is a source of frustration to some accounting scholars. Laughlin (1995, p.77), for example, argues that the "… insights generated through these Comptean derivatives are as partial and incomplete as any of the more 'subjective' approaches …", suggesting that this may be due to "… our human desire for certainty and a fascination with something which claims to be absolute truth". A discussion of post- and non-empiricist philosophy, which questions the realism and testability of theories, is outside the scope of the present study but see, for example, Feyerabend, 1975; Habermas, 1978; Kuhn, 1970; Lakatos, 1970; Popper, 1959, 1963; Schreuder, 1984, for an introduction to the debate.
18. Researchers in accountancy tend to confuse the term 'methodology' with 'method', using the two terms interchangeably, suggesting they are one and the same. However, *methodology*, in its philosophical sense, refers to the *study* of methods, whereas *method* refers to the particular research approach used to investigate and learn about social phenomena. In the social sciences, 'methodology' has been defined as the rationale for accepting or rejecting scientific theories or hypotheses (Blaug, 1980).
19. It is important not to confuse 'positivism' in an ontological sense with positivist methodology. Positivism, in an *ontological* sense, when applied to the social world, effectively treats the social world as if it behaves in the same way as the natural world, assuming the existence of and searching for universal laws which pre-occupied many of the renowned natural scientists such as Galileo Galilei, Charles Darwin and Albert Einstein. Positivist *methodology*, on the other hand, is dominated by the use of nomothetic methodologies which place emphasis on the testing of hypothesis in accordance with *canons of scientific rigour* (Burrell and Morgan, 1979, p.7). Both these research traditions dominate the natural and social sciences although there is no *a priori* reason why this should be so.

20. The present fixation with empirical research in mainstream accounting and finance is a relatively recent phenomenon (Mattessich, 1980). Prior to the 1970s, 'normative' thinking and theorizing ruled supreme. Ryan *et al.* (1992) suggest that various factors contributed to the rise in popularity of empirical research in accounting, including developments in computer technology and the increasing number of accounting faculties, especially in the US, with an economics and/or quantitative background and little or no accounting experience. Laughlin (1995) offers a different line of thought suggesting that there was, in analogous terms, a 'tissue rejection' of normative ideas in accounting practice, as well as pressure from both the 'economics' and 'behavioural' schools of accounting research for greater empirical understanding of accounting. The increase in empirically-based research has seen the development of highly sophisticated statistical techniques and rigorous hypothesis testing. Mattessich (1984a) argues that part of the reason for continuing this sort of research, despite its limitations, lies in the need for confirmation, which, given the relative intellectual scientific immaturity of accounting, is a necessary prerequisite for further, deeper understanding. However, Mattessich (1984a) also asserts that the poor training given to accounting researchers has allowed them to equate statistical *methods* with scientific *methodology*. Similarly, Christenson (1983), in his scathing criticism of the 'Rochester School' (see Chapter 5), asserts that methodology has been adopted by accounting researchers when they are concerned neither with philosophy nor with logic, but simply with methods. This confusion over *methods* and *methodology* continues to be an every-day occurrence amongst accounting practitioners and researchers, highlighting the current poor state of knowledge of the philosophy of science within accountancy.
21. Functionalism developed from early nineteenth century sociologists' observations of how well the various elements of a society were interdependent, with social institutions functioning for society as the heart does for the body in circulating the blood (Abercrombie *et al*., 1994). This analogy with the human body is carried further in functionalism, with the notion that social systems, like the body (and other living organisms), tend over time towards a state of equilibrium (or homoeostasis). Abercrombie *et al.* (1994, p.176) define functionalism as a perspective which "… accounts for a social activity by referring to its consequences for the operation of some other social activity, institution, or society as a whole". One example of the functionalist argument is that societies have certain needs which must be met if society is to survive, with institutions serving the function of meeting those needs (Abercrombie *et al*., 1994). One of the criticisms levelled at functionalism is the argument that it cannot explain extreme forms of social conflict such as wars and revolutions given that it perceives of society as a unitary entity, bonded by social integration and the harmonious effect of common values. In reply, functionalists have argued that social conflict may actually have a positive function in relation to social order (Abercrombie *et al*., 1994).
22. Ontologically, many social scientists (particularly economists and accounting researchers) treat the social world as if it behaves in exactly the same way as the natural world, notably via the use of 'quasi-experimental' research techniques and 'control groups', which are very popular amongst researchers committed to positivist methodology. Conversely, others argue that people cannot be treated as natural scientific objects because they are self-interpretive beings who create institutional structures around them (Habermas, 1978).
23. For an illustration of this, see, for example, Chua's (1986, pp.615 *et seq*.) comparison of two pieces of research (Boland and Pondy, 1983; Demski and Feltham, 1982) which apply quite different social-world views (one mainstream, the other interpretive) to the same accounting phenomenon.
24. A number of alternative schemas for the classification of accounting theories have been proposed (see, for example, AAA, 1977; Belkaoui, 1992; Davis *et al*., 1982; Laughlin and Gray, 1988; Laughlin and Puxty, 1981). The schema presented by Gray *et al*., (1996) is broadly similar to these other alternatives.
25. During the early years of accounting research in the 1920s and 1930s two quite different approaches began to emerge. In the UK, where accounting research was still in its embryonic stage, accounting researchers trained in economics and economists focused their efforts on deriving models of 'true income' under the Hicksian (Hicks, 1946) concept of economic income (i.e. capital maintenance). Conversely, in the US, where accounting was an established university

subject in its own right, accounting researchers studied existing accounting practices as a potential source for the establishment of theoretical principles.

26. The Hicksian (Hicks, 1946) concept of economic income (i.e. capital maintenance) plays a central role in defining 'true' accounting measures of income and wealth. Briefly stated, Hicks defined income as the maximum which a person (or organization) can consume in a given period without reducing the stock of wealth existing at the start of the period. Thus, income represents the difference between alternative measures of wealth at two moments in time. Consequently, a key aspect of this approach to the measurement of income is the basis (or bases) on which economic wealth is measured. Whilst the *acquisition cost* or *historical cost* of goods and services has long been a fundamental accounting principle, advocates of some form of 'true' measure of income have generally been of the view that *current price information* is more useful to users in making economic decisions (see, for example, Edwards and Bell, 1961; Sterling, 1970). Hence, theories from the 'true income/deductive' school have normally provided some form of alternative to the historical cost principle, such as current purchasing power (see, for example, Jones, 1956), replacement cost accounting (see, for example, Revsine, 1973) and present value accounting (see, for example, Solomons, 1961).
27. Accounting 'techniques', 'procedures' and 'practices' are used interchangeably to describe computational algorithms used or suggested in the preparation of financial accounting statements (Watts and Zimmerman, 1979). 'Accounting standards' represent accounting 'procedures' which have been established as standard or recommended accounting practice by authorative bodies such as CCAB, FASB and IASB.
28. This does not mean that 'non-priced' social and environmental issues *have* to be excluded from the calculation of income. By changing our definition of 'capital' from a purely economic one to one that is based on the maintenance of social, human and environmental capital as well, we can 'factor in' these other concepts of capital to derive alternative, more holistic forms of social accounting. However, the present basis of determining accounting income, with its focus on the maintenance of money capital (and therefore that which has a market price) clearly does not maintain these other forms of social and environmental capital and therefore, in this context, overstates accounting income (see, for example, Bebbington and Tan, 1996, 1997; Bebbington and Gray, 1993, 1996, 2001; Bebbington *et al*., 2001; Gray 1991c, 1992; Gray *et al*., 1993; Gray and Bebbington, 2000, 2001; Howes, 1999, 2000; Rubenstein, 1992, 1994)
29. The shift away from *a priori* research to research which considers *at the outset* the needs of users of financial statements was clearly a major shift in accounting thought. Broadly speaking, the advocates of a decision-usefulness approach argue that the prime question which had to be addressed by researchers centred on the objectives of financial statements and that this would require answers to the following questions: who are the users of financial statements?; how do they go about making decisions?' and, what are their information needs?
30. It is important to appreciate the difference between the 'factual' aspect of this statement and the underlying normative agenda. The assumption that accounting information is useful (or not) to investors and creditors serves as a basis for empirical research using hypothetico-deductive methods (verificationism or falsificationism). However, this is quite different from justifying the assumption itself. Empirical research *cannot* justify the assumption that accounting 'should' be useful to investors and creditors since that is an *a priori* value judgement which can only be explained by the value-background of the researcher (Weber, 1922/1968). The Weberian position strives for a separation between 'objective' science and 'subjective' value judgements. It is arguably just as important to investigate why accountants would make such normative assumptions in the first place as it is to study the 'scientific truth' of those assumptions. In other words, rather than just focus on the 'ends' of accounting theory, researchers should also consider the 'means'. Of course, to do so implicitly requires that 'values' be recognised within accountancy, something which positivists (in a methodological sense) reject as 'non-science' given that value judgements cannot be subjected to empirical testing. In contrast, critical social theorists (especially Habermas, 1963/1973, 1976b) have rejected strongly the positivist separation of 'means' and 'ends', arguing that if the social sciences deal only with offering technical advice for the realization of pre-given ends, 'science' effectively becomes a purely technical affair. To most practicing accountants, this is perhaps accepted as a given, but in so-doing, there is an

underlying *normative* acceptance of 'what is', in terms of the social system and the goals of that system , as being 'what should be'. As noted by Schreuder (1984), Habermas' fear in this context is that a science which focuses on means and not ends produces powerful instruments of control while abdicating responsibility for its use. I am unable to reconcile these different perspectives. However, it seems clear, even to me, that the stakes could not be higher given that the issue goes to the very heart of the social sciences and the role and purpose of scientific enquiry. As such, in the end it comes down to each of us *choosing* consciously for ourselves which set of values should guide the selection of methodologies and theories, such values in themselves reflecting our perceptions of the degree to which the present social system itself should be changed. This issue is returned to, briefly, in Chapter 11.

31. Under the EMH, the market for shares is deemed to be efficient when share prices fully reflect (i.e. fully discount) all publicly available information and, by implication, that market prices react instantaneously to new information in an unbiased manner (Fama, 1965). In an accounting context, a market is also said to be efficient if it is able to 'see through' variations in reported corporate profits which are due to differences in the choice of accounting methods or standards rather than variations in the underlying profitability, in cash terms, of the business.
32. There are, however serious question marks over whether current financial statements do in fact serve the 'rational decision models' of investors or meet the needs of the stock market (see, for example, Macdonald, 1995; Puxty and Laughlin, 1983).
33. Benston (1982), for example, provides a classic neo-classical, free-markets argument *against* corporate social responsibility accounting. Based on his analysis, Benston concludes that managers have little discretion to act other than in the interests of shareholders (1982, p.92) and thereby asserts, "… if concern for shareholders is the motivating factor behind this accounting, there is no reason to require its inclusion in public reports. To do so would impose costs on shareholders for the benefit of those who contract with it (e.g. employees) or would support the values of some groups in society (e.g. advocates of programs that they say are socially-responsible) over others (shareholders, customers and employees)" (1982, p.93). In considering the question of externalities, i.e. social and environmental costs imposed on society which are not reflected in market prices, Benston is equally dismissive, concluding that accounting for such costs is not justified on the grounds that (a) those who have contractual relationships with corporations (i.e. shareholders, employees, customers, creditors and others) are "… likely to be well served by the accounting procedures voluntary adopted by corporate managers and directors" (1982, p.102) and (b) that the problems associated with the measurement of the negative externalities imposed by the corporation on other sections of society (i.e. those who do not have contractual relations with it) are so great as to place this "… outside the scope of accounting" (1982, p.102). Benston's views are strongly influenced by the Chicago School of Economics and its offshoot the Rochester school of accounting (see Chapter 5) which generally regard any form of regulation as a bad thing and that the free market provides the best solution for the supply of accounting information.
34. The perception that it is human society which 'creates wealth' is intrinsically anthropocentric. Wealth in this context generally refers to economic, i.e. monetary, wealth, the underlying belief system being that it is 'rational' behaviour for investors to seek to maximise their wealth. However, from an ecological, Neo-Darwinian perspective, the only 'real' wealth is that to be found in nature, with societies simply appropriating natural wealth for the purposes of satisfying human needs and wants (see, for example, Birkin and Bank-Jorgensen, 1994; Gray, 1992; Pearce *et al*., 1989).
35. *Rational* as used here refers to behaviour which accords to some set of *a priori* rules or principles which are considered 'rational', usually for the purpose of prediction and explanation. Obviously, this is a tautological argument since there is no 'objective' basis for determining 'rational' behaviour, such judgements being inherently value-laden. This term is explored in more detail in Chapter 5 in the context of economic agency theory.
36. As noted in Chapter 1, in the vast majority of cases CSR is treated as an addendum to conventional accounting (Gray *et. al*., 1995), the latter adopting (usually implicitly) a "… pristine liberal, economic democracy view of the way society is, and should be, organised" (Gray *et al.* 1996, p.50). Whilst much is made in mainstream accounting of the merits of 'positive accounting

theory', particularly as regards its concern with describing 'what is', as opposed to value-based, prescriptive theories of 'what should be', the perception that social theories, including the economic variety, are in some sense 'value-free' is naïve. The argument within mainstream accounting for a focus on 'what is' is done partly because 'what is' accords with a preconceived view of 'what should be' (Tinker *et al*., 1982).

37. The relationship between prediction and explanation differs as between the natural sciences and the social sciences. In the former, the precise relationship between a law and a theory "… is that the latter is a higher order intellectual artefact designed to supply an answer, however speculative, to the question why? In this way theories do not predict – that's the function of laws" (Roslender 1992, p.122). Conversely, in the social sciences, including economics and accounting, laws are seen to have much less value than theories due to the fact that the predictive capability of a theory is seen as of much less value than the ability of theories to explain, offer understanding and resolve problems. However, the desire to equate the social sciences with the natural sciences continues to generate the belief amongst finance and accounting theorists that the objective of accounting theories should be to both *explain* and *predict* accounting practice (see, for example, Watts and Zimmerman, 1986). Indeed, the focus of much of modern accounting research continues to be on describing, explaining and predicting the behaviour of accountants and managers rather than *understanding* the behaviour of organizations in a wider socio-political context (Christenson, 1983). The *predictive* qualities of a theory are seen by some to outweigh concerns over the 'realism' of the assumptions underlying that theory. Friedman (1953, p.14), on the methodology of positive economics, for example, argues that "… truly important and significant hypotheses will be found to have 'assumptions' that are widely inaccurate descriptive representations of reality, and, in general, the more significant the theory the more unrealistic the assumptions".
38. Laughlin (1995) refers to the emergence in the accounting literature over the last two or three decades of a number of different, major schools of thought which have been used to explore the nature of accounting in organizations and society. These include the 'accounting economists' (see, for example, Watts and Zimmerman, 1986), ethnomethodology (for example, Berry *et al*., 1985), Marxism (for example, Tinker, 1985), German critical theory (for example, Arrington and Puxty, 1991; Laughlin, 1987) and French critical theory and post-structuralism (for example, Arrington and Francis, 1989).
39. Hermeneutics, in its original form, is a theological term concerned with the problem of recovering the 'authentic truth' of religious writings, particularly the bible the earliest copies of which pre-dated printing and had to be produced by hand-copying which resulted in numerous errors (Abercrombie *et al*., 1994). In the context of the social sciences, hermeneutics is the theory and method of interpreting meaningful human action and owes much to the work of the German philosopher and historian Wilhelm Dilthey (1833-1911). Dilthey argued that there is a clear difference between the study of nature and the study of human action, the latter requiring a special method of analysis because of its associated 'lived experience'. Dilthey suggested that human action can be analyzed by reference to the outlook or world-view which gives it meaning (Abercrombie *et al*., 1994). Likewise, it is possible for the social scientist to construct a world-view based on the individual manifestations of that world (see, for example, Mannheim, 1952). The circular relationship between a whole and its parts is known as a hermeneutic circle.
40. The assumption that reality is a human construct also has important implications for the researcher. Under the interpretivist approach researchers assume that they themselves construct reality (since it is assumed that all humans construct reality) which they bring to the research setting. Erlandson *et al*. (1993), for example, cite attempts made by people with one primary language to communicate with people whose primary language is different as evidence of constructed realities. In this context, language is seen as having a crucial role in the construction of reality. In other words, language is not only the instrument of communication, it is also the instrument for giving meaning to what we experience. The science of linguistics is thus important to those who believe in the constructionist's view of the world.
41. The recognition given by social scientists to "… the phenomenology of everyday life… " (Lee 1991, p.348) is reflected in the familiar phrase 'the social construction of reality' (Berger and Luckmann, 1967).

42. Researchers working within the interpretive paradigm generally prefer qualitative methods of research to quantitative although both methods can and are used in practice (Erlandson *et al*., 1993). This preference for qualitative research methods is based on the perception that quantitative methods seek to reduce aspects of reality to single, discrete (mathematical) terms such that much of the rich detail, and thus inherent meaning, is lost.
43. In phenomenological sociology, for example, Weber's celebrated 'postulate of subjective interpretation' (Schutz, 1972) refers not to the presence of 'bias' or 'opinions' but to the *process* by which meaning is ascribed to something by humans. From this perspective, the primary task of the social scientist is to *understand* the meaning which an aspect of the social world has for the observed human subject, not for the observer (Lee, 1991). Since all social action creates social reality, it is argued that the latter must and can only be understood by reference to the subjective meanings given to the former. In short, by understanding a person's perceptions it is seen as possible to gain a subjective understanding of that person's behaviour. However, interpretation is not seen as fixed or immutable but subject to iteration, each new iteration bringing new meanings to the same set of human actions such that over time, through a process of *hermeneutic analysis*, the reading of human behaviour evolves to a higher state of consistency and harmony (see, for example, Bernstein, 1983; Taylor, 1979; Tice and Slavens, 1983).
44. It is now well established, for example, than neither conventional accounting numbers nor conventional economic measurement provide a complete picture of the human, social and environmental consequences of economic activities and events (see, for example, Bebbington *et al*., 2001; Constanza, 1991; Ekins, 2000; Gray, 1990a; Pearce *et al*., 1989).
45. The concept of 'pluralism' in an accounting and reporting context represents a major difficulty to those operating within the functionalist paradigm. The latter perceive accounting information as being used to meet the needs of the primary users of financial statements, i.e. financial investors and creditors. To suggest, for example, that organizational stakeholders have a moral or natural *right* to information beyond legal or quasi-legal rights (see, for example, Gray *et al*., 1996), irrespective of the any utility function, is problematical to those with a structured, pragmatic view of the social world (see, for example, Sternberg (1997) in the context of stakeholder theory). The underlying meta-theoretical assumptions about the nature of society remain 'functionalist', society being 'regulated' to preserve the status quo. Issues of social justice, democracy and accountability cannot be *seriously* accommodated within the functionalist paradigm since this implies removing many of the structural functionalist assumptions underlying the present financial reporting framework.
46. The Frankfurt School refers to an influential movement in modern sociology, generally seen as 'neo-Marxist' and based on a group of social scientists originally employed at the University of Frankfurt, Germany during the first half of the twentieth century (Abercrombie *et al*., 1994).
47. Held (1980) views critical social theory as a diverse body of thought, centred around four key characters (Horkheimer, Adorno, Marcuse and more recently, Habermas). In the specific discipline of accounting, 'critical accounting research' and 'critical theorists' have come to be used in so many different contexts that they have lost much of their clarity of meaning. Indeed, one accounting research journal is specifically dedicated to critical thoughts on accounting (*Critical Perspectives on Accounting*, from 1990 onwards). However, it is perhaps fair to suggest that critical accounting research within accounting draws its ideas from a number of different philosophical schools of thought, including the Frankfurt School and classical Marxism, as well as the hermeneutic and phenomenological research traditions, reflecting a concerned for or commitment to the emancipation and enlightenment of humans (see, for example, Dillard, 1991; Gallhofer and Haslam, 1997a; Laughlin 1987, 1999; Lehman, 1992; Power and Laughlin, 1992 and, in the specific context of social and environmental accounting, Birkin, 1996; Gallhofer and Haslam, 1997b; Gray, 1998).
48. See also, for example, Hines (1989), who, in an exposition of the underlying assumptions of mainstream financial accounting research, argues that such research, in communicating a 'reality' also constructs a world-view, i.e. a way of seeing the world. Thus financial accounting, far from being unbiased and objective, is, from a socio-political perspective, seen as both socially *constructed* and socially *constructing*.

49. A more detailed discussion of Chua's (1986) difficulties with the Burrell and Morgan framework in the context of accounting is provided as an appendix to her paper.
50. The analysis which follows takes the position that MST and OLT are situated within the interpretive research tradition. Given that these theories are employed in the present study using predominantly hypothetico-deductive methodology, such methodology being associated with 'normal science' which belongs to the positivist tradition, there is something of a contradiction here. Two points are made here in defence of the position taken. Firstly, this contradiction exists as an evident feature of extant CSR research. In practice, CSR researchers employ MST and OLT using both the positive and interpretive research traditions, although there is obviously greater sympathy and intuitive support for the latter (see Chapter 6 and 7 for details). This may be explained, at least partly, by recognising that CSR researchers are not so concerned about the research methods they employ but they are very concerned about highlighting aspects of the current business hegemony in an accounting and reporting context which concerns them. Evidently, both the positive and interpretive research methodologies permit them to express these concerns, although from different standpoints. Secondly, there are important aspects in the make-up of these theories which clearly distinguish them from the structural-functionalist tradition such as that found with EAT. These aspects are brought out more clearly in Chapters 5, 6 and 7.
51. Although multi-paradigm research (or meta-paradigm research as it is sometimes called) is still quite rare amongst the accounting research community, it is becoming more common amongst organization theorists. For example, Lewis and Grimes (1999) used meta-paradigm research based on Burrell and Morgan's (1979) typology to study tensions arising in organizations following the implementation of advanced manufacturing technology (AMT). Their *functionalist* 'account' presented AMT designs as systemic interactions between task and machinery programmes to enhance flexibility and control, whereas their *radical structuralist* account represented AMT as a technocratic mechanism to enable managers to objectify their interests through less obvious forms of control. In addition, their *interpretivist* account of AMT involved exploring local meanings ascribed to AMT and work through personal experiences, whilst the *radical humanist* account allowed them to explore the illegitimacy of social identities, particularly the way in which 'specialists' mystified their expertise. Likewise, Gaventa (1980) used three different 'lenses' to explore the varied dimensions of power and control mechanisms employed by managers to influence the preferences of coal miners in the US. Others have used a functionalist lens to highlight formal, managerialist understandings within organizations augmented by more critical views to expose fragmentation and conflict (see, for example, Bradshaw-Camball and Murray, 1991; Martin, 1992).
52. In this context it is important to appreciate the direct link between epistemological assumptions and research methods, the former effectively defining the latter: "Epistemological assumptions decide what is to count as acceptable truth by specifying the criteria and the process of assessing truth claims. … Methodological assumptions indicate the research methods deemed appropriate for the gathering of valid evidence. … Clearly, both sets of assumptions are closely related. What is a 'correct' research method will depend on how truth is defined" (Chua 1986, p.604). In the context of the present study, positivist epistemological assumptions had a strong bearing on the selection of a research method that was considered appropriate by the project supervisors for the purposes of arriving at 'scientific truth'. The research method is described in detail in Chapter 8.
53. Gray *et al.*'s (1995b) approach is a good example of the use of 'soft' hypotheses in multi-theory research which does not involve the use of hypothetico-deductive methodology. In their case, 'hypotheses' were formulated, but these were expressed in very general terms. Essentially, under this approach, one begins with an *a priori* understanding about relationships between organizations and society through the explicit recognition of the existence of certain structures and relationships that exist within society. These *a priori* assumptions are used to formulate general understandings about the changes which are taking place within society over a specific time period and the main determinants of those changes (Governments, industry, labour, capital). Thus, for example, one can hypothesise that, given the change in attitudes towards 'green' issues within society generally, there is a general expectation that companies would give greater emphasis to environmental issues. The process involves interplay between the data and the theory,

popping between the two, looking for trends and then trying to interpret those trends based on a perception of the changes that are taking place within society over time (Gray *et al.*, 1995b).

54. A major tenet of logical positivism, for example, is its *thesis of the unity of science* (Hempel, 1969; Kolakowski, 1968), which asserts that the methods of the natural sciences are the *only* legitimate methods for use in the social sciences (Lee, 1991). However, in adopting a search for 'hard' empirical data, other equally important aspects of different world-views are thereby excluded from analysis. Although it may, conceivably, be possible to deduce simple 'tight' hypotheses from all theories, the functionalist methodology of testing theories is not conceivable in my view in the case of classical political economy theory where 'soft' hypotheses are explored in seeking to understand how corporate reports are used to manipulate mediate and mystify (see, for example, Neimark, 1992; Tinker, and Neimark, 1987). It was this restriction which, in the end, led to the formal exclusion of the classical political economy theory from the present study, the author concluding that the requirement to follow functionalist epistemology using hypothetico-deductive methodology effectively meant trying to 'fit a square pin into a round hole'. However, a compromise position was reached whereby the project's supervisors accepted the inclusion of an interpretive analysis of the trends of CED over time which could also include a classical political economy perspective (see Chapter 10).
55. As indicated in the preceding footnote, this is, in large part, a pragmatic compromise between the values of the supervisors and those of the researcher. In reaching a compromise, the primary analysis follows the hypothetico-deductive research method using variables that can be 'measured' objectively (see Chapter 9), with one part of a chapter of the thesis devoted to interpreting trends in CED over time using interpretive analysis (see Chapter 10).

Chapter 5

Economic agency theory and management's 'opportunistic' use of CED

5.1 Introduction

Previous chapters (3 and 4) completed the structure definition stage (see Chapter 1, Table 1.2) of the thesis. Chapter 4 (Table 4.3) situated four accounting theories within Burrell and Morgan's (1979) framework of sociological paradigms and provided a brief overview of the key meta-theoretical characteristics of these theories from within that framework. The next stage of the research approach (stage 3) leads to the building of theoretical models which are used to test empirically three of these theories (viz.: EAT, MST and OLT). Modelling in this context involves the formulation of a set of hypotheses under each theory which attempt to provide some *a priori* prediction of and explanation for variations in the volume of CED between firms. The purpose of this chapter is to develop such a set of hypothesis in relation to economic agency theory (EAT).

Agency theory has been adopted by scholars from a number of different disciplines including accounting (Demski and Feltham, 1978), economics (Spence and Zeckhauser, 1971), finance (Fama, 1980), marketing (Basu *et al*., 1985), organizational behaviour (Eisenhardt, 1985) and sociology (White, 1985). In the specific context of the firm, agency theory owes much of its intellectual development to the seminal articles of Spence and Zeckhauser (1971), Ross (1973) and Jensen and Meckling (1976) in relation to the 'agency problem' arising from the separation and dispersion of ownership and control with the advent of limited liability corporations. However, the notion of agency can be traced back much further to early developments in theories of private property rights, most notably the work of Coase (1937). Moreover, the principal-agent phenomenon has a much longer history, going as far back as the fourteenth century in English common law and the law of torts (Bowie and Freeman, 1992). At its simplest, agency theory focuses on the agency relationship in which one actor or group (the agent) has certain contractual obligations to another actor or group (the principal) which arises out of the *economic* relationship between these two parties. However, agency theory has become more sophisticated in recent years and now covers a wide-range of work including complex model building, empirical studies and behavioural experiments, each of which give different weights to the normative and descriptive elements in theory building. Jensen (1983) distinguishes between two types of agency theory:

- analytical or principal-agent model building, which is essentially mathematical and normative; and,
- a 'positive' theory of agency which is essentially empirical and strongly influenced by a branch of philosophy known as 'positive' economics.

It is the latter, more commonly referred to as the *Rochester School brand of agency theory* (Thornton, 1984), which forms the focus of the present study[1]. This brand of agency theory

was developed within the finance wing of neo-classical economics in the 1970s, primarily as a means of addressing the conflicting relationships between the owners and managers of large corporations run by professional managers separate and distinct from the providers of money capital (Fama, 1980; Fama and Jensen, 1983; Jensen and Meckling, 1976)[2]. In the same decade, 'positive' accounting researchers adopted the theory because of its perceived value in predicting and explaining corporate accounting practices (Watts, 1977). Since that time, accounting researchers have employed the *Rochester School brand of agency theory* in a number of different areas of accounting, including management accounting (Baiman, 1982, Zimmerman, 1979), financial accounting (Watts and Zimmerman, 1978, 1979) and financial auditing (Mills, 1990). However, as noted by Christensen (1983, p.5), the programme of the *Rochester School* is concerned with "… describing, predicting and explaining the behaviour of accountants and managers, not that of accounting entities." Thus, the *Rochester School's* approach to predicting and explaining accounting practices is more appropriately viewed as a behavioural theory or what Christenson (1983, p.5) refers to as a 'sociology of accounting' rather than accounting theory. Proponents of this brand of agency theory (referred to throughout this thesis as economic agency theory – EAT[3]) rely on a number of key theoretical constructs, models and assumptions drawn from different branches of the social sciences, notably sociology, political science and neo-classical economics. These key theoretical constructs or 'givens' include assumptions about the behaviour of individuals (e.g. self-interest ('rational' *economic* behaviour), bounded rationality, risk aversion), the behaviour of markets generally (neo-classical economic theory), and the behaviour of capital markets in particular (e.g. the efficient markets hypothesis (EMH)), and information (e.g. information is a commodity that can be bought and sold). Though unproven in a Popperian sense (see Chapter 4), these theoretical constructs play a central role in informing the explanation that is provided by proponents of the theory in relation to observed phenomena, and are thus critical to understanding that explanation. Although some aspects of these theoretical constructs are explored below, a detailed review and critique is beyond the scope of the present study[4]. An overview of some of the more important elements of EAT which form the basis for the remaining sections of this chapter are summarised in Table 5.1 below.

Table 5.1
Key elements of economic agency theory

Aspect	Description
Key idea	Principal-agent relationships should reflect efficient organizations of information and risk-bearing costs
Unit of analysis	Contract between principal and agent
Human assumptions	Self-interest
Organizational assumptions	Partial goal conflict among participants
Information assumption	Information asymmetry between principal and agent
Contracting problems	Agency (moral hazard and adverse selection)
Problem domain	Relationships in which the principal and agent have partially differing goals and risk preferences

Source: Eisenhardt (1989, p.59)

This rest of this chapter is structured as follows. Section 5.2 provides an introduction to the roots of the *Rochester School brand of agency theory*, particularly the 'philosophy of science' issues underlying 'positive' economics which serve as important artefacts for prediction and explanation under the methodology employed in *positive accounting theory* (PAT), the research tradition that is most closely associated with EAT in accounting and finance. PAT, together with some of the key theoretical constructs informing this perspective, are explained in more detail in Section 5.3. A number of other, equally important theoretical constructs and assumptions that relate to human nature and the nature of the modern corporation guide the *Rochester School's* 'positive' approach to accounting theory. These are explored in Section 5.4, which includes an overview of neo-classical economic theory of the firm and its core, non-conjectural propositions about human nature and the behaviour of markets.

Section 5.4 also reviews moves to introduce more realism into neo-classical economics, notably the recognition of the separation of ownership from control which gave rise to the 'principal-agent' problem. Section 5.5 explores principal-agent theory as it relates to the economic consequences of the separation of ownership from control, including the seminal contributions of Berle and Means (1932) on the 'agency problem' and Jensen and Meckling (1976) on a single-period model of 'agency costs' in capital markets. The latter model's depiction of agency costs is explored in more detail in Section 5.6, together with a discussion of 'bonding' and 'monitoring' arrangements between the executive management and outside shareholders. Such arrangements are seen by 'positive' accounting researchers as particularly significant in an accounting context, notably that a manager may voluntarily limit his/her options in relation to choices of accounting methods in order to reduce agency costs. Accounting choice is considered in Section 5.7, where assumptions concerning motivation are applied to aspects of accounting practice in explaining and predicting management choice according to the *economic consequences* and *political costs* of such choices. Although the agency costs hypothesis has mostly been explored in the context of financial accounting and reporting, it has also been used to predict and explain other areas of corporate reporting, such as CSR. Section 5.8 reviews CSR research which has used the agency costs hypothesis and provides a set of testable hypotheses for predicting variations in the volume of CED. Section 5.9 provides some concluding remarks.

5.2 Positive economics and its underlying philosophy of science

The roots of the *Rochester School brand of agency theory* can be traced back to early, neo-classical studies of economic organization and the economic nature of the firm (for example, Coase, 1937; Knight, 1921). The neo-classical economics literature contains a series of seminal writings which still serve as the core of a body of work that has deepened in institutional detail and branched out into empirical studies (Putterman and Kroszner, 1996; Hart, 1989). This body of work provides neo-classical economics with the tools and techniques with which to explore, predict and explain the behaviour of firms and the behaviour of markets at the aggregate (i.e. macro-economic) level. It is one particular branch of this body of work, *positive economics*, from which the *Rochester School's brand of agency theory* draws its inspiration. *Positive economics* is concerned with the study of economic propositions which, in principle, can be verified by observation of events or states of the real world without recourse to 'value judgements' (Bannock *et al*., 1992)[5]. This desire to avoid 'value judgements' is fundamental to the *Rochester School's* methodological approach to

accounting research. The origins of positive economics are to be found in Friedman's (1953) seminal essay *The Methodology of Positive Economics* which has had considerable influence on post-WWII neo-classical economists and more particularly on 'positive' theorists in accounting and finance. Essentially, Freedman (1953) argues for a distinction to be drawn between 'positive' economics and 'normative' economics, a distinction attributed to J. N. Keynes (1891) who defined 'positive' science as:

> *... a body of systematized knowledge concerning what is; a normative or regulative science as a body of systematized knowledge relating to criteria of what ought to be, and concerned, therefore, with the ideal as distinguished from the actual* (Keynes 1891, pp.34-5, as quoted in Belkaoui 1992, p.155)[6].

One of the key elements of Friedman's (1953) 'philosophy of science' was his argument that the reality of a theory's assumptions is *irrelevant*; rather, what matters is the ability of a theory to *predict* aggregate economic phenomena. This philosophical position has since become known as 'instrumentalism', a school of philosophy which departed from *positivism* (an epistemological doctrine which assumes that knowledge can only be based on observations) due to the difficulties experienced in dealing with non-observable, theoretical entities (Ryan *et al*., 1992)[7]. Essentially, as noted in Chapter 4, 'positivism' is strongly wedded to 'realism', especially the notion that the existence of phenomena can be objectively verified (or falsified) using rational (i.e. empirical) criteria. However, in the social world, economists encounter difficulties with many of the theoretical terms which are constructed in everyday life but which have abstract meaning, for example, the 'value' of an asset, which, because of the variety of ways in which its value can be determined (e.g. historical cost, replacement cost or realizable value) is said to be over-defined observationally. Instrumentalists overcome this problem by accepting the existence of differences between theoretical (non-observational) and observational terms but arguing that theoretical terms have no real *observational meaning* (Ryan *et al*., 1992). The result is a weak form of 'realism', essentially the instrumentalists' position, which "… relegates theoretical language and entities to the role of linguistic conventions which allow us to tie up observational terms into loose bundles which we can carry around while they serve their purpose and abandon when they do not" (Ryan *et al*. 1992, p.11). As such, theoretical entities and terms which are non-observable assume the role of instruments or calculating devices which serve as conventional analytical constructions whose sole purpose is to aid prediction.

Instrumentalists, such as Friedman (1953), departed from positivist methodology (see Chapter 1) by arguing that whilst a proposition, to be valid, must always be *verifiable* against observable *predictions* (i.e. the methodology of 'logical positivism'), the theoretical constructs by which those propositions are formulated (i.e. theories or models) are, in themselves, unimportant:

> *Truly important and significant hypotheses will be found to have "assumptions" that are wildly inaccurate descriptive representations of reality, and, in general, the more significant the theory, the more unrealistic the assumptions (in this sense) ... [However] the relevant question to ask about the "assumptions" of a theory is not whether they are descriptively 'realistic', for they never are, but whether they are sufficiently good approximations for the purpose in hand* (Friedman 1953, pp.14-15).

Thus, under 'positive' economics, the purpose of theories or models is to provide mental constructs or propositions by which *observable* predictions can be generated 'objectively' for 'rigorous' empirical analysis[9], employing what Lipsey (1975, p.7) refers to as 'the scientific approach'. Hence, the "…. principal thrust of the instrumentalist position is the use of theories as convenient artefacts for the generation of observational predictions" (Ryan *et al*. 1992, p.12). In this way, 'positive' economists are essentially free to focus on constructing and testing models, based on assumptions about human nature and social behaviour, without caring too much for the 'reality' of those models and its attendant assumptions. It is in this context that neo-classical economics is said to have been reasonably successful in predicting aggregate (i.e. macro) economic behaviour, although far less so in predicting the behaviour of individuals (Cohen and Cyert, 1975).

5.3 A 'positive' approach to accounting research

The issues underlying 'positive' economics, as described above, provide the 'philosophy of science' framework for 'positive accounting theory' (hereafter, PAT)[9]. The label 'positive accounting theory' was first applied by Watts (1977) and Watts and Zimmerman (1978) to an existing set of research studies which began in the 1960s with Ball and Brown (1968), Beaver (1968) and others who introduced empirical finance methods to financial accounting. Watts and Zimmerman describe this body of work as 'positive' in order to emphasise that the role of accounting theory, *in their view*, is to provide predictions and explanations for accounting practice (Watts and Zimmerman, 1990)[10]. Thus, the early 'positive' literature investigated the relationship between accounting data (notably earnings, dividends, and cash flows) and the stock market's valuation of securities, the underlying assumption being that accounting data contained information which served as inputs to the market's valuation models (e.g. cash flows). The 'information content' branch of accounting research, as it became known, has significance to financial accounting and accountants in particular because it suggests that management, if so minded, could manipulate accounting data through forms of 'creative accounting' to serve their own self-interests. One of the earliest to suggest this was Hepworth (1953) who argued that rather than being concerned with reporting maximum profits, management's objective was to smooth the firm's reported earnings over time (known as the 'income-smoothing hypothesis'). Other researchers who explored influences on the choice of accounting principles also took up this general line of argument (see, for example, Gordon, 1964; Gordon *et al*., 1966; Gagnon, 1967). The income-smoothing hypothesis had important implications at the time given that the capital markets were widely believed to take financial statements at face value, such statements perceived to be the only source of information used by investors to assess share prices (the 'monopolistic hypothesis', Ball, 1972).

Significantly, if proven, the income-smoothing and monopolistic hypotheses imply that the capital markets and venture capitalists could be 'fooled' by management who used accounting statements to inflate or smooth profits. However, despite a number of early empirical studies (see, for example, Ball and Watts, 1972; Barefield and Comiskey, 1972; Beidleman, 1973; Copeland, 1968; Dasher and Malcolm, 1970), the income-smoothing hypothesis was never completely accepted by all researchers[11]. In particular, several research studies (see, for example, Fama, 1970; Gonedes and Dopuch, 1974; Kaplan and Roll, 1972; Sunder, 1975) cast doubt on the ability of management to manipulate share prices directly via changes in accounting procedures and proceeded to offer an alternative hypothesis, namely

that the stock market *cannot* be fooled, i.e. it *is* able to discriminate between real economic events and mere changes in accounting procedures, a theoretical construct known as 'the efficient market hypothesis' (see below). Around the same time, Friedman's (1953) ideas were taken up by finance researchers, notably, Jensen (1976), who, together with a number of colleagues at the Universities of Rochester and Chicago (*the Rochester School*), proceeded to develop 'a positive theory of accounting', what Jensen (1976, p.13) describes as "… the development of a positive theory of accounting which will explain why accounting is what it is, why accountants do what they do, and what effects these phenomena have on people and resource utilization." *The Rochester School's* approach to accounting research, most notably in the US in relation to the studies of the affects of financial accounting on stock market behaviour and in 'positive' theory of agency research on the use of accounting information, came to typify mainstream US financial accounting research in the 1980s (Ryan *et al*., 1992). The notion of prescriptive accounting theory being 'unscientific' is central to the avowed mission of the 'positive' accounting school (see, for example, Jensen, 1976; Watts, 1977). Simply put, their basic philosophical (normative) position is that theory should be value-free, i.e. devoid of any normative arguments or judgements. Watts (1977), for example, states (emphasis added):

> *The financial accounting literature concentrates on prescriptions: on what 'should' be the contents of financial statements. Very little attention is given to developing a theory to explain many interesting observed phenomena, in particular to explain why financial statements take their current form. In other words, the literature is* ***unscientific****. We have no theory of corporate financial statements, in the form of a group of internally consistent, interrelated hypotheses which have been subjected to formal tests and 'confirmed'* (p.54)[12].

Watts' reference to 'formal tests' reflects the 'positive' accounting school's concern that *prescriptions* in the accounting literature are based on hypotheses about observations in capital markets, political processes and other areas which lack evidence in support of assertions, i.e., they are not subjected to empirical testing but simply accepted as taken-for-granted 'truths'. *The Rochester School* sought to replace these 'unscientific' theories with 'positive' theories which generate prediction, such as, for example, why a particular accounting procedure would be chosen in preference to another and the factors influencing the accounting standards-setting process (Watts and Zimmerman, 1986, 1990). In order to develop such a theory, *the Rochester School* introduced information or transaction costs into their analysis (Watts and Zimmerman 1990, p.133)[13]. This introduction occurred via the concept of 'positive' agency costs of debt and equity (Jensen and Meckling, 1976), management compensation plans and positive information and lobbying costs in the political processes to generate hypotheses about accounting choice (Watts, 1977; Watts and Zimmerman, 1978, 1979). These developments were assisted by other theoretical constructs, particularly the efficient market hypothesis (EMH). Under the EMH, contrary to the income-smoothing hypothesis, stock market prices are assumed to be dependent on a company's cash flows rather than accounting profit and investors are said to be able to separate relevant information from irrelevant, cosmetic accounting changes which have no impact on future cash flows. Hence the capital markets are assumed to be able to distinguish between accounting policy changes which have 'information content' and creative accounting which involves mere window dressing. Moreover, by using other sources of information (i.e.

rejecting the monopolistic hypothesis – see above), the EMH asserts that capital markets are able to adjust the figure of accounting profit to arrive at a more comparable figure with which to assess a corporation's (and thus its management's) performance[14].

5.4 Neo-classical theory of the firm and its core, non-conjectural propositions

The *Rochester School*'s 'positive approach' to accounting theory as outlined above is guided by a number of other, equally important theoretical constructs and assumptions that relate to human nature and the nature of the modern firm and which have been adopted from neo-classical economic theory. Neo-classical economics began as an outcrop of classical economics and is strongly characterized by a concern with the behaviour of firms and markets (see, for example, Kristol, 1981). Classical economics itself can be traced back to the second part of the nineteenth century and was heavily influenced by 'classical' economists such as Adam Smith (*Wealth of Nations*, 1776), David Ricardo (*The Principles of Political Economy and Taxation*, 1817) and John Stuart Mill (*Principles of Political Economy*, 1857). These economists were concerned with economic value and the costs of factors of production (particularly labour, Adam Smith's 'wealth of nations' and capital) in the context of free-market competition. The presumption of competition has been described as the foundation of classical economics, with classical economists believing that although individuals were motivated by self-love and personal ambition, free competition (Adam Smith's 'invisible hand') guaranteed benefits for the community as a whole (Bannock *et al*., 1992). Classical economists' focus on labour and capital and the distribution of wealth between the two had obvious political connotations. However, in the twentieth century, neo-classical economists such as Hicks (1937), Hicks and Allen (1934) and Samuelson (1947, 1984), with their focus on mathematical economics, utility functions and general equilibrium theory, attempted to shift the emphasis away from 'value' and 'production' towards concepts of 'utility', 'indifference curves' and 'preferences', a process which has been observed as an attempt to de-politicise economics (Tinker *et al*., 1982). At the heart of the resultant neo-classical economic theory of the firm lie a number of core, taken-for-granted, non-conjectural propositions about human nature and the behaviour of markets[15]:

- *human nature* – i.e. that investors and decisions makers, as economic agents, are, at the individual level, formally 'rational' and 'utility maximisers'; and,
- *behaviour of markets* - i.e. that financial markets are perfectly competitive and information is freely available[16].

The assumption relating to human nature is explored in more detail in Section 5.5 below. However, it is important to appreciate at this stage that the behaviour of individuals and the behaviour of firms and markets are inextricably linked in the context of the theory of the firm as is being used here. Thus, Bell (1981) describes positive economic theory as being based upon two specific assumptions relating to human behaviour and its social settings, one being the notion of 'utility maximisation', the motivational foundation for purposeful action, and the other a theory of markets as the structural location in which transactions take place, these assumptions converging in the thesis that "… individuals and firms seek to maximise their utilities (preferences, wants) in different markets, at the best price, and that is the engine that drives all behaviour and exchange" (Bell 1981 p.70). Within this framework of economic analysis, the firm is viewed as a black box, or what has been described as a "… set of feasible

production plans …" (Hart 1989, p.1758) involving the use of factors of production, principally land, labour, capital, in a combination that is designed to maximise the welfare of the owner of the firm, where welfare is normally represented by profit[17]. Such a view of the firm is not concerned with and thus does not explain what goes on inside the 'black box' in relation to such matters as the organization of production, the recognition and resolution of conflicts between the various factors of production or how the goal of profit-maximisation is achieved. Rather, such conflicts of interest are effectively assumed away because of the assumptions of perfect information and the absence of any transaction costs (Lerner (1972)[18].

Despite its obvious lack of realism, such a theoretical construct was seen as a good approximation to the pre-incorporation firms that dominated the business world during the second half of the nineteenth century. Moreover, as noted by Demsetz and Ricardo-Campbell (1983), it is a mistake to confuse the firm in neo-classical economic theory with its real world counterpart given that the chief mission of neoclassical economics is to understand how the price system (i.e. markets) coordinates the use of resources, not to understand the inner workings of real firms (hence, the black box analogy). In other words, the 'firm' is merely a theoretical construct used for predicting the relationships between (changes in) prices and (changes in) economic activity. The fact that real firms fail to correspond to this theoretical construct does not, it is claimed, undermine its relevance as a general theory of markets for predicting and explaining economic behaviour in terms of the relationships between prices, production and consumption at the aggregate level. Indeed, as noted by Jensen and Meckling (1976, p.306), the economics literature generally subsumed under the heading 'theory of the firm' is not a theory of the firm at all, but rather a theory of markets in which firms are important actors. This general framework of neo-classical economics continues to provide the basis for many of the models and theories currently used in economics and accounting, including numerous (normative) decision models which prescribe optimal profit maximising behaviour in relation to capital investment, linear programming and cost-variance investigation (Hart, 1989). However, in the latter half of the twentieth century, a number of economists sought to develop alternative theories of the firm which incorporate 'real world' features of the modern limited liability corporation and other economic institutions into their analysis (Hart, 1989). For example, the assumption of utility maximization has been the subject of considerable empirical enquiry over the years, much of it conducted within the discipline of cognitive psychology. The resulting empirical evidence suggests that individuals do not possess a degree of rationality needed to conduct the marginal analysis that is required for utility maximization. This led to the development of 'behavioural' and 'managerial' theories of the firm which focus on the motivations of managers who control but do not own and has little resemblance to the classical 'economic man' (Fama, 1980). Examples of these alternative postulates of managerial behaviour include Simon's (1957, 1959) concept of 'bounded rationality' (which produces satisficing rather than maximising behaviour) and Baumol's (1959) suggestion that managers simply seek to keep their owners (a diffused set of shareholders) happy by providing a minimum acceptable positive return (see also, for example, Cyert and March, 1963; Leibenstein, 1976; March and Simon, 1958; Williamson, 1964, 1970, 1975, 1985)[19].

Many economists were, however, reluctant to relinquish the assumption of maximising behaviour[20]. Rather, they moved towards theories which, whilst rejecting the classical model

of the firm, assumed classical forms of economic behaviour (Fama, 1980). As a consequence, a number of different streams on the economic nature of the firm emerged, notably[21]:

- *principal-agent theory* (Alchian and Demsetz, 1972; Berhold, 1971; Berle and Means, 1932; Fama, 1980; Heckerman, 1975; Jensen and Meckling, 1976; Marris, 1964; Ross, 1973, 1974);
- *transaction (or contracting) cost theory* (Coase, 1937, 1960; Knight, 1921; Monson and Downs, 1965; McManus, 1975; Williamson, 1975, 1985, 1988); and,
- *property rights theory* (Alchian, 1969; Demsetz, 1967; Furubotn and Pejovich, 1972; Hart and Moore, 1990; Holmstrom and Tirole, 1989; Milgrom and Roberts, 1988).

A detailed review of these different traditions in economics is outside the scope of the present study (for an overview, see, for example, Hart, 1989; Machlup, 1967; Preston, 1975; Putterman and Kroszner, 1996). They do, however, have an important role to play in terms of the respective, individual aspects of conventional neo-classical theory which they explore and expand. Thus, whereas 'information economics'[22] led to researchers relaxing the assumption of costless information, agency theorists such as Fama (1980) went further and, reflecting the changed ownership/management relationship of the post-corporate organization, dispelled the long-held, classical view of 'entrepreneurs' (owner-managers) of organizations. The changed ownership/management relationship, which forms part of principal-agent theory, is explored in the next section.

5.5 Separation of ownership from control – the 'principal-agent problem'

Amongst economists, particularly those belonging to the finance wing, principal-agent theory is seen one of the most important developments in the theory of the firm since the mid-1970s, addressing as it does some of the weaknesses of the neo-classical approach described above (Hart, 1989). Whilst principal-agency theory still views the firm as a 'black box' or 'production set', a new factor of production is recognised in the form of *professional managers* whose task it is to run the business, with complete executive control over major decisions such as how to structure the operations, where to locate new factories, how many people to employ and long term capital investment projects. In so doing, contemporary agency theory in the context of modern, large corporations, lays to rest not only the presumption that a corporation has owners in any meaningful sense, but also the presumption of an 'entrepreneur' in classical economics parlance, the two functions of management and risk bearing having been separated under contractual arrangements (Fama, 1980). The main issue confronted by principal-agent theory, which is not addressed by conventional neo-classical theory, is not so much the divorce of ownership from control, but rather the *economic consequences* of this separation. Economists recognise that, following the separation, conflicts of interest can arise between the agent and the principal because of the utility maximisation assumption under which *all* people are assumed to be rational, maximising individuals who, crucially, do not have the same information (Thornton, 1984). As a consequence of this 'information asymmetry', agents' actions can be hidden from the principal, enabling them to profit at the expense of the latter, leading to sub-optimal economic behaviour. Moreover, not only is it assumed that agents will act in their own self-interest but that they will logically do so 'with guile' (Williamson, 1985). 'Guile' is used here

in its literal sense, i.e. acting with treachery, deceit and cunning. Economists and organization theorists refer to the 'self-interest seeking with guile' assumption as 'moral hazard' (Arrow, 1963) or 'opportunism' (Williamson, 1964, 1981)[23].

The separation of ownership and control can be traced back to the advent of the joint-stock company in the seventeenth century. Joint-stock companies came into existence in order to meet the needs of venture capitalists for larger amounts of capital, particularly overseas trading companies, precipitating the emergence of the professional manager (Bannock *et al*., 1992). Up to that time, the traditional institution of business was owner-controlled, with the owner assuming the role of managing the business and enjoying the rewards of any surplus after paying amounts due to the other 'factors of production' such as wages to employees and rents to landlords. Over time, the introduction of the concept of limited liability for both public and private companies and the gradual emergence of the modern giant, global corporation, fundamentally changed the nature of the venture capitalists' relationship with the organization in which their money capital was invested, giving rise to what is termed the *agency problem* (Ross, 1973)[24]. The 'agency problem' stems from the recognition that (a) with different utility functions, the desires, needs and wants of the principal and agent conflict and (b) it is difficult and/or expensive for the principal to verify what the agent is doing. One of the earliest writers to address the 'agency problem' was Adam Smith (1776/1937) in his seminal treatise on *The Wealth of Nations*:

> *The directors of such [joint stock] companies, however, being the managers rather of other people's money than of their own, it cannot be well expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are easily apt to consider attention to small matters as not for their master's honour and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company* (Smith 1776/1937, p.700, as quoted in Jensen and Meckling 1976, p.305).

However, it was not until the early 1930s that economists started to take the principal-agent problem seriously. Berle and Means (1932), in a seminal paper on the separation of ownership and control, focused on its economic implications in the context of the modern corporation:

> *The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear. ... In creating these new relationships, the quasi-public corporation may fairly be said to work a revolution. It ... has divided ownership into nominal ownership and the power formerly joined to it. Thereby the corporation has changed the nature of profit-seeking enterprise* (Berle and Means 1932, p.6).

In short, Berle and Means' thesis is that professional managers not only run the corporation but also essentially are not controlled by the shareholders (Benston, 1982). Berle and Means depicted modern corporations as largely controlled by a management having only a very small percentage of its listed shares, and thus very little financial interest in the profitability

of the firm's activities. This loss of control over the daily management of the business was seen as compounded by the fact that ownership of the firm is broadly dispersed across large numbers of small shareholders such that the typical shareholder had little incentive to monitor closely the managers of a corporation. Consequently, professional managers had greater freedom in the use of the firm's resources. With managers recognised as utility maximisers and having other goals in mind, such as 'opportunism', 'on-the-job consumption', 'empire building' and an 'easy life', and the problem of information asymmetry (see above), it appeared no longer possible for the owners to control the pursuit of their own profit-maximising objectives, even under contract with the manager. Indeed, because they lack the detailed knowledge of the production set, the owners were seen as being unable even to establish, *ex post*, whether the manager even chose the right plan (Hart, 1989). In addition, the principal and agent are seen as having different attitudes towards risk, giving rise to a different set of utility preferences and, *ceteris paribus*, different courses of action which may adversely affect the principal's welfare. In this situation, the principal is seen as caught between a rock and a hard place, unable to control the agent's 'sub-optimal behaviour' without incurring prohibitive or excessive monitoring costs or, alternatively, tying down the agent's activities by drawing up an enforceable contract which specifies all the duties of the agent in *all* situations[25]. This perception of the modern corporation not only reduces the attractiveness of stock markets to investors but, for Berle and Means, represented a serious impediment to the social function of private ownership of property – that is, the efficient allocation of scarce resources through competition (the invisible hand of the market place) – a system based on decentralization through private ownership of the means of production and distribution.

Berle and Mean's assessment of the relationship between shareholders and managers was important because, notwithstanding its omission of the potentially important role of banks and other investment funds in controlling managerial behaviour (see, for example, Bricker and Chandar, 2000[26]), it provided the starting point for the subsequent development of agency theory. Neo-classical economists, for example, responded to Berle and Means' negative appraisal of the 'agency problem' by exploring the impediments to the pursuit of profit maximisation as well as the constraints on managerial discretion in more detail[27]. Agency theorists, for example, approached the problem of opportunism by looking at the nature of the firm and the reason for its existence (Thornton, 1984). In a seminal paper, Alchian and Demsetz (1972) argue that firms logically arise because of the need for a control system to mitigate 'destructive opportunism' or 'shirking', also known as 'perquisite consumption' (Demsetz and Ricardo-Campbell, 1983)[28]. Alchian and Demsetz (1972) provide not so much a 'theory of the firm' but of a particular form of economic organization (what they describe as a specialized surrogate for a market for the team use of inputs) for situations involving *team production*. By focusing on team activity, they highlight the 'monitoring (or metering) problem' associated with matching reward to effort in joint production arrangements. The 'metering problem' in a team context is concerned with rewarding and inducing to work efficiently the members of a team where the marginal products of co-operative team members are difficult to identify or observe, i.e. action and/or decision-making are 'hidden' when trying to meter outputs. If measuring individual performance were a costless exercise, this would not be a problem. However, Alchian and Demsetz argue that if the employer cannot tell at zero cost which employee is shirking, each

member of the team has an incentive to cheat against the other by engaging in more than the average amount of leisure. Alchian and Demsetz's solution to the problem of shirking is for the team to appoint a *team monitor* who, in return for being entitled to the residual cash flows, assumes various roles such as observing input behaviour and giving assignments and instructions[29]. This model of the firm is used to explain the modern firm in the context of relationships between the various corporate 'inputs'. As long as inputs are observable, business corporations will be established because they are the most effective means of monitoring the team's inputs. Where inputs are not observable, i.e. where it is not possible to tell from observation whether someone is enjoying perquisite consumption or working, then monitoring is impossible and, according to Alchian and Demsetz's analysis, firms will not be formed.

Alchian and Demsetz's analysis is also important for the insights it gave into the concept of 'property rights' of individuals (or more correctly, the specification of human rights since, with the abolition of slavery, human 'property' is indivisible and not for sale). The specification of individual property rights determines the distribution of costs and rewards among the participants in any organization. Since the specification of such rights is normally effected through contracting (whether explicitly or implicitly), individual behaviour is seen as dependent on the terms of these contractual arrangements (Jensen and Meckling, 1976). For example, the agent is normally rewarded on the basis of output, with an accounting number (such as net income) serving as a surrogate for a measure of the agent's performance in achieving that output. Net income is obviously a figure that is observable by both parties, but for it to serve as a vehicle for contracting the accounting number it must possess two key attributes (Thornton, 1984):

(i) *conditional predictability* – i.e. being able to predict how the accounting number will be affected by the agent's activities and by events which occur during the period of stewardship (see, for example, Thornton, 1982); and,
(ii) *hardness* – i.e. the ability of the accounting number to withstand political pressures from either party (see, for example, Ijiri, 1981).

In the context of accounting, 'hardness' is affected by the degree to which particular accounting methods are susceptible to variation through *choice*, such as for example, how to calculate depreciation. In an agency context, hard accounting numbers which possess conditional predictability serve as observable instruments for contracting and performance evaluation. According to principal-agent theory, the agreement reached between an agent and a principal for sharing rewards will be a compromise, reflecting their relative attitudes towards risk and the extent to which the agent responds to incentives. Such arrangements can include a fixed fee (which reduces the agent's exposure to risk of no reward) and a bonus element, linked to the agent's performance as measured by, for example, accounting income. From the principal's perspective, the aim is to devise a monitoring and reward structure which recognises the needs of the agent (i.e. his/her utility function) whilst at the same time motivating the agent to direct his/her efforts towards goals which benefit the principal (Thornton, 1984). The presence of opportunism means that both parties will logically choose an accounting system that favours themselves, including the agent's propensity to enjoy on-the-job consumption. Moreover, both parties are assumed to act with *ex post* opportunism, i.e. *after* the terms of their relationship have been negotiated. Thus both agent and principal will

attempt to manipulate the accounting system in their favour. Ng (1978), for example, deduced from his agency model that, *ex post*, an agent whose remuneration is tied to net income will pursue changes in the accounting information system that bias reported income upward, that is, beyond what was contemplated *ex ante* at the time the contract was negotiated.

5.6 Agency costs in capital markets

Although influential, Alchian and Demsetz's (1972) exposition of shirking, monitoring and the metering problem did not succeed in assuaging the basic concerns raised in Berle and Means' (1932) analysis. Rather, it was a group of finance economists, notably Fama (1980), Jensen and Meckling (1976) and Manne (1965), who restored the venture capitalists' faith in the system of managerial capitalism. Jensen and Meckling's (1976) seminal paper focused on the behavioural implications of one aspect of 'property' (i.e. individual) rights effected through contracting, namely those individual rights specified in contracts between the owners and executive managers of the modern corporation in the context of principal-agent relationships[30]. Thus, Jensen and Meckling define an agency relationship as:

> *… a contract under which one or more persons (principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent* (1976, p.308).

This contractual relationship between owners and managers of firms lies at the heart of economic agency theory (Shankman, 1999). In essence, the 'principal-agent' model views managers of firms as economic agents of the shareholders by virtue of 'property rights', i.e. rights implicit in the ownership of the principal's private property (money capital). These private property rights are seen as giving rise to a moral obligation on the part of managers to act *always and only* in the interests of the owners. This obligation is justified on the basis that it is the owners' personal wealth which is at risk and thus it is they who assume the greater exposure to economic loss. Hence, the investment in private property for the creation of economic wealth carries with it the expectation that those who are hired to manage firms will work toward achieving that end (Quinn and Jones, 1995). The central problem addressed by Jensen and Meckling, in the context of this delegated decision-making, was how to induce an agent to behave *as if* s/he were maximising the principal's welfare (the incentive problem). Jensen and Meckling retain the assumption that *all* individuals are rational utility maximisers and add an additional one, the assumption of a competitive capital market, i.e. a market which offers lots of investment opportunities for investors. Under this model, shareholders and bondholders (i.e. the principal) overcome the incentive problem by simply adopting a worst-case scenario of 'managerial opportunism with guile' and price their securities accordingly. Thus, the costs of capital (in the case of shares, share prices and, in the case of bonds, the rate of interest) are discounted for the fact that managers of businesses *will* behave opportunistically. As a result, the agent is forced to bear the entire agency costs associated with opportunistic behaviour through the price they have to pay for outside capital. This is, in essence, the Jensen-Meckling single-period model of agency costs. The model provides a detailed analysis of the concept of agency costs which Jensen and Meckling explore in two stages, the simple cases involving only equity capital markets and then a more complex case involving debt capital[31]. Both cases are explored below.

(a) Agency costs of equity

The Jensen-Meckling model is explained at the outset from the perspective of a single owner-manager who owns all 100 per cent of the equity in the company. In this situation, the costs of any on-the-job consumption are born entirely by the owner-manager given that the resources consumed are not available for use in the business. The 'story' continues as follows. A situation may arise in which the owner-manager wishes to sell a portion of the equity stake in the business. The sale of say 70 per cent results in a situation in which the owner manager retains a stake of 30 per cent of the shares in the business but continues to enjoy all the benefits of his/her on the job consumption. In effect, the owner-manager has even greater incentive for consuming perks given that, *ceteris paribus*, the cost to him/her is only 30 per cent of the resources consumed, not 100 per cent as before. The incoming shareholder is assumed to be aware of this and reduces the price s/he is prepared to pay for the shares[32]. The owner-manager, being a utility maximiser, has incentives to minimise the share price reduction. He/she attempts to do so by voluntarily offering various *monitoring and bonding covenants* with the incoming shareholder. Such *ex ante* covenants include a promise not to increase on the job-consumption, hiring independent auditors to verify such consumption, paying for the costs of setting up proper accounting systems for producing annual accounts and to have those accounts audited by an independent accountant, and putting up bonds which are to be forfeited in the event of breaching these covenants. However, the assumption of competitive and efficient capital markets implies that investors anticipate opportunism on the part of the owner-manager, who therefore has to bear *all* the wealth effects of the expected costs of these monitoring and bonding arrangements[33]. Effectively, under the Jensen-Meckling model, the incoming shareholder is indifferent between the agent incurring the *ex ante bonding costs* or reducing the price to be paid for the shares. Jensen and Meckling (1976, p.308) thus define agency costs as the sum of:

(i) the monitoring expenditures by the *principal* ('monitoring costs');
(ii) the bonding expenditures by the *agent* ('bonding costs'); and,
(iii) the 'residual loss' from dysfunctional decisions.

Monitoring costs represent the costs incurred by the incoming shareholders (the principal) in attempting to control the opportunistic behaviour of the manager[34]. Such costs include not only the costs of measuring and monitoring management's behaviour but also efforts on the part of the principal to 'control' the agent's behaviour through devices such as auditing, formal control systems, budget restrictions, operating rules and the contracting of incentive compensation systems which serve to tie the manager's interest more closely with those of the outside shareholders, etc. The costs of such monitoring will vary from one company to another depending on such factors as the physical size, complexity and dispersion of the company, the tastes of managers for non-pecuniary benefits, the ease with which they are able to pursue their own preferences, statutory and common law, and human ingenuity in devising contracts (Jensen and Meckling, 1976; Watts, 1977). Given that, as explained above, under the Jensen-Meckling model of agency costs, *ex ante* the manager will be forced to bear these costs, Jensen and Meckling argue that it will pay the *manager* to voluntarily expend resources on locking himself/herself into appropriate 'governance mechanisms' (Eisenhardt, 1989) such as monitoring arrangements (covenants) which solve the agency problem by guaranteeing that the agent will not act in a way which contravenes the duties implied by the

agency relationship, or to contract to compensate in the event that s/he does. These costs are defined as *ex ante bonding costs*. Significantly such expenditures are said to reduce monitoring costs which, *ex ante*, would otherwise be incurred by the principal and thus reduce the agency costs of equity. However, because of different attitudes towards risk, it is highly unlikely that the manager will always act in the best interests of the outside shareholders. Consequently, in most cases, both the manager (agent) and the outside shareholders (principal) will incur positive bonding and monitoring costs, respectively. The 'residual loss', represents the wealth effect of the divergence in actions between those of management and those of the outside shareholders had the latter been managing the business themselves.

(b) The introduction of bondholders

Jensen and Meckling (1976) argue that there are also agency costs involved in situations where corporations take on debt financing[35]. In the absence of monitoring or bonding covenants which protect the investment of bondholders, a manager is able to increase his/her wealth and that of the outside shareholders at the expense of the bondholders. In effect, a manager with a small shareholding in the company, being a utility maximiser, has an incentive to convert the assets of the company into dividends, leaving fewer assets to meet the obligations which the company has to the bondholders. If all the assets of the company were paid out as dividends, the bondholders would be left with just a 'shell' company with no assets to meet their claims, thus exposing the bondholders to the negative consequences of the firm's insolvency (for a more detailed analysis of agency costs of debt and the manager's incentive to reduce them, see, for example, Black and Scholes, 1973; Black *et al*., 1974; Lys, 1984; Myers, 1977). Similar wealth transfers can also take place by the manager pursuing goals at the expense of both the shareholders and bondholders (e.g. extravagant offices, empire building, an easy life-style)[36]. The agency costs in this situation arise out of the price which the bondholder is willing to pay for buying the bonds, with higher agency costs being reflected in a lower bond price. Again, *ex ante*, managers are assumed to want to reduce the agency costs of debt and to do so in a way which involves the lowest cost. They are said to do this by voluntarily offering bonding and monitoring arrangements which restrict their property (i.e. individual) rights[37]. Such arrangements include:

(i) bond covenants (restrictive covenants) which guarantee that the manager will not take certain actions which harm the interest of the outside shareholders and bondholders or that the manager will compensate them in the event that s/he does;

(ii) covenants to perform monitoring activities ('monitoring covenants') through the introduction of an accounting system which provides some degree of comfort over the security and value of the shareholders and bondholders' investments and loans, respectively (e.g. a covenant to provide shareholders with audited financial information with which they can monitor the financial performance of the company) and for measuring and disclosing the various covenant ratios negotiated, such as interest cover (ratio of profits earned to interest paid) and gearing (long term debt as a ratio of shareholder funds or net tangible assets); and,

(iii) a programme for monitoring the company's compliance with the covenants (e.g. the appointment of a trustee, an auditor and procedures for compliance reporting to the bondholder or the trustee).

These arrangements obviously involve bonding costs which reduce the wealth of the owner-manager but are assumed to be incurred *ex ante* because the marginal benefits outweigh the marginal costs. For example, a manager may find it cost-effective to agree in advance to incur the cost of providing the bondholders (or outside equity holders) with detailed financial statements (similar to those required under law) as a means of monitoring his/her behaviour, and also to pay for the cost of having their accuracy verified by an independent outside auditor. Jensen and Meckling (1976) hypothesize that management is able to reduce the agency costs of equity even further by entering into monitoring and bonding contracts which tie their compensation package (i.e. their pecuniary rewards for services provided) more closely to the source of the shareholders' own wealth. This can be done, for example, either indirectly through share options, or directly by linking bonus payments to 'profits' or the performance of the company's listed securities[38]. Such compensation 'controls' provide a sense of security to shareholders, knowing that management's own utility is effectively tied to their own, thus reducing economic risk and therefore the agency costs of equity. Management compensation plans of this kind are known to have existed for many years, particularly in the case of UK companies, a fact which is said to lend credibility to Jensen and Meckling's hypothesis (Watts, 1977). Most companies today are also required by law to publish detailed audited financial statements, although this was not always the case[39]. Nevertheless, even in an unregulated economy where audited financial statements are voluntary, owner-managers would, under the Jensen-Meckling model, still agree to provide them, *ex ante*, because they reduce the agency costs of equity and debt by providing a useful device for monitoring voluntary agreements between owners, managers and bondholders and thus serve a useful function in the capital markets (Jensen and Meckling, 1976; Watts, 1977; Watts and Zimmerman, 1979)[40].

The bonding and monitoring agreements described above form an essential part of what Jensen and Meckling refer to as the 'nexus of contracts', i.e. the "… complex set of contracting relationships which delineate the rights of the parties involved" (Jensen and Meckling 1976, p.357). Such contracting relationships give form to what is said to be the essence of the firm:

> *It is important to recognize that most organizations are simply* ***legal fictions*** *[i.e. an artificial construct under the law]* ***which serve as a nexus for a set of contracting relationships among individuals****. … The private corporation or firm is simply one form of* ***legal fiction which serves as a nexus for contracting relationships*** (Jensen and Meckling 1976, p.310-311, original emphasis).

The nexus of contracts theory, as an economic theory of the firm, suggests that there are many different forms of contractual relationships possible, all of which lie along a continuum that includes contracts between firms as well as within firms. The 'nexus of contracts' is simply a collection of economic arrangements which together form a single 'standard form' contract that is used where there is an *economic* incentive to do so[41]. From this perspective, the firm is seen not as having any identity of its own but as a form of internal market, the

behaviour of which is dependent on the outcome of a series of contractual arrangements between shareholders, employees, suppliers, customers, creditors and other parties that are essential to the firm's operations. Thus, questions such as 'who owns the firm?' or 'what should be the objective function of the firm?' are nonsensical from this perspective:

> ***The firm is not an individual*** *.... The 'behaviour' of the firm is like the behaviour of the market, i.e., the outcome of a complex equilibrium process* (Jensen and Meckling, 1976 p.311, original emphasis).

The neo-classical economics tradition is clearly evident here, with the firm being viewed not as an individual but merely as an overlapping set of contracts among principals and agents which specify (i) the ways 'inputs' or factors of production cooperate together for the purposes of creating outputs and (ii) the way in which the economic inflows of this cooperation are to be shared out amongst those inputs (Baiman, 1982; Fama, 1980). Fama (1980, p.290) stresses the fact that, from a 'nexus of contracts' perspective, ownership of the firm is an irrelevant concept:

> *Dispelling the tenacious notion that a firm is owned by its security holders is important because it is the first step toward understanding that control over a firm's decisions is not necessarily the province of its security holders.*

Rather, the firm mirrors the market as a complex network of contracts, except in the case of the firm they are structured within the organization rather than outside it, these contracts effectively determining the behaviour of the firm (Baiman, 1982). Thus, according to the 'nexus of contracts' view of the firm, the organization is a legal entity that serves as a nexus (i.e. a connection, tie or link between individuals of a group, members of a series, etc.) for a complex set of contracts, both written and unwritten amongst disparate individuals (Jensen, 1983; Jensen and Meckling, 1976). It is this view of the firm which led Jensen (1983) to claim, rather arrogantly, that the Rochester School had put into place the foundations of a "... revolution in the science of organizations" (p.318). The contribution of both Alchian and Demsetz (1972) and Jensen and Meckling (1976), in their view of the firm as a set of contracts among factors of production, provides a model of analysis in which each team of inputs acts from self-interest, creating an internal, competitive market, held together by management's pursuit of economic efficiency on all fronts. Thus, from a 'set of contracts' perspective, based on 'property rights' established by contracts, the separation of security ownership and control, rather than being a cause for concern (Berle and Means, 1932), creates an "… efficient form of economic organization" (Fama 1980, p.289). In essence, it is the assumptions in relation to *economic self-interest* not ethics which provide the means of restraining managers from acting opportunistically with guile[42]. This is seen as creating a set of circumstances which leads to the most desirable social outcome – the pursuit of wealth maximising behaviour on behalf of the principal (Shankman, 1999). Although non-maximising wealth behaviour is not completely eliminated, given that there is a cost to determining whether behaviour is wealth maximising or not, Jensen and Meckling's model provides a rebuttal to Berle and Mean's (1932) central concerns and thus restore confidence in the efficiency of the capital markets. Efficient capital markets (under the EMH) are assumed to make managers pay for their personal on-the-job perks, creating a market force towards verifiable, wealth maximising behaviour patterns by managers even with small or zero ownership stakes[43]. However, Jensen and Meckling (1976, pp.351 *et seq*.) recognized a

number of qualifications to their model, notably its lack of 'real-world' features such as multiperiodicity of agency relationships, outside shareholders' voting rights, debt-holding by managers ('inside debt') and the lack of a theory of monitoring, aspects which the authors were content to leave for further analysis in the future. Moreover, no evidence is presented by Jensen and Meckling which offers convincing support as to the motive underlying the decision by managers to enter into monitor and bonding contracts. Rather, Jensen and Meckling formulated a series of hypotheses which Watts (1977) views as consistent with observed phenomena in the real world. Similarly, in relation to management compensation schemes, Watts (1977, p.58) states he has "… noted the existence of such contracts in the UK in the late nineteenth and early twentieth centuries", the implication being that this evidence supports the Jensen-Meckling model of agency costs. In both cases, consistent with Friedman's (1953) instrumentalist philosophy (see Chapter 4), motive is *assumed* rather than empirically verified.

Jensen and Meckling's presentation of individuals as 'morally hazardous' also involves an assumption of motive, management behaviour being perceived as not just opportunistic but also immoral in the sense that they have a propensity to lie, cheat, steal and shirk (Shankman, 1999). *The egoistic paradigm*, as it is sometimes called, is based on the notion that agents (and principals) will honour contractual agreements only if it is in their own self-interest to do so is and is derived from a field of descriptive ethics whose focus is on the role of motive in human interaction. This assumption about human behaviour has been argued to be contradictory on the grounds that some trust has to exist between the agent and principle, otherwise, if the extreme assumption of egoism was factually correct, the principal-agent relationship could not exist (Shankman, 1999). Agency theorists argue that the principal gets around the moral hazard problem by assuming the worst and acting accordingly (Thornton, 1984). However, it is also in the principal's interest to create conditions under which s/he can achieve an optimal level of cooperation. Otherwise, the resource requirements to ensure that the agent's interests remain aligned with that of the principal could become so significant as to defeat the whole concept of the principal-agent relationship. In the 'real world' it is hard to perceive of managers of large global corporations being granted control over large amounts of shareholders' funds without there being at least some element of trust. Consequently, this implies that the use of resources for the purposes of interest alignment in the complete absence of trust is economically inefficient. In other words, there are strong *economic incentives* for principals to appoint individuals who have a track record of trust worthiness because the costs of contracting with such individuals will be lower than the costs of contracting with individuals whose trust worthiness is either unknown or unproven (Barney, 1990)[44].

Thus, the assumption of greed appears to run counter to the efficient functioning of agency relationships. Rather, it is in the interest of the principal and agent to establish a trusting relationship, given that this, arguably, creates a more productive working environment but also reduces the level of resources that are expended on monitoring agency relationships (Shankman, 1999). However, the assumption that people will always behave in their own self-interest effectively precludes this form of optimal contracting. Hence, it could be argued that the agency costs which so concern Jensen and Meckling (1976) are in fact a function of the way in which neo-classical and finance economists *choose* to construct the principal-agent problem based on a carefully selected and specified set of assumptions about human

nature. Organizational researchers, for example, have identified a much broader range of human motives besides greed, including needs for achievement, responsibility, recognition, altruism, belief, respect for authority, and the motivation which comes from carrying out a task that is inherently enjoyable (Donaldson, 1982). This more complete, but necessarily more complex, picture of human behaviour arguably raises serious doubts about the simplified view presented by agency theorists. This is not to suggest that individuals should or can always be trusted. Rather, that some individuals may sometimes behave in ways which are not in the interests of the principal, implying that there is a need for a "… contingency perspective that treats individuals as capable of acting both egoistically and non-egoistically and then examining the appropriate mechanisms of interest co-alignment" (Shankman 1999, p.330).

Nevertheless, the separation of ownership and control has, arguably, on a psychological level at least, some impact on the perceptions of venture capitalists who invest in organizations as a result of which they have no direct control over the management of their affairs. The fact that bonding and monitoring covenants exist in the 'real world' is not in doubt. Watts (1977), for example, refers to abundant examples of monitoring and bonding arrangements, with restrictive covenants in relation to the payment of dividends going as far back as the 1600s[45]. Protection clauses are also inserted in lending agreements, including 'restrictive covenants' concerning taking on more debt, the maintenance of working capital, merger activity, the disposal of all or part of the assets of the firm and the purchase of certain securities (Leftwich, 1983). Such bonding arrangements are seen to have particular significance in an accounting context. *Ex ante*, a manager may voluntarily limit his/her options in relation to choices of accounting methods under the nexus of contracts in order to reduce agency costs. This restriction of accounting choices is said to be motivated by 'efficiency' reasons, i.e. to maximise firm value (Watts and Zimmerman, 1990). Such economically-efficient arrangements are known as 'efficient contracting models' (Watts and Zimmerman, 1986)[46]. However, the manager is assumed to be left with some discretion in the choice of accounting methods, i.e. 'the accepted set', which is predicted to vary across firms (Watts and Zimmerman, 1990)[47]. *Ex post*, managers, as utility maximisers, are assumed to exercise such discretion opportunistically. Hence, an understanding of the motivations of those involved in the contracting process is said to provide a model for predicting and explaining accounting choice in the context of the principal-agent relationship. This model is explored in more detail in the following section.

5.7 A 'positive' theory of accounting choice

The principal-agent relationship has long been recognised in the accounting literature as a basis for explaining observed accounting practice (see, for example, de Ste Croix, 1956; Yamey, 1962). Indeed, the origins of accounting and written records may have their roots in the need for the owners of money and other assets to be able to check the honesty and reliability of agents to whom such assets were entrusted (Yamey, 1962). In the accounting literature this is known as the 'stewardship' concept and has been used to explain, for example, feudal accounting in England (Yamey, 1962) and the provisions of company law in relation to financial reporting (Littleton and Zimmerman, 1962). Thus, there is nothing new in using principal-agent theory to explain accounting practice. However, Jensen and Meckling's (1976) theory of agency costs provided a fresh avenue of research possibilities to

the *Rochester School* of accounting researchers by introducing a new element into the principal-agent relationship, i.e., the incentive for managers to reduce agency costs, which had implications for corporate accounting and reporting practices (Watts, 1977; Watts and Zimmerman, 1986; Zimmerman, 1980)[48]. Whereas much of the accounting literature takes the position that the purpose of accounting information is to provide information that is useful to investors for their decision-making purposes (see, for example, Paton and Littleton, 1940; AICPA, 1973; ASB, 1999, 2002; FASB, 1978), there is a subtle but important difference between this objective and information provided by managers under bonding covenants in the context of agency costs, as explained by Watts (1977):

> *Information for monitoring bonding covenants is contracted for in advance as part of a mechanism by which the manager restricts the extent to which his actions deviate from the interests of shareholders and bondholders. The emphasis is on information as part of a* ***management control mechanism****. In the alternative information function the emphasis is on the provision of information to investors to enable them to value securities and make 'rational' investment decisions. The emphasis is on information for market valuation* (p.63, emphasis added).

In an *unregulated* economy, i.e. one free from government intervention, Watts and Zimmerman (1979) contend that it is the market itself which regulates the amount of diversity in accounting practice. In such an economy, accounting procedures designed to reduce agency costs of contracts are likely to vary across firms given that such costs will themselves vary from one firm to another, giving rise to a variety of accounting techniques, formats and practices[49]. However, in a *regulated* economy, Watts and Zimmerman contend that it was government regulation in both the US and the UK which led to the search for accounting principles and that much of the resulting accounting theory, including the idea that the 'objective' of financial statements is generally to provide information that is useful to investors rather than to control agency costs, resulted from government intervention (see, for example, Benston, 1976; Shakleton, 1977; Zeff, 1974)[50]. Their main line of argument is that were it not for the actions of individuals involved in the political process in the US (i.e. the US Congress and the US SEC as the designated regulatory agency) stating that corporate financial statements *should* provide information to investors, such statements would not exist because they contain little information that is 'new' to the capital markets (see, for example, Ball and Brown, 1968; Brown, 1970; Foster, 1977). This interpretation is based upon two distinct but important sets of theoretical assumptions, both of which concern human behaviour.

The first set of assumptions relates to the *Rochester School's* perceptions of political processes and government intervention in the US. These perceptions are themselves derived from political theories developed in the 1970s (e.g. Downs, 1957a, b; Mueller, 1976; and, in the context of accountants, Pichler, 1974) as well as the contribution of economists such as Buchanan and Tullock (1962) and Meckling (1976) in relation to the behaviour of individuals[51]. According to Watts (1977) the prime contribution of neo-classical economists to the political process literature was the introduction of the assumption that individuals involved in the political process (including voters, the media, lobbyists, elected officials, appointed office holders and bureaucrats) seek to maximise their expected utilities (i.e. their

own self-interests)[52]. Jensen and Meckling were themselves both part of a movement in neo-classical economics which sought to give explicit recognition to the political dimensions of economic theory rather than to continue with presenting economic processes as a political neutral activity (Davidson, 1981), with others going so far as to suggest that there existed a crisis in economic theory (Bell and Kristol, 1981)[53]. The key contributions, in this context, are (in chronological order) those of Berle and Means (1932), Coase (1937), Manne (1965), Alchian and Demsetz (1972), Jensen and Meckling (1976), Fama (1980) and Fama and Jensen (1985). In the 1950s and 1960s, there was considerable debate between, on the one hand, traditional neo-classical economists who defended so-called 'black-box' theories of the firm and, on the other, 'behaviouralists' and 'managerialists' who sought to open up the black box by offering theories which provided 'better' accounts of the contractual and organizational structure of business enterprises. These 'better' accounts have generally been concerned with explaining why there are firms, the scope of their activities (known as the firm-market boundaries) and why firms are organised as they are (Putterman and Kroszner, 1996). To those operating in this area, this literature on the economic nature of the firm is seen as opening up the 'black box', allowing economics as an academic discipline to progress considerably beyond the days when neo-classical economists ignored institutions to a time in which it represents "… the frontier of economic research" (Putterman and Kroszner 1996, p.31)[54].

These assumptions about human behaviour are not confined to the political process. The *Rochester School*, and thus, PAT, assumes that *all* individuals are innovative (i.e. resourceful), creative (i.e. opportunistic) and rational[55] (Meckling, 1976). 'Rational' in this context refers to each individual maximising their own self-interest, usually conceptualised as utility and wealth-related (Ryan *et al.* (1992). Of the many core, non-conjectural propositions of neo-classical economics, it is the rationality assumption which is central to the general framework of analysis employed in both the *Rochester School's* approach to principal-agent relationships and PAT research. This assumption implies that behaviour accords with the von Neumann-Morgenstern axioms of rational choice which postulates that individuals are able to evaluate and rank alternative choices in terms of their personal preferences (Ryan *et al*., 1992). However, this assumption is not subjected to empirical testing and thus Watts (1977) is guilty of the same 'sin' which he levels at prescriptive accounting theorists such as Chambers (1966). Rather, Watts (1977) claims that the justification for the assumption is to be found in "… the rich set of testable hypotheses generated about corporate financial statements and the extent to which those hypotheses are consistent with observed phenomena" (pp.54-55). In other words, this assumption is used in an *instrumentalist* sense to predict and explain *aggregate* behaviour, without getting too involved in understanding the psychology of individuals (Ryan *et al*., 1992)[56]. Critics argue that it is no more than a convenient assumption for economic analysis (Gaffikin, 1988):

> *[I]t can be argued that all actions are rational to the actor. But how does an external party observe (or even comprehend) the action as being* ***rational****. This can only be achieved by some imposed universal standards; there are no such standards. Individual economic rationality (materialistic hedonism) is not necessarily rational for a society or economy as a whole (an obvious example is the case of the pollution resulting from the activities of 'economically rational' producers). There may well be conventionally*

> *accepted standards of management behaviour but they cannot be claimed to be standards of rationality* (Gaffikin 1988, p.18, original emphasis).

These assumptions about aggregate human behaviour are applied by the *Rochester School* in their description of how information is traded by managers of firms in the context of agency costs. The trading of unregulated information in this context is itself constructed within a second set of assumptions, also drawn from neo-classical economics. Under the 'information hypothesis', all information, including accounting information, is seen as an *economic good* that is traded between willing buyers and sellers who seek to negotiate a price which maximises their own self-interests[57]. Managers are said to have little incentive to release information relevant to the value of a corporation's securities because of the 'free rider' problem. Rather, as utility maximisers, in the absence any regulations, managers of firms are assumed to trade that information as they would with any other commodity for self-interest purposes. Thus, in an unregulated economy, it is assumed that managers will not supply information *voluntarily* (i.e. outside the terms of the nexus of contracts) unless two conditions are met (Watts, 1977):

(i) the information is relevant to determining a company's stock market value (e.g. information about the company's future cash flows); and,
(ii) the manager can maintain exclusive access to that information until it is published (i.e. the outside shareholders cannot obtain the information from another source and there is no alternative or substitute).

In the absence of these two conditions, financial information is argued to have no value whatsoever to the outside shareholders or bondholders and thus managers will not be rewarded for supplying it. By applying the above set of neo-classical assumptions in relation to human behaviour and unregulated information to the Jensen-Meckling model of agency costs, positive accounting theory constructs a narrow lens of high resolution through which to view a world dominated by economic risk, managerial opportunism with guile and universal selfishness in which nobody is to be trusted (Roslender, 1997). The principal actors are managers, shareholders, lending institutions and other 'inputs', whose various 'property rights' are determined according to the terms set out in contracts negotiated either within the firm or in the market place. Within the firm, the 'nexus of contracts' is put together by managers purely out of economic interest, resulting, *ex ante*, in various bonding and monitoring arrangements which, in the presence of competitive capital markets, deliver economic efficiency. Managers' interests are seen as determined by the terms set out in their contracts with the firm as well as in contracts between the firm and specific external parties such as suppliers, lenders, governments and regulators, many of which are based on earnings or other financial information issued by the company (Cormier and Magnan, 1996). These market-based contracts are seen as giving rise to a situation in which managers, being both rational and opportunistic, are assumed to adopt a strategic posture to accounting choice, managers preferring to select those accounting choices which maximise their personal interests and well being.

The study of the effect of contract terms on accounting choices is known as 'efficient contracting theory' or 'positive accounting theory' (PAT) (Watts and Zimmerman, 1986, 1990) and has been applied to a number of different areas of accounting, including:

(i) as a basis for determining accounting theory construction in the context of the accounting standard-setting process (Watts and Zimmerman, 1986);
(ii) as a basis for explaining the form of corporate financial statements (Watts, 1977);
(iii) as a basis for explaining accounting theory as an economic good, with individual theories being supplied to meet the demands of particular interest groups to support their position in the context of a political (lobbying) process where individuals compete for the coercive power of government to achieve wealth transfers (Watts and Zimmerman, 1979)[58];
(iv) as a basis for predicting and explaining management *behaviour* (a) in terms of economic costs and benefits (Zimmerman, 1979) and (b) in the accounting standard-setting process (Watts and Zimmerman, 1978)[59].

Item (i) above is more or less the *Rochester School*'s *normative* stance in relation to the standard-setting process, whereas items (ii) to (iv) are *descriptive* or 'positive' models for explaining and predicting behaviour. However, all five areas adopt assumptions in relation to the behaviour of markets (i.e. aggregate market behaviour, e.g. the EMH) and the behaviour of individuals. Items (ii) to (iv) are of relevance to the present study in one form or another, although the focus is predominantly on item (iv) because of the present study's emphasis on predicting, explaining and understanding managerial behaviour. According to Watts and Zimmerman (1978), the 'nexus of contracts' between the contracting parties influences a manager's choice of accounting practices in terms of how those practices are expected to affect a firm's cash flows and other specified accounting ratios and performance indicators. In their 'positive' theory of the determination of accounting choice, Watts and Zimmerman (1978) posit that certain factors affect a firm's future cash flows and, in turn, a manager's *ex post* choice of accounting procedures. This area of research has since become known as the 'economic consequences of accounting choice' literature. Importantly, management is seen as playing a central role in the determination of accounting standards because (i) it is impossible for investors to enter into bonding arrangements which cover all eventualities and (ii) despite the developments in financial reporting there is still considerable scope for choice in the selection of accounting policies, methods and disclosure (see, for example, Moonitz, 1974). Management's freedom in this respect is constrained under bonding and monitoring covenants (see Section 5.6 above) which serve to limit the scope for destructive opportunism by, *inter alia*, restricting *ex ante* accounting policy choice in relation to wealth transfers (e.g. dividends) and economic risk (e.g. gearing). Additionally, the existence of compensation arrangements which tie management's utility function to that of the outside shareholders (e.g. through cash bonuses and shares and share options linked to share price performance) and the EMH, which implies that management is unable, *ex post*, to affect share prices by direct accounting manipulation since the market is viewed as being able to distinguish between 'real events' which have economic (i.e. cash flow) consequences and mere creative accounting (or window dressing) which does not, act as constraints on managerial opportunism with guile.

Nevertheless, management still has some *ex post* choice in accounting methods[60]. Significantly, it is the *economic consequences* of any *ex post* changes to accounting choice which, according to PAT, explains managerial behaviour in relation to the choice and development of accounting standards. Actions by or on behalf of the management of large corporations to influence both national and international accounting standards have been described as 'political pressures', where 'political' in this context refers to self-interested

behaviour on the part of preparers and others which may be detrimental to the interests of investors and other users of financial reports (Zeff, 2002). Zeff's (2002) analysis of numerous aggressive attempts by industry and other affected parties both in the US and other countries to successfully prevent an accounting standard-setter from introducing accounting requirements which are unattractive to such parties provides support to the 'economic consequences' argument (Zeff, 1978)[61]. (To what extent such phenomena are likely to affect the work of the newly-formed IASB as it seeks to improve the quality and comparability of international financial reporting, is, as yet, unknown. Evidence from the U.S., where the impact of political pressure is much greater due to the existence of a rigorous enforcement mechanism through the SEC, suggests that the IASB is likely to come under intense political pressures from powerful lobby organizations funded by industry-specific trade associations.) Under the economic consequences or 'political costs' argument, such lobbying activities are said to depend directly on the extent to which any proposed changes in accounting standards impact on a company's future cash flows (Watts and Zimmerman, 1978). Management's utility function, which is assumed to be a positive function of expected pecuniary compensation in future periods, is presumed to be directly linked to and thus directly affected by any change in the company's future cash flow. Therefore, management is said to have an incentive to consume the company's resources in lobbying accounting standard-setters based on management's own-self interest. Management's position vis-à-vis the proposed adoption of a new accounting standard is thus said to depend upon how the choice of a new accounting standard affects management's wealth via its influence on a company's future cash flows.

Watts and Zimmerman (1978) identified a number of factors likely to affect a firm's future cash flows, including information production costs (e.g. extra bookkeeping costs), taxes (e.g. changes in the methods of accounting favoured by fiscal authorities which affect the basis on which corporate income is assessed for taxation purposes), management compensation plans (e.g. changes in the income measure used as the base for management incentive bonus plans), new government regulations (e.g. rate increases arising out of an accounting standards change for firms operating in regulated industries) and political costs (e.g. wealth transfers from firms operating in industries perceived by governments to be earning 'super' or excessive profits)[62]. In competitive markets, the possibility of passing on such costs is restricted and hence it is assumed that management has an incentive to lobby for the adoption of accounting standards which do not involve any information costs or which reduce such costs. In practice, because large firms already have sophisticated internal cost information systems, the extra bookkeeping costs arising from the adoption of a new accounting standard are likely to be insignificant (Felton, 1982). Where a company's management's compensation package includes a bonus element that is directly linked to the company's reported accounting income, then clearly management has an incentive to lobby for accounting policies which inflate reported income. However, in practice, higher reported earnings can have undesired consequences as a result of attracting the attention of regulators or politicians, resulting in 'political costs'[63]. 'Political costs' in this context include such things as the threat of nationalization of the industry, expropriation of profits (and thus cash) where companies are perceived by regulators or governments to be making excessive (i.e. 'super') profits and antitrust suits where companies are perceived by regulators or governments to be acting in a manner inconsistent with the principles of free and fair trade. The 'government intervention' argument is the one most often associated with political costs in the context of the *Rochester*

School's theory of agency costs, the argument being that firms having contact (actual or potential) with governments, directly or indirectly, can affect future cash flows by discouraging government action through the reporting of lower net incomes. Watts and Zimmerman (1978), drawing on alternative theories of economic regulation (see, for example, Stigler, 1971, 1976; Peltzman, 1976; Posner, 1974) and public choice (e.g. Mueller, 1976), which assume positive information costs and lobbying costs, argue that the corporate sector, representing large pools of wealth is especially vulnerable to political costs from wealth transfers:

> *Certain groups of voters have an incentive to lobby for the nationalization, expropriation, break-up or regulation of an industry or corporation. This in turn provides an incentive for elected officials to propose such actions* (p.115).

These elected officials, such as politicians and bureaucrats, acting in the guise of the 'public interest' are assumed to move to reduce shareholders' property rights or to redistribute wealth to other, disadvantaged groups in society[64]. Watts and Zimmerman (1979) depict the political sector as being dominated by greedy individuals:

> *We assume that private citizens, bureaucrats, and politicians have incentives to employ the powers of the state to make themselves better off and to coalesce for that purpose. One way by which coalitions of individuals are made better off is by legislation that redistributes (i.e. confiscates) wealth* (p.280)[65].

Financial accounting statements are seen to play a key role in these wealth transfers, both directly in terms of the regulation of the rules governing the determination of accounting income and indirectly in the use of such statements in the regulatory process and the basis for legislative intervention. This in turn is said to provide managers, in seeking to avoid such wealth transfers, with an incentive to lobby for accounting practices which defer reported earnings from the current to future periods to keep the firm out of the public eye (Watts and Zimmerman, 1986). Watts and Zimmerman (1978) tested their 'positive' theory of the determination of accounting standards by examining the lobbying activities of management in relation to submissions made to the US Financial Accounting Standards Board (FASB, 1974) concerning the proposed accounting standard for General Price-Level Accounting (GPLA)[66]. Specifically, they tested two hypotheses:

(i) firms whose earnings are *increased* by the adoption of the proposed standard will oppose its adoption, irrespective of size; and,
(ii) the larger the size of a firm which experienced *reduced* earnings as a result of the adoption of the proposed standard, the more likelihood that its managers would lobby for its adoption (i.e. there is a positive association between asset size and submission for firms with income decreases)

To test these hypotheses, Watts and Zimmerman (1978) looked at putative associations between various firm characteristics and the lobbying position of 34 firms. These firm characteristics included size (rank on assets according to the *Fortune 500,* 1973) and market share, as proxy variables for political costs, the existence of a management profit-sharing plan and whether or not the firm was in a regulated industry. Watts and Zimmerman (1978) argue that the magnitude of political costs is highly dependent on size, based on studies of the determinants of anti-trust activity in the US in the early 1970s (Seigfried, 1975). These

studies suggested that size *per se* represented a criterion for action against US corporations, a phenomenon described at the time as 'the curse of bigness' (Watts and Zimmerman 1978, p.115). Early theories of government regulation in the US (e.g. Peltzman, 1975) implied that wealth transfers from corporations to the State were also a positive function of economies of scale. Since economies of scale are assumed to be directly linked to absolute size, Watts and Zimmerman conclude that government intervention will be greater for larger firms. Watts and Zimmerman (1978, p.115) also refer to the hearings of a US Congress, Senate, Subcommittee on Antitrust and Monopoly into the US petroleum industry where *absolute* and not relative profits were argued as being the relevant variable for explaining political action against corporations. Watts and Zimmerman quote Professor Menke's of Tufts University submission to the Subcommittee on Antitrust and Monopoly (1976, p.1893):

> *... precisely because the actions of large firms are so visible, the American public has always equated absolute size with monopoly power. The major oil companies are among the very largest and most visible companies doing business in the United States. Huge accounting profits, but not high profit rates, are an inevitable corollary of large absolute firm size. This makes these companies obvious targets for public criticism.*

The results of the Watts and Zimmerman (1978) study provided partial support for their hypotheses. In the case of larger firms lobbying for a method of GPLA which would have had the effect of reducing the level of reported earnings, *size* (rank of assets) was the only significant variable[67]. Thus, perceived political costs, using the proxy of size, appeared to be positively associated with lobbying behaviour directed at an accounting choice which would have decreased reported income. However, Watts and Zimmerman were not able to distinguish the political benefits from the tax benefits and thus it is not clear whether the major benefits from reporting lower earnings are derived from political or tax considerations, only that "… both tax and political costs affect management's attitudes" (1978, p.127). Moreover, there were a number of large, well-known US companies which did *not* make submissions to the FASB in relation to GPLA, notably IBM, General Telephone, Mobil Oil and US Steel (Watts and Zimmerman 1978, p.127). Unable to explain some of these notable non-submissions, particularly IBM which would have recognised a material reduction in its earnings with the adoption of GPLA, Watts and Zimmerman note, "While we can only expect a positive theory to hold *on average*, the failure of IBM to submit is puzzling" (p.127, emphasis added). Following Watts and Zimmerman (1978, 1979), the 'efficient contracting' model has been subjected to a number of empirical tests in a variety of settings (see, for example, Hagerman and Zmijewski, 1979; Zmijewski and Hagerman, 1981; see Holthausen and Leftwich (1983) for an early review of the literature and Watts and Zimmerman (1978, 1986 and 1990) for later work). These studies have provided a body of evidence in support of the 'size hypothesis' in the context of firms who seek assistance from, or become the subject of enquiry by, regulatory authorities (Jones *et al*., 1992; Cahan, 1992; Watts and Zimmerman, 1990). Although the results appear to hold true only for the largest firms (Zmijewski and Hagerman, 1981), measures of sensitivity to political government-sanctioned intrusion other than firm size have provided further support for the political costs hypothesis, including profitability and industry affiliation (see, for example, Cahan, 1992; Cahan *et al*., 1998; Sutton, 1988; Wong, 1988)[68].

The foregoing analysis has focused on how the political costs associated with accounting policy choice may influence managerial behaviour in the accounting standard-setting process. Positive accounting researchers have also explored the influence of the capital structure of a firm on the management's choice of accounting policy in the context of debt covenants that use accounting numbers to reduce dysfunctional behaviour. The so-called 'debt/equity hypothesis' predicts that the higher the firm's debt/equity ratio, the more likely it is that managers will use accounting methods which *increase* reported earnings as this can ease the restrictions imposed by bonding and monitoring arrangements under the 'nexus of contracts' between shareholders, bondholders and managers, and thus lessen the likelihood of managers incurring debt renegotiation or default costs (Watts and Zimmerman, 1990). Watts and Zimmerman refer to the *ex ante* restrictions on accounting choice under the nexus of contracts as being motivated by *efficiency*, whereas accounting choice in *ex post* situations is said to be motivated by *managerial opportunism*. In this particular *ex post* situation, management's manipulation of accounting profit is said to be motivated by a desire to ease the restrictions on wealth transfers between bondholders and the firm by choosing accounting policies that *inflate* reported income. The EMH implies that any increases in accounting profit which arises as a result of changes in accounting procedures rather than any underlying change in cash flows will not affect the value of the firm or the level of economic risk, *unless* of course such accounting changes influence the *perceptions* of bondholders and shareholders (see, for example, Gore *et al*., 2000). In the case of the latter, if management is cognisant of the influence of accounting changes on the perceptions of the outside shareholders and bondholders then there is an added incentive to manage accounting profit upwards for companies with high gearing ratios. Early studies tended to use the debt/equity ratio as the proxy variable for closeness to the covenant constraint. However, other studies used more direct tests such as the tightness of the dividend constraint as specified in the debt covenant. These studies have tended to use the ratio of dividends to 'unrestricted retained earnings' as the proxy variable for the dividend constraint (see, for example, Bowen *et al*., 1981).

The agency costs model of accounting choice referred to above is said to have "… uncovered systematic empirical regularities in accounting …" (Watts and Zimmerman 1990, p.132) in terms of an association between firms' accounting choice and other firm variables such as size, industry affiliation, profitability and leverage. Nevertheless, some researchers (see, for example, Ball and Foster, 1982; Holthausen and Leftwich, 1983; McKee *et al*., 1984) have been critical of the research methods used and the inferences drawn. Watts and Zimmerman's (1990) reply is partly one of clarification, the suggestion being their critics have misunderstood them, and partly one of refutation: "The methodology we and the subsequent literature use is the methodology of economics, finance, and science generally. This methodology has been successful in accounting and we feel no necessity to apologize for it" (p.150). Watts and Zimmerman's (1990) overall response to their many critics (see footnote 3) has been to urge other researchers to focus their efforts on improving the internal and external validity of the general rationale, rather than to reject the research approach altogether. In summary, the *Rochester School's* 'positive' accounting research programme has, using Jensen and Meckling's (1976) model of agency costs and the general rational of the 'economic consequences' of accounting choice, generated a body of research which lends support to the hypotheses that managers will employ accounting techniques and strategies to (Cormier and Magnan, 1996): (i) minimize political costs; (ii) minimize the firm's financing

costs i.e. the costs of debt and equity capital; and, (iii) maximize their own self-interest. Although these hypotheses have mostly been explored in the context of financial accounting and reporting, they have also been used to predict and explain other areas of corporate reporting, such as the disclosure of social and environmental information. As argued by Ness and Mirza (1991, p.216):

> *.... the existence of alternative approaches [to CSR does] not diminish the validity of the application of positive accounting theory to social reporting. The rationale of positive accounting theory does have a bearing on explaining social disclosure. As positive accounting research has been found to be applicable to this area, more of this research could be used to examine social disclosure in annual reports.*

The application of PAT to CED is explored in the next section for the purposes of arriving at a set of testable hypothesis under EAT.

5.8 Development and statement of hypotheses

Following Watts and Zimmerman (1978, 1979), models of agency costs theory when employed in the specific context of CSR to develop 'positive' models of the decision to disclose social and environmental information have generally been based on one or more of the following hypotheses:

- the 'political visibility' (or 'size') hypothesis;
- the 'industry environmental sensitivity' hypothesis; and,
- the 'debt/equity' hypothesis.

These three hypotheses are explored below for the purpose of arriving at a set of testable hypotheses with which to predict and explain variations in the volume of CED between companies. In each case, the behaviour of managers is predicated on a number of key assumptions embedded in the *Rochester School brand of agency theory*, namely that: (i) managers bear all the agency costs of debt and equity; (ii) *all* individuals act in their own self-interest. In addition, management is assumed not to voluntarily supply accounting or other information unless (i) it is relevant, directly or indirectly, to determining the value of a company's securities, (ii) the manager can maintain exclusive access to that information until it is published, i.e. the outside shareholders cannot obtain the information from another source and there is no alternative or substitute and (iii) the economic benefits of disclosure exceed the costs. Furthermore, given that CED is being discussed here in an *ex post* context (i.e. *after* negotiating the nexus of contracts between the contracting parties), 'accounting choice' is assumed to be motivated by *opportunism* (i.e. self-interest) rather than economic efficiency (Watts and Zimmerman, 1990). Accounting choice in this context concerns principally the executive management's decisions over what, where and when to disclose information. Decisions concerning the selection and introduction of corporate environmental policies, practices and programmes and the information costs incurred in the recording, analysing and reporting of such programmes may be relevant to this choice. Abbott and Monson (1979), for example, argue that a significant outlay of resources on CSResp programmes is done not for any altruistic reasons, but to create an impression of sensitivity to important non-market influences that are perceived to be in the shareholders' long-term

interests. Whilst such programmes are not separately identified in the present study, the primary arguments employed in the context of agency theory are the same, namely that CED is seen as an *economic* good the use of which is predicated on neo-classical economic assumptions in relation to the nature of the firm, the nature and structure of markets and 'rational' human behaviour.

(i) The 'political visibility' hypothesis

The political visibility hypothesis is based on Watts and Zimmerman's (1978, p.115) analysis of political costs (see Section 5.7 above) in the context of wealth transfers and associated costs which arise from unwanted intervention by the political sector acting in the guise of the 'public interest'. Ensuing wealth transfers from political interference are assumed to reduce future cash flows to the outside shareholders with, *ceteris paribus*, a consequent fall in the firm's share price. In the absence of any action on the part of management, it is presumed (i) that outside shareholders will seek compensation for such wealth transfers by renegotiating the management compensation plans and (ii) that management's pecuniary interests in terms of their own personal shareholdings and options in the firm will be adversely affected (Felton, 1982). Since management's utility function is assumed to be a positive function of the expected compensation in future periods, management would, *ceteris paribus*, be worse off as a result (Watts and Zimmerman, 1978). The firm's management is said to employ a number of devices to counter political intrusions and thus minimize political costs, including CSR (Abbott and Monson, 1979; Belkaoui and Karpik, 1989; Eilbert and Parket, 1973; Freeman, 1984; Ness and Mirza, 1991; Watts and Zimmerman, 1978; Trotman and Bradley, 1981). Although cash outflows are incurred in undertaking such disclosure, provided such costs are not excessive, the economic benefits, in terms of reduced risks from political interference, are presumed to justify the costs and thus outside shareholders are presumed to approve of managers incurring these costs. Given that management can maintain control over disclosure campaigns until they are published, managers will be rewarded for supplying it (Watts, 1977). Hence, under the economic consequences argument, a clear motivation may exist for managers, acting in their own self-interest, to *voluntarily* disclose social and environmental information.

As noted in the previous section, Watts and Zimmerman (1978) argue that the magnitude of political costs is highly dependent on size. Large corporations, representing large pools of wealth, are seen as targets to certain groups in society including public pressure groups and regulatory authorities. Such corporations are assumed to be highly visible politically and thus vulnerable to political costs. The likelihood of government interference in this context depends on a number of factors, including the metric used by the courts, legislators and regulators. Watts and Zimmerman (1978, p.115) cite absolute size as important in explaining government regulation, noting also that market share, concentration and size were commonly used in the US at that time. Eilbert and Parket (1973), for example, suggest that 'giant' corporations perceive themselves as visible targets which, because of the dominance, leads them to make visible efforts to establish their social responsibility credentials. In a general voluntary reporting context, Camfferman (1996) notes that under agency theory larger companies are perceived as facing higher agency costs which may justify management incurring higher discretionary disclosure costs. Researchers have used various proxies for size under the political costs hypothesis (see, for example, Belkaoui and Karpik, 1989;

Kimberly, 1976; Klumpes, 2000; Lim and McKinnon, 1993; Newbould and Wilson, 1977; Patten, 1990, 1991, 1992; Roberts, R., 1992; Trotman and Bradley, 1981), including: (i) total assets; (ii) total aggregate market value of a company's listed equity securities (i.e. market capitalisation); (iii) number of employees; (iv) total capital employed (shareholders' funds plus long term debt); (v) capital intensity (e.g. the ratio of gross fixed assets to sales); and, (vi) profits (i.e. profit before interest and tax, PBIT)[69].

In the case of profits, for example, Watts and Zimmerman (1978) report that huge accounting profits, as an indication of possible monopoly rents, are an inevitable corollary of large absolute firm size. Gray *et al.* (2002), based on a review of prior CSR literature, argue that, if social and environmental disclosure can be thought of as being a manifestation of systematic behaviour by corporations, then that manifestation might be expected to be related, in turn, to surrogates of corporate size and profile. Evidence that CSR may be influenced by size can be found in several studies (see, for example, Belkaoui and Karpik, 1989; Eilbert and Parket, 1973; Gray *et al*., 2001; Spicer, 1978a, b, c, 1980; Trotman and Bradley, 1981). Trotman and Bradley (1981) in their study of the social responsibility disclosures of 207 of Australia's largest listed companies tested, *inter alia*, for association between size and the extent of such disclosures[70]. Their findings that the extent of social disclosures is positively associated with size (total assets) at the 0.05 level of significance provide support for the political visibility hypothesis in the context of CSR.

Based on the foregoing analysis, it is predicted that, under the political visibility hypothesis, there will be a positive association between the size of the firm and the volume of CED. Four proxies are chosen as surrogates for the size measure: Total Assets, Profit, Capital Employed and Number of Employees. This choice reflects the cross-sectional nature of the sample companies included in the study (see Chapter 8), notably the inclusion of banks and insurance companies which negates the use of turnover as a proxy for size[71]. The formal hypothesis is stated below in alternative form, the null hypothesis being the hypothesis of no difference:

> H_1: There is a positive association between political visibility and the volume of CED.

(ii) The 'industry sensitivity' hypothesis

The 'industry sensitivity' hypothesis is, strictly speaking, a variation of the political visibility hypothesis outlined above. According, to Watts and Zimmerman (1978), certain industries are seen as being more vulnerable than others in relation to the lobbying activities of voters (i.e. the electorate)[72], the oil industry being cited as one such example (p.115). Similarly, Spicer (1978a) argues that institutional investors, aware of the increased economic risks to their investments in companies prone to environmental problems, expect management to introduce, subject to cost/benefit considerations, effective controls and management procedures (e.g. pollution controls) and to provide appropriate information to society which demonstrates a concern for social issues. There is also some evidence that the political process is influenced by the industry concerned (Zimmerman, 1983). Thus, the threat of wealth transfers from political intrusion is not uniform across all industries of the economy. In relation to the environment and product safety issues, for example, certain industries are more affected by government regulations than others (Epstein *et al*., 1976). How might this affect the behaviour of managers in a CSR context? As was described in Sections 5.5 and 5.6 above, in a principal-agent relationship the presence of agency costs of equity, which would

otherwise be borne by the manager, motivate managers to, *ex ante*, enter into bonding and monitoring arrangements which reduce these costs by, *inter alia*, linking a manager's utility to that of the outside shareholders (Jensen and Meckling, 1976). This implies that, *ex post*, managers will act in ways which are consistent with the interests of outside shareholders. Corporate annual reports are seen as providing an opportunity for managers to be seen to be acting in such a manner, such reports being a primary means by which managers provide information to shareholders (Jensen and Meckling, 1976; Ness and Mirza, 1991; Watts, 1977). Although under the bonding and monitoring arrangements a manager contracts to supply specific accounting and other information to the outside shareholders, acting in the outside shareholders' interests implies that managers will also, *ex post*, provide other information in company annual reports when that information is perceived of as relevant to shareholders, i.e. that it has 'information content'.

The question then arises: what environmental information are shareholders likely to consider relevant? Recognising that the 'relevant' social and environmental information is likely to vary from one company to another, one of the contingency variables in this context is assumed to be the industry in which the company operates (Ness and Mirza, 1991). Prior research suggests that shareholders and other users of annual reports associate a particular industry with specific areas of social responsibility, reflecting the nature of that industry's operations (see, for example, Cowen *et al*., 1987; Dierkes and Preston, 1977; Ness and Mirza, 1991). As an example, oil and chemical companies are generally perceived by the electorate as having a greater impact on the natural environment than, say, retail or distribution companies (see, for example, Patten, 1992; Rockness *et al*., 1986). Similarly, Ness and Mirza (1991) argue that it is plausible to assume that companies operating in the oil sector would emphasize environmental disclosures in their annual reports as part of the 'relevant information' hypothesis, and that such disclosures would highlight favourable environmental performance rather than activities which were harmful to the environment. Under Watts and Zimmerman's (1978) 'positive' theory of accounting, the focus of attention by the media and the electorate on environmental issues provides 'excuses' for the political sector to intervene in the guise of acting in the public interest. Outside shareholders, aware of the increased risk of political interference, are assumed not to be neutral towards management's disclosure strategy but rather *expect* the latter to voluntarily provide information over and above that required by law or contractually agreed under the 'nexus of contracts'. Management is assumed to be aware of such expectations and, motivated by their own self-interests, provide social and environmental disclosure, subject to cost/benefit considerations, in the company's annual report.

Ness and Mirza (1991) employed the *Rochester School brand of agency theory* in deriving testable hypotheses to explain CSR. Specifically, they sought to ascertain whether a significant relationship existed between the oil sector and environment-related disclosure using two hypotheses: (i) a greater proportion of companies in the oil sector included such disclosures relative to the proportion of companies in other industries, and (ii) that oil companies included a greater proportion of such disclosures relative to their overall social disclosures compared to other companies. These tests were performed using the 1984 annual reports of 131 largest industrial companies in the UK, divided into six industry groups and counting the number of social disclosures (categorized into four groups: product; employee; environment; and community). Their tests revealed a significant association (at the one per

cent level) in the case of both hypotheses, supporting the existence of a positive association between environment-related disclosures and the oil industry[73]. However, Ness and Mirza (1991) did not control for the influence of size. Given that a third of the oil companies in their sample was in the top ten according to size, it is possible that their results were influenced by the political visibility hypothesis as described above.

Based on the foregoing analysis, it is predicted that companies operating in environmentally-sensitive (ES) industries provide a greater amount of environment-related disclosures in their corporate reports than companies in less environmentally-sensitive industries (LES). The categorisation of industries as between ES and LES is explained in Chapter 8. The formal hypothesis is stated below in alternative form, the null hypothesis being the hypothesis of no difference.

> H_2: There is a positive association between industry environmental sensitivity and the volume of CED.

(iii)The 'debt/equity' hypothesis

In a general accounting context, the 'debt/equity' hypothesis posits that the larger a corporation's debt/equity ratio, the more likely the corporation's managers are to select accounting choices which have the effect of shifting reported earnings from future periods to the current period (Watts and Zimmerman, 1986). Managers of firms with higher levels of debt finance relative to equity funding are perceived as being more anxious to avoid breaches of the debt covenants since the resulting costs (i.e. wealth transfers) would affect their own economic wealth. Thus, in attempting to avoid any such breaches, management is said to choose accounting methods which increase the current period's reported income. Similarly, firms with high financial leverage (that is, a high ratio of debt finance relative to equity finance) are argued to adopt policies which increase reported earnings, for example, by reducing discretionary social and environmental programmes or by not carrying out any programmes which would reduce reported earnings in the short term (Felton, 1982). A number of studies have produced empirical results consistent with the debt/equity hypothesis in relation to the 'positive' economic model of accounting choice (see, for example, Dhaliwal, 1980; Dhaliwal *et al*., 1982; Hagerman and Zmijewski, 1979; Healy, 1985; Holthausen, 1981; Holthausen and Leftwich, 1983; Kalay, 1982; Leftwich, 1983; Smith and Warner, 1979; Zmijewski and Hagerman, 1981).

General disclosure research into this association has generally hypothesised that higher levels of gearing are associated with higher levels of disclosure in annual reports as managers seek to meet some of the *perceived* needs of shareholders and lenders (see, for example, Conover and Wallace, 1994; Cooke, 1998; Dhaliwal, 1978; Gore *et al*., 2000; Hwang and Kim, 1998; Leftwich *et al*., 1981; Malone *et al*., 1994; Myers, 1977; Wallace *et al*., 1994)[74]. Similarly, there is a branch of markets-based accounting research which champions what is known as the 'competitive disclosure hypothesis' and which has been particularly influenced by the adverse selection argument (Grossman, 1981; Milgrom, 1981) for full disclosure of valuation-relevant information[75]. Put simply, this asserts that if potential investors are aware that a certain type (though not its content) of information is being withheld by a firm, then, in the absence of full disclosure, investors will rationally mark down the value of the firm by assuming the worst case (Fekrat *et al*., 1996). Firms in a competitive environment are said to compete with each other to disclose information that is better than the worst case in order to avoid suffering the negative financial consequences of a higher cost of capital associated with withholding unfavourable information.

The competitive disclosure hypothesis has led some authors to argue that in a global competitive market, market forces tend to drive up the level of environmental disclosure to the level set by rival firms with the highest mandated or voluntary disclosure (Meek and Gray, 1989). Positive accounting researchers see the concept of risk as playing an important role in this context[76]. Firms which disclose less, or which disclose information of an inferior quality relative to other firms of similar economic size and risk characteristics are said to be *perceived* by lenders as secretive and less forthcoming in disclosing information useful for decision purposes and thus are considered more risky. As a result, such firms are charged a higher risk premium. Conversely, higher or superior levels of disclosure are argued to lead to a lower cost of debt capital. The latter is said to result from the fact that 'informative disclosure' assists creditors in understanding the economic risk of an investment. Risk is this context is normally seen as a function of (i) the risk-free rate of return, normally seen in terms of the yield on government treasury bills, (ii) economic risk, i.e. the risk from economic factors, and (iii) the information risk premium, i.e. the cost of transacting without full informative disclosure (Elliot and Jacobson, 1994). Given that the only way creditors can assess the economic risk of an investment is through information, informative disclosure is seen as crucial in determining the total cost of debt capital. Firms which provide inadequate or incomplete information are said to be penalised by creditors who, in response, demand a higher return by charging a premium over and above the aggregate of the risk-free rate of return and the economic risk premium[77].

The above analysis has important implications for EAT in the context of a firm's environmental disclosure strategy because it implies that managers have an economic incentive (subject of course to cost/benefit considerations) to disclose information over and above that required under the various 'nexus of contracts' arrangements (see Section 5.6 above) since, by doing so, such disclosure can lead to a lower cost of debt capital, and thereby higher returns to both the firm and, through compensation packages linked to earnings and/or share price performance, the agents[78]. Although it is difficult to prove empirically that the cost of capital is lowered by informative disclosure (because of the obvious link between economic risk and informative disclosure), efficient capital markets research (see Section 5.3 above) has provided abundant evidence that prices on the capital markets are influenced by disclosure. It is also known that providers of capital demand accounting disclosures *a priori* by inserting clauses in lending agreements (see Section 5.6 above) and there is anecdotal evidence which suggests that many firms are aware that institutional investors prefer to invest in companies which provide lots of information and that good investor relations can have a positive impact on stock prices (Sweeney, 1994). Prior research into the corporate disclosure/cost of capital association has also shown that (i) investors and financial analysts reward improved disclosures through better access to the capital markets (see, for example, Eccles and Khan, 1998) and (ii) firms which are perceived by analysts and potential bondholders to be less forthcoming in their corporate disclosure policy incur a higher cost of *debt* (see, for example, Sengupta, 1998) and *equity* (see, for example, Botosan, 1997) capital. Furthermore, disclosure can have public relations benefits in terms of a firm's relations with its investment community (Benston, 1982). Elliot and Jacobson (1994), for example, argue that investors and creditors obtain impressions of a firm's openness and forthrightness from a variety of sources including external ratings of the quality of annual reports and accounts. Financial analysts who become aware of the companies that received awards for excellence, for example, are likely to have a more favourable impression of those companies, resulting in a lower cost of capital.

Social and environmental disclosure has long been considered as one form of valuation-relevant information in this context (Anderson and Frankle, 1980; Belkaoui, 1976; Dierkes

and Antal, 1985; Epstein and Freedman, 1994; Ingram, 1978; Jaggi and Freedman, 1985; Narver, 1971; Shane and Spicer, 1983; Spencer-Cooke, 1994 - see Chapter 3, Section 3.4 for a brief overview of prior research in this area). Although to date no clear empirical evidence has emerged to support the assertion that the volume of CSR/CED influences stock market behaviour (see, for example, Richardson *et al*., 1999), there are nevertheless *a priori* grounds for assuming that, from a purely *economics* perspective, it pays the company to be 'good' (but not 'too good' – see Ullmann, 1985) in relation to environmental issues. Against a backdrop of an increasing number of areas in which social and environmental activity can have direct, material financial consequences for business organizations (Murray *et al*., 2001, for example, cite prior literature in relation to cost-saving measures, cost or liability avoidance, revenue-generation and signals of best-in-class management practices), the presence of such factors, and investors knowledge thereof, arguably provides *a priori* reasoning for suggesting that management may use environmental disclosure to influence the perceptions of the investment community. Since managers have incentives to disclose 'good' news and to withhold 'bad' news (Scott, 1994; Verrecchia, 1983), the absence of extensive environmental disclosure could be seen by investors and creditors as a negative signal concerning the firm's exposure to environmental risk and future regulatory costs (Blacconiere and Patten, 1994). Using the competitive disclosure hypothesis as set out above, it follows that firms which are less willing than others to disclose environmental information may be perceived of as more secretive (the motive being, for example, to hide a less 'hands on' approach to the management of environmental issues) and thus more risky. The European Federation of Financial Analysts' Societies (EFFAS, 1994), for example, reports a concern amongst financial analysts in the early 1990s for more detailed environmental information in annual reports. This concern existed because of the potential financial effects on a company's net worth from society's concern about the state of the environment. This situation caused confusion and uncertainty amongst financial analysts who began to realize that environmental issues could change materially the risk of an investment (e.g. through regulations requiring the clean-up of industrial activities, which would erode the net worth of those companies affected). Hence, financial analysts began to feel they needed more detailed information in order to make investment decisions[79]. As such, a firm which discloses more details about its activities in relation to environmental issues, even if these disclosures are merely discursive, may nevertheless be perceived as less risky than firms which make no disclosures at all. Thus, in keeping outside creditors informed by supplying environmental valuation-relevant information, these groups are presumed to perceive a lower level of risk in relation to their investment in the firm.

Given that the market's perception of a firm's economic risk is likely to be influenced by the firm's ability to stay within its covenanted limits on financial leverage and payout rates, firms with debt finance operating closer to these limits assumed to be more likely to provide higher levels of environmental disclosure than other firms. Specifically, such firms are assumed to be anxious to avoid breaches of the debt covenants, the latter resulting in costs (i.e. wealth transfers) which would affect their own economic wealth (Belkaoui and Karpik, 1989)[80]. Two common forms of debt covenants, known as 'key market variables', which given rise to contracting and monitoring costs and which management voluntarily enters into in order to reduce the agency costs of debt (Jensen and Meckling, 1976) are: (i) *limits on financial leverage*, i.e. the amount of debt capital that managers can take on relative to the total assets or equity capital of the company; and (ii) *limits on payout rates*, i.e. the amount of cash distributions that can be made out of profits to shareholders (normally) by way of dividends. Based on the foregoing analysis, it is hypothesised that CED is positively associated with a firm's contracting and monitoring costs as represented by financial leverage and dividend cover, where financial leverage is expressed as (i) the ratio of long term debt to equity capital

(shareholders funds) and (ii) the ratio of long term debt to total assets, and dividend cover is expressed as the ratio of dividends to available unrestricted retained earnings. The formal hypothesis is stated below in alternative form, the null hypothesis being the hypothesis of no difference.

> H_3: There is a positive association between contracting and monitoring costs and the volume of CED.

5.9 Some concluding remarks

Despite its many critics, 'positive' accounting research literature has been credited with uncovering systematic patterns in accounting choice (Whittington, 1987). Whilst it may not be true that *all* individuals are utility maximisers all the time, for those working in a *milieu* where money matters most it would perhaps be naive to suggest that the selection of accounting methods and techniques is merely a 'technical' process where all parties strive to achieve the best possible model of accounting income and value measurement. This view of accounting and accountancy may be particularly relevant in the context of societies such as New York and Chicago in the US where there exists a relatively extreme version of liberal economic democracy. However, even in a society of near-angels, there will still exist, according to the doctrine of ethical relativism, behaviour which is considered unethical (Thornton, 1984). Agency theory studies, particularly that of Watts and Zimmerman (1978), highlight the fact that accounting has a *political* dimension that is notably absent from the stewardship or decision-usefulness literature that has for so long preoccupied the international accountancy profession. Rather, corporate financial statements are viewed as:

> *.... products of both markets and political processes and the interactions among individuals and groups in these processes. Individuals are assumed to maximise their self-interests* (Watts 1977, p.53).

The *Rochester School* see no need for the regulation of accounting in the context of agent-principal relationships (see, for example, Benston, 1982). Rather, through the 'nexus of contracts', it is argued that efficient contracts will be put in place such that the various parties involved, acting in accordance with their own self-interests, arrive at a *state of equilibrium* where the cost of providing accounting information is equal to the benefits derived from it. From this perspective, mandatory disclosure relating to accounting, or any form of reporting, is seen as unnecessary and undesirable given that such disclosure is best left to market forces. Indeed, statutory requirements for accounting information are seen as an unwelcome interference given than they will effectively generate excessive information at additional cost, thereby disturbing the steady-state of equilibrium. Thus, negotiating the supply of accounting information through private contracting is seen as more efficient than government regulation. The same reasoning is employed in relation to social and environmental information. Provided there are competitive and efficient capital markets, managers, being motivated by self-interest, will supply what the markets want. Some discretionary spending is permitted, even encouraged, where it is in the shareholder's economic interest.

EAT has attracted many followers within the accounting research community precisely because of (i) its focus on the very issues which concern mainstream accountants – i.e. accounting choice and the management of accounting choice – and (ii) its intuitive appeal in depicting managers, shareholders and politicians as motivated by their own self-interest[81].

Rather than focus on the underlying causes of such greed, the *Rochester School* are content to develop behavioural theories which seek to explain the actions and activities of accountants, auditors, managers, standard-setters and the providers of money capital. In an economic risk context, these groups of actors are the principal constituents of a capitalist society that is taken for granted and left unchallenged. Other sections of society do not come into the field of vision offered by the 'positive' lens because they are not directly relevant in terms of what the theory is attempting to predict and explain. Watts (1977) for example, refers to "… the market interaction of individuals associated with the corporation …" (p.55). Thus, it is not a broad, social theory, but a narrow, *economic* theory. The *Rochester School's brand of agency theory* may have value in a narrow economic context, constructing as it does a lens that provides a high level of resolution but which has a limited field of vision, shutting out large sections of society.

Do these other sections of society matter? Would a more a direct consideration of the behaviour of other sections of society increase our understanding of managerial behaviour in the context of CSR/CED? By concentrating only on the 'network of contracts', economic agency theory (EAT) significantly restricts an analysis of the discourse that takes place within a neo-pluralist society. On the one hand, it would be possible to follow the path of some organization theorists who suggest that additional research is needed for the purposes of fully appreciating the insights offered by EAT in terms of our understanding of the organization-society relationship (see, for example, Donaldson, 1990; Hill and Jones, 1992; Pfeffer, 1982)[82]. Alternatively, a more complete and complex set of interrelations between the various actors in society can be allowed to enter our field of vision by employing alternative socio-economic and socio-political theories. The following two chapters step outside the narrow confines of neo-classical economics to explore the contribution of stakeholder and legitimacy theories in explaining and understanding the nature and causes of CED.

Notes

1. The 'Rochester School' refers to a research tradition in economics and accounting which has its origins in the Chicago School of Economics' concept of 'positive' economics (Friedman, 1953), the central assumption of which is rooted in Pareto optimality (see, for example, Reder, 1982) and which is strongly wedded to realism and empiricism (see Chapter 4). This tradition is commonly associated with the University of Rochester, New York, and the University of Chicago, these two universities being the ancestral home of the original ideas and subsequent dev elopments in the research method and empirical studies. The Rochester School is also the intellectual home of the *Rochester School of Accounting* to which Watts and Zimmerman (see below), amongst others, belong.
2. The finance wing of neo-classical economics is seen by many as the 'hardest' of the social sciences and employs rhetorical techniques. These techniques involve the use of research methods which are claimed to provide 'hard evidence' being based on a structural-functionalist view of the social world (see Chapter 4). Such 'hard' evidence is likely to be more persuasive to its intended audience than other forms of evidence (McClosky, 1985).
3. The *Rochester School brand of agency theory* and the term economic agency theory (EAT) as used in the present study may, for all practical purposes, be assumed to be one and the same. Other influences on the model of agency theory as employed here are discussed in this chapter but the predominant influence belongs to the Rochester School.
4. Whilst the arguments for rejecting the *Rochester brand of agency theory* have been well-rehearsed elsewhere from a number of different perspectives (see, for example, Armstrong, 1991; Arrington

and Francis, 1989; Christensen, 1983; Gaffikin, 1988; Hines, 1988b; Lowe *et al*., 1983; Mathews and Perera, 1991; Ronen, 1979; Ryan *et al*., 1993; Schreuder, 1984; Sterling, 1990; Tinker and Okcabol, 1991; Tinker *et al.*, 1982; Whittington, 1986, 1987), the position adopted in the present study is essentially pragmatic, having due regard to the boundaries within which the present project was constructed. However, readers should be aware of the veracity of criticism levelled at the *methodology* of 'positive' accounting research, particularly Christensen (1983) who asserts that members of the Rochester School are ignorant of the meaning of methodology, describing positive accounting theory (PAT) as a philosophy of science that is "…no longer taken seriously" (p.13), and Sterling (1990) who assesses its accomplishments, both actual and potential, to be "…nonexistent …" (p.131), classifying PAT as a mere "… 'cottage industry' at the periphery of accounting thought…" (p.97). These criticisms have been casually shrugged off by the *Rochester School* in a footnote (Jensen, 1983) and seem to have had little effect on accounting researchers eager to demonstrate that they are abreast of the methodological views they perceive as 'normal' science (Gaffikin, 1988).

5. There is a fundamental difference between 'positive' economics as described here and *logical positivism* (Schreuder, (1984). The latter is concerned with what 'can be', whereas the former is concerned only with what *is*. Essentially, to deny the existence of that which cannot be observed empirically is very different from seeking to test the verifiability or refutability of a proposition using logic and/or scientific method.
6. Belkaoui (1992) *incorrectly* attributes this to John Maynard Keynes (1883-1946), the originator of 'Keynesian economics' based on his highly influential *General Theory of Employment, Interest and Money* (1936). In actual fact it was Keynes' father, John Neville Keynes (1852-1949) (see Friedman 1970, p.3; Gaffikin 1988, p.29), a British logician and economist who lectured in moral science at Cambridge University, England, who defined positive science in this way.
7. In philosophy, 'instrumentalism' is a term applied to a view about the status of scientific theories held by anti-realist philosophers of science such as George Berkeley (1685-1753) and Ernst Mach (1838-1916). In essence, instrumentalists view theories as merely *instruments*, i.e. tools or calculating devices for deriving observable statements (predictions) from other observed phenomena or data (Flew, 1983). From an instrumentalist perspective, it is nonsensical to consider whether a theory is true or false since it can be neither one nor the other. Friedman's general proposition has been challenged by a number of economists (see, for example, Nagel, 1963; Samuelson, 1963). As noted by Lowe *et al*. (1983), one significant problem, illustrated by the work of Kuhn (1970), which Friedman's positivist approach leaves unanswered occurs where two theories, both of which yield the same predictions and which accord with the apparent facts. In this situation, there is no means of deciding which of the two theories is more correct than the other. This issue is particularly relevant in the context of the present study (see Chapter 11).
8. Empiricism grew out of a dissatisfaction with, and as a counter philosophy to, 'rationalism' in the seventeenth, eighteenth and nineteenth centuries and can be traced back to trade guilds and professions which placed emphasis on the transfer of skills by careful observation and practice (master to apprentice) rather than through a formal, classical education system. This led to a philosophy based on the notion that true knowledge can only be acquired through the senses, i.e. observation, and that the only route to certain knowledge was not through non-observable reason and logic but through experience via perception. Exemplars of this line of reasoning include Bacon, Hume, Lock and Berkeley. Although modern empiricists have relinquished the notion that knowledge is *only* determined by experience, they contend that knowledge acquired through experience (i.e. observation in the 'real world') represents a valid basis for determining our beliefs about what we know. This philosophical position contrasts with that of the post-empiricist school, such as Kuhn (1970) and Lakatos (1970), who argued that *observation is theory-laden*, such that it is impossible to separate 'values' from 'observations'. If empirical observations are theory-laden, then it becomes impossible to tell whether an observation is verifying or refuting a particular theory or the theoretical presuppositions of the observer (Ryan *et al*., 1992). A more tenable *empirical* position might be to accept that observations and measurements are susceptible to interpretation but that through replication, collective and independent experimenters can desensitise observations to meaning variance and theoretical conditioning (Ryan *et al*., 1992). However, Habermas (1978) cautions against placing too much reliance on empiricism as the sole

begetter of 'truth' due to the subjectivity of meanings and interpretations given to observations made in the social sciences. Moreover, research, as a *social process*, is governed by social norms and values which are fiercely protected by those whose reputation and standing matters to *them*, and whose role as 'gatekeepers' for the assessment and publication of research accords them a position of considerable power and influence over what is deemed to be 'good science'. As such perhaps the one redeeming quality, or 'the governing moral principle' is that a researcher publishes only that which s/he *honestly* believes to be true (Harre, 1986) and it is left up to his/her peers to decide whether or not the researcher has 'made the grade'.

9. A detailed discussion of the philosophy of science issues underlying PAT is outside the scope of the present study. However, it is important to appreciate the central role which both neoclassical economics in general and agency theory in particular play in PAT research. The assumptions underlying both neoclassical economics and agency theory are taken for granted by PAT researchers who place all their methodological emphasis on the strength of their hypotheses to predict and explain behaviour. It is these methodological assumptions which have been the central concern of critics of agency theory and PAT (see above), their basic argument being that it is not possible to separate the assumptions underlying a theoretical construct such as agency theory from the value of research results derived from the empirical application of that construct.
10. The term 'positive' as used by Watts and Zimmerman to describe a branch of accounting research should not be confused with the term 'positivism' as used in a philosophy of science context (e.g. logical positivism). These two terms are unrelated to one another, the former being used merely to distinguish normative accounting research from research aimed at explaining and predicting accounting practice (Watts and Zimmerman, 1990).
11. Although the monopolistic hypothesis was refuted by some (see, for example, Beaver, 1972), others (for example, Kamin and Ronen, 1978) concluded that a majority of firms behaved *as if* they were income smoothers with management-controlled firms appearing to smooth income to a greater extent than owner-controlled firms.
12. One of the chief concerns voiced by Watts (1977) and Watts and Zimmerman (1978) is that the focus of accounting researchers on prescriptive theory had led to a proliferation of divergent views on the role and purpose of financial accounting and reporting, and, as a result, academic theory failed to exercise any significant influence on actual accounting practice. Watts and Zimmerman (1978) argue that this was because research in accounting had, hitherto, been 'unscientific' due to is preoccupation with *a priori* (i.e. postulational) research and thus was overtly normative.
13. Watts and Zimmerman (1990, p.132) note that finance theories at that time assumed information to be costless and that transaction costs were absence from both the Modigliani and Miller (1958) and capital asset pricing model (CAPM) frameworks.
14. There is empirical evidence which supports the EMH, such as for example, in relation to the non-impact of changes in the method of depreciation (e.g. Archibald, 1972) and of differences in the method of accounting for business combinations (e.g. Hong *et al*., 1978) on share prices. However, there is considerable empirical evidence contradicting the EMH (see, for example, Dyckman and Morse, 1986). Hines (1982), for example, raises a serious question mark over the EMH, her findings indicating that shareholders are heterogeneous rather than homogeneous and, moreover, differ in terms of both their interpretative skills and their expectations of future returns. Hence, it may be presumptuous to assume that there is a consistent and efficient reading of the various sources of information available to investors and that investors have similar expectations and thus valuation models. Rather, it may be more plausible to recognise the investment community as being comprised of different factions, with some espousing Friedman's (1962, 1970) view on the social responsibilities of business corporations whereas others, particularly those who invest in the emerging and growing market for ethical and green investment funds, taking a different, more ethical view.
15. Neo-classical economists made a further series of assumptions to assist their analysis in predicting the behaviour of markets and firms. Four of the most important assumptions were: the owner-manager, i.e. the owner of the firm is also responsible for its day to day management; perfect competition; perfect knowledge; and, zero transaction costs. Over time some of these assumptions have been relaxed as neo-classical economists sought to introduce greater 'realism' into their

analysis (see, for example, Hart, 1989). For an overview of the assumptions of neo-classical economics in the context of their impact on accounting see, for example, Lehman (1992, Chapter 2).

16. This assumption of the behaviour of markets is closely wedded to the significant faith which PAT researchers place in the effectiveness of the free-market system (Ryan *et al*., 1992). This issue is an important one, though not addressed here, because it reflects the ideological acceptance by PAT researchers of private interests which, in turn, implies an acceptance of the existing social order and the privileging of the shareholder and managerial classes. Critical accounting scholars (see, for example, Cooper and Sherer, 1984; Puxty and Laughlin, 1983) have asked the important question of whether an analysis of the relationship between two actors in society (managers and stakeholders) is an appropriate basis for analysing the effects of accounting standards on *social welfare*. This in turn led to calls from a number of researchers for research in accounting to address the social nature of accounting and the role of financial reporting in a wider economic, social and political perspective (Ryan *et al.*, 1992). This wider perspective is considered in Chapters 6 and 7 of this thesis in the context of CED. However, it is important to appreciate that the *choice* of what to study within 'the Rochester School's avowed concern with 'what is' is itself a normative issue. As Gaffikin (1988) rightly points out, it is simply not possible to describe 'what is' from the near-infinite variety of reality without influencing the construction of that reality - choices have to be made and any 'reality' is always relative. The Rochester School's decision to focus on managers and stakeholders reflects a normative position based upon underlying value and belief systems. In that context, to see accounting information as an economic good is a *normative* position given that other, alternative perspectives on accounting information are equally plausible.
17. Although this might seem to be a rudimentary caricature of the modern firm it has retained its allure to neo-classical economists for a number of reasons (Hart 1989): it lends itself to elegant mathematical formulation; it is particularly useful as a model in predicting how a firm's production plans respond to exogenous (i.e. external) changes in its operating environment (such as a change in tax on sales or an increase in wages); and, it is also useful for analysing the behaviour of firms under conditions of non-perfect competition (such as in the case monopolistic and oligolopolistic competition).
18. Lerner (1972) refers to exchanges under the conventional neo-classical model of the firm as 'solved political problems', alluding to the fact that all contracts for the exchange of goods and services are both comprehensive and fully enforceable at no cost to the exchanging parties. However, problems can arise where comprehensive contracts are not feasible or enforceable (see, for example, Bowles and Gintis, 1990).
19. The main tenets of the behavioural school are that firms attempt to satisfice rather adopting maximising behaviour and that the firm is a set of individuals and groups each of which has its own goals, leading to a continuously bargaining process and the pursuit of many complex goals (Bannock *et al*., 1992). However, the theory has not displaced the neo-classical theory of the firm given that, unlike the latter, it is unable to predict the behaviour of firms in any particular circumstances. As has been mentioned previously, the neo-classical theory of the firm does not attempt to look inside firms to see what is taking place but to provide a construct through which to predict production and consumptions behaviour patterns in response to price changes caused by exogenous events at the aggregate level (see, for example, Demsetz, 1982, for a more detailed exploration of the neo-classical economic theory of the firm).
20. Jensen and Meckling (1976), for example, did not consider it necessary to relax the maximising assumption: 'We retain the notion of maximising behaviour on the part of all individuals …' (p.307).
21. It is worth noting that many of these alternative theories of the firm are regarded by some economists as often lacking precision and rigour and consequently have failed, by and large, to remove the neo-classical theory of the firm from its dominant and lofty position of authority (Hart, 1989).
22. 'Information economics' focuses on the information problematic arising from a relaxation of the neo-classical economic assumptions that individual investors have perfect information at zero cost and with no uncertainty. By introducing uncertainty into the analysis, information, including

accounting, takes on the features of a commodity which can be traded and valued in terms of its costs and benefits (see, for example, Zimmerman, 1979). Information economics provided researchers with a way of dealing with the 'conditional truth' problem associated with traditional decision models. In essence, researchers began developing an alternative 'costly truth' approach to decision models, one in which information production costs and the provision of information were seen as problematic, leading researchers to focus on issues of information system choice and information system design (see, for example, Demski and Feltham, 1976, 1 978). Developments in information economics models of accounting income (see Chapter 4) led to a redefinition of the relationship between the organization providing the information and the intended recipient of that information, as 'agent' and 'principal', respectively (Ryan *et al*., 1992).

23. The earliest use of the term 'moral hazard' in this context is normally attributed to Arrow's (1963) article in which he refers to the incentive of people to misrepresent their state of health when applying for medical insurance so as to limit the premium to what a person of 'average' health would pay. Normally, this would be possible given that one tends to be better informed about one's health than a doctor assessing an application for medical insurance without a proper medical examination. Such a situation is referred to as a 'hidden knowledge' agency problem. In economics, the moral hazard problem occurs where incentives exist for individuals to act in (immoral) ways that incur costs which they do not have to bear, giving rise to a 'market distortion' (Bannock *et al*., 1992).
24. In the context of the modern business organization, the relationship between principal and agent normally involves the transfer of funds from the former to the latter. There is a legal expectation that agents, as stewards of those funds, will act at all times in the interests of the principal (Loughlin and Gray, 1988). However, the recognition that professional managers may have agendas of their own (empire building, plush offices, on-the-job perks, an easy life, etc.) was troubling to those who believed in economic liberalism since it introduced a 'sub-optimal performance' issue which, if left unresolved, could reduce the venture capitalists' confidence in the system. For a more detailed discussion of the 'agency problem', see, for example, Baiman (1982).
25. The principal cannot obviously know in advance what future situations may arise. Even if this were possible, it would still be very costly to draw up a contract which specifies every eventuality. This gives rise to the problem of incomplete contracts, with the principal unable to tie the agent's behaviour down to acts which serve his/her best interests rather than that of the agent. The problem of incomplete and under-specified contracts is explicitly discussed within one branch of neo-classical economics known as property rights theory of the firm (see, for example, Demsetz, 1967; Holmstrom and Tirole, 1989; Grossman and Hart, 1986; Hart and Moore, 1990). Under this approach, the firm is seen essentially as "… a collection of [non-human] assets, with ownership providing control rights over these assets" (Hart, 1989, p.1773). The value of property rights theory in the context of the principal-agent relationship lies in its contribution in understanding (a) the behaviour of individuals and (b) the managers' ability to influence individual and team performance through factors such as the motivational skills, talent, charisma, knowledge of the team leader, the quality of information held by the workers, and the degree of worker inertia (Hart, 1989).
26. Bricker and Chandar's (2000) central thesis is that Berle and Means (1932) were misguided in their focus on the 'agency problem' as between managers and shareholders. Rather, Bricker and Chandar argue that, based on historical and contemporary US evidence and contemporary evidence from other parts of the developed world, investment funds' control and influence over companies was "… pervasive and probably a common characteristic of modern capital markets" (p.529). They suggest that by taking a two-tier approach to viewing the capital markets, i.e. involving investors, company managers and investment managers, results in a richer, better and quite different perspective on financial reporting issues.
27. Benston's (1982) neo-classical analysis of the limitations on managerial discretion to act other than in the interests of shareholders identifies four such limitations: (i) the market for goods and services; (ii) the market for finance and for corporate control; (iii) the market for managerial services; and, (iv) internal and external monitoring systems. Benston, a member of the *Rochester School* of accounting, concludes, perhaps not surprisingly, that these constraints ensure that "…

corporate managers have little discretion to act other than in the interests of shareholders" (1982, p.92). Whilst Benston suggests that it is the internal and external monitoring systems which are the most important in this context, Murray *et al*. (2001) posit that it is the "… rapacious, self-serving and short-termist …" (p.5) nature of the financial markets, and the related lack of international political will to control these markets, which severely restricts even the best run, well-intentioned and intelligently informed of companies from carrying out discretionary actions of a socially and environmentally responsible nature.

28. Alchian and Demsetz's (1972) basic thesis is that the efficient allocation of economic resources within capitalistic societies is achieved not through 'authority relations', as suggested by Coase (1937), but through *cooperative* specialization between the owners of these resources. Their particular focus is on co-operation, departing from Coase's notion of a superior authoritarian directive or disciplinary power, with the firm being seen as a form of policing device utilized when joint team production is present. In this context, team productive activity is defined as a union, or joint use, of inputs which, under the supervision of a central, common party, facilitates a larger output than would be possible through separate use of each input (Alchian and Demsetz, 1972). The terms *shirking*, *destructive opportunism* and *on-the-job consumption* all have negative connotations, seen in the context of economic sub-optimality as an unnecessary and avoidable 'loss' to the owners of money capital. However, from the perspective of the worker, *team organization* and *perquisite consumption* were central features of the lives of the common people in Western Europe before the industrial revolution and the replacement of cottage industries with cotton mills, factories and furnaces (see, for example, Dickens (1854/1985) *Hard Times For These Times*).
29. Alchian and Demsetz (1972) argue that it is the person who receives the residual rewards from the reduction in shirking who assumes the role of monitor of the team members. Since this residual claimant-monitor must also be given some powers by which to discipline the team to reduce shirking, powers which include the right to revise or amend the contract terms and incentives of individual team members, the result is a 'bundle of rights' invested in the monitor. Alchian and Demsetz identify this 'bundle of rights' as comprising the right to (i) be a residual claimant, (ii) to observe input behaviour, (iii) be the central party common to all contracts with inputs, (iv) alter the membership of the team, and (v) to sell these rights. It is this entire bundle of rights which, according to Alchian and Demsetz, defines the ownership (or the employer) of the classical (capitalist, free-enterprise) firm. However, in the context of the modern corporation, Fama (1980) argues that it is better to separate the manager (i.e. the agent of items (ii), (iii) and (iv)) from the risk bearer (i.e. the venture capitalists as described in items (i) and (v)).
30. The focus on contracting rights is consistent with Friedman's (1962, 1970) 'pristine liberal economic' philosophy which, essentially, represents an *individual agreement theory* whereby a business is seen to have a responsibility to its constituents, i.e. those with whom it voluntarily enters into exchange agreements, and to live up to the terms of those agreements (Woodward, 1999). In the case of those with whom the business has no contractual relationship, its responsibility is, in this context, simply to avoid violating their individual rights (see, for example, Den Uyl, 1984; Sohn, 1982; Wates, 1973).
31. Agency costs are said to arise as a direct result of the divorce of ownership from control and the consequent agency 'problems' associated with the assumption of utility maximization and the consequential 'moral hazard' problem, together with a number of 'real world' phenomena: (i) information asymmetry; (ii) positive (not zero) monitoring costs; (iii) metering (i.e. performance measurement) problems; and (iv) imperfect (not perfect) (accounting) information (see, for, example, Holmstrom, 1979, 1982). All of these phenomena are seen as acting not only against the interests of the owners (i.e. investors) in their 'rational' pursuit of utility maximisation (i.e. self-interest) but also, by implication, against the interests of the social system (i.e. economic liberalism) in general. Although Jensen and Meckling's 1976 paper includes a good deal of neo-classical economic analysis, their underlying goal is to assuage the fears of the venture capitalists and thus *positively* reinforce a set of personal values associated with the 'rightness' of free market capitalism and the selfish pursuit of individual self-interest. As such, their work is both value-laden and values-driven.

32. The Jensen-Meckling analysis becomes more complex at this point. For a useful overview of the negotiations that are assumed to take place between the owner-manager and the outside shareholders, see for example, Thornton (1985).
33. For a formal proof of the argument that the residual loss is borne by the promoter (or manager), see Jensen and Meckling (1976, pp.318-319). Essentially, the equity market is assumed to be characterized by rational expectations such that buyers will be aware that the owner-manager will continue to increase his/her non-pecuniary consumption as his/her ownership interest in the company is reduced. Thus, the economic costs to the owner of raising additional funds in the equity markets increases as the owner's fractional interest falls.
34. Jensen and Meckling (1976, p.308) state that the principal can limit the aberrant activities of the agent in two ways: by establishing appropriate incentives for the agent (for example, tying the agent's compensation plan more closely to the principal's source of wealth); and, by incurring monitoring costs.
35. Promoters (or managers) of large, modern business corporations seek to finance long-term capital investment projects (such as a new power plant, a new airport runway or a new hotel and leisure complex) with various forms of long-term paper securities, including preferred and ordinary equity shares and various types of fixed-interest securities (e.g. bonds and debentures). The recognition of fixed-interest securities introduces a further factor into the equation given that, since *all* individuals are assumed to act in their own self-interests, potential conflicts of interest exist, for example, between shareholders and bondholders. These conflicting interests give rise to a further 'moral hazard' problem.
36. Jensen and Meckling (1976, p.335) demonstrate, using conventional neo-classical economic analysis, a simpler and less severe form of wealth transfer under which the owner-manager first sells the bonds to potential investors on the basis of a loose covenant to invest in a project with a low variance of return and then by using the acquired funds to invest in a project which has the same systematic risk (i.e., systematic risk as defined in the CAPM employed by Sharpe, 1964 and Lintner, 1965), but a higher variation of return. Moreover, if it turns out that the later has a lower expected return than the low variance project then there will be a consequent fall in the total value of the firm's (a wealth loss representing the 'residual loss portion' of the agency costs of debt), which is borne by the owner manager.
37. This does not imply that the outside shareholders and bondholders incur no monitoring costs in seeking to protect their interests. Rather, that such costs will be passed on to the manager (and incumbent shareholders) through the operation of a competitive and efficient market in the companies shares and bonds. Thus, for example, if the bond covenants turn out to be under-specified, an efficient bonds market would simply 'correct' the situation by hiking up the required rate return, resulting in a lower bond price.
38. Shareholder wealth in the context of equity investments is normally assumed to be determined by the cash value of the future income streams from such investments. In a perfect world, managers would, under Jensen and Meckling's (1976) theory of agency costs, be able to reduce the agency costs of equity by tying their compensation plans to the future positive cash flows from the company. However, the lack of perfect information about the future means that accounting profit is normally used as a surrogate for cash flows. The latter places the manager in a strong position in terms of the agent-principal relationship as the agent has custodial charge over the production of accounting information. Two matters are said to reduce the costs to the agent of this information asymmetry. Firstly the provision of audited financial statements, which provided an external seal of quality to the figure of net income; and secondly, the efficient market hypothesis (EMH) under which it is assumed that investors are able to 'see through' changes in methods of accounting which may smooth, increase or reduce reported earnings but which have no impact on the company's underlying ability to generate positive cash flows in the future.
39. See, for example, Benston (1976), who notes that corporations in both the UK and the US were not generally required to provide financial statements in the nineteenth century.
40. Jensen and Meckling's (1976) argument is as follows. Take the case that the principal finds it worthwhile to produce detailed financial statements similar to the information contained in the published annual accounts. If the manager can produce such information as lower costs than the principal (possibly because much of the data already exists for management's own internal

decision-making purposes) then, according to Jensen and Meckling, "… it would pay [the manager] to agree in advance to incur the cost of providing such reports and to have their accuracy testified to by an independent outside auditor. This is an example of what we refer to as bonding costs" (pp.338-9). Watts (1977) suggests that Jensen and Meckling's hypothesis can be tested by looking at what existed in the nineteenth century.

41. Significantly, in this context, the recognition of information as a costly good created information asymmetries which, rather than leading to market failures, was seen as creating a market in which a series of contracts (a 'nexus of contracts', Jensen and Meckling, 1976) were freely negotiated between rational economic persons according to the economics of supply and demand. Observations of decision makers were seen to accord with this model and thus agency theory provided a model of how decisions makers are believed to behave.
42. In effect, "… agency theory exploits the power of self-interest as a stabilizing and predictive force" (Baiman 1982, p.170). The principal is assumed to choose the payment schedule and monitoring system that best exploits the agent's self-interested behaviour based on the principal's own self-interest.
43. Under Jensen and Meckling's (1976) model, there is a cost incurred in generating information for determining when behaviour is wealth maximising. As such, managers are never perfect agents of owners. This implies that the highest return to a manager will occur if the manager owns all the shares. This raises the question as to why, in practice, owners would want to sell any of their shares or why managers have only a small or zero shareholdings. Fama and Jensen (1985) provide two reasons as to why delegating management is sometimes efficient. Firstly, wealthy financiers do not always possess the required managerial talent, and vice versa. Hence, because an owner-managed firm will return less value when run by a wealthy financier who is a poor manager, there may be economic incentives for wealthy financiers to trade with non-wealthy managers, despite any agency costs. Secondly, even if all wealthy persons were talented managers, there might not be enough persons of sufficient wealth to run all potentially profitable firms. Moreover, a risk-averse wealthy financier would prefer to hold a diverse portfolio of assets and thus would be willing to sacrifice some wealth in return for a reduction in the perceived level of personal risk.
44. Recent large corporate failures involving fraud and deception on a huge scale, notably in the case of ENRON, have shaken the US capital market's confidence in the trustworthiness of executive management and the reliability of accounting numbers. Attempts to restore this loss of confidence have focused on issues such as corporate governance, the role of non-executive directors and the accounting rules. However, no amount of checks and balances can provide complete security where one person is effectively entrusted with another's wealth. Indeed, this is a relationship of fiduciary trust. As such, there is likely to be much more focus in the future on the personality and leadership styles of senior executives with a shift away from executives who 'play hard' towards those who are less aggressive but more dependable.
45. Watts (1977, p.57) cites several early examples such as Kehl's (1941, p.4) reference to the New River Company's corporate charter which included a clause stipulating that dividends could only be paid out of profits. According to Kehl (1941), the inclusion of such dividend covenants in corporate charters began in the 1600s and had become increasingly common by the eighteenth century (as quoted in Watts 1977, p.55). The fact that covenants entered into after 1620 did not contain similar dividend covenants is said to provide evidence that its inclusion in the New River Company's charter was a voluntary act on the part of its promoters (Watts, 1977). Other examples cited by Watts include the case of the Leeds Estate Building and Investment Company (1887), the articles of which included a provision that linked bonus payments to the manager and directors to the amount of distributable profits (Edwards, 1968) and the Spanish Prospecting Company (1911), an officer of which was entitled to a salary on condition that there were sufficient profits from the business to do so (Hatfield, 1927).
46. 'Efficient contracting' refers to the various instruments and arrangements which the contracting parties put in place as part of an economic risks approach to principal-agent relationships and which thus make up the firm's efficient set of implicit and explicit contracts. These include debt covenants, compensation contracts, the accounting systems and accounting method all of which make up what Watts and Zimmerman (1990, p.144) describe as the "… firm's efficient contracting technology."

47. Notwithstanding the potential economic importance of financial statements and the increasing number of accounting regulations and standards issued by accounting standard setters such as the IASB, managers still enjoy considerable latitude when it comes to the selection of accounting policies and methods. By focusing on the accounting flexibility under GAAP, particularly in relation to the discretionary accruals-based aspect of accounting (see, for example, Cahan *et al*., 1997), the earnings management literature has shifted the emphasis of markets-based accounting research back to accountants, managers and the financial statements they prepare (Cormier and Magnan, 1996), particularly on the firm's use of discretionary accruals to alter the timing of recognition of revenues and expenses in the income statement (see, for example, Cahan, 1992; Jones, 1991; McNichols and Wilson, 1988). Discretionary accruals in this context refer to that part of total accruals which can be adjusted by managers within the constraints of the financial accounting and reporting rules (Cahan *et al*., 1997).
48. At the time of the publication of their seminal article in *The Accounting Review* (January, 1978), both Watts and Zimmerman were Assistant Professors at the University of Rochester. In their efforts to develop a positive theory of accounting, Watts and Zimmerman were heavily influenced by the work of Jensen, as revealed by Watts (1977, p.53).
49. Such practices are explored by Watts (1977) and Watts and Zimmerman (1979) in the context of nineteenth century corporate reporting in the UK and the US. However, for the purposes of the present study, we limit our analysis to accounting and reporting practices in the context of a regulated economy.
50. It is important to appreciate the significance of government regulation in the context of the positive accounting school's theories. The existence of a regulated economy not only provides an incentive to individuals to lobby government agencies but also creates a situation in which individuals compete for the coercive power of those agencies to achieve wealth transfers (Watts and Zimmerman, 1979). Moreover, the government agencies are seen as staffed by bureaucrats who are themselves political animals whose behaviour is governed by their own self-interests (Watts, 1977).
51. It is important to bear in mind that such models and perceptions of behaviour reflected the socio-political culture in the US in the 1970s, a situation which was undoubtedly influenced by a number of key political events in the US in the 1960s and 1970s (notably the assassination of key political figures such as President John F. Kennedy, Senator Robert Kennedy and Dr. Martin Luther King), the Vietnam War and the 'Watergate' scandal surrounding President Richard Nixon's 1972 re-election campaign, all of which had a significant negative impact on public confidence in the US political system. Moreover, it also reflects the particular mechanisms and institutional structures of US politics, notably the strong lobbying culture and use of money to 'win friends and influence people', in a country which espouses a strong form of free-market capitalism and individualism (i.e. self-interest).
52. The positive school of accounting's view of the political process as dominated by self-interest is not new or unique. Sociologists such as Schumpeter (1976) have long recognised that in modern democracies politics will become a career. In Schumpeter's view, the behaviour of politicians is analogous to the activities of entrepreneurs competing for customers (Held, 1996). Thus, just as businessmen deal in commodities such as oil, politicians deal in votes (Schumpeter, 1976). To see the professional politician as interested primarily in his/her own career rather than the public interest is as Schumpeter argued, not to see politics as frivolous or cynical, but to recognise that democracy, far from being a self-regulated community guided by the common good, is subject to the whims of those whose interests will be served above all others: the interests of those actually in charge. However, whether it is appropriate to use an *economic* framework to explain a *political* process, as in the case of Watts and Zimmerman (1979) is controversial. Lowe *et al*. (1983), in their critique of Watt's and Zimmerman's paper, argue that to do so requires at least a justifiable defence which Watts and Zimmerman do not provide.
53. Both Jensen and Meckling produced research papers which covered aspects of US politics and the behaviour of individuals in the 1970s. Watts and Zimmerman (1979) refer to three such papers: M. C. Jensen, 'Towards a Theory of the Press', unpublished paper, Graduate School of Management, University of Rochester, June 1976; W. H. Meckling, 'Towards a Theory of Representative Government', presented at the Third Annual Conference on Analysis and

Ideology, Interlaken, Switzerland, June 4 1976; W. H. Meckling, 'Values and the Choice of the Model of the Individual in the Social Sciences', *Revue Swisse d'Economic Politique et de Statistique*, December, pp.545-560.

54. However, all such accounts continue to focus solely on the *economic*, and are still wedded to the main assumptions embedded in neo-classical economics (the market mechanism and rational economic behaviour) and the moral acceptance of the present social system. Hence, there is an *a priori* acceptance of the moral basis of capitalism. Thus, these writings do not question the social system but seek ways of trying to explain important *economic* aspects of it. The world-view is predominantly economic, reflecting a belief in free enterprise and the market mechanism, where firms are distinctive models for organizing economic activity (Putterman and Kroszner 1996, p.7). Indeed, the writings cited by Putterman and Kroszner (1996) are generally intended to defend the market mechanism and provide support for the functioning of capital markets in the context of a separation of ownership and control. In that context there is an agenda at work here, one which supports, rather than questions the present social system of free-market capitalism under liberal democratic government. In essence, their analyses are value-laden.
55. 'Rationality' as used in the disciplines of economics, finance and accounting represents one of the 'core terms' (Lakatos, 1970) which are held as irrefutable, namely the assumption that *all* individuals are rational utility maximisers. For a discussion of the fundamental importance of the assumptions of resourceful, evaluative, maximising behaviour on the part of individuals in the development of the *Rochester School brand of agency theory* see Meckling (1976). 'Rational behaviour' as used here should not be confused with 'rationalism', the latter referring to the notion that certain knowledge can only be acquired through the power of logic and mathematics in determining the truth of competing theoretical arguments and which argues that real truths about the world cannot be discovered by observation (empiricism) alone but by reason (Ryan *et al*., 1992). Thus, rationalism, at a methodological level, asserts that it is possible to make *a priori* empirical true statements. Today rationalism has a more general meaning, encompassing the whole family of scientific traditions (including empiricism, positivism and logical positivism) which asserts that the truth of a proposition can be established by reference to 'rational' criteria, 'facts' or otherwise. In other words, truth remains a verifiable concept, and that science is the process of applying the means (rational objective criteria) for establishing the ends (truth). The anti-thesis of rationalism is idealism which argues that knowledge is only created through the action of the mind, i.e. reasoning, a mental process (introspection) which enables humans to acquire understanding of the world around them (e.g. Berkeley, Kant, Hegel).
56. The assumption of rational behaviour as discussed here does not imply that *all* investors behave rationally, only that, at the aggregate level, the vast majority do such that the assumption is said to be reinforced by aggregate market behaviour. 'Irrational' (i.e. non-utility maximisers) investors can and do exist but are argued as not to exist in such numbers and with such influence as to create sufficient 'noise' to disturb the aggregation process. However, the recent significant growth in ethical investment funds and other forms of investment screening which have a moral, social and environmental dimension (see, for example, D'Antonio *et al*., 2000) may cast doubts over the 'rationality' assumption that investors are interested *only* in the financial aspects of their investments (see, for example, Murray *et al*., 2001).
57. Under the EMH, all information is impounded in the price of a security immediately it becomes public. Empirical evidence suggests that price-sensitive information can come from a variety of sources (Fama, 1976), with accounting numbers such as sales and net income being discounted in share prices before the company's financial statements are released. Although early 'leaking' of accounting numbers does occur, some of the price adjustment occurs because information is available from other sources such as trade information (Watts, 1977).
58. From this perspective, accounting theories, far from being value-free, are viewed as products of both markets and political processes. That is, the function of accounting theory is merely to provide a 'market for excuses' to satisfy the demands of vested interest groups lobbying for accounting standards that will result in wealth transfers favourable to such groups. Watts and Zimmerman (1979) argue that managers' ability to lobby for accounting standards which maximise their own utility (i.e. self-interest) results in the use of surrogate arguments such as 'in the public interest' to gain public support, disguising and thus excusing the underlying self-

interest. In this context, the supply of accounting theories (and standards) is seen as being a response to demand, with suppliers supplying 'excuses' to satisfy the demands of political processes. As such, all accounting theories are viewed as mechanisms for satisfying the utility functions of vested interest groups (i.e. self-interest) with different vested interest groups prevailing on different issues. Though this perspective has come in for some strong criticism (see, for example, Lowe *et al*., 1983, who, *inter alia*, provide contrary evidence which rebuts the 'market for excuses' theory) it highlights a very real issue, namely that any political process, including accounting and reporting, is, *potentially* at least, open to hijacking from those whose interests are affected by the outcome of that process. In much the same way, environmentalism and 'sustainability' are seen as having been hijacked by global corporations to protect their own self-interests (see, for example, Beder, 1997; Korton, 1995, 1999; Mayhew, 1997; Welford, 1997).

59. This particular *a priori* statement reveals one of the normative assumptions underlying the *Rochester School's* approach to accounting theory. As discussed in Chapter 4, the desire to equate the social sciences with the natural sciences continues to generate the belief amongst accounting theorists that the objective of accounting theories should be to both *explain* and *predict* accounting practice. Such a meta-theoretical position is predicated on the assumption that the social world contains 'universal laws' similar to those which exist within the natural sciences. The equating of economic behaviour with the natural world can be seen, for example, in Coase's (1937) classic essay on the nature of the firm where he describes the economic system as 'working itself', being coordinated by the price mechanism, a system in which society becomes not an organization but an *organism* (see also, Dobb, 1925; Hayek, 1933; Henderson, 1922). However, prediction is the function of universal laws, not theories (Roslender, 1992). Theories test these laws which is why Popperian methodology argues that theories should be (i) value free and (ii) falsifiable and not verifiable. The *Rochester School*, in seeking to attribute both explanative and predictive qualities to their theories are, in effect, socially constructing a view of the social world and thus imputing their own normative assumptions and *a priori* values into their construction of theories.
60. Earnings management in the context used here is not the same as earnings manipulation. Earnings management stays within the rules of accounting GAAP, whereas earnings manipulation does not. Thus, earnings management has been described as the purposeful intervention in the external financial reporting process for the purpose of obtaining some private gain (Schipper, 1989).
61. The lobbying behaviour of corporate-funded organizations and industry groups acting in the interests of both management and/or shareholders is equally consistent with a classical (i.e. Marxian) political economy analysis of managerial behaviour. *However*, the difference between the latter analysis and that offered by Watts and Zimmerman (1978) and Zeff (1978, 2002) has to do, fundamentally, with the field of vision employed to explain socio-political processes. Whereas the economic consequences argument focuses on the *economic* wealth of managers and shareholders (i.e. economic self-interest), classical political economy addresses the wider, deeper socio-political issues arising out of the ability of managers *and* shareholders to use their economic power to preserve existing power asymmetries and structural inequalities and thus privilege money capital over other forms of capital, including social, human and cultural and ecological. The fact that the latter do not enter into the 'economic consequences' argument presented by the *Rochester School* and positive accounting theorists highlights the choices which researchers make and are constantly *choosing* to make, based on their own ideological values, when they seek to predict, explain or interpret social phenomena.
62. This set of factors *excludes* the 'information content' effect of an new accounting standard on share prices. Watts and Zimmerman (1978) took this decision on the basis that, at the time, "… economic theories of information and capital market equilibrium were not sufficiently developed to allow predictions to be made regarding the influence [of] an accounting standard on the capital market's assessment of the distribution of returns" (p.114). The information content factor is therefore excluded from their analysis. The extent to which this under-specification affects the results of their empirical study is difficult to gauge, depending as it does on, *inter alia*, the extent to which the markets are able to obtain information from other sources. As noted in Section 5.8 above, the assumption of efficient and competitive markets implies that price-sensitive

information is obtained from many different sources. Nevertheless, it is possible for new accounting standards to change the market's perception of economic risk (and thus affect both share and bond prices) at the time of their adoption by reporting companies. A notable example is the UK's debate over goodwill accounting in the 1990s, which led to the adoption of Financial Reporting Standard (FRS) 10 (ASB, 1997) which required capitalisation and amortization of goodwill, thereby affecting debt covenant restrictions previously negotiated with lenders. In these circumstances, the adoption of FRS 10 has been found to have *perceived* information content based on managements' belief about FRS 10's impact on market perceptions of their companies, thus influencing management preferences, and hence, their lobbying behaviour (Gore *et al*., 2000).

63. Watts and Zimmerman (1978, pp.117-121) provide a more detailed analysis to support their model of management lobbying on accounting standards. In essence, their model argues that, in the case of firms operating in regulated industries or subject to political pressures, managers have *greater* incentives to choose accounting standards which report *lower* earnings than to choose accounting standards which report *higher* earnings. This is because political and tax considerations are assumed to outweigh the compensation factor because of the cash flow implications. Although, *prima facie*, lobbying for an accounting choice which would reduce reported earnings appears contradictory to the assumption of utility maximisation (given that reduced earnings would reduce management's compensation package if linked to reported earnings), in fact the behaviour is perfectly 'rational' given that, under the EMH, share prices will not be affected by any change in accounting method which is neutral in terms of its affect on cash flows, and that management's compensation package in linked to share price performance through share options. Thus, it is the threat from political interference which is seen as the underlying motivational factor, with the reduction of reported earnings having no effect on the company's share price (although it may reduce the tax charge on profits) since the markets will not react given that it has no negative impact on future cash flows.
64. The 'public interest' argument is portrayed by Watts and Zimmerman (1979) as commonly used by the political sector in serving its own self-interest. This rather jaundiced view of the political sector is associated particularly with issues surrounding the notion of 'market failure': "Often, those public interest arguments rely on the notion that the unregulated market solution is inefficient. The typical argument is that there is a market failure which can only be remedied by government intervention" (Watts and Zimmerman 1979, p.282).
65. Wealth transfers between the government and the private sector are an ever-present part of modern liberal democracies, despite the strong emphasis placed on 'free and fair' trade. As noted by Watts and Zimmerman (1979), the business sector is both the source (via, for example, taxes and tariffs) and the recipient (via, e.g. tax credits, and subsidies) of many wealth transfers. Within the EU, wealth transfers take place between Member States and the private sector, most notably in the form of huge financial subsidies which are granted to the agricultural sector under the EU's Common Agricultural Policy (CAP).
66. The argument by Watts and Zimmerman (1978), that corporate management attempt to secure through political lobbying accounting standards which best serve their own self-interests and only indirectly the interests of their employing organization and its shareholders, was a sort of wake-up call to the accounting profession. It had been long thought (by accounting standard-setters) that the basic objective of financial statements is to provide information useful for making economic decisions (ASB, 1999; FASB, 1978; IASB, 2002). However, Watts and Zimmerman (1978) argue that, rather than being a technical process to produce 'better' (i.e. more accurate or more useful) information for investors, the formulation of accounting standards is a political process amongst various segments of society, each seeking to lobby for accounting standards which will promote wealth transfers favourable to themselves.
67. Watts and Zimmerman (1978) observed the lobbying behaviour of all 34 submissions to the FASB in relation to the proposed standard in GPLA. Of these, 26 were non-utility corporations whose net income would have been decreased by its adoption. In the case of these 26, eight supported the proposed standard and 18 opposed it. These eight came from the larger firms. Using a non-parametric test (i.e. the Mann-Whitney U test), they were able to reject the null hypothesis that there is no association between firm size and the attitude of its management towards the

proposed standard at the 0.001 level of significance. In the case of the smaller firms that lobbied for the adoption of a standard which would increase reported earnings, Watts and Zimmerman suggest the behaviour of smaller firms reflected the fact that the economic benefits to management from higher reported earnings under their compensation packages outweighed the associated political costs, whereas the reverse was true for the largest firms.

68. Early tests of the political cost hypothesis use firm size to proxy for expected political costs (see, for example, Daley and Vigeland, 1983; Watts and Zimmerman, 1978; Zmijewski and Hagerman, 1981). However, following questions over the use of size as a valid proxy for political costs (see, for example, Ball and Foster, 1982; Leftwich, 1990), researchers using the political costs hypothesis have employed proxies which are claimed to more closely approximate actual political events or more closely capture firm characteristics which increase the likelihood of the firm becoming a political target (see, for example, Cahan *et al*., 1997; Sutton, 1988; Wong, 1988). Nevertheless, proxies for political costs remain relatively unsophisticated (Cahan *et al*., 1997) and no one proxy has been established conclusively to capture political costs. Rather, researchers choose to test the political costs hypothesis by employing a variety of surrogates for political costs. A similar approach is adopted in the present study. Other alternative, surrogates for political costs may exist but are not considered here.
69. There appears to be some confusion in the CSR literature as to whether profit is a surrogate for company size or part of a company's socio-political profile in its own right. A detailed discussion of this issue is outside the scope of the present study. However, it seems reasonable to argue that the absolute size of a company's profits influences its political visibility, as demonstrated by the UK government's decision to impose one-off taxes on the 'super' profits of energy companies in the wake of the privatisation and marketisation of the UK energy supply and distribution sector in the 1990s. Hence, for the purposes of the present study, profit is employed as a surrogate for size.
70. Trotman and Bradley (1981), following Spice (1978a), also extended the political costs argument under agency theory to include the 'social constraints' on a firm. Essentially, their basic argument is that it is the *threat* of sanctions (e.g. legislation, government regulation, judicial decisions, protests by special interest groups and consumer boycotts) against corporate activities judged to be socially-undesirable which induces management to adopt policies and report on its performance in relation to social issues, including environmental issues. Hence, CSR is seen as being influenced by the extent to which management perceives the threat of potential financial penalties for poor social performance. However, whilst this line of research may well offer insights into managerial behaviour, there are a number of practical difficulties involved, not least the identification and measurement of appropriate proxies for 'social constraints'.
71. Market capitalisation was also considered for inclusion as a proxy for size but was subsequently excluded owing to the fact that a large minority of the companies in the sample were in fact not listed on a recognised stock exchange either because they were part of the public sector and owned by national or regional governments or were wholly-owned subsidiaries of other companies.
72. Watts and Zimmerman's (1978) reference to the 'electorate' rather than the 'general public' is intentional. Although these two sections of society may be one and the same, it is the votes of an electorate which attract the interest of elected officials, the latter also being seen as utility maximisers whose only motivation is their own self-interest.
73. Of the 131 companies included in their study, 12 were oil companies of which 7 (58%) made environmentally-related disclosures; of the 119 non-oil companies, only 18 (15%) made environmentally-related disclosures. The oil companies made a total of 154 social disclosures of which 10 (6%) related to the environment; the non-oil companies made a total of 1,367 social disclosures, of which only 24 (2%) related to the environment (Ness and Mirza, 1991).
74. There is also a branch of the general disclosure literature which explores the relationship between disclosure and the extent to which companies rely on the public capital markets for external finance (see, for example, Camfferman, 1996; Choi, 1973; Firth, 1980; Frankel *et al*., 1995; Meek *et al*., 1995). In essence, this literature hypothesises a *general* disclosure relationship between capital market activity and disclosure under which, over time, companies which have a greater reliance on the capital markets through new issues of shares and bonds are asserted to provide higher levels of disclosure, and a *specific* relationship under which increases in disclosure over

time are asserted to be associated with new demands (i.e. new calls for external finance) on the capital markets. Whilst this line of empirical research may have value in a general reporting context, its relevance in the specific context of CSR is more difficult to ascertain and thus is not addressed in this thesis.

75. Disclosure in this context usually refers to 'informative disclosure', i.e. disclosure which is useful for decision-making. Formally, this may be taken as meaning that the information content of a message has the capacity to reduce uncertainty, where increased 'informativeness' leads to decreased information risk demanded by investors and thus a lower cost of capital (Elliot and Jacobson, 1994).
76. The assumption here is that an investor's perception of risk is influenced by the degree to which the managers of the firm are seen as open and forthcoming in disclosing information. On this basis, it is assumed that higher level of disclosures are associated with a more transparent and less-secretive board of directors. This assumption is clearly open to question in a CSR context given the public relations aspect surrounding much of CSR/CED (see Chapter 3). Nevertheless, there may be some justification for arguing that even discursive environmental disclosures influence investor perceptions, particularly in relation to environmental progress in areas that are likely to yield future benefits in the form of better employee, customer, public and government relations (see, for example, Benston, 1982). Market pressures, however, particularly the financial markets' preoccupation with short term returns (see, for example, Murray *et al*., 2001) are likely to act as a severe constraint on management's use of this argument.
77. In the context of CSR, this analysis makes a number of assumptions about the usefulness, reliability and influence of CSR under the investor decision usefulness framework (see, for example, Cooper, 1988; Chan and Milne, 1999). A discussion of these issues is outside the scope of the present study but it is important to appreciate that the prior literature on the perceived usefulness and influence of CSR/CED on investors and other users of annual reports, notwithstanding the apparent demand from investors for social and environmental information (see, for example, Deegan and Rankin, 1997; Epstein and Freedman, 1994; Goodwin *et al*., 1996; EFFAS, 1994), remains equivocal and controversial (see, for example, Belkaoui, 1980; Chan and Milne, 1999; Ince and Gifford-Gifford, 1996; Harte *et al*., 1991; Rockness, and Williams, 1988; Teoh and Shui, 1990). On one side, it may be suggested that environmental disclosure, *ceteris paribus*, over the long run, reduces risks and that the potential benefits from an exemplary environmental management programme would generate a positive reaction from investors. However, it may also be that investors do not favour either the expenditure or its disclosure. Cooper (1988) suggests that investors' attitudes may vary along a continuum, ranging from no expenditure and minimal disclosure as this maximises returns to investors (at least in the short run) to discretionary expenditure on pollution-abatement and maximum disclosure to achieve major public relations benefits. Thus, whilst it may be that *some* investors value extensive environmental disclosures because this indicates corporate management have minimized the risk of prosecution, it seems equally plausible to suggest that other investors may prefer that managers do *not* comply with standards, and for this violation *not* to be identified (Cooper, 1988).
78. Some informative disclosures can lead to competitive disadvantage and thus weaken a company's ability to generate cash flows. Disclosures such as information about technical and managerial innovation may actually harm a company's future prospects by creating competitive disadvantage and thus are not in the interests of the company. However, a distinction can be drawn between information which is useful to investors and creditors for the purposes of estimating the amount, timing and certainly of future cash flows and information which creates competitive disadvantage. As such, any overlap between information designed to meet investors' needs and information which benefits competitors is perhaps coincidental, with the management of the firm being able to inform investors whilst not suffering undue competitive disadvantage (Elliot and Jacobson, 1994).
79. EFFAS (1994) argued, "… current accounting standards are not sufficiently developed to provide the necessary support for decision making" (p.2) and went on to provide a list of the type of information which companies might provide (EFFAS 1994, p.20). This list included: details of the firm's environmental policies and targets; details of the system for collecting environmental data at a local and group level; details of any environmental audits; discussion of main environmental challenges and problems; whether the company had complied with world-wide existing

environmental law and regulations; whether the company had taken out special insurance for environmental risks; and, whether the company had signed up to the ICC-Charter for Sustainable Development.

80. The contract and monitoring costs hypothesis was employed by Belkaoui and Karpik (1989) to explain variations in voluntary CSR across firms. The authors' reasoning in this context was developed under EAT as follows. Lenders of loan capital include terms in debt agreements which are intended to reduce management's ability to create wealth transfers between shareholders and the lenders. These terms, known as restrictive covenants, include limits on financial leverage and limits on payout rates. The authors argue that given these restrictive covenants and the *assumption* that social and environmental disclosure follows an outlay for discretionary expenditure on social and environmental performance improvement programmes which reduce short term earnings, it follows that companies facing less restrictions under the restrictive covenants (e.g. by having a lower debt to equity ratio) are able to carry out more discretionary social and environmental programmes and thus provide a higher level of social and environmental information in their annual reports. Thus, the authors hypothesised that there is a *negative* association between CSR and contracting and monitoring costs. The authors' assumption of a causal link between discretionary spending programmes and disclosure may have been appropriate given that their raw data was drawn from the Ernst & Ernst (1978) survey data which focused on particular forms of social disclosure. The raw data for the present study, however, makes no *a priori* assumptions about discretionary environmental spending programmes nor does it attempt to link such programmes with the type and nature of CED as defined (see Chapter 8). Moreover, as discussed in Chapters 7, 10 and 11, the present study suggests that much of the reporting of CED has a public relations gloss to it rather than reflecting any particular underlying spending programme. Accordingly, Belkaoui and Karpik's approach is not deemed appropriate in the context of the present study.
81. Most 'mainstream' members of the financial accounting wing of the accounting profession operate in a narrow, economic, markets-based world and will most likely be aware of the potential pressures which accounting standard-setters come under from the business sector (see, for example, Zeff, 2002). It is this world, the world of accounting regulation and standard-setting, which is much more familiar to traditional accountants than one which sees accounting as a form of social construction designed to privilege money capital over labour. As such, it is understandable why EAT is so popular amongst mainstream accounting research and practice, compared to other more radical, political theories such as legitimacy or political economy of accounting theory. For similar reasons, agency theory has been argued as being relevant and valuable to the study of organizations because it reminds us "… that much of organizational life, whether we like it or not, is based on self-interest" (Eisenhardt 1989, p.64).
82. Hill and Jones (1992) advocate a stakeholder-agency theory in which agency theory considerations are applied to all stakeholders rather than just to shareholders and bondholders. However, given the core, non-conjectural assumption of utility maximisation, for the *Rochester School brand of agency theory* to be valid as a broad social theory implies that all sections of society are greedy and selfish, concerned only with their own interests. It is difficult to accept such a perspective given that the world is populated by large numbers of people who clearly do not act in their own self-interest. Non-governmental organizations (NGOs) such as Amnesty International, Greenpeace, Friends of the Earth, Medicin sans Frontier, the International Red Cross, and the hundreds of other non-violent action groups around the world are actively campaigning for an alternative to the 'greed is good' culture which so underpins neo-classical economic analysis.

Chapter 6

Managerial stakeholder theory and the use of CED to manage stakeholder groups

6.1 Introduction

Managerial stakeholder theory (MST) is one element within a broad body of literature that forms stakeholder theory which has tended to diverge along several different research streams, each one reflecting a different set of values and preferences. Thus, whilst stakeholder theory's ultimate justification may be perceived to lie in its *normative* bias towards more pluralist social systems (see, for example, Carroll, 1995; Freeman, 1995; Jones, 1995), it offers several fundamentally distinct models for analysis (Donaldson and Preston, 1995)[1]:

(i) *normative* (i.e. prescriptive) model – i.e. how *should* management address stakeholder concerns and interests as opposed to what actually takes place in practice;
(ii) *instrumental* (i.e. means-ends) model – i.e. businesses which recognise and respond to stakeholder concerns will succeed better than those that do not; and,
(iii) *descriptive* model – i.e. businesses *do* recognise and respond to stakeholder interests and/or pressures.

In each case, the stakeholder concept shifts the focus of organizational analysis away from the simple principal-agent relationship towards a more pluralistic one which perceives the corporation as an entity that is centrally-controlled by the management, a prime responsibility of which is to recognise and respond to the needs and concerns of the various internal and external stakeholder groups. The first of the three streams identified above is concerned with what *ought* to be the case, rather than what *is* the case. Although still at a relatively primitive stage of development, this model already includes many different versions of stakeholder theory drawn from different fields of philosophy and the social sciences, including postmodernism, ethics and morality, feminism, corporate governance, ecology and psychoanalysis, each of which specifies different sets of stakeholders and privileges a different set of principles, rationales, values, rights and interests (see, for example, Argandõna, 1998; Burton and Dunn, 1996; Freeman, 1994; Freeman and Gilbert, 1992; Goodpaster, 1991; Logdson and Yuthas, 1997; Quinn and Jones, 1995; Slinger, 1999; Starik, 1995; Weiss, 1994; Wicks *et al*., 1994; Yuthas and Dillard, 1999). In its normative form, stakeholder theory relies on a sophisticated version of deontology, duties being owed by corporations to stakeholders because of the latter's inherent interests (Gibson, 2000). Underlying the normative approach is a fundamental 'middle of the road' belief that there is a way in which managers can run their businesses in the context of a pluralist visualisation of organization-society relationship that is both *justifiable* on ethical and moral grounds, and *workable* (Jones and Wicks, 1999). However, just what this 'account' of the business-society

relationship *should* look like varies according to the particular normative arguments used. The normative variant of stakeholder theory also includes a number of contributions from accountancy in general (for example, Niskala and Näsi, 1995) and CSR in particular (for example, Gray, 1989, 1992; Gray *et al*, 1988, 1995d, 1996, 1997; Woodward, 1999). Gray *et al.*'s (1988, 1996) *prescriptive* model of organizational 'accountability', for example, focuses on the organization-stakeholder interplay in the context of a socially-grounded relationship or 'social contract' under which an organization is perceived as having a responsibility to render an account to all its stakeholders, the nature of that account being determined according to the relationship between the organization and the stakeholder concerned.

Although useful for debating the precise nature and form of the 'account' organizations should render to their different stakeholders, the normative model has little descriptive or explanatory power in a CSR context. In contrast, the *instrumental approach* seeks to offer a specific *justification* for a business' response to stakeholders' demands based on the notion of 'enlightened self-interest' (see, for example, Freeman, 1983, 1984; Shankman, 1999; Zadek *et al*., 1997). The instrumental model's underlying premise is that certain desired outcomes or ends (e.g. maximising shareholder value) are *more likely if* firms behave in a certain way towards their stakeholders. This model reflects a contingency theory framework along the lines of *if A then B* (Jones and Wicks, 1999). For example, it is argued that by strategically investing in stakeholders' demands firms can gain a competitive advantage by developing additional, complementary skills that competitors find nearly impossible to imitate (Russo and Fouts, 1997). Similarly, the Royal Society for the Arts' UK study (RSA, 1996) of the kind of companies which are expected to be successful in the future speaks in terms of tomorrow's company being 'inclusive' by forming closer, more embedded relationships with 'key stakeholders' as a strategy for financial success[2]. In the context of CSR, a good deal of the professional accountancy and consultancy-orientated stakeholder literature falls into the instrumental category (see, for example, Aloisi de Larderel, 1998; BiE, 1990, 1998; ACCA & Aspinwall, 1997; CICA, 1993a; DTTI, IISD & SustainAbility, 1993; Elkington, 1997; Ernst & Young *et al*., 1999; Gonella, *et al*., 1998; KPMG/WIMM, 1999, 2002; Industrial Society, 1995; RSA, 1996; Sillanpää, 1998; UNEP/Sustainability, 1996a; Wheeler and Sillanpää, 1997)[3]. Essentially, firms are willed to be responsive to stakeholders because by doing so they are predicted to be more successful in conventional business terms (profit, stability, growth, etc.) than those which do not[4]. Such a vision is based on the view that companies which recognise the interests of their stakeholders will provide the foundations to an 'inclusive' society (Zadek, 1998), and that the welfare of all groups of society can be increased by including these groups rather than excluding them (Shaoul, 1998). This 'managerialist rationale' argument is succinctly summarised by Zadek (1995) as follows:

> *... to survive and prosper in society, business needs to know what is happening, what people think about them, and* ***how best to influence those perspectives****. ... this highlights the need for managers to have a broader understanding of stakeholder needs and views, and the patterns of demands on business that are likely to arise in the future* (p.1425, emphasis added).

Importantly, there is no *a priori* reason why the motives underlying this managerialist rationale need to be ethically based. They can be, as in the case of Jones (1995), for example, who seeks to meld ethics and economics in an instrumental model of stakeholder theory, but

it is equally possible to ground instrumental variants of stakeholder theory in traditional economic, amoral accounts given that the underlying premise is the acceptance of the 'business case' (see, for example, Jensen, 2001). Moreover, despite all the rhetoric, the 'enlightened self-interest' argument remains empirically unproven (see, for example, Aupperle *et al*., 1985; Cornell and Shapiro, 1987; Preston and Sapienza, 1990; Ullmann, 1985; Wood and Jones, 1995), persisting merely as an *analytical argument* which has attracted a lot of followers (Donaldson and Preston, 1995)[5]. Hence, even though it lacks supporting empirical evidence, the argument that the welfare of all of society can be increased by an 'inclusive' stakeholder approach may be the result of changing *socio-political* influences such as the renewed debate on CSResp and corporate governance (see, for example, Cadbury 2000; Elkington, 1997, 2001; Freeman and Evan, 1990; OECD, 1999a, b; Tricker, 2000; Witherell, 1999; Zadek *et al*., 1997).

The third research stream identified above uses stakeholder theory as a basis for a *descriptive* model that can be used to explain observed managerial behaviour. The descriptive model, as the name suggests, describes what is perceived to take place in practice based on the notion that "… managers do recognise and respond to the wishes of interested parties" (Maltby 1995, p.84). It is in this context that stakeholder theory is seen as possessing value because of its descriptive accuracy (Donaldson and Preston, 1995). A *purely* descriptive approach to stakeholder theory has led to a new line of empirical research which seeks to establish a relationship between corporate social performance, in terms of a company meeting the demands of multiple stakeholders, and corporate financial performance (see, for example, Ruf *et al*., 2001)[6]. This approach has been particularly common amongst some of the early studies of social and environmental reporting to stakeholders. Such studies, however, suffer from a number of weaknesses (Maltby, 1995). For example, they fail to explore the issues of relative stakeholder importance, stakeholder power and power asymmetries (as in the case of Adams, 1992b) or to address the important question of *why* firms are reporting, or even if reasons are suggested, these are couched in vague terms which lacks any sort of theoretical framework (as in the case of Spencer-Cooke, 1994) by which we might understand the various mechanisms at work. More sophisticated models of descriptive stakeholder theory have been used to describe a number of specific corporate characteristics and behaviours, including the way managers think about managing, and how corporations are actually managed (see, for example, Brenner and Cochran, 1991; Jones, 1994; Mitchell *et al*., 1997; Jawahar and McLaughlin, 2001; Roberts, R., 1992; Ullmann, 1985). In this context, stakeholder theory is seen as 'managerial', going beyond a purely descriptive observation that organizations have stakeholders (which is taken for granted but which carries no direct managerial implications) to assert that stakeholders *influence* the attitudes, perceptions, structures and practices of managers and that management seeks to influence the attitudes and perceptions of the firms stakeholders. It is this particular descriptive model, based on the perceived structure of the relationship between a business and its stakeholders, which forms the subject matter of the present chapter.

The rest of this chapter is structured as follows. Section 6.2 begins with a brief examination of the rise of large-scale organizations, notably the private corporation, in industrial societies, the socio-political analysis of which stimulated a number of developments, notably 'pluralism'. The concepts of pluralism and its more recent variant, 'neo-pluralism' are

explored in more detail in the remainder of Section 6.2. A key aspect of neo-pluralism is that it suggests the main socio-political challenge to managerial capitalism comes from those sections of society whose activities or views are perceived as a threat to a corporation's short-term economic profitability. The implications of this threat are explored in Section 6.3 where a neo-pluralist framework is provided for the study of CSR/CED in the context of the stakeholder theory of the firm. Section 6.4 briefly explores the history of the stakeholder concept from its origins in the 1930s through to present-day practice-based models. One particular model, Freeman's (1983, 1984) 'stakeholder approach to strategic management', forms the basis for the empirical analysis of the present study, and is examined in detail in Section 6.5. Elements of a descriptive model of managerial stakeholder theory to explain and predict management behaviour are analysed and explored in Section 6.6. The application of this model in the specific context of CSR is explored in Section 6.7. Based on this analysis, a set of hypotheses with which to empirically test MST in relation to CED are developed and set out formally in Section 6.8. The final section (Section 6.9) offers some concluding remarks.

6.2 Pluralism and neo-pluralism

The development and growth of Western industrial capitalism in the nineteenth and twentieth centuries had profound implications for many aspects of social life, particularly issues of democracy, class, power and conflict. Such issues are largely ignored by classical and neo-classical economics, but generated considerable discussion amongst some of the early contributors to modern social science, notably Friedrich Engels (1820-1895), Karl Marx (1818-1883), Joseph Schumpeter (1883-1950) and Max Weber (1864-1920). Weber (1946, 1978) refers to the emergence in the nineteenth century of a 'new model of democracy', what Held (1996) calls 'competitive elitism', in which the individual is seen as having been replaced by ever-larger organizations including corporations, trade unions, mass political parties and nation-states[7]. In this context, one of the central questions which Weber addresses is the issue of personal liberties in a world increasingly dominated by such large-scale organizations which impose limited roles on individuals (Held, 1996). Whereas Marx (1867, 1885, 1894/1970) presented conflict in society as essentially class-based between the owners of labour and the owners of capital, Weber (1946, 1978), although recognising that intense class struggles were of considerable importance in explaining many of the features of industrial capitalism, strongly disputed the notion that the analysis of conflict could be reduced to an analysis along class lines (Held, 1996).

Similarly, whereas Marx and Engels saw 'bureaucracy' as the unelected apparatus of the state, Weber regarded it as much more pervasive, characterising all forms of large-scale organization, including the nation-state, industrial enterprises, trade unions, political parties, universities and hospitals. To Weber, all such organizations were essentially *undemocratic* because bureaucrats were not accountable to the demos, creating a structure of super-ordination and sub-ordination sustained by a variety of motives and means of enforcement (Held, 1996). In particular, Weber was concerned that, in the absence of appropriate checks, parliamentary government would fall prey to powerful private interests, particularly organized capitalists, who would not have the public or national interest as their prime concern. In a capitalist economy, i.e. a social system based on the private ownership of the

means of production and distribution, parliamentary government was seen by Weber as vital for democracy because it provides a degree of openness, a forum for debating public policy, and a space for negotiation of entrenched positions, competing ideas and interests. It thus provided "… an essential mechanism for the preservation of the competition of values" (Held 1996, p.169). From this perspective, the rise of large-scale organizations, notably private corporations, was seen by Weber as a threat to democracy because of their ability to erode parliamentary influence in the nation-state. Weber's writings on liberal democracy[8] have had significant influence in sociology and political science, particularly in the Anglo-American world, and stimulated a number of developments, notably the theory of democracy as developed by Schumpeter (1976)[9] and empirical democratic theory, or 'pluralism' which took as its starting point Weberian ideas about the multi-dimensionality of power (Held, 1996)

Political theorists of the eighteenth and nineteenth centuries, such as Rousseau (1755/1913) and de Tocqueville (1835, 1840) argued that democracies, by their very nature, are pluralist, being composed of other, smaller societies or associations each of which has its own interests, goals and maxims. However, 'pluralism', as a political philosophy was developed by English liberals and socialists in the early twentieth century (Abercrombie *et al*., 1994). Proponents of pluralism assert the desirability of power within the nation-state being diffused widely among a variety of associations, including religious, economic, professional, educational and cultural, together with a fragmentation of government into decentralized units, so as to ensure that society is neither dominated by the state nor by any one class. Within modern political science and sociology, *pluralism* as is used here developed from a school of political analysts widely known as 'empirical democratic theorists' or 'pluralists'[10]. Dahl (1982, p.5), for example, defines pluralism (or pluralist) as referring to "… organizational pluralism, that is to the existence of a plurality of relatively autonomous (independent) organizations (subsystems) within the domain of the state". Pluralism in this context refers to political societies (i.e. democracies) in which power is seen as diffused amongst these various organizations. Thus, according to Dahl (1982), a country is a pluralist democracy if it is a democracy in the sense of a polyarchy and important organizations are relatively autonomous. Hence, all democratic countries are pluralist democracies[11].

Early pluralists such as Dahl (1956, 1985, 1989) and Madison (1966) focused on the problems of 'factions' – what are more commonly referred to today as 'interest groups' or 'pressure groups'[12]. In particular, pluralists emphasised the process creating, and resulting from, individuals *combining* their efforts in groups in the competition of power (Held, 1996). Whereas neo-classical economics emphasises a laissez-faire approach to markets, and the sovereignty of the *individual's* utility function (maximising self-interest), pluralism is concerned with groups of individuals who *voluntarily* join forces to maximise their common interests[13]. Pluralists also provide a utilitarian conception of individuals as satisfaction-maximisers acting in competitive exchanges with others in markets and in politics (Elster, 1976). However, a pluralist perspective focuses on the tendency for individuals to form groups rather than to act alone. This focus on the activities of *groups of individuals*, rather than on the activities of individuals as utility maximisers, represents one of the key differences between pluralism and the model of economic behaviour under principal-agent relationships as outlined in Chapter 5. A plurality of relatively independent factions, or interest groups, within a democratic society has come to be seen not only as a natural

consequence of democratisation but also a healthy aspect of democracy. For pluralists, the existence of a diverse range of competitive interests is the basis of democratic equilibrium (Dahl, 1982; Held and Krieger, 1984). Hence, 'pluralism' in political science has come to be seen in terms of idealised forms of liberal democracies in which potentially authoritarian tendencies are kept in check by the free interplay of interest groups that have a stake in government:

> *The pluralist vision is of a society where different interest groups bargain and compete for a share of the balance of power and use their influences to realize Aristotle's ideal of politics: a balance of negotiated order that creates unity out of diversity* (Morgan 1986, p.185).

In a pluralist context, *conflict* may be said to occur when interests of two or more autonomous groups collide because of some real or perceived divergence of interests (Morgan, 1986). The essential hallmark of a pluralist society is the acceptance of the inevitability of conflicts of interest between the various autonomous groups. Since these various groups have different interests, aims and maxims, it is accepted that each group will use its membership to pursue its own ends. In this context, the role of the state is seen as advisory and conciliatory in helping to broker compromised arrangements which allow the various factions to co-habit with one another within the constraints set by the constitutional rules of society as a whole. This reflects the Aristotelian (1981) view of politics as an inevitable feature of society and its constructive role in the creation of social order based on an even, negotiated distribution of power. The pluralists' meaning of *power* in this context is generally interpreted as being a capacity to achieve one's aims in the face of opposition (Held, 1996). Thus Dahl (1956, p.13) describes power as A's capacity to act in such a manner as to control the responses of another (B). From this perspective, A's capacities, are seen as bounded by the resources at A's disposal, and, particularly on the relative balance of resources between A and B. Resources in this context refers not just to economic resources but to a variety of sources of power including education, wealth, health, etc., which are seen as being sources of potential inequalities in society, depending on the extent to which there is fair and equal access to each type of resource. Thus, rather than being seen as a class issue (as contended by Marx), power is depicted in terms of different groups in society having access to different kinds of resources, the influence of any particular 'fraction' or group generally varying from issue to issue according to their access to resources and the importance of such resources in each case. Thus, power, from a pluralist's perspective, is not elitist in structure (as suggested by Schumpeter, 1976) but an:

> *... endless process of bargaining between numerous groups representing different interests, including, for example, business organizations, trade unions, political parties, ethnic groups, students, prison officers, women's collectives and religious groups. These interest groups may be structured around particular economic or cultural 'cleavages', such as social class, religion or ethnicity* (Held 1996, p.202).

The result of this *process* of bargaining between the different interest groups within a society is said to be a series of compromises, trade-offs and appeasements by decision-makers in response to the demands of relatively small groups. Importantly, 'classical' pluralism does not present a single, powerful decision-making body at the hub of these compromises as

portrayed by agency theorists (e.g. Alchian and Demsetz, 1972; Jensen and Meckling, 1976) under the 'nexus of contracts' umbrella. Rather, since power is essentially dispersed throughout society, and since there are numerous pressure points (i.e. points of potential conflict), a variety of competing, policy-formulating and decision-making centres are said to emerge (Held, p.203).

Table 6.1
Alternative views on the socio-economic structure of society

Aspect/Structure	Unitary	Classical pluralist	Neo-pluralist	Classical Marxism
Paradigm	Functionalist	Functionalist	Interpretive	Radical structuralist
Group interests	Emphasis on common objectives and the sovereignty of the nation-state	Emphasis on political liberty, diversity of groups and group interests to prevent the emergence of excessively powerful factions	Recognition of multiple pressure groups with a divergent range of interests but political agenda seen as biased towards corporate power	Emphasis on structural, class conflict. Society a battleground where rival forces seek to achieve largely incompatible ends
Power	The issue of power is largely ignored, common interests being achieved through the sovereign rule of the state which exercises leadership and control	Power shared and bartered by numerous groups with no one group having absolute power, such that each interest group is itself a power base. Value consensus and dispersion of resource base amongst the population ensures political stability (equilibrium)	Power seen as contested by numerous groups, but poor resource base prevents many groups from participating fully in the political process. An uneven distribution of socio-economic power leads to domination by powerful multi-national economic interests	Power also a key aspect, but seen as unevenly distributed along class lines, reflecting the wider inequalities in society as a whole (e.g. economic wealth, education, the legal system, etc.)
Conflict	Conflict seen as a rare and transient phenomenon, but easily dealt with through appropriate action to root out 'troublemakers'	Conflict viewed as both inevitable and necessary for vibrant, healthy democracy. The state mediates and adjudicates competing demands within the constraints of constitutional rules	Conflict seen as embedded within a diverse political culture and system of radically unequal economic resources. The state and its departments forge their own sectional interests	Conflict seen as structurally inevitable, part of a wider class struggle suppressed and maintained by a ruling elite

Source: Based on Burrell and Morgan (1979), Morgan (1986), Held (1996)

A steady-state of equilibrium or stability is thus seen as existing because of what Truman (1951) refers to as a 'protean complex of criss-crossing relationships' that change in strength and direction, the very diversity and overlapping of interests in society acting as a barrier against the emergence of a dominant elite. This 'classical' pluralistic view of the process of mediation results in what Dahl (1956) describes as a relatively efficient system for reinforcing agreement, encouraging moderation and maintaining social peace. This view of society may be distinguished from other, alternative frames of reference such as the 'unitary', 'neo-pluralist' and 'radical' viewpoints (Table 6.1 above). A unitary (functionalist) view of modern society is seen by classical pluralism as somewhat naive in its depiction of an integrated, non-competitive whole, the various elements of which are synchronised in such a way that the interests of the individual and those of the whole are assumed to be synonymous. Conversely, classical pluralism, whilst also functionalist, served a useful purpose as a descriptive theory in highlighting aspects of politics – interaction, competition, power and conflict – which are embedded within the business organization and administration of the modern nation-state.

The adequacy of the classical pluralist view, particularly in relation to its depiction of power, was challenged by a number of critiques (for example, Burrell and Morgan, 1979; Clegg, 1979; Giddens, 1979). Although power is sometimes seen as a resource which one possesses (e.g. economic power), social and political scientists tend to perceive power as a social relation characterized by some form of dependency, i.e. as an influence or control over something or someone (Morgan, 1986). The pluralist view of power draws on the work of writers such as Dahl (1957, 1982), Emerson (1962) and Lasswell (1936). Dahl (1982), for example, asserts that to be autonomous is, in a political sense, not to be under the control of another. In other words, from a pluralist perspective, power involves the ability to persuade or coerce someone to do something which they would not otherwise have done (Dahl, 1957). Classical pluralism was charged with failing to systematically evaluate this aspect of 'realism' in the context of normative models of democracy (Held, 1996). Events in the 1960s and 1970s, such as the anti-Vietnam war movement, the left-wing student movement, and many other political groups associated with 'the New Left', altered the political landscape of many Western democracies to such an extent that, to some, classical pluralism became almost an anachronism[14]:

> *The new movements seemed to define themselves against almost everything that the traditional political system defended. They defined the systems as rigid, regimented, authoritarian and empty of moral, spiritual and personal content. ... it is not easy to exaggerate the extent to which [these movements] shattered the premises of classical pluralism* (Held 1996, p.212).

Since the 1960s, one of the 'new movements', the advocacy movement, has succeeded in calling society's attention to a number of social and environmental issues, notably product safety, environmental protection, employment discrimination and occupational health and safety (Heard and Bolce, 1981). The failure of classical pluralism to adequately characterise Western politics following the events of the 1960s and 1970s can be traced, partly at least, to its concept of power and power relations. Bachrach and Baratz (1962), in a seminal critique of the classical pluralist concept of power, agreed with Dahl's (1957) conception of power, i.e. that one party (A) has power over another party (B) when A participates in the making of

decisions which affect B. However, Bachrach and Baratz argued that power is also exercised when A uses his/her energies to create or reinforce social and political values and institutional practices which *prevent* a discussion of policy conflicts or *limit* such discussions to only those issues which are relatively innocuous to A. By so doing, A is said to effectively control B's behaviour by participating in a *non-decision-making process* which restricts debate to issues that are not seriously detrimental to A's set of preferences. The significance of Bachrach and Baratz's analysis is their depiction of how power can be used not only to make things happen but also to make things *not* happen. However, even this concept of power is relatively simple. Others, such as Lukes (1974), suggest that the bias of a system in favour of certain sections of society is not simply maintained by the action or non-actions of individuals but also, most importantly, by the socially-constructed and culturally-patterned behaviour of groups and practices of institutions. These collective forces were seen as being absent from the classical pluralist's analysis of power:

> *[C]lassical pluralists failed to begin to grasp those asymmetries of power – between classes, races, men and women, politicians and ordinary citizens – which were behind, in large part, the decay of what they called 'consensus politics'* (Held 1996, p.213).

It is the existence of these *power asymmetries*, which became more obvious following the challenges to consensus, unitary politics in the 1960s and 1970s, that precipitated a re-evaluation of classical pluralism as a realistic representation of modern democracies[15]. Such power asymmetries, reflecting the uneven distribution of power within a society, clearly have important implications for any form of social analysis, including economics and accounting, and which classical pluralists failed to pursue sufficiently (Held, 1996). For example, critics of classical pluralism argue that just because a power centre or lobby group exists does not mean that it has an influential voice in the political process. Rather, what counts is *relative power*, with governments being susceptible to most influence from those who wield the greatest amount of power relative to others. By the same token, those with relatively least resources to engage in lobbying are seen as marginalized, whilst powerful lobby groups and big business define, manage and control the agendas of governments and nation-states.

As classical pluralism appeared to segment into a series of competing schools in the late 1970s and early 1980s, developments in both Marxist and pluralist theory led to the emergence of what we now call 'neo-pluralism' (see, for example, Dahl, 1978, 1985, 1989; Lindblom, 1977; McLennan, 1984, 1995). Neo-pluralism is a form of pluralism which pays special attention to the threat to equality and liberty posed by 'economic liberalism', or what Dahl (1985, p.50) refers to as the "… liberty to accumulate unlimited economic resources and to organize economic activity into hierarchical governed enterprises". Dahl (1985) was particularly concerned with how the modern system of ownership and control of organizations, given the latter's government-sanctioned responsibility for creating economic wealth, *contributed* to, rather than alleviated, inequality in society. As noted in Chapter 5, neo-classical economics is relatively silent on the issue of power, adopting a unitary view on the socio-economic structure of society (Table 6.1). Dahl (1985), however, argues that the capitalist system of ownership and control of the means of production within an economy is deeply implicated in the creation and perpetuation of a variety of forms of inequality – income, status, skills, information, control over information and propaganda, access to the

political elite, and predictable life chances for the unborn and infants – inequalities which reduce the capacities and opportunities for citizens to participate as political equals in governing the nation-state. Thus, from a neo-pluralist viewpoint, economic power is not assumed to be located within a single individual or group (for example, the state, capital, or a ruling elite), nor evenly distributed within society as a whole (see Table 6.1)[16]. However, the neo-pluralists' analysis of power goes beyond the implications of *economic inequalities*. Fundamentally, neo-pluralists argue that, as with many Marxists, violations of the political and democratic processes under systems of liberal economic democracy extend to a point at which elected governments are constrained by the requirements of private property accumulation from acting in ways that interest groups may desire (Dahl, 1985; Lindblom, 1977)[17]. In other words, the demands of the social system based on free market enterprise within a liberal economic framework which encourages private investment, property rights and private property, and which fosters private enterprise, economic growth and the accumulation of money wealth, creates a context in which governments are *forced* to pursue goals consistent with that system:

> *In order to remain in power in a liberal democratic electoral system, governments, must ... take action to secure the profitability and prosperity of the private sector: they are dependent upon the process of capital accumulation which they have for their own sake to maintain* (Held 1996, p.215).

From this perspective, it is the *managerial capitalists* running the large transnational corporations, not the elected representatives of the demos, who are in fact given control over jobs, prices, production and growth, as well as the long-term economic security of a country's citizens (see, for example, Korten, 1995, 1999). A major function of government in this context is thus to create the right conditions under which the system of private enterprise flourishes. As a result, democracy is seen by neo-pluralists as being embedded in a socio-economic system that systematically grants a privileged position to the interests of 'big business' (Held, 1996). In effect, the demos is seen as having surrendered both the democratic right to self-determination (and thus self-government) and the right to productive property in the work place in return for a system which promises economic security, higher wages and a higher standard of living. Moreover, unlike neo-classical economists such as Berle and Means (1932) who worried about the economic risk implications of a separation of ownership from control (see Chapter 5), neo-pluralists perceive no such separation. For them, the ownership *and* control of firms is vested in the hands of a politically-privileged group of society – professional managers, venture capitalists and the managers of investment funds held by banks, insurance companies and other financial institutions[18]. Thus, the neo-pluralist perspective suggests that interest groups should not be perceived as necessarily equal and that the state should not be perceived as a neutral arbiter in addressing conflicts of interests between these various interest groups (Dahl, 1985, 1989; Lindblom, 1977). Rather, it is the *business organization* which has a privileged position, wielding a disproportionate influence over the state and thus over the nature of the democratic process (Held, 1996). Thus, neo-pluralism differs from classic pluralism in a number of ways (see Table 6.1 above):

- the state is portrayed as an active influencing agent, rather than a passive intermediary;

- the struggle for power is seen as contested terrain between the various factions within society, rather than a meeting place where power is shared or exchanged in a civil, courteous manner; and,
- multinational corporations and nation-states are seen as occupying powerful positions due to the uneven distribution of socio-economic resources.

As a result, whereas classical pluralism is structured around a perception that the social world is essentially harmonious moving 'naturally' towards a steady-state of equilibrium, neo-pluralism perceives society as being in a continual state of flux, with the uneven distribution of socio-economic power generating a constantly-changing set of opportunities for and limits to political options such that no equilibrium or steady-state is achievable. Thus, neo-pluralists, in deference to conflict theory, are much more willing to explore issues of power and the political struggles that take place within a society, such struggles seen as essentially problematic (see, for example, in the context of corporate reporting, Ogan and Ziebart, 1991). Rival, alternative theoretical perspectives, particularly the neo-Marxism perspective, have extended the neo-pluralists' critique of classical pluralism (see for example, Miliband, 1969; Offe, 1984; Poulantzas, 1972)[19]. The classical Marxist view (see Table 6.1 above) sees society as being comprised of antagonistic interests which are structurally divided along *class lines*, "… characterized by deep-rooted social and political cleavages, and held together as much as by coercion as by consent" (Morgan 1986, p.186). This view of society, which has been strongly influenced by the work of Marx and Engels and Marxism, is radical because of the attendant belief that the interests of suppressed groups (typically labour and women) can be advanced significantly only by *radical* changes (revolution) in the structure of society which lead to the removal of those currently in power. Neo-Marxists such as Offe (1984) provide an alternative perspective of the relationship between the state and class power which is, nevertheless, closer to the neo-pluralist view, arguing that the state is itself enmeshed in the contradictions of capitalism, particularly the fact that the state receives part of its revenues from taxation of private property which is used by private corporations in gainful production to generate profits. Consequently, the state has a vested interest in sustaining such profitable production. Neo-pluralists, such as Dahl (1971, 1978 and McLennan (1984), do not place such a strong emphasis on class as the central structural (and thus structuralist) determinant of democracy but rather retain Weber's depiction of conflict as cutting across the class divide as well as along it. As such, conflict is seen by neo-pluralists as split not only along class lines but also *within* each class, with each class being made up of individuals and groups which contest a number of different issues other than those which relate to the class struggle.

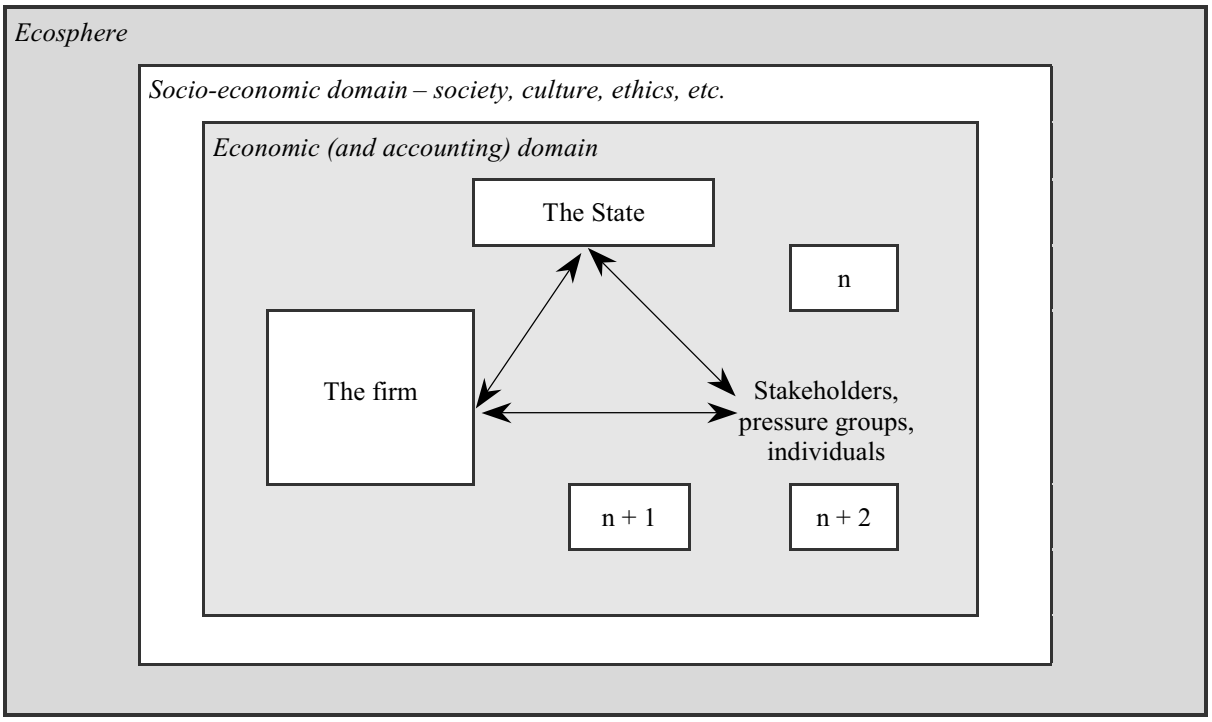
The significance of the analysis of power as provided by neo-pluralists such as Lindblom (1977), for example, in the context of modern, global corporations, is that, far from being fearful of political costs (as suggested by Watts and Zimmerman, 1978, 1986, 1990), the public policy options available to the political sector to control the activities of businesses are severely constrained by the demands of the social system itself. A key implication of this perspective is that it suggests the threat to managerial capitalism comes not from the political sector's response to demands from sections of society, since the political sector is largely impotent, but *directly* from those sections of society whose activities or views are perceived

as a threat to a corporation's long-term survival. The implications of this are explored in the next section in the specific context of CSR.

6.3 The study of CSR within a neo-pluralist visualisation of society

Within accounting, there has been growing interest since the early 1970s in exploring issues of conflict and power and the political struggles both within organizations (see, for example, Benston, 1975; Burwoy, 1979; Lindblom, 1977; Marglin, 1974) and between organizations and interest groups (see, for example, Heydebrand, 1977; Larson, 1977). Significantly, these studies do not assume organizations to be collectives within which potential conflicts of interest are either assumed away or settled through 'efficient contracting' arrangements or external markets, as is suggested by proponents of the *Rochester School brand of agency theory* (see Chapter 5). Rather, the organization is seen as the potential repository of deep conflicts which mirror wider, societal contradictions and crises (Burrell, 1981; Clegg, 1981). Despite the fact that mainstream accounting research has largely ignored these developments, they are seen to offer new insights into the power effects of accounting within organizations and society (Chua, 1986). Neo-pluralism, in the context of the description provided above, provides a potentially useful heuristic for exploring corporate behaviour to both accounting scholars generally and CSR researchers in particular. Figure 6.1 below summarises, diagrammatically, the main elements of the neo-pluralist visualisation of society (Gray *et al*., 1996).

Figure 6.1
A neo-pluralist view of the wider society



Source: Gray et al. (1996) (as adapted)

Figure 6.1 illustrates the relationship between the 'economic (and accounting) domain', which formed the basis for the analysis of the *Rochester School brand of agency theory* in the

previous chapter, and the wider 'socio-economic domain', which provides the structure of analysis in this chapter. Essentially, 'the economic' is seen as a sub-part of 'the socio-economic', with society, its values, norms, culture and ethics determining, to a considerable degree, the structure and acceptable modes of behaviour (Gray *et al*., 1996). Widening the field of vision even further, the socio-economic domain is itself depicted as a sub-system of the ecosphere, the latter depicted as the 'holistic whole' within which all forms of social interaction take place. Although most Western societies tend to depict the socio-economic as being separate and distinct from the natural environment, Figure 6.1 conveys a post-modernistic view of the world, highlighting both the interdependency of these various aspects of reality and of humankind's ultimate dependency on the natural world for survival[20]. Ecosphere, in the sense being used here refers to the sphere of living organisms comprising parts of the atmosphere, the hydrosphere, i.e. oceans, inland waters, and subterranean water, and the lithosphere, i.e. the crust enclosing the kernel of the Earth (Gilpin, 1996).

These different layers of the planet, both biotic and aquatic, and their attendant life-forms, are seen as components of an integral complex of interdependent systems, the true nature, purpose and functioning of which remains largely beyond human comprehension (see, for example, Lovelock, 1982, 2001, 2002). From this perspective, an organization's operating environments are seen as inseparable from the non-human world and the notion that human environments – be they political, economic, social or cultural – can be separated from elements of the non-human, natural environment is seen as nonsensical since such a world does not in fact exist (see, for example, Starik, 1995). This perspective is perfectly consistent with one of the central arguments of the neo-pluralistic approach to the study of CSR, namely that an understanding of real-world phenomena cannot be performed properly without also incorporating an understanding of the social, political and other aspects of the whole:

> *[N]o particular framework can be thought of as immutably 'right' as all categories of systems are artificial and all frames of reference are conditional upon some set of underlying faith – whether about deities, the purpose of the human species or about the functioning of markets. Any delineation of systems, and in our particular case, the attempt to restrict accounting to the conventional economic, is* ***bound*** *to be artificial. At a minimum there must be interactions between the systems – between the economic (and thus accounting) and the social, the political, the ethical, the environmental, etc. We cannot begin to understand the one (the economic, the accounting) without understanding others (e.g. social, environmental, political)* (Gray *et al*. 1996 p.27, original emphasis).

Within these various sub-systems of the ecosphere are situated the various organizations and individuals which represent the dominant players in the economic domain – public and private sector companies, the nation-state, and the various interest groups, pressure groups and individuals – which make up a neo-pluralist visualisation of society. Traditionally, as was shown in the previous chapter, economics and accounting restrict themselves to an examination of the relationships between a narrow sub-set of society, focusing mainly on companies (i.e. management) and a very restricted set of interest groups (shareholders and bondholders). As a result, the subsequent analysis is almost devoid of any consideration of society, values, morals, ethics, culture and the natural environment, such issues being

effectively assumed away under the guise of economic efficiency. Whereas those such as Friedman (1962, 1970) are of the opinion that such wider systems are best served by a focus on economic efficiency, it is the more complex and thus richer model of the world provided by the neo-pluralist perspective which is used to explore CED in this and the following chapter as part of the flows of information which "… reflect and construct the society of which they are a part" (Gray *et al*. 1996, p.34). In recent years, this neo-pluralist perspective has become popular amongst a number of social accounting researchers (see, for example, Bebbington and Gray, 1996; Gray, 1992, 1994a, 1998; Gray *et al*., 1987, 1995d, 1996; Maunders and Burritt, 1991; Owen, 1990). Importantly, this perspective has opened the door to a number of social and political theories, unashamedly 'borrowed' from other branches of social science, which offer CSR researchers new theoretical perspectives as to the possible nature and causes of CSR (see, for example, Gray *et al*., 1988, 1991, 1995b; Guthrie and Parker, 1989, 1990; Patten, 1992; Roberts, R., 1992; Ullmann, 1985). It is these theories – notably stakeholder theory, legitimacy theory and the perspective offered by political economy theory – which are seen as having provided the more insightful and penetrating analyses of CSR in recent years (Gray *et al*., 1995b). Such research tends to be informed by a heavily modified conception of liberal economic democracy, what Gray *et al.* (1996, p.24) refer to as "… neo-pluralism and participative democracy …", drawn from writers on modern liberal economic democracy such as Held (1996) and Macpherson (1977) and the rich theoretical heritage provided by 'classical' political economy'[29].

Under neo-pluralism, the presence of an uneven distribution of power between the various factions within a society implies that different forms of accounting – including CSR and CED – are likely to emerge, their different forms depending on the relative power bases and degrees of influence of these factions. Moreover, power relationships may also be seen as a means whereby issues, moral or otherwise, can be silenced or kept 'hidden' from the demos such that there is no resulting 'account' of those issues (Yuthas and Dillard, 1998). To the extent that one views power asymmetries within society as undemocratic, accounting will itself be undemocratic, forming part of the means by which an undemocratic state of affairs is maintained. In that context, a change in the forms of accounting which enter the economic, and thus the wider socio-economic, domain, may themselves be a signal of a more fundamental change in society, one in which accounting is used to reinforce existing power asymmetries or, alternatively, one which reflects a shift in the relative, underlying distributions of power within society:

> *Thus if some information on polluting discharges to water (for instance) is provided to society by companies there may have been a shift in the relative power of these two groups which brought about this and that switch in the levels of information asymmetry may reinforce that change.* ***That is, information is never neutral*** (Gray *et al*. 1996, p.34, emphasis added).

Critical accounting researchers, such as Puxty (1986, 1991) and Tinker *et al*. (1991), however, have argued that because most academic exploration of social accounting theory and practice is embedded in a liberal economic framework, such exploration is limited to preserving, and thus by default, legitimising, the status quo in supplying the 'market for excuses'. In other words, instead of achieving any real change of substance, it actually prevents it (Gray *et al*., 1996)[22]. Such criticism is informed, primarily, by a 'classical' (as

opposed to 'bourgeois') political economy view of the structure of modern western societies. Classical (i.e. Marxian) political economy is instructive in this context because of the emphasis which it places on power and the relationship between the production, distribution and consumption of wealth in human society and the role of the state. In essence, what classical political economy (in the sense being used here) attempts to tease out is the human aspects, in social, political and institutional terms, which are missing from a purely economic approach, such as that provided by Jensen and Meckling's (1976) theory of agency costs, but which are seen as an integral part of the system within which 'the economic' takes place. Thus, in the context of CSR and CED, classical political economy holds that 'the economic' is only one element of organizational life, and, as such, needs to be supplemented by, and interwoven with, a recognition of the social and political aspects of human society (Gray *et al*., 1995b). As noted in the previous (necessarily limited) discussion of the Marxian perspective of power and conflict (see Table 6.1 above and Chapter 4, Figure 4.1), 'classical' political economy places sectional (i.e. class) interests, power asymmetries, structural conflicts and the role of the state at the epicentre of any analysis of the production, distribution and consumption of wealth in human society. Thus, a key argument from a Marxian perspective is that any understanding of the conflicts between group interests requires an analysis and understanding of the *structural* and *institutionalised* power asymmetries and inequalities which are seen as the root cause of these conflicts. However, bourgeois political economy largely ignores these root causes, being content to perceive the world as essentially neo-pluralist (Gray *et al*., 1995b)[23]. Thus, in comparison to the Marxian perspective, the bourgeois 'lens' of political economy has a higher level of resolution but a narrow field of vision, focusing on the *relationships* between interests groups based on a neo-pluralist vision of society, ignoring the powerful socio-economic, political and institutional *processes*, by which structural conflict is 'mediated, modified and transformed' and which foster, shape and give form to those self interests as group (i.e. factional) interests (Tinker, 1984b).

It is at this point in the present study's analysis of neo-pluralism that the exploratory path opened up by Gray *et al*. (1995b) may, tentatively, be joined in attempting to draw a distinction between managerial stakeholder theory (MST) and organizational legitimacy theory (OLT)[24]. Essentially, this requires staying with a neo-pluralist view of interest groups, power and conflict and the way in which such conflict is 'resolved', whilst at the same time recognising the fact that both theories are concerned with, and thus attempt to make more visible, how corporate social and environmental disclosure is used by management to mediate, modify and transform the business organization's relationship with society (see Table 4.3, Chapter 4), although from *different points of view* (Gray *et al*., 1995b)[25]. These different points of view are brought out in this and the subsequent chapter which explore MST and OLT, respectively, in the context of CSR. From within a neo-pluralist 'visualisation of society', power asymmetries are seen as a source of conflict between the various factions within society, with information playing a key role, both in terms of who controls its distribution and access to it, and in its use as a means of 'mediating, modifying and transforming' such conflict. Thus, CSR (and accounting in general) constitutes a potential source of power to the business organization in terms of the organization's ability to use CSR in managing stakeholders (MST) or to maintain or regain the status of legitimacy (OLT). The rest of this chapter explores MST in the context of the theoretical framework outlined above,

beginning with a discussion of the stakeholder concept. The same framework, but from a different point of view, is used to explore OLT in Chapter 7.

6.4 The 'stakeholder' concept of the firm

The 'stakeholder' concept of the firm is one of the essential elements of MST, the basic premise being that a business organization has *relationships* with many constituent groups ('stakeholders groups') that affect and are affected by its decisions (Freeman, 1984). The precise origins of the term 'stakeholder' are difficult to pin down. Freeman (1984) traces its origins back to Ansoff (1965) who himself makes references to Abrams (1954) and Cyert and March (1963). Others, such as Mason and Mitroff (1982), attribute the term to Rhenman (1968). However, according to general consensus (see, for example, Freeman, 1984; Hummels, 1998; Slinger, 1999), the term *stakeholder* was first used in 1963 in an internal memorandum at the Stanford Research Institute's (SRI) Long Range Planning Service, where it was being used by various individuals, including Marion Doscher, Ansoff and Rhenman working at SRI and at the planning department of Lockheed Inc. (USA) at that time. However, Preston and Sapienza (1990), trace the origins of the stakeholder *approach*, though perhaps not the use of the term itself, as far back as the 1930s when the US firm General Electric Company identified four stakeholder groups (i.e. shareholders, employees, customers and the general public). In contrast, Sillanpää (1998) traces the business case for 'stakeholder inclusion' back to the more sensitive management theories, notably the Hawthorne Studies of Mayo (1933). Whatever its origins, post-1963 the stakeholder concept started to appear far more frequently in the research literature of several different fields, including corporate planning (e.g. Ackoff, 1970, 1974; Ansoff, 1965), systems theory (e.g. Churchman, 1968, 1971; Marris and Mueller, 1980), corporate social responsibility (e.g. Dierkes and Preston, 1977; Dill, 1975) and organization theory (e.g. Rhenman, 1968). Ansoff (1965), for example, in his seminal book, *Corporate Strategy*, argued that one of the major *responsibilities* of the management of a business organization is to acquire the ability to balance the conflicting demands of the organization's various stakeholders. However, Ansoff (1965) did not favour the idea that responsibilities equated with *objectives*, and thus rejected a normative *stakeholder theory* which derived the objectives of the firm through some form of compromise amongst the conflicting claims of managers, workers, stockholders, suppliers and vendors. Rather, Ansoff (1965) favoured an approach which separated the firm's objectives into 'economic' and 'social', the latter being seen as merely a *secondary* modifying and constraining influence on the former.

In this respect, Ansoff was no different from mainstream neo-classical thinking at that time which focused on the 'dominant coalition' view of organizations which privileges the economic interests of the firm above the social interests of the wider society. This prescriptive, instrumentalist orientation was already being generally referred to in Europe as the 'stakeholder' concept, within which the role of management was essentially seen as that of *mediation* among the various stakeholder constituencies (CBI, 1973; Dierkes and Preston, 1977). The Confederation of British Industry's (CBI) (1973) report, *The responsibilities of the British Public Company*, for example, argued that companies should be encouraged to recognise duties and obligations that arise from a company's relationship with its creditors, suppliers, customers, employees and society at large, striking a balance between the interests

of such groups and the interests of the shareholders. Shortly thereafter, *The Corporate Report* (ASSC, 1975) (see Chapter 2) attempted to kick-start a major review of the users, purposes and methods of financial reporting by UK companies (Birkin and Woodward, 1997). In particular, *The Corporate Report* noted that top management of large, publicly listed companies no longer regarded the primary objectives of business enterprises as being the maximisation of shareholders' profit. Rather, the majority view, based on the study group's own survey amongst the chairpersons of 300 of the largest UK listed companies, was that the primary objective was to make a profit for the benefit of a number of groups and that "… this could only be achieved if due attention was paid to the particular interests of each of these groups" (ASSC 1975 p.38)[26]. *The Corporate Report* was significant at the time because of its recognition of a broad range of users of corporate reports. Notably, the study group took a strongly normative position in arguing that companies "… whose size or format renders it significant …" (ASSC 1975 p.18) have an implicit responsibility to report publicly, whether or not required to do so by law or regulation.

'Significant' in this context was defined as applying to an organization which "… commands human or material resources on such a scale that the results of its activities have significant economic implications for the community as a whole …" (ASSC 1975 p.15), with all listed companies being considered 'significant'. This responsibility to report was argued to go beyond those who possess special authority (e.g. managerial, proprietoral or statutory), extending to a "… larger class of general users to whom a responsibility to report is owed and who are not in a privileged position to enforce special demands" (*op cit*., p.9). This extended *normative* model of corporate social responsibility led the ASSC study group to identify the users of corporate reports as being "… those having a reasonable right to information concerning the reporting entity …", (*op cit*., p.17) such reasonable rights existing "… where the activities of an organization impinge or may impinge on the interest of a user group" (*op cit*., p.17). On this basis, the study group identified seven 'user groups', i.e. equity investors, loan creditors, employees, analysts/advisers, business contacts (including suppliers and customers), government, and 'the public' the latter being defined as "… including taxpayers, ratepayers, consumers and other community and special interest groups such as political parties, consumer and environmental protection societies and regional pressure groups" (*op cit*., p.17). Thus, in a somewhat unexpected development, the UK accountancy profession argued that economic entities have responsibilities to a wide variety of interest groups, extending the social responsibility and related accountability of business organizations well beyond the traditional principal-agent stewardship relationship[27].

Although the term 'stakeholders' was not used in the *Corporate Report* it seems reasonable to argue that the concept was clearly in the minds of the members of the study group at that time. However, the study group recognized the practical problems in preserving a balance between the needs and interests of the different user groups, particularly where the needs of one user group conflict with the interests of other interest groups. *The Corporate Report* appears to imply that, since management has final responsibility for the production and publication of corporate reports, such conflicts will (and thus, can) be resolved by management in seeking to "… preserve a balance" (ASSC 1975 p.18). At the same time, within the CSResp literature other normative theories started to emerge concerning the organization-society relationship and corporate responsibilities to society (see, for example,

Davis, 1973; Dierkes and Antal, 1986; Dill, 1975; Steiner, 1972). Such theories argued that although the business organization is, fundamentally, an economic institution, larger firms exert significant influence in society and have wider responsibilities to use some of their resources in altruistic ways to meet social goals (Roberts, R., 1992). Dill (1975) went further, suggesting that the *active participation* of non-traditional stakeholders should be incorporated more strategically within the corporate management process. These ideas were later taken up by others in the 1980s, notably by Freeman (1983, 1984) to develop a model of strategic management (see Section 6.5 below). In the 1990s, an upsurge of interest in corporate environmental reporting led to a number normative developments in stakeholder thinking in relation to environmental reporting (see, for example, CICA, 1993a; Van Dalen, 1997; Woodward, 1999). The work of the SustainAbility/ UNEP (1996a, b, 1997, 1998) *Engaging Stakeholders* partnership, in particular, led to more widespread recognition of stakeholder groups. In the specific context of environmental issues, the report of the *Environment Research Group* of the Institute of Chartered Accountants in England and Wales (Macve and Carey, 1992) was significant in its claim that the management of business are responsible not just to their shareholders and investors but also have duties of stewardship which extend to a wide range of stakeholders, including employees, creditors, consumers, the government and wider community. In what Macve and Carey describe as a "… middle view, reflecting what is in companies' enlightened self-interest …" (*op* cit., p.12), the report's authors argue that companies "… will be wise to ensure that appropriate information is provided to all those groups – whether they are groups with which it has direct contact, or in society generally – which are in a position to take action, in the light of their perception of a company's environmental performance, that may directly or indirectly affect the company's present or future position" (*op cit*., p.12).

Business organizations too began to take a more inclusive approach to stakeholders. One of the leading examples in this context is the annual *Partnership Report* by the Co-operative Bank plc (1997, 2001), a UK retail-banking group. In its 1997 partnership report, (Co-operative Bank, 1997), the company identified seven 'partners' (i.e. shareholders; customers; staff and their families; suppliers; local communities; national and international society; and, past and future generations of 'co-operators') as part of what it saw as a radical departure in attempting to define "… a new model for managing a successful business in the 1990s and beyond" (p.1) and which included a commitment of social, ethical and environmental responsibility. At the present time (2003), the number of stakeholder groups being explicitly recognised by companies as part of the renewed interest in CSResp and corporate governance includes more and more elements of society – extending to the state, local and regional authorities, industry associations, neighbours and local communities, non-governmental organizations (NGOs), the media, science and education, the general public, future generations (i.e. the un-born), other life-forms and the bio-sphere[28]. Consequently, two of the distinguishing features of the stakeholder theory of the firm in general are: (i) its explicitly systems-based view of the organization and its environment; and, (ii) the consequent recognition of the dynamic and complex set of interrelationships between these various elements of a pluralist society (Gray *et al*., 1996). These two issues are explored more fully in the next section.

6.5 A stakeholder approach to strategic management

Freeman's (1983, 1984) 'stakeholder approach' to strategic management was explicitly normative, his underlying goal being to use an emerging concept to change and enrich the way in which business managers thought about organizations in the context of the business organization–society relationship. The importance of Freeman's seminal work in the present context is that it provided a rational, instrumentalist argument as to the basis of the kinds of responsibilities that corporations had to stakeholders and which became widely accepted in managerial circles (see, for example, Shankman, 1999). Up until that time, management theorists were struggling with such questions as to how to recognise such interests and, indeed, whether such interests should be recognised. Freeman (1984) argued, from a predominantly North American perspective, that traditional approaches to understanding the business environment in the 1980s had become anachronistic in failing to give sufficient consideration to a wide, emerging range of groups who are able to affect, or be affected by, the corporation:

> *Local, national and global issues and groups are having far-reaching impacts on organizations. Gone are the "good old days" of worrying only about taking products and services to market, and gone is the usefulness of management theories which concentrate on efficiency and effectiveness within this product-market framework* (p.4)[29].

According to Freeman (1984), traditional approaches to the management of the organization–society relationship in Western liberal economic societies privilege those constituents in a society that are either the principal source of finance or linked directly to the organization's products and markets. Drawing on the work of other scholars in the area of strategic management (see, for example, Carroll, 1981; Glueck, 1980), Freeman argues that this predominant view is inappropriate for a modern corporation which seeks to manage its environment *systematically* and in a positive *proactive* fashion. Easton's (1965) socio-political analysis of the business corporation, for example, depicts the firm as being subjected to a variety of competing demands and supports (inputs) from its 'constituencies' located within the socio-political environment, as well as regular inputs from the markets in which it operates. In attempting to recognise these constituencies more fully, the business organization is not viewed as a simple resource-conversion 'black box' (as in the neo-classical tradition – see Chapter 5) but as a social institution subject to internal and external 'turbulence'[30]. Freeman argues external turbulence is due to the emergence of new groups in society, such as pressure groups, who have come to have a stake in the actions or inactions of the corporation. The 'black box' view of the firm is thus seen by Freeman as no longer relevant to the modern corporation, the major issue facing contemporary business organizations being how to manage in a pluralist world where there are multiple influences from various external factions, including consumer groups, environmentalists, the media and special interest groups. Importantly, Freeman asserts that it is the way in which such factions have changed in the latter part of the twentieth century in the context of the organization-society relationship which matters. These changes are seen as requiring a fundamental shift in how management views the organization-society relationship:

> *Just as the separation of the owner-manager-employee required a rethinking of the concept of control and private property as analysed by Berle and Means*

> *(1932), so does the emergence of numerous stakeholder groups and new strategic issues require a rethinking of our traditional picture of the firm. ... The changes, both internal and external, that have taken place yield a need for a radical rethinking of our model of the firm* (Freeman 1984, p.24).

Freeman (1984) suggested that one solution to the practical problem facing management in operating in a pluralist environment is to throw away the product-market/principal-agent lens with which to view the firm and replace it with a lens which effectively redraws the socio-economic landscape by explicitly recognising the influence and importance of numerous interest groups. In other words, rather than isolating 'social issues' from their economic impact and, conversely, isolating 'economic issues' from their social impact, Freeman argued for a more inclusive *socio-economic* model of the firm. In formulating his ideas, Freeman was particularly influenced by the work of organization theorists (notably, Aldrich and Whetton, 1981; Evan, 1966; Katz and Khan, 1966; Pfeffer and Salancik, 1978; Rhenman, 1968; Thompson, 1967) who sought not only to understand the social and psychological aspects of the organization–environment relationship but also developed an 'open-systems' approach to the study of organizations which focused on defining the organization relative to the larger system of which it is a part (see Figure 6.1 above). Thompson's (1967) work in particular is important because of his notion that an organization operates in an environment populated by groups which can *make a difference* to that organization. Freeman's (1984) managerial stakeholder theory is a development of this notion, his argument being that, from a strategic management perspective, managers *should* be concerned with the management of the relationships of those groups which 'make a difference'. Significantly, Freeman (1984) argued that groups which can make a difference should for that reason be seen as having a stake in the organization:

> *By using "stakeholder", managers and theorists alike will come to see these groups as having a "stake". "Stakeholder" connotes "legitimacy", and while managers may not think that certain groups are "legitimate" in the sense that their demands on the firm are inappropriate, they had better give "legitimacy" to those groups in terms of their ability to affect the direction of the firm. Hence, "legitimacy" can be understood in a managerial sense implying that it is "legitimate to spend time and resources" on stakeholders, regardless of the appropriateness of their demands* (p.45).

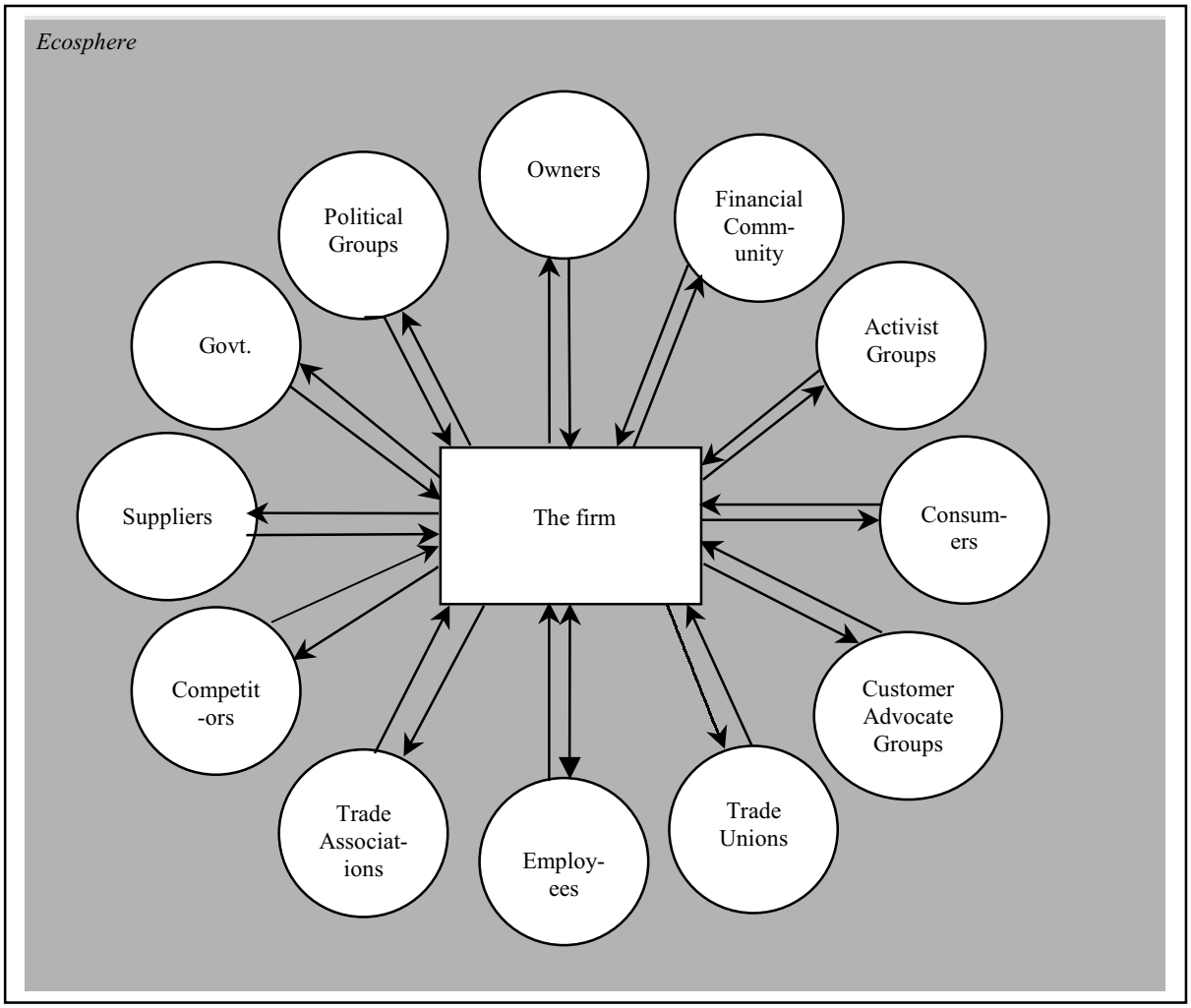
Freeman (1984) thus defined a 'stakeholder' based on the concept of being able to 'make a difference' to the organization's objectives:

> *Simply put, a stakeholder is any group or individual who can affect, or is affected by, the achievement of a corporation's purpose. Stakeholders include employees, customers, suppliers, stockholders, banks, environmentalists, government and other groups who can* ***help*** *or* ***hurt*** *the corporation* (p.iv, emphasis added)[31].

Freeman's definition of 'stakeholders' based on the concept of who can affect (i.e. help or harm) or be affected (i.e. helped or harmed) by the firm is perhaps the most widely quoted in the CSR literature[32]. Conceived of in this way, 'stakeholders' becomes an overarching concept, including any "… persons or groups of persons that have, or claim ownership,

rights, or interests in a corporation and its activities, past present or future" (Clarkson 1995, p.106) as well as "… any human agency that can be influenced by, or can influence, the activities of the organization in question" (Gray *et al*. 1996, p.45)[33]. Given the context in which Freeman is working, i.e. strategic management, it is perhaps obvious why those groups who can affect (i.e. help or harm) the corporation should be regarded as 'stakeholders'. However, the inclusion of those groups who are affected (i.e. can be helped or harmed) by the organization is perhaps less obvious given that not all groups which can *affect* an organization are themselves *affected* by the organization. According to Freeman, organizations must deal not only with those groups that can affect it, but also to be *socially responsive* to those who are affected by it in order to be effective *in the long run*[34]. Freeman's definition of stakeholders thus includes the more traditional stakeholder groups (owners, customers, suppliers and the financial community) as well as 'emerging' stakeholder groups such as customer advocate groups and activists groups (e.g. NGOs) (Figure 6.2)[35].

Figure 6.2
A 'rational' stakeholder map of a very large organization



Source: Freeman (1984)

The stakeholder view as depicted in Figure 6.2 provides a model of the organization-society relationship which more closely resembles the 'real-world' in which the modern business organization operates. Essentially, Figure 6.2 presents diagrammatically the notion that all

those who can affect or are affected by a corporation have a legitimate interest in or receive benefits/suffer harm from the corporation. Hence, the arrows between the firm and the various stakeholder groups run in both rather than in a single direction[36]. In contrast to the principal-agent stewardship model of the firm discussed in Chapter 5, Figure 6.2 illustrates a totally different view of the firm whereby the *explicit* role of management is to act as a sort of countervailing force to keep *all* the various stakeholders reasonably happy whilst accomplishing their own desired results for the perpetuation of the organization. The model is, as Freeman recognises, an enormous over-simplification of the real world, particularly in its depiction of stakeholders as static whereas in reality they change over time. Nevertheless, the model arguably represents a suitable basis from which to proceed for the purposes of the present study, Figure 6.2 providing a practical framework for identifying the various stakeholders that a very large organization interacts with in a pluralist society.

The identification of stakeholder groups is obviously important and there are numerous different definitions which have been proposed for this purpose (see, for example, Carroll, 1989; Clarkson, 1995; Friedman, 1970; Laughlin, 1990). Clarkson (1995), for example, distinguishes between 'primary' and 'secondary' stakeholder groups, the former being defined as "… one without whose continuing participation the corporation cannot survive as a going concern …", and the latter being "… those who influence or affect, or are influenced or affected by, the corporation, but … not engaged in transactions with the corporation and are not essential for its survival …" (pp.106-7). However, the essential point to grasp is that, regardless of the definition, the stakeholder model as shown in Figure 6.2 depicts relationships as a two-way exchange, reflecting Freeman's key notion that stakeholders may not only help or harm the activities of a corporation, but may also be helped or harmed by those activities. One interesting issue in this context is whether the natural environment is itself a 'stakeholder'. Woodward (1997), for example, in a revised stakeholder approach based on *The Corporate Report* (ASSC, 1975) argues that the environment is an 'area of interest' rather than an 'interest group' *per se*. Woodward's (1997) inclusion of the natural environment (i.e. fauna and flora, land and water, and the biosphere), 'squares the circle' in terms of the domain referred to as 'the Eco-sphere' in Figure 6.2 above. The natural environment demonstrably falls within Freeman's (1984) definition of a stakeholder group given that it is clearly affected by (sometimes disastrously and forever) and can affect the achievement of a corporation's purpose (since no organization can exist outside the eco-sphere). Additional support for the inclusion of the environment as a stakeholder can be found elsewhere (see, for example, Freeman, 1995; Gray *et al.*, 1996; Smith, 1993; Starik, 1995; Woodward *et al.*, 2001).

However, actually expanding the organizational map to include the natural environment is highly problematic since the non-human part of the eco-sphere (i.e. the natural environment, its elements, processes, ecosystems and non-living components) is unable to give expression to its unique feelings about the environmental degeneration and endangerment (see, for example, Starik, 1995). In effect, non-human entities do not possess a political-economic voice and thus have not been able to identify or assert their 'stakes', whatever these may be (Hibbitt, 1999). Nevertheless, from a pluralist perspective, the non-human part of the eco-sphere is, arguably, separate and distinct from green pressure groups such as Greenpeace and Friends of the Earth which, although part of the 'new era' of environmentalism (Smith,

1993), can, potentially at least, elicit behaviour patterns on the part of management which differ from an enlightened approach to the natural environment *per se*. Moreover, taking Freeman's (1984) definition literally, given the increasing internationalisation of modern life, and the global connections now possible through improved transportation, computer technology and telecommunications, those affected (directly or indirectly) by a large organization "… include virtually everyone, everything, everywhere …" (Sternberg 1997, p.4). Thus, whilst the natural environment constitutes a stakeholder group in its own right, there are real practical problems still to be overcome in terms of how this particular interest group is recognised as a stakeholder in the context of the organization-society relationship. Fortunately, it is not necessary to resolve this normative issue for the purposes of the present study. Freeman's (1983) stakeholder approach to strategic management provides a pluralist 'narrative' or 'account' of the organization-society relationship which gives explicit recognition to a variety of interest groups within that society. Importantly, it also provides the basis for a *descriptive* stakeholder theory that can be used to explain and predict management behaviour in relation to CED.

6.6 A managerial stakeholder model of the organization-society relationship

Much of the literature on stakeholder theory that has appeared in the last 15 years or so has provided a strongly normative challenge to neo-classical business models, particularly those based on agency theory and firms-as-contracts theory (as discussed in the Chapter 5). It is therefore perhaps not surprising that stakeholder theory has come in for strong criticism from those who favour social systems based on liberal economic democracy and private property rights. Sternberg (1997), for example, perceives stakeholder theory as subversive:

> *… stakeholder theory is incompatible with business and all substantial objectives, and undermines accountability and property rights; it subverts the duty of agents to principals, and wealth-creating capabilities of business as strictly understood. Stakeholder theory should, therefore, be firmly resisted* (p.9).

Sternberg's assertion that stakeholder theory is incompatible with 'business as strictly understood' is based on a *normative* model of the theory (although which one is not clear since Sternberg appears to move between different models at will) which sees the central role of the firm as balancing the objectives of all stakeholders, and thus precluding objectives which privilege particular groups (for example, the objective of maximising long-term shareholder value). Such an objective may indeed be, as Sternberg argues, unworkable in practice. However, this is not the management-centred model of stakeholder theory as employed here. Rather, the present study, from a pluralist perspective, recognises that conflicts both between and within the different factions that make up a liberal democratic economy create a *socio-economic* context within which management (using Freeman's (1984) argument), instrumentally-speaking, adopts a positive attitude towards stakeholder management because it is seen as being in the long-term interests of the firm. Such a strategy is argued to be one of the means of *managing* (but *not* necessarily *balancing*) the conflicting interests of the different stakeholder groups. Indeed, as Sternberg (1997) acknowledges, such conflicts are routinely resolved by management in practice by using the substantive goal of the organization, whatever than may be, as a decision criterion.

Thus, the present study employs a *management-centred* model of stakeholder theory (Gray *et al*., 1996) which takes a pragmatic view of the relationship between organizations and the society in which they operate and which is based upon Freeman's model of such relationships as set out in Figure 6.2 above. Essentially, both stakeholder groups and their relative importance are defined *by the organization* itself not by the wider society in which it operates, with the process of stakeholder identification and recognition being grounded in a managerialist-stewardship perspective. That is, stakeholder relationships are perceived of in terms of the extent to which the management of an organization judges that there is a need to manage such relationships for the purposes of furthering the goals of the organization with which management has been entrusted, whatever these goals may be. Thus, under this model, the more important the stakeholder to the organization, the more effort will be directed at managing that relationship (Gray *et al*., 1996). Hence, the organization is viewed as a centrifugal controlling force, with the executive managing the varying and conflicting interests between the organization and its stakeholders. The role of accounting (and other) information is seen as a potential source for managing the perceptions and thus, in turn, the behaviour of the various stakeholder groups where the latter's expectations are not congruent with the principal goal(s) of the organization. Given its predisposition to empirical testing, it is this model of stakeholder theory which is employed here.

Using a neo-pluralist perspective on the socio-economic structure of society (see Table 6.1 above), a number of features can be added to this model which increase the level of resolution for visualising the organization-society relationship. Firstly, members of one stakeholder group are quite likely to be members of other stakeholder groups. As a result, each stakeholder group itself is seen as heterogeneous, rather than homogeneous. Secondly, and following on from the previous statement, conflict is seen as existing both within each *individual* and within each stakeholder group. Thirdly, there are interconnections between the various stakeholder groups, a phenomenon known as 'interorganizational relationships' in organization theory (see, for example, Evan, 1976; Nystrom and Starbuck, 1981). Thus, for example, the employees of a business organization may belong to a trade union which, as part of its lobbying activities, funds a single issue activist group, the membership of which includes some of the members of the trade union and/or employees of the business, to lobby a key government agency into enacting higher environmental health and safety standards for the industry in which the firm operates. Such interorganizational relationships create a complex web of networks and affiliations which go well beyond the simple economic 'nexus of contracts' (Jensen and Meckling, 1976) or 'efficient contracting' (Watts and Zimmerman, 1990) discussed in Chapter 5. Fourthly, these networks and affiliations are not immutable or static but can come and go at will. For example, coalitions of various non-governmental organizations (NGOs) are increasingly established via the Internet to fight a specific social or environmental campaign within a particular region or town. Lastly, the goal of the business organization is no longer seen as being concerned with the pursuit of profit maximisation or some other maximisation strategy on behalf of the outside shareholders. Rather, modern managerial capitalism is seen as necessitating the pursuit of a diverse set of objectives of which profit is (important but) only one (see, for example, McGuire, 1963; Marris, 1964).

Such a view of the firm is consistent with some of the reasons advanced in the CSR literature for the emergence of CSResp as touched upon in Chapter 3 (see, for example, McAdam,

1973; Estes, 1976; Epstein *et a*l., 1976; Heard and Bolce, 1981), all of which identified increased public expectations, assisted by pressure group activity, as a possible primary cause.

The managerial model of stakeholder theory, as outlined above, has provided the dominant descriptive interpretation within the academic literature, with a number of research studies explicitly using the stakeholder concept to explore stakeholder relations (see, for example, Chakravarthy, 1981; Hummel, 1998; Smith, 1998; Sonnenfeld, 1981; Sturdivant, 1979). Sturdivant's (1979) study, for example, of the values of senior management and activists groups, found fundamental differences between the values of these two stakeholder groups. Although Sturdivant did not suggest that management should adapt to the demands of activists groups, conflicting interests were seen as relevant from a corporate strategy perspective. Hence, one of the important attributes of management is seen by Freeman (1984) as the ability to introduce "… a set of transactions or bargains to balance the interests of these stakeholders to achieve the organization's purpose" (p. 53)[37]. From a neo-pluralist perspective, an uneven distribution of power amongst the various factions within society is likely to lead to conflicts and antagonistic behaviour, particularly where there is a difference of views on the roles and responsibilities of each faction within that society. Smith (1998), for example, in her study of Du Pont's ethical strategy in relation to chlorofluorocarbons (CFCs) from 1975 to 1995, highlights the clear conflicts which arose between the company's shareholders on the one hand, and environmentalists on the other. Such studies highlight the ethical dilemma facing many global corporations over the extent to which business can legitimately be asked to take into account the interests and values of individuals and groups that are affected by the operations of business. Similarly, Hummel's (1998) case study of the conflicts which arose between Royal Dutch/Shell and the Ogoni-people in Nigeria demonstrates that the management of big corporations are apt to place unilateral limits on the extent to which they accept responsibility for what happens to individuals and groups which are harmed by their business operations, and thus the extent to which corporations assume responsibility as *moral agents*[38] (see, for example, Bowie and Freeman, 1992; Evan and Freeman, 1993; Handy, 1995; Langtry, 1994; Maitland, 1994; Mitroff, 1983; Sharplin and Phelps, 1989; Weiss, 1995).

Whether or not corporations are indeed moral agents depends on how we construct and give meaning to the organization-society relationship. The study of economic agency theory in the previous chapter, for example, provided a view of large business organizations, based on a series of neo-classical assumptions and theoretical constructs, that is analogous to a player in a game devoid of moral values and thus of moral agency, whose actions are merely the outcome of a given contracts-based structure (Donaldson, 1982). The 'rational' pursuit of self-interest, bounded within and by a set of legal contracts, property rights and market pressures, forces managers to behave *as if* they were maximising the interests of their shareholders (Jensen and Meckling, 1976) and thus, effectively, assumes away other forms of moral responsibility. Moral agency on the part of the business organization is neatly subsumed within these legal and economic structures. Maximising the achievement of a specified set of contractual and legal objectives rules out the possibility of acting on the basis of moral norms and, since moral norms are a necessary condition for moral agency, business organizations, from this perspective, cannot be moral agents (Donaldson, 1982). Such a view,

however, assumes that the outcomes of the unifying process under a nexus of contracts and the 'invisible hand' of the market have no moral dimensions. As a consequence, there is no explicit recognition of the fact that the management of such organizations can do harm. In practice, however, companies *do* commit acts which are claimed to have harmful effects[39].

Table 6.2
Comparison of the economic agency and managerial stakeholder perspectives

Dimension	Economic agency theory	Managerial stakeholder theory
A. Theoretical aspects		
• Explanatory power	Narrow	Broad
• Levels of analysis	Individual	Groups/firms/societal
• Unit of analysis	Contract	Stakes/Interests/interrelation ships
• Direction of analysis	One-way	Two-way (dialogue)
• Basis of relationship	Economic risk	"Stakes" (i.e. the ability to affect or be affected by the organization)
• Criteria for organizational effectiveness	Efficiency (economic)	Stakeholder management capability
• Nature of markets	Efficient (e.g. EMH)	Imperfect, messy
• Role of resources	Only information	Important for long-term survival
• Determinant of outcomes	Free market competition	Power (socio-economic and political)
• Assumption of free will	Voluntary agents	Interdependence
• Assumption of power	Equal	Differential
• Description of corporations	Amoral agents	Moral agents
B. Human relationships		
• Nexus or core	Set of economic contracts	Set of socio-economic relationships
• Relationships of individuals	Goal conflict/divergent	Contingent, interdependent
• Primary relationship	Owner-manager	All stakeholders (ranked according to influence on the goal(s) of the firm)
• Assumption of human behaviour	Bounded rationality; risk averse; opportunistic	Bounded rationality; risk averse; contingent
• Motive	Self-interest (egoism)	Enlightened self-interest
• Scope of responsibilities	Economic	Socio-economic (positive and negative)
• Types of rights	Property rights (economic)	"Stakes" in the firm
• Overriding managerial responsibility	Maximise positive future cash flows	Management of stakeholders whilst pursuing the firm's overall objective(s)

Source: Shankman (1999, as adapted)[43]

Whilst few would deny that the actions of the senior management (as the ultimate responsible party) of corporations are *sometimes* harmful, the key issue here is the *capacity* to do harm, implying that corporations do indeed have a moral dimension. In other words, corporations *are* moral agents in terms of their capacity to commit harmful acts, to be blamed for such acts, to have been able to foresee such acts and to take moral (rather than just contractual) responsibility for rectifying the resulting harm. It is this which provides a strong case, *prima facie*, for granting moral corporate agency (Donaldson, 1982). In accepting the above argument that large corporations are moral agents, this raises the question as to how much autonomy (i.e. independence) large business organizations *should* be allowed in pursuing the interests of their shareholders. Whilst this normative issue is outside the scope of the present study, it does represent one of the fundamental dilemmas of pluralist models of liberal democracy[40] (Dahl, 1982). Such models offer *socio-economic* lenses through which to view the activities of organizations in the context of modern Western liberal economic democracies. This societal view of the firm, however, differs from neo-classical visualisation provided by economic agency theory along numerous important dimensions (Table 6.2 above).

Central to the managerial stakeholder model is the argument (from the organization theory literature) that the traditional neo-classical view of the firm, as presented by EAT, for example, is no longer a credible conception of the modern corporation (see, for example, Barney, 1990; Freeman, 1984; Newton, 1992). Other important differences between this stakeholder model and the economic model of contract-based relationships under EAT as depicted in Chapter 5 are (Jones and Wicks, 1999; Shankman, 1999):

- the recognition of social *influencers* in addition to economic influencers;
- a rejection of the notion that human behaviour is guided *only* by self-interest, rather it is asserted that such behaviour is both *varied*, i.e. self-interest, trusting and co-operative, and *variable*, e.g. sometimes self-interested, sometimes trusting, sometimes cooperative[41];
- human behaviour is also seen as *malleable*, i.e. shaped by the external factors such as the organizational setting, personal circumstances and the cultural context, implying that an individual's behaviour is, at least partially, defined according to the environment in which he/she operates; and,
- it is a theory of socio-economic *relationships* which are seen to have a broader basis than *contracts* or *transactions*.

The relative explanatory power of these two theories (i.e. EAT and MST) remains a continuous source of debate amongst organizational and managerial scholars[42]. Some have attempted to develop a hybrid 'stakeholder agency' theory which essentially seeks to subsume stakeholder relationships within a principal-agent perspective (see, for example, Hill and Jones, 1992; Quinn and Jones, 1995). However, attempts to broaden the economic agency view of the firm in this way still employ the same assumptions which underpin much of neo-classical economics, notably than human behaviour is driven by self-interest. As such, the criticisms levelled at EAR (see Chapter 5) apply equally to these hybrid-models. Others have taken a completely opposite perspective, arguing that economic agency theory is, at best, a narrow form of stakeholder theory that, when properly modified, can be subsumed within the stakeholder theory of the firm (Shankman, 1999). However, from a pluralist

perspective, the existence of a multiverse of interdependent relationships across a diverse range of groups with a diverse range of interests offers a view of the firm that is completely at odds with the narrow set of motives and assumptions offered by economic agency theory. In particular, managerial stakeholder theory (MST) as employed here recognises the existence of a plurality of interests which need to be managed by the organization to secure the long-term goals of the firm. This is not to deny the legitimate property rights of shareholders and bondholders, rather that these rights are part of a much wider set of socio-economic relations made up of stakes, rights, claims and interests which management is required to manage with 'enlightened self-interest' as part of the strategic management of the business in reacting to an ever-changing and complex external environment (see, for example, Dietrich and Woodward, 2000).

In Chapter 5, the main focus of the discussion under economic agency theory centred on the economic power and concerns of three 'market' stakeholders (managers, shareholders and bondholders). Such matters obviously form an important part of the network of interrelations between the various stakeholders which affect and/or are affected by an organization. However, other, 'non-product-market' power relations exist of a socio-economic nature which can also affect and be affected by the organization. The managerialist version of stakeholder theory suggests that in these situations management will use other non-economic strategies for managing conflicts, strategies which are consistent with the long-term interests of the firm (Freeman, 1984; Smith, 1998). It is in this sense that stakeholder theory is argued to offer a powerful tool for bringing into the business-society debate other interest groups and which, as a result, help in understanding more fully managerial behaviour in a corporate accounting and reporting context. By recognising these wider interests, the way is opened up to explore how moral issues, such as social justice, accountability, democracy and ethics, issues that are traditionally excluded from mainstream economics and accounting which takes for granted that the purpose and practice of business is self-justifying and that business owes little to society other than what it provides by virtue of its existence (what Medawar (1976) refers to as 'the social problem' in terms of a more enlightened view of CSR). Under the management-centre model of stakeholder theory, management's aim is to respond to stakeholders in a way that *appears* to address their concerns, while at the same time maintaining the business on its long-term strategic goal(s). In using information as part of a calculated and measured response to such concerns, the relative importance of stakeholders to these overall goals is seen as one of the factors that may influence the volume of CSR.

6.7 Application of the managerial stakeholder model to CSR

Following on from the issues addressed in the previous sections, a tentative outline can now be drawn on how a managerialist version of stakeholder theory may be used to explain CSR in general and CED in particular. In the review of developments in CSR post-1945 (Chapter 2), it was noted that social accounting opens the door to providing other, non-traditional accounts of the social and environmental effects of corporate behaviour, particularly non-market effects. By adding to this the neo-pluralist perception of the conflicts which may arise between different stakeholder groups over what those social accounts might actually look like, it becomes apparent that conflicts over CSR are bound to arise as a result of the various stakeholders' different interests with regard to the information that is published (Ullmann,

1979). Hence, CSR, from this perspective, begins to take on a socio-political role in the business-society relationship, with management's motives for publishing CSR being seen in terms of managing stakeholders. Freeman (1984), for example, argues that, in seeking to manage its relationships with multiple stakeholders, the management of organizations will employ a variety of strategies, including the implementation of communication processes to manage stakeholder relations, the anticipation of stakeholder concerns and the design of strategies to influence those concerns, and the negotiation and implementation of strategies to obtain voluntary agreements with stakeholders on critical issues.

It is in this context that MST may hold promise in terms of a lens through which to explain and predict management behaviour in relation to CED. Essentially, this stems from the notion that information – be it financial or otherwise – is a powerful weapon in managing stakeholders for the purposes of gaining their support and approval, or, conversely, to diminish their opposition and disapproval (Gray *et al*., 1996). From this perspective, information is viewed quite differently from that under economic agency theory where information is depicted as an *economic good* that is traded between willing buyers and sellers who seek to negotiate a price which maximises their own self-interests. In contrast, managerial stakeholder theory within a neo-pluralist framework views information as more than just an economic resource, conferring on those who possess and control it the ability to manipulate, mediate, modify and transform their social, economic and political relationship with others[44]. A practical example of the way in which information is used by large corporations in this way is provided in Smith's (1998) study of Du Pont's changing CFC strategy through the 1970s, 1980s and 1990s. In this context, managerial control over what is disclosed, over and above that required by the law, privileges the adoption of a variety of corporate reporting strategies which include fiduaciary, financial, social, persuasive and paternalistic (Ogan and Ziebart, 1991). Pilger (1998), for example, provides a telling insight into the way the public relations departments and assorted marketing experts of large corporations and governments employ 'information' in the 'media age'. Swift (2001) argues that corporations engaging with their various stakeholders use information as part of a trust-building process to enhance corporate reputation. What appears to result from the use of information in this way is a process of reporting devoid of any real or true accountability to the wider society, a process which, according to Gray (2001) should, if done properly, *hurt*: "If it doesn't raise difficulties, cause unwelcome re-examinations of the organization and so on, then it is probably not good social accounting" (Gray 2001, p.11)[45]. The essential point here is that there is an important difference between 'good' CSR, which, from an accountability perspective, is about identifying responsibilities and providing information about such responsibilities to those who have rights to that information (Gray *et al*., 1996), and how information is used to successfully manage and influence stakeholder groups. Moreover, just because a company chooses to report *more* information which may be classified as social and environmental does not necessarily imply that it is either more *accountable* in terms of its various social and environmental impacts or that it performs *better* in relation to those impacts. Indeed, there is a growing perception that current practice in CSR is:

> *... simply a new form of managerial opportunism (Owen et al., 2000), that it represents the possible trivialisation of social accounting by powerful*

> *organizations (Gray et al., 1997), or constitutes manipulation of society's views on social responsibility (Woodward et al., 1996) through clever spin doctoring* (Swift 2001, p.16).

Such 'managerial opportunism' results, partly at least, because of existing power asymmetries between the firm and its stakeholders, with information, or access to it, being seen as a proxy for power (Huse and Eide, 1996), particularly large organizations which have the socio-economic muscle to pursue corporate agendas at the expense of stakeholders' interests (Oliver, 1990; Swift, 2001). In terms of the present study, with its focus on large organizations from a neo-pluralist perspective, these various factors – existing power asymmetries, management's control over the collection and distribution of voluntary information, the absence of any detailed legal requirements concerning CED (see Chapter 2), and the relatively large economic resources available to such organizations – creates a context in which management has the means to use CED for a variety of different corporate ends, whether they be 'reputation building' (Swift, 2001), cynical corporate self-interested 'public relations' (Kellaway, 2000), 'mystification' (Tinker *et al*., 1991) or 'reputational risk management' (Brown, 2000; O'Dwyer, 2001b). The general rationale underlying these different uses of information accords with Freeman's (1984) argument that the *management* (i.e. control) of a business organization's relationships with its stakeholder groups *matters* in terms of the organization's overall organizational (and particularly financial) performance (see, for example, Gonella *et al*., 1998; Pilling, 1998). Waddock and Smith (2000), for example, suggest that most managers view the tensions between conflicting demands for financial performance and social, ethical and environmental performance as an 'either/or" rather than a 'win/win' situation, giving rise to trade-offs (see also Berman *et al*., 1999; ISEA, 1999; Ogden and Watson, 1999; Preston Donaldson, 1999). However, the preceding analysis suggests that where the primary goal(s) of the organization are at stake, this will be not so much a 'trade-off' as a 'management of impressions' whereby management uses information, such as CED, to pacify stakeholders concerns without disturbing these primary goal(s). It is this analysis, with its construction of and emphasis on:

- a neo-pluralist interpretation of modern liberal economic democracies, particularly the existence of conflicting interest groups;
- a variety of constantly-changing socio-economic relationships between an organization and its various stakeholder groups;
- the important role of information in *managing* these relationships;
- the voluntary, self-reporting of information via corporate reports on issues relating, *inter alia*, to the natural environment, employees and communities,

that is seen as holding promise in terms of advancing an understanding of the nature and causes of CSR/CED (Gray *et al*., 1995b)[46]. Such a perspective views the organization-society relationship as one which is, from management's perspective, problematic rather than destructive, potentially both helpful and harmful, and *manageable* through the acquisition of appropriate skills, means and mechanisms. Hill and Jones (1992), for example, argue that stakeholders differ among themselves in a number of respects, notably (i) the importance (to them) of their stake in the firm and (ii) their power vis-à-vis the managers. Moreover, Hill and Jones argue that there is considerable friction within the stakeholder-manager negotiation process, such that these relationships are in a constant state of flux. In that sense, it lies within

a meta-theoretical view of society which depicts the organization–society relationship as fundamentally inimical (i.e. hostile) within which CSR/CED becomes a weapon for managing stakeholders and/or to maintain or regain the status of legitimacy. Thus, MST as employed here is concerned with "… how the organization *manages* its stakeholders. Thus, information disclosed to the stakeholders may be assumed more properly by the organization to be part of a legitimacy and/or social construction process" (Gray *et al*. 1997, p.333, original emphasis). It is in this specific context that MST offers a theoretical framework within which to predict and explain variations in CED. Such a perspective suggests, for example, that the overall goal of management will be to keep the organization on course in terms of its strategic goal(s), but that the interests of stakeholder groups will also receive attention according to the degree to which such groups are important to the business organization in terms of achieving its primary goals(s).

From a 'classical' (i.e. Marxian) political economy perspective, this framework is explicitly bourgeois. Rather than focusing on the underlying institutional power asymmetries and systemic inequalities which are argued to be at the heart of conflict between the various factions that make up a society, the MST lens through which the world is constructed focuses on the management of the organization who, from a strategic perspective, are concerned primarily with ensuring the continued success of the company (see, for example, Bowie, 1991; Carroll, 1993; Donaldson and Preston, 1995; Freeman, 1984; Goodpaster, 1991; Mitroff, 1983; Savage *et al*., 1991; Weiss, 1994). It is in this context that stakeholders are seen as important, given that an organization's continued success is regarded as dependent on the support and approval of stakeholders and that, where necessary, the activities of the organization will be adapted to win that approval (Gray *et al*., 1995b). However, from a neo-pluralist perspective, some stakeholders will have more power and influence on an organization than others. Consequently, an organization's interaction with its various stakeholder groups will not be consistent across all such groups. Rather, the more powerful the stakeholder group, the more efforts will be undertaken by the business organization to gain their support and approval. Clarkson (1995), for example, argues that a business organization's continued survival depends on its ability to create sufficient wealth, value or satisfaction for its '*primary'* stakeholders, suggesting that these primary stakeholders are likely to be perceived as more important that other 'secondary' stakeholders. Clarkson's list of primary stakeholders is, however, quite broad, being comprised of shareholders and investors, employees, customers, and suppliers, as well as 'the public stakeholder group', the latter being defined as the government and communities that provide infrastructures and markets whose laws must be obeyed and to whom taxes and other obligations may be due. This notion of 'primary' stakeholders is quite common in the literature (see also Cohen, 1995; Donaldson and Preston, 1995; Freeman, 1984) and is supported by case study examples where management has clearly chosen to focus on privileging the interests of certain stakeholder groups over others (see, for example, Smith, 1998).

Carroll (1993) also distinguishes between 'primary' and 'secondary' stakeholders, primary stakeholders being defined as those who have a formal, official, or contractual relationship, with all others being classified as secondary. However, Carroll argues that managers must still consider the interests of secondary stakeholders because of their ability to influence the effectiveness of the firm, either positively or negatively. In the context of CSR, the

'stakeholder' was seen as long ago as 1977 as "… the new aristocrat to replace the monarchical shareholder … with vested interests at least equal to those of the shareholder" (Lessem 1977, p.281). However, Lessem was sceptical about the extent to which these interests would move beyond a mere 'blinker' and shift the balance away from financial primacy and economic single-mindedness:

> *… the blinker that has come in its path is the one of "peripheral concern". In other words, no businessman can ignore such issues as pollution control, minority hiring and charitable contributions to the community, but these are seen as essentially peripheral to the mainstream of the company's business. … All too quickly, then, an accepted set of "social concerns" has crept into both theory and practice, along with a stakeholder philosophy to back it up. This, perhaps, is the greatest blinker of them all* (Lessem 1977, p.281).

The notion that the relative importance of stakeholders to a firm influences firm behaviour is common to many studies (see, for example, Ansoff, 1965; Carroll, 1981; Freeman, 1983, 1984, 1986; Gray *et al*., 1995, 1997; McGuire *et al*., 1988; Pfeffer and Salancik, 1978; Roberts, R., 1992; Sturdivant, 1979; Thomson, 1967; Ullmann, 1985). Jawahar and McLaughlin (2001), for example, show that at any given organizational life-cycle stage, certain stakeholders, because of their potential to satisfy certain critical organizational needs, will be more important to the organization than others. Jawahar and McLaughlin suggest that the strategies an organization uses to deal with multiple stakeholders change as the organization evolves through the stages of formation, growth, maturity, and decline or revival. Similarly, in the context of CSR, Gray *et al*. (1996, p.46) suggest that stakeholder theory "… encourages us to interpret examples of voluntarily disclosed CSR as indicative of which stakeholders matter most to an organization and, thus, those which the organization may be seeking to influence." It is this interpretation which underlies much of the empirical studies that have employed the stakeholder concept to explore the nature and causes of CSR. Maunders and Burritt (1991), for example, argue that due to an uneven distribution of power amongst the various stakeholder groups, certain groups, being those that the company perceives as being relatively important, will receive more and better environmental information.

An essential feature brought out by this literature is that voluntary CED serves a much broader function than merely to inform. Rather, in much the same way as product advertising, it is used to *persuade* by shaping, colouring, defining and giving specific context to the social intercourse which takes place between an organization and its various stakeholders. Indeed, there is considerable evidence to support the view that annual reports to shareholders are used to influence the external demands, expectations and bargaining positions of many different stakeholder groups, not just shareholders (see, for example, Mitnick, 1981; Freedman and Wasley, 1990; Craft, 1981, 1984; Foley and Maunders, 1977; Maunders and Foley, 1984). The premise for such disclosures is assumed to be, based on the above analysis, a means by which management seeks to influence the perceptions of an organization's stakeholders. Hence, the present study does not seek to discover whether managers behave as if stakeholders have morally or ethically valid claims on the firm (for an example of this type of research, see Clarkson, 1995). Rather, MST takes, as a basic starting point, the broad if rather vague position offered by Brenner and Cochran (1991):

> *The stakeholder theory of the firm posits that the nature of an organization's stakeholders, their values, their relative influence on decisions and the nature of the situation are all relevant information for predicting organizational behaviour* (p.462).

As noted in the review of prior CSR research in Chapter 3, the relationship between corporate social disclosure and financial, economic and social performance, despite extensive empirical work, is inconclusive (Ullmann, 1985; Griffin and Mahon, 1997; Wood, and Jones, 1995). Ullmann (1985) suggests that rather than exploring the existence and direction of these putative correlations, researchers should search for the missing element which, when included in the model, would help to explain the "… varying nature of the relationships among social disclosure and social and economic performance, thereby making it possible to forecast the circumstances under which correlations and their direction can be expected" (p.552). The 'missing element', according to Ullmann, is corporate strategy, i.e. the strategy which complex organizations adopt for coping with their operating environment. There is some evidence in prior CSR research to suggest that corporate strategy may be an important element influencing corporate behaviour in general and social disclosure in particular. Bowman and Haire (1975) in reporting a U-shaped correlation between economic performance and environmental performance (i.e. that middle-range polluters outperform economically the best and worst polluters), provided evidence which suggests that managers are confronted with a resource allocation dilemma in choosing between various dimensions of effectiveness (e.g. economic, environmental, social, ethical, etc.) for successfully managing their operating environments.

But how do organizations choose which dimensions of effectiveness to focus on? This is where the contribution of organizational theorists, particularly those working within a neo-pluralist perspective on the resolution of conflicts between different factions within a society is seen to have particular relevance. Thompson (1967), for example, suggests that complex organizations are selective about which factions within society they privilege, not only in terms of their recognition, but also in relation to what actions they take to achieve an optimal relationship with these groups. Importantly, Thompson argues that rational complex organizations choose to be most alert to and place emphasis on those effectiveness issues which are most visible to important elements within the task environment. But what determines 'importance'? Pfeffer and Salancik (1978), for example, suggest that stakeholder group importance derives from their power to control the resources that are important to the organization. This perspective is based on the argument that the survival of an organization depends on the extent to which it is 'effective', *inter alia*, in managing the conflicting demands of interest groups who have power over the resources and support which the organization depends upon. Significantly, this 'resource-dependence' perspective[47] (see for example, Frooman, 1999; Miles, 1982; Mitchell *et al.*, 1997; Pfeffer and Salancik, 1978; Jawahar and McLaughlin, 2001) is seen as taking place within a two-way system of exchange (see Figure 6.2 above) which involves a process of negotiation and bargaining for monetary as well as non-monetary resources (e.g. physical resources, information, etc.) and social legitimacy:

> *Because organizations are not self-contained or self-sufficient, the environment must be relied upon to provide support. For continuing to*

> *provide what the organization needs, the external groups or organizations may demand certain actions from the organization in return* (Pfeffer and Salancik 1978, p.43).

It is this dependency of organizations on stakeholder groups for both resources and support that is seen as creating a context in which organizations *must* engage in a negotiation process if they are to survive. From an instrumentalist position, for example, those organizations which are most effective in this negotiation process will, it is argued, be the most successful in terms of meeting the goals which an organization's management sets for itself, whatever those goals may be (Pfeffer and Salancik, 1978). However, business organizations are seen as having some degree of latitude in terms of the various demands and expectations of the different stakeholder groups. This implies that such organizations will adopt different negotiation strategies for dealing with each stakeholder group, including pro-action, accommodation, defence and reaction (Burke *et al*., 1986; Carroll, 1979; Clarkson, 1991; 1995; Gatewood and Carroll, 1981; McAdam; 1973). A reactive response, for example, involves adopting an antagonistic posture 'fighting all the way' and not giving in to stakeholders' demands, whereas a proactive response involves being more conciliatory towards stakeholder groups, resulting in partial or total fulfilment of their demands. However, such an approach is made difficult because of the need for ensuring some degree of unanimity amongst the more powerful stakeholder groups as to what constitutes corporate social responsibility, including agreement on facts, values and means (Waddock and Mahon, 1991). Clarkson (1991), for example, argues that managers face difficulties in evaluating a company's performance against stakeholder demands because of the lack of mechanisms and principles by which the management of stakeholder issues can be quantified or measured in such a way as to satisfy accountants, managers or the general public. Consequently, the practical difficulties involved in achieving levels of social performance which satisfies everybody imply that management may seek to manage stakeholder relations by *managing their impressions* of the organization rather than managing the organization's social performance (Ullmann, 1985).

Hence, whilst it is certainly possible for a company to use CED as a means of reporting on actual environmental performance, the argument employed here is that an analysis of CED may be explored in terms of the relative importance of various stakeholders to the organization as a whole, CED being used as part of a management strategy to manage stakeholder groups within a process of negotiation in a neo-pluralist context[48]. The use of CED in this way is consistent with prior CSR research which suggests that organizations do not respond to individual stakeholders but, rather, address the simultaneous demands of multiple stakeholders (Rowley, 1997). As such, a significant difference exists between the MST approach as adopted in the present study and the use of the stakeholder concept for the analysis of corporate social and environmental *performance*. The latter approach (see, for example, ACCA & Aspinwall, 1997; Engledow, 1978; Churchill, 1974; Jaggi and Zhao, 1996; Kolk, 1998; KPMG, 1997b; Moneva and Llena, 2000; Niskala and Näsi, 1995; Woodward, 1993, 1997, 1999) is generally concerned with the extent to which CSR meets or should meet the information wants and/or needs of the various stakeholder groups. As such, there is assumed to be some form of accountability or decision-usefulness function underlying the corporate reporting process. Whilst this may be true in the case of the more

progressive environmental reporters (see, for example, the rankings provided by SustainAbility/UNEP, 1996a, b, 1997), reviews of prior CSR research (see in Chapter 3) suggests that the vast majority of such reporting is generally of low quality with very little disclosure that would be considered 'information' in the normal sense of the word (Gray, 1993). It is also known from other studies that companies are selective in the types of social performance they emphasize (Kedia and Kuntz, 1981). This issue was also apparent to UNEP/SustainAbility (1996a, b) in its review of the usefulness of environmental reporting by large international companies in the early part of the 1990s:

> *...there is a mismatch ... companies are still treating the CER [corporate environment report] primarily as a public relations vehicle – for reassurance and 'feel good' image-building – whereas stakeholders are increasingly using CERs as a means of comparing and differentiating between companies on the basis of hard performance data* (p.7).

Hence, for the purposes of the present study, CSR/CED is interpreted as being used by management primarily for managing the business organization's relations with various stakeholder groups rather than informing them about its environmental performance[49]. Ullmann (1985) provides one of the earliest attempts within the CSR literature to develop a model for explaining social disclosure based upon the managerialist model of stakeholder theory under which, employing Freeman (1984) and others' approach to strategic management, conflicting external demands on the firm are negotiated by the use of CSR activities, including CSR[50]. Essentially, the management of these stakeholder relationships is seen by Ullmann as a process of "… managing dependence relationships …" (p.553), which is said to require an understanding three issues:

(i) *who* are the stakeholders and what are the perceived stakes?
(ii) *what* are the organizational processes used to either implicitly or explicitly manage the organization's relationships with its stakeholders, and do these processes 'fit' with the 'rational' stakeholder map of the organization (see Figure 6.2 above)?
(iii) *what* are the set of transactions or bargains among the organization and its stakeholders and do these negotiations 'fit' with the stakeholder map and the organizational processes for stakeholders (see Figure 6.2 above)?

Ullmann (1985) sought to explain CSR, inter alia, by reference to *stakeholder power*, the basic premise being that there is a positive relationship between stakeholder power and the firm's responsiveness to that power, including the level of CSR. A similar analysis was used by Gray *et al*. (1997) when exploring the concept of stakeholder power in the context of CSR, raising three critical questions:

(i) *who* defines the stakeholders?
(ii) *who* determines the priorities of the organization vis-à-vis the conflicting interests of the different stakeholder groups?
(iii) *who* decides what information is to be reported to each stakeholder group?

Possible answers to these questions can arguably be found in exploring the concept of 'stakeholder power' from an explicitly bourgeois perspective, i.e. from one which is management- or organization-centred. Ullmann (1985) defined stakeholder power in terms of a particular stakeholder's ability to influence the behaviour of corporate management, such

influence being seen as a function of the stakeholder's degree of control over resources required by the corporation. Hence, under Ullmann's model, the more critical a stakeholder's resources are to the future viability of the corporation, the greater will be the degree to which the corporation mediates in addressing the demands of stakeholders. Freeman (1984) suggests that management can respond to these external demands by adopting a variety of different strategic postures, including an 'active' posture which denotes a situation in which managers seek to influence their organization's relationship with important stakeholders in order to operate at higher levels of effectiveness. Such an active posture includes voluntary disclosure of CSR in relation to social and environmental issues. Freeman also argues that as the level of stakeholder power increases it becomes more important for management to meet the demands of stakeholders. Other studies (see, for example, Barton *et al.*, 1989; Chakravarthy, 1986; Cornell and Shapiro, 1987; Kreiner and Bhambri, 1991) provide evidence which indicate that firms are influenced by the views of a variety of stakeholder groups in their corporate strategy decisions.

Thus, if CSR is seen as an effective tool for managing an organization's relationship with its stakeholders, a positive association may exist between stakeholder importance from the perspective of the organization and CSR. To date, however, there has been very little prior research which explores the association between stakeholder power and CSR[51]. Roberts, R. (1992), drawing on the work of Freeman (1984) and Ullmann (1985), carried out an empirical test of the determinants of CSR by exploring the relationship between the *quality* of social disclosures (as rated by an independent third party) and various independent variables perceived as influencing such disclosures including stakeholder power. Roberts selected three proxies for stakeholder power: passive *stockholder* power, as measured by the dispersion of issued share capital amongst outside shareholders; *political* pressures faced by the corporation, as measured by corporate political action committee contributions; and, *creditor* influence as measured by the debt to equity ratio. The empirical model was estimated using logical regression and was found to be significant at the 0.001 level with a Chi-square score statistic of 34.29 and a correlation coefficient of 0.296. However, only one of the proxies for stakeholder power (political contributions) was found to be significant. Roberts' model for predicting CSR was replicated by Christopher and Humoto (1996) in the latter's study of environmental disclosures by a sample of Australian listed mineral mining companies. Christopher and Humoto used the same three independent variables as Roberts, R. (1992) but their model provided only a partial explanation for variations in environmental disclosures in that not all of the three dimensions were found to be significantly associated with such disclosures. Although both studies offer a useful contribution to the development of a descriptive stakeholder theory, the model developed by Roberts reflects a limited range of stakeholder pressures, being based on just three stakeholder groups – shareholders, loan creditors and legislative bodies – and thus ignoring many others stakeholder groups recognised by Freeman (1984). Whilst both Roberts, R. (1992) and Christopher and Humoto (1996) clearly focused on those stakeholders groups which were seen, *a priori*, as being most important to a business and thus the most influential, it is difficult to accept that either offer a pluralistic construction of stakeholder influences.

Attempts to empirically construct a more pluralist model of stakeholder group influences on the behaviour of corporations are to be found in, for example, Kreiner and Bhambri (1991),

whose definition of stakeholders was based on that provided by Freeman (1984) (see above). Kreiner and Bhambri (1991) sought to understand the behavioural models used by top executives in relation to public policy strategic issues by focusing on their relationship to factors such as stakeholder power. Their results suggest that managers are more concerned with, and give higher priority to, *public policy issues* which are of concern to those stakeholders which are perceived as possessing greater power. However, empirical evidence on the extent to which organizations formally rank their stakeholders in terms of some perceived level of relative importance is still rather patchy (see, for example, Dunlap, 1996; Mahoney, 1997; Woodward *et al*., 2001). Woodward *et al*. (2001) interviewed senior executives of UK companies that were identified as being amongst the highest disclosers of social information in their respective sectors. The authors report that in seven out of eight cases, the companies concerned had no explicit ranking of stakeholders. Nevertheless, the presence or absence of a formal ranking process does not necessarily negate the existence and/or application of an informal and implicit ranking of stakeholders by management in the context of the business-society relationship. It is this latter perspective which is adopted in the present study, wedded to an empirical investigation into the extent to which the relative importance of stakeholder groups varies in practice, both within and across firms, in relation to the firm's business as a whole.

Other studies have explored the degree to which environmental information is perceived to be important to stakeholders. Clearly, any argument which suggests that management uses CSR to manage stakeholder impressions implies that CSR influences, or is perceived to influence, those impressions. However, to date, empirical evidence concerning the perceived importance of environmental information to stakeholders is both sparse and equivocal. Bouma and Kamp-Roelands (2000) carried out a study into the *expectations of stakeholders* in relation to a Dutch chemical company's environmental information system, the type of environmental information they require and, their requirements concerning the quality of this information. Bouma and Kamp-Roelands report that while differences existed between the information needs of internal and external stakeholders, such differences are largely matters of emphasis rather than outright differences in priorities. Frost and Wilmhurst (1996), based on the responses to a questionnaire sent to the *chief financial officer* of the top 500 companies listed on the Australian stock exchange, report that only 43 per cent of respondents perceived environmental information to be important to users of annual reports, with 17 per cent indicating that it was not important and 40 per cent undecided due perhaps to doubts over the usefulness of environmental information to report users or to not having fully considered the issue. Nevertheless, given that environmental information has the *potential*, at least, to be important to all stakeholders (CICA, 1994a; KPMG, 1997b), a useful avenue of research lies in exploring the association between stakeholder power in relation *to the business as a whole* and the level of environmental disclosure.

In summary, the concept of 'stakeholder power' is visualised by employing Freeman's (1984) definition of 'stakeholders' based on the concept of who can affect (i.e. help or harm) or be affected (i.e. helped or harmed) by the firm. Extending this argument further, a neo-pluralist perspective suggests that for organizations which are driven by similar goals (e.g. long-term profitability), an uneven distribution of power amongst stakeholder groups is likely to mean that some stakeholder groups are perceived as relatively more powerful, and thus more

important, than others in the context of the *interests of the organization as a whole*[52]. Thus, stakeholder groups are presumed to be seen by the management of business organization across varying degrees of importance, with some groups being more important than others. From this perspective, CED forms part of a strategic, proactive management of the corporation's stakeholders in response to management's "… specifically-constructed definition of its own stakeholders and their needs, values, expectations and demands" (Woodward *et al*. 2001, p.364).

6.8 Development and statement of hypotheses

Based on the preceding analysis, the present study employs a managerial model of stakeholder theory to explore the use of CED as part of management's corporate strategic management of stakeholder groups. Under this model, stakeholder relationships are perceived of in terms of the extent to which the organization (i.e. its management) judges there to be a need to *manage proactively* such relationships for the purposes of furthering the interests of the organization. Given that information – whether financial or some other form of reporting such as environmental – is one of the major elements that can be employed by an organization in managing a particular stakeholder group, then it can be hypothesised that there will be a positive relationship between the perceived relative importance of stakeholders to the organization as a whole and the amount of CED appearing in company reports. Thus, the general line of argument employed in the development of hypotheses is based on the following, related premises:

(i) that the relative importance of stakeholder groups varies both within firms and across firms;
(ii) that management seeks to manage (often conflicting) relationships with stakeholder groups using a variety of strategic practices, policies and tactics, one of which is the use of *information* to influence the perceptions and impressions of stakeholder groups;
(iii) that corporate environmental disclosures (CED) are used in this manner; and,
(iv) that, based on the above, there is a positive association between stakeholder importance and CED.

Based on prior research referred to throughout this chapter, 12 stakeholder groups were identified for the purposes of the research approach[53]. In addition, using Freeman's (1984) definition of stakeholder groups, senior management is also recognised as a stakeholder group given that they are clearly in a position to affect the achievement of the organization's effectiveness and goals. The formal hypotheses are stated below in alternative form, the null hypothesis (H_0) in each case being the hypothesis of no difference:

H_4: The relative importance of stakeholder groups to the firm's business as a whole varies both within firms and across firms.

H_5: There is a positive association between perceived stakeholder importance and the volume of CED.

H_6: There is a positive association between the extent to which senior management is directly involved in formulating environmental policy and the volume of CED.

Hypothesis H_4 is relevant in the context of the model of stakeholder theory being employed in the present study (see Figure 6.2 above), involving an examination of differences in the perceived importance of stakeholder groups both individually (i.e. within firms) and collectively (i.e. across firms). 'Individually' in this sense refers to the relative importance of one stakeholder group as compared to another, whereas 'collectively' refers to a comparison of the relative importance of stakeholder groups as a whole across firms. Thus, it may be posited that some stakeholder groups are likely to be perceived by companies as more important than other stakeholder groups *and* that some companies perceive their stakeholders *as a whole* to be more relatively important in comparison to other companies. In both cases, this may be posited as being associated with the level of CED (H_5). An analysis of the relative importance of individual stakeholder groups thus permits a more detailed investigation of the association between CED and stakeholder importance under H_5. Hence, hypothesis H_5 is explored by investigating stakeholder importance to the business as a whole at different levels of analysis, i.e. (i) individual stakeholder groups, (ii) 'clusters' of stakeholder groups, and (iii) stakeholder groups collectively (see Chapter 9)[54].

The particular influence of senior management is explored under H_6. For the purposes of the study, senior management is defined as being made up of the following: the president/chairman; the chief executive officer (CEO); the executive board of directors and the non-executive board of directors. Prior research suggests that senior management play a significant role in determining the environmental policies, programmes and reporting practices of business organizations (Freedman and Jaggi, 1988; Hackston and Milne, 1996; Roberts, R., 1992; Ullmann, 1985). Such influence can be due to a number of motivational factors – e.g. their own personal values, morals and priorities, and/or the influence of pressures from other stakeholder groups, both internal and external. Thus, for example, a chairperson or CEO whose personal values and beliefs are weighted towards a more environmentally-benign policy for the company as a whole is likely to have a direct and biased influence on the company's environmental policies and programmes as well as the reporting of such policies and programmes to society[55]. The extent to which senior management is involved in formulating a company's environmental policy is assumed to be a valid indication of the importance which they give to environmental issues. Thus, it is hypothesised that there is a positive association between the extent of this involvement and CED.

6.9 Some concluding remarks

Stakeholder theory remains somewhat controversial as a model of *prescriptive* behaviour given that, as Sternberg (1997) argues, it may be perceived to undermine property rights (because it allegedly denies owners the right to determine how their property is to be used) and the principal-agent relationship between owners and managers (because it allegedly interferes with the contractual duty of trusteeship which the latter has to the former). However, the managerial model of stakeholder theory as employed here does not *itself* undermine these two 'sacred cows' of liberal economic democracy. Rather it suggests that by recognising a variety of interest groups, which goes well beyond a simple principal-agent or transaction-based contract, and the conflicts between these groups, provides a lens through which to explore more fully the tensions and constraints which persist in the socio-economic

environment within which the management of a large, modern business organization actually operates. In this sense, such a model focuses on what Goodpaster (1991) calls the 'strategic level' of stakeholder theory, whereby management takes into account the non-owner stakeholders' interests as a means of achieving the firm's long-term economic objectives which may or may not have an *explicit* moral content (Argandõna, 1998). Thus, the present study's focus is not on the fact that, for example, Royal Dutch/Shell's interpretation of its moral responsibilities to the Ogoni-people in Nigeria (Hummels, 1998) differs from that of Amnesty International or Friends of the Earth, but that management is likely to devise a strategy for *managing* stakeholder relations based on a particular *chosen* moral position, and that information, including CSR/CED, provides a means by which management seeks to re-enforce that position. It is known, for example, that, following the Ogoni and Brent Spar affairs, Royal Dutch/Shell became convinced of its need to engage in debate with its non-market stakeholders (Arts, 2001; Dickson and McCulloch, 1995; Hummels, 1998). But this does not imply that Royal Dutch/Shell sought to change the basic terms on which it does business. Rather, if as Evan and Freeman (1995) claim, management's modern-day duty is to safeguard the health and welfare of *the corporation* by balancing the multiple claims of conflicting stakeholders, then its public relations machinery is likely to play an important role in managing these conflicting interests. As CED represents a potential source for such management, the argument employed here under MST is that business organizations play the CED 'card' at the business-society table as part of an overall long-term strategy aimed at preserving corporate sovereignty[56].

Notes

1. The normative, instrumental and descriptive/empirical variants of stakeholder theory, as described here, provide one way of categorising the different research streams. However, this involves a high level of reductionism. Freeman (1999, p233/4), for example, in his response to Donaldson and Preston's (1995) typology states "… there is no way to have a meaningful distinction between normative and descriptive without relying on the distinction itself". Moreover, there are obviously other ways of typologising the various studies of stakeholder theory, such as their level of stakeholder inclusivity and the degree to which "... the power locus is located within hierarchical, paternalistic structures" (Yuthas and Dillard 1999, p.41). Within the latter's typology, the traditional, managerial model of stakeholder theory is depicted as implying strong hierarchical and paternalistic administrative structures coupled with limited stakeholder inclusivity which prevents a serous challenge to "... the hegemony of reason, rationality and cost-benefit calculus" (p.42).
2. The tem 'key' stakeholders is obviously subjective, depending on a particular perspective of the business-organization relationship. In practice, KPMG/WIMM (2002), for example, report that companies, communicate with their stakeholders by explicitly singling out 'key stakeholders' whilst a minority restrict their main stakeholders to a small number of interest groups comprising employees, customers, shareholders and society/communities.
3. See, for example, O'Dwyer (2001b) for a more in-depth analysis of the accountancy profession's involvement in this area.
4. This concept has been extended to a macro-economic level to what is called 'the stakeholder economy' (Hutton, 1995) or Elkington's (2001) vision of 'stakeholder capitalism', and which was widely promoted in Britain by Prime Minister Blair (Shaoul, 1998).
5. An exploration of the hypothesis that firms which respond to stakeholder needs are more successful in conventional business terms is outside the scope of the present study. In an overview of this literature, Donaldson and Preston (1995) note that attempts to test this relationship involve formidable challenges, most notably the problems of identifying reliable proxies for stakeholder

management and being able to establish that "… the optimal strategy for maximising a firm's conventional financial and market performance is stakeholder management" (p.78). Whether followers of the instrumental model would be willing to abandon the concept if it turned out to be only as *equally* efficacious as other conceptions of managerial capitalism remains to be seen.

6. Ruf *et al*. (2001) make an attempt to establish a relationship between corporate social performance (CSP) and financial performance using 'meeting multiple stakeholder demands' as a proxy for social performance. However, their evaluation of CSP was done using performance ratings supplied by a third party (who used the values of just one stakeholder group, 'social investors') and the researchers themselves, without recourse to the stakeholders in the companies themselves. Thus it is possible that the involvement of other, non-shareholder stakeholder groups might have resulted in a different evaluation of firms' CSP. Arguably, in assessing *social performance* based on 'meeting multiple stakeholders demands', empirical researchers using hypothetico-deductive methodology need to consult a wide range of stakeholders on a wide range of issues for a wide range of companies. Such research is likely to highlight the conflicting, irreconcilable expectations which exist amongst different stakeholder groups.
7. As Craig (1969/1985) states in his introductory notes to Charles Dickens' novel *Hard Times* (1854/1985): "Dickens's lifetime saw the beginning of the end for the old cottage industry. The family which in the time of, say, Defoe [Daniel Defoe, 1661-1731] had carded, spun, and woven, washed and bleached, as a team was now scattered from home, out into the mills, there to be knit together again as a class no longer based on the blood ties. … Instead of work following the rhythms of close personal relations – work until the piece was finished, a journey to sell it, and then perhaps a long week-end until the money was finished – now the men, women and children must submit to a rigid time-table laid down by a management avid that every minute should be worked to the full. … The point for *Hard Times* is that people had become less a law unto themselves, the stuff of their lives less variegated, and it is this sense of lives clamped under a grid that haunts Dickens throughout his work" (p.17).
8. The model of liberal democracy employed here relates principally to the countries of Europe and North America, and those nations whose culture has been significantly influenced by European and Anglo-American traditions. In that sense, our analysis is culturally specific and does not necessarily have the same value or meaning in the context of other cultures.
9. For an overview of Schumpeter's contribution in the context of liberal democracies, see, for example, Held (1996, pp.177-198). Schumpeter's (1976) primary task was explanatory, i.e. to account for how democracies actually work and his conception of the modern industrial society was indebted to both Marx and Weber. Essentially, Schumpeter argued that political values and attitudes of the demos are overwhelmingly shaped by the messages they receive from political institutions, the media and other 'socialization' agencies. Although the social sciences have provided a large variety of evidence which suggests that the impact of these socialization agencies is indeed considerable, there is also evidence to suggest that their power should not be over-exaggerated (Held, 1996). Rather, other interpretations have suggested that the views aired in politics and the media intersect in complex ways according to daily experience, local tradition and social structure (Thompson, 1967, 1984, 1995).
10. Several pluralist theories exist such as the 'classic' version found in the writings of, amongst others, Truman (1951) and Dahl (1956, 1961, 1971) and a new variant, frequently referred to as 'neo-pluralism' or 'critical pluralism' which stems from investigations into the distribution of power in Western democracies. For an overview of what pluralists say about their respective version of pluralism, see, for example, Jordan (1993).
11. Dahl (1982) clarifies this further. He states (pp.29-30): "… not all pluralist systems are democratic: relatively autonomous organizations also exist under some nondemocratic regimes. Nor are all democratic systems necessarily pluralist: democracy might conceivably exist on a very small scale without relatively autonomous subsystems …. However, all large-scale democratic systems, all democratic countries, all polyarchies, are organizationally pluralist in the meaning of the terms I have tried to clarify in this chapter."
12. A wide variety of organizations have been described as 'special interest groups' or 'pressure groups'. Richardson (1993), for example, refers to the existence of over 20 terms – including

political group, lobby, political interest group, special interest group, voluntary association, organized group, pressure group - for what is essentially the same phenomenon, namely organizations pressing government to act or not to act, as the case may be. Wilson (1991) defines an interest group as an organization which has some autonomy from government or political parties and which tries to influence public policy. Kimber and Richardson (1974) suggest that a pressure group may be regarded as any group which articulates demands that the political authorities in the political system or sub-system should make an authoritative allocation, adding that such groups should be distinguished from political parties and other groups whose objective is to take over government. Richardson (1993) extends this definition further by noting that the study of pressure groups is essentially concerned with "… the processes by which *interests* become *organized* in society and the processes by which those organizations participate in public policy making" (p.10). All of these aspects are instructive in the context of the present study. However, as set out in Chapters 2 and 3, interest in CSR and CSResp are depicted as elements of a growing counter-hegemony which questions the role of business in society. As such, it is the emergence of social movements, such as the environmental movement, as a source of countervailing power which is of particular relevance to the present study (see, for example, McFarland, 1987).

13. Issues of group interests, conflict and power in the context of political systems have long been of interest to scholars and theorists. For an overview of the literature in a pluralist context, see, for example, Morgan (1986, p.362 *et seq*.).
14. Aspects of 'the New Left' included demands for peace, the extension of democratic rights to workers in industry and to local communities, the emancipation of women, resistance to racism, all of which were part of a protest movement which, in 1968, brought France to the brink of revolution (Held, 1996).
15. The pluralist model of power suggests that in the decision-making process all sections of society have an equal chance of influencing the outcome, i.e. that no single section of society holds absolute power (Rahman, 1998). However, neo-pluralists recognized the existence of power asymmetries within liberal economic democracies which meant that the outcome of the decision-making process was not based on an equitable distribution of power.
16. As an example of the latter, companies such as Royal Dutch Shell, Exxon and General Motors clearly have more economic power than almost any individual on the planet (the one or two exceptions being the very richest individuals such as Bill Gates) and use this power to influence socio-economic and political matters (see, for example, Neimark, 1992).
17. The neo-pluralists argument in this context is similar to that of the 'corporate tendencies' contribution, the latter being based on a number of appraisals by social and political scientists in relation to the significance of the "… progressive emergence of formal and/or informal extra-parliamentary arrangements between leaders of key labour, business and state organizations to resolve major political issues in exchange for the enhancement of their corporate interests" (Held 1996, p.219). Such appraisals can be found in, for example, Schmitter (1974), Panitch (1976) and Pierson (1991). Corporatist arrangements in this context refer to tripartite arrangements between the three great power blocks in society – the labour movement (labour), the owners of private money capital (capital) and the state with the state acting as the facilitator and intermediary to steer the vehicle of society as a whole. Such corporate arrangements have taken hold in only a few countries, notably Austria, the Netherlands and Sweden. For an overview see Held (1996, chapter 6).
18. The important challenges which such a system poses for democracy are outside the scope of the present study but see, for example, Dahl (1985, 1989).
19. The neo-Marxist contribution is not directly relevant to the present study and thus is only mentioned briefly to provide context to the neo-pluralist view. For a review of the neo-Marxist perspective in general, see, for example, Held (1996, chapter 6). For a more detailed analysis see, for example, Miliband, 1969; Offe, 1984; Poulantzas, 1972. In the specific context of social accounting and accountability, see, for example, Chua, 1986; Cooper and Sherer, 1984; Laughlin and Puxty, 1986; Neimark, 1992; Puxty, 1986; Tinker, 1984a, b, 1985; Tinker and Lowe, 1980; Tinker *et al*., 1991.

20. For a review of the arguments of post-modernistic thinking in a stakeholder context, see, for example, Yuthas and Dillard (1999). The essential point to grasp here is that nature can survive without humans but humans cannot survive (for the time being at least) without nature. Whilst much of modern-day life in the developed world centres on man-made technology, including aspects of agriculture, and humankind's connection with nature becomes more and more tenuous, it is an inescapable fact that humans are the dependent ones.
21. The reference to 'classical' political economy is important in terms of avoiding possible confusion between the two different traditions in political economy, namely that of 'bourgeois' political economy, most often associated with John Stuart Mill, and 'classical' political economy, notably the writings Karl Marx (see, for example, Held, 1980; Macpherson, 1973, 1977). In its traditional usage, 'political economy' was used as an early title for the general subject of economics, emphasising the importance of choice and alternatives in economics (Bannock *et al*., 1992). Within contemporary social science, much of the theoretical groundwork for the separate disciplines therein was established in the eighteenth and nineteenth centuries by writers such as Adam Smith, John Stuart Mill and Karl Marx who focused on the relationship between the production, distribution and consumption of wealth in human society and the role of the state, particularly in terms of social class, the value of labour and the division of labour at a macro-economic level (Abercrombie *et al*., 1994).
22. Chapter 5 explored the *Rochester School brand of agency theory* and information economics in predicting and explaining corporate social reporting. This approach, grounded in neo-classical economics, is one extreme along a continuum which contains somewhere in the middle the neo-pluralist approach as adopted by those such as Gray *et al*., (1996). At the other extreme can be found more critical/radical accounting researchers such as Puxty (1986, 1991) and Tinker *et al*. (1991). The latter argue that the systems of power, economic activity and social organization are so fundamentally wrong that there is little point in addressing issues of environmental protection, social justice, cultural diversity, etc. unless and until such systems are themselves replaced (see Chapter 10). All accounting researchers posit themselves, whether out of choice or ignorance, somewhere along this continuum. A detailed consideration of critical accounting researchers' criticisms of a neo-pluralist approach to social accounting is outside the scope of the present study. However, it is important to recognise that any discussion of systems of power, conflict, group interests, social organization and activity, and of the methods by which researchers seek to explore and understand such systems and activity, is predicated on certain *normative* assumptions about the extent to which (i) there are 'problems' with the present social system and (ii) the ways, if any, in which we should go about correcting such 'problems'.
23. As noted by Gray *et al*. (1995b), the (predominantly) bourgeois interpretation of political economy as applied in accounting (see, for example Guthrie and Parker, 1990) is diametrically at odds with the classical (i.e. Marxist) interpretation (see, for example, Tinker *et al*., 1991). As such, the two views are irreconcilable in that the former treats as important issues which the latter sees as "relatively trivial" (Gray *et al*. 1995, p.53).
24. Stakeholder theory and legitimacy theory, along with 'classical' political economy theory (see, for example, Cooper and Shearer, 1984), are the most widely employed descriptive theories within accounting to explain CSR. As noted by Gray *et al*. (1995b), this literature does not speak with one voice, with suggestions that the social and political theories used to explain CSR are in competition with each other rather than offering complementary insights (see, for example the discourse between Arnold, 1990 and Guthrie and Parker, 1990). Rather than become involved in this discourse, it seems more fruitful (in the context of the present study at least) to adopt the position of Gray *et al.* (1995b), which is, essentially, to view stakeholder theory and legitimacy theory as two overlapping perspectives within an overall neo-pluralist framework which draws on the assumptions of 'political economy'.
25. This is not to deny that, in negotiating relationships with various stakeholder groups, business organizations do not take genuine steps to listen to and thus give a voice to such groups in the various aspects of the organization-society relationship. Indeed, there are many cited examples of organizations taking a more enlightened and benign approach to stakeholder engagement (see, for example, Zadek, 1993; Zadek and Evans, 1992, Zadek and Raynard, 1995; Zadek *et al*., 1997).

However, by and large, such examples remain the exception rather than the rule and quite distinct from the mainstream corporate community (Zadek and Evans, 1997). The emergence of some form of 'stakeholder capitalism' (Elkington, 2001; Hutton, 1995) based upon a more even distribution of economic and political power within liberal economic democracies still seems a long, long way off.

26. Of the 166 replies to the ASSC's (1975) study group's survey, 58% linked a company's primary objectives to profits, with the majority of these companies also recognising a responsibility to employees (71%) and to customers (53%). However, only 28% recognised a responsibility to the community, with few recognising a responsibility to the environment (7%). Of the 58% which linked a company's primary objectives to profits, only 10% of the total number of replies expressed the extreme view that the primary objective was to earn profits *only* for the benefit of shareholders. The 'softer' and more common view was that companies had a primary responsibility to maximise the wealth of shareholders but that this was subject to maintaining certain standards of quality to their employees, customers and the communities in which they operate (ASSC, 1975).
27. Although not radical in the context of developments in the whole field of CSR, *The Corporate Report* was at the time a significant departure from tradition for practising accountants, introducing them to a different domain to the one they were used to (see, for example, Renshall, 1976). *The Corporate Report* received support from the UK government's Department of Trade (DoT) in a report *Aims and Scope of Company Reports* (DoT, 1976) and the UK Labour government in a consultative document *The Future of Company Reports* (HMSO, 1977), both of which favoured a wider-reporting concept which recognised that companies have responsibilities not only to shareholders but also to employees and the wider community. Nevertheless, there was also considerable opposition to *The Corporate Report* from other sections of society, notably the London Stock Exchange and the employers' organization The Confederation of British Industry (CBI) (Woodward, 1997). However, the election of a UK Conservative government in 1979 saw a return to a more traditional perspective in which a company's primary responsibility is seen as being to its shareholders and not to other groups such as employees and customers (Woodward, 1997). More recently, the stakeholder concept appeared to come back into favour amongst professional accountancy circles with the publication of a discussion document *Making Corporate Reports Valuable* by the Institute of Chartered Accountants of Scotland (ICAS) (McMonnies, 1988), although the ICAS report recognised only four user groups and excluded the general public as one such user group.
28. This trend is also taking place in other contexts. For example, in the US, stakeholder interests have been recognised by law in 29 states; in Britain, laws requiring its adoption have been advocated by the Confederation of British Industry (CBI) and the Trades Union Congress (TUC), and more recently it was used as one of the central theme's of the British Labour Party during its successful election campaign in 1997 (Sternberg, 1997).
29. Freeman (1984) readily acknowledges that this is a tremendous oversimplification of the issues. His argument is not that business has never dealt with non-marketplace stakeholders, on the contrary, they always have, but rather that the relative importance of such stakeholders is damagingly underplayed by management theories in their privileging of the product-market framework.
30. Freeman's (1984) readily acknowledges that many, from Adam Smith onward, have recognised the business organization as a social institution. However, Freeman's argument is that the 'external turbulence' experienced by the modern corporation is not adequately acknowledged in the current neo-classical view of the modern corporation.
31. Although Freeman (1984) focuses primarily on the business organization, he argues that the stakeholder concept can be applied equally to non-business organizations such as government agencies, not-for-profit organizations and volunteer organizations. For an example of the concept's application to hospitals, see, for example, Freeman *et al.* (1981).
32. Other definitions and constructions can be found in the stakeholder and CSR literature (see, for example, Carroll, 1993; Clarkson and Deck, 1993; Cornell and Shapiro, 1987; Donaldson and

Preston, 1995; Gray *et al*., 1996; MacMillan and Jones, 1986; Sturdivant and Vernon-Wortzel, 1990) but that provided by Freeman is the one used in the present study.

33. At the present time (2003), the term 'stakeholders' has come to mean different things to different people, depending on their perspective on the relationship between business and society and the role of business in society. In particular, it is becoming increasingly apparent that factions within society are attempting to capture the stakeholder concept by using a definition which furthers their own socio-political agendas. FEE (2002), for example, in a recent discussion paper "Providing Assurance on Sustainability Reports" defines stakeholders as those "… having a non-trivial interest in the decisions of a company" (p.67). Such a definition is not just socially-constructing the business-society relationship by use of the term 'non-trivial' (to whom?) but is particularly *unhelpful* from a pluralist perspective because of the obvious attempt to arrive at some form of closure by focusing on the company rather than the wider society.
34. It is this approach which underlies much of the developments in prescriptive, practice-based models of stakeholder accountability in the 1990s, especially the work of Elkington (1997, 2001) and SustainAbility/UNEP (1996a, b, 1997, 1998). That is, such models adopt the view that it is in the long-term interests of business to manage more effectively its relationship with its various stakeholders. More radical, prescriptive models which involve redressing existing power asymmetries (Turnbull, 1995) or in which management's duty is seen as being to listen, remove barriers to interaction, organise and facilitate meaning, and to safeguard open debate and negotiation between stakeholders (Freeman and Liedtka, 1991; Kuhn and Shriver, 1991; Hummels, 1998; Weick, 1979) or to trigger critical comments and encourage 'noise' (Alvesson and Willmott, 1992) have yet to be taken seriously by business, the accountancy profession or those involved in providing consultancy services to business on stakeholder issues.
35. Later on in his book, Freeman (1984) qualifies this inclusive concept of stakeholders by arguing that "… when we put the concept to practical tests we must be willing to ignore certain groups who will have little or no impact on the corporation" (pp.52-3).
36. Freeman's (1984) argument for using this model of the firm is essentially normative, his concern being that there is a need for "… dealing with multiple stakeholders on multiple issues. For each major strategic issue we must think through the effects on a number of stakeholders, and therefore, we need processes which help take into account the concerns of many groups" (p.26). These normative issues are outside the scope of the present study. However, the model provided by Freeman has descriptive value in terms of the way in which it allows us to view how the management of business organizations may indeed use information as part of strategic management for managing relations with a number of stakeholders.
37. Freeman (1984, pp.75-7) provides an interesting example of how voluntary negotiations between an organization's management and its various stakeholder groups are played out in practice. Identical in form to the so-called 'Prisoners' Dilemma' game, the 'Stakeholder Dilemma' game essentially involves either party adopting one of two strategies – negotiation or hard-ball – with negotiation by *both* parties being the only strategy which results in a mutually acceptable solution. Thus Freeman concludes, "The only way out is to *voluntarily* adopt a posture of negotiation with stakeholder groups. Because, there is no other way to keep from having a solution imposed upon the organization from outside. And, to accept such an imposition of a solution to a problem is to give up the managerial role" (1984, p.77, original emphasis).
38. A moral agent may be defined as an agent which is capable of performing intentional acts (Donaldson, 1982). Thus, on this basis, all humans are moral agents because, unlike machines, they have a conscience, which implies that all acts are willed acts based on conscious intention. For a discussion of moral agency in the context of the large, business organization, see, for example, Donaldson (1982, chapter 2).
39. One example will serve to illustrate this point (Donaldson 1982, p.33): two companies, Nestlé and Bristol-Myers, as part of a number of US firms, used policies of aggressive advertising, which included the handing out of free samples, to persuade some mothers in Third World countries to switch from breast feeding to infant formula. This marketing strategy, aimed at increasing sales of the formula, was challenged by critics who argued, *inter* alia, that infant mortality rates rose as a direct result of mothers mixing the formula with contaminated local water supplies. Such acts

have a moral dimension because they can do harm to others and as such companies *are* moral agents.

40. The term 'democracy' is used throughout this and the subsequent chapter, forming an integral part of view of society constructed through the lenses of MST and OLT. Although a detailed discussion of democracy is outside the scope of the present study, it is perhaps important to point out that there are different models of democracy (Held, 1996), a key distinguishing feature of which is the degree to which power is devolved to the demos (for an overview from accounting perspective, see Gray *et al*., 1996, chapter 2). An important aspect in this context is the extent to which participatory information flows to the people of a state are recognised as a democratic right (i.e. accountability) rather than as an 'economic good' that is subject to the whims of those who have control over such flows.
41. Gibson (2000), for example, argues that a large proportion of the population's actions are guided by *prudence*, not self-interest, such prudence being rooted in a religious or spiritual belief that their actions will be subjected to divine scrutiny in the after-life.
42. The conflict between economic agency and stakeholder theories of the firm has long been entrenched in the organizational and management literature. At the epicentre of this debate lies an ongoing struggle between, on the one hand, an economic view of the firm with its roots in neo-classical economics and which is essentially silent on the moral and ethical implications of the modern corporation and, on the other, a strongly humanistic or ethical version with its roots in organization theory and organization behaviour which places the need for an understanding of the moral and ethical implications of business at the centre of the analysis (see, for example, Barney, 1990; Bowie and Freeman, 1992). Such ethical positions are strongly normative in terms of what *should be* the role of business organizations in society and as such are outside the scope of the present descriptive study. See, for example, Shankman (1999) for a more detailed analysis of the agency-stakeholder conflict from a prescriptive viewpoint.
43. Shankman's (1999) comparison of the agency and stakeholder perspectives is based on a normative, societal model of stakeholder theory which explicitly seeks ethical and moral responsibility on the part of managers. This model has therefore been adapted here to reflect a managerial (i.e. organization-centred) stakeholder model based on Freeman (1984), which is essentially concerned with the management of stakeholders for the strategic survival of the firm.
44. The control over the production and distribution of information is one source of power and is clearly an important power asymmetry in the context of the organization-society dialogue. In a stakeholder context, there are other potential sources of power and thus power asymmetries, notably, control over resources, involvement in decision-making, and skills or knowledge (Johnson and Scholes, 1989).
45. There are, of course, a number of examples of 'good' social accounting and reporting to be found, particularly among the more 'values-based' companies such as Ben and Jerry's Homemade Inc. (US), Traidcraft plc (UK), The Body Shop International plc (UK), the Co-operative Bank plc (UK), Sbn Bank (Denmark) and the Consumer Co-operative (Italy) (see, for more details, Zadek *et al*., 1997). However, these companies remain 'oddballs' in comparison to the vast majority of social reporting practices.
46. There are obvious limitations in seeking to socially construct and thus ascribe socio-economic meaning to CSR practice (see, for example, Tinker *et al*., 1982). Nevertheless, by being explicit about the framework within which such construction takes place (i.e. neo-pluralism) and by making clear the suggested role and purpose of information in an organization-society context (management of stakeholders), this study has at least addressed, if not overcome, some of the criticisms that have been levelled at the CSR literature (see, for example, Parker, 1991; Puxty, 1986, 1991; Tinker *et al*., 1991).
47. Although resource-dependence theory offers insights in terms of explaining why some stakeholder groups might be more influential than others, it leaves aside the question as to what mechanisms management might use to respond to such influences. In the present study, it is presumed that CSR/CED represents one such mechanism.
48. The corporate strategy literature suggests that there are a number of strategies which management can use to manage stakeholder demands, including developing a corporate reputation through

social responsibility activities and the disclosure of such activities (see Ullmann, 1985; Roberts, R., 1992). However, there is no reason, *a priori*, to presuppose that CSR *follows* social responsibility activities. In the management of stakeholder relations, information can be used as part of the process by which existing power asymmetries (including information asymmetries) are exploited to mediate, modify and transform relations between conflicting interest groups within society. It is this view of the role of information in the organization-society relationship which is considered the more insightful in the context of the present study.

49. In the 1990s, many leading companies (e.g. BP, J. S. Sainsbury, IBM) started to carry out research into the expectations of their various stakeholders in relation to environmental issues as part of the drive towards more effective environmental reporting via stand-alone environment reports (ACCA & Aspinwall, 1997). Such research is seen as useful in providing companies with guidance on what matters to report to stakeholders, although it does not mean that such information is always reported in practice, For an introduction to the kind of useful environmental information which the various stakeholder groups are likely to be interested in, see, for example, ACCA & Aspinwall, 1997; Bouma and Kamp-Roelands, 2000; DTTI, IISD & SustainAbility, 1993; KPMG, 1997b; UNEP/SustainAbility, 1996a, b, 1997.
50. Ullmann's (1985) 'contingency framework' provided a three-dimensional model for explaining the conflicting results regarding the correlations amongst social disclosures and economic performance, these three dimensions (i.e. independent variables) being (i) stakeholder power (high versus low), (ii) strategic posture (active versus passive) and (iii) economic performance (good versus poor). This model thus provided various scenarios for predicting CSR. For example, Ullmann predicts that where stakeholder power is high, economic performance is good and the strategic posture of management is active, both social performance (SP) and social disclosure (SD) will be high. Conversely, where stakeholder power is low, economic performance poor and management adopts a passive strategic posture, both SP and SD are predicted to be low.
51. For this reason, no table of prior empirical studies employing MST is provided in this chapter. As indicated previously, a significant amount of research has debated the normative arguments surrounding the stakeholder model of the firm but very little empirical research has been conducted into the actual influence of stakeholders on CSR strategies.
52. Whilst there are a variety of ways in which stakeholder groups can harm the interests of a business organization, the more obvious ones include customer boycotts of a company's products, employees taking strike action for better working conditions or more pay, regulators or local governments refusing to renew plant operating licences and suppliers refusing to supply their products.
53. The list of 12 stakeholder groups used in the study was based on a review of prior research which specifically addresses the issue of stakeholder reporting. For a useful overview of prior research which has identified various stakeholder groups to whom environmental information should be reported, see Stray and Ballantine (1996). Although no unanimous agreement exists as to which stakeholder groups should be recognised and which should not, there is widespread agreement that employees, shareholders, local communities and regulatory bodies ought to be included (Stray and Ballantine, 1996).
54. No attempt is made in the present study to link the content of environmental disclosures to specific stakeholder groups. Rather, emphasis is placed on measuring the amount of disclosure with some further analysis as to their nature. Prior research into the content of environmental policy statements, for example, suggests that companies place emphasis on disclosures related to employees, government, the community and consumers with very little being related to shareholders (Ince and Gifford-Gifford, 1996).
55. Practical examples of the influence of senior management in a company's approach to social and environmental issues are to found in the case of well-known pioneers of values-based companies such as Dame Anita Roddick (1992), one of the founders of The Body Shop, Ray Anderson in the case of Interface Inc., and Ben Cohen and Jerry Greenfield in the case of Ben & Jerry's Homemade, Inc.
56. Public affairs departments are used by large business organizations to monitor corporate policy in relation to such matters as public relations, governmental affairs and issues management (Marcus

and Kaufman, 1988). Moreover, such departments are increasingly using an organization's public relations function as a means of building long-term rapport and goodwill with various stakeholders and to safeguard or increase revenues by controlling political and business risks (Roberts, R., 1992). As such, there is no reason to suppose why CED would not be used as part of a business organization's corporate public relations strategy for the purposes of mediating, modifying and reinforcing power asymmetries in the overall context of managing the organization-society relationship.

Chapter 7

Organizational legitimacy theory (OLT) and the use of CED to legitimate business

7.1 Introduction

Organizational legitimacy theory (OLT) places the study of CED predominantly within a *socio-political* context, distinguishing it from that offered by the *economic* lens of economic agency theory (EAT) and the *socio-economic* lens of managerial stakeholder theory (MST). Generally speaking, OLT seeks to explain CSR, and thus CED, by reference to the values, norms, customs and attitudes of the wider society within which a business organization operates (Boulding, 1978; Dowling and Pfeffer, 1975; O'Donovan, 1999a, 2002)[1]. In short, OLT posits that the continued existence of a business organization within society depends on there being a perception amongst the wider society that the values adopted by that organization are commensurate with society's own values (Gray *et al*., 1996). Thus, by implication, to the extent that a business organization's *perceived* social values are out of step with those of the societies in which it operates, the legitimacy of the organization is said to be under threat (Lindblom, 1994). In response to this 'legitimacy gap', organizations are argued to employ various strategies of legitimation, the aim of which is to close the 'legitimacy gap' (Dowling and Pfeffer, 1975; Lindblom, 1994). CSR/CED is seen as one of the means by which a business organization seeks to maintain, reclaim and reinforce its legitimacy in the face of conflicts and dissention within a society. CSR/CED is thus depicted as a *reaction* on the part of the organization to a perceived threat to its legitimacy. Thus, whereas MST highlights how stakeholder groups may be important to a business organization from the perspective of the *organization*, legitimacy theory asserts that there are other, equally important tensions in the organization-society relationship at the level of *society*. OLT offers an alternative explanation for the behaviour of the management of business organizations by reference to potential or actual conflicts in this relationship and is seen by some as *the* most important reason underlying CED (De Villiers and Barnard, 2000).

The rest of this chapter is structured as follows. Section 7.2 introduces the concept of legitimacy in its modern context, highlighting the problem of political representation and consent associated with various socio-political aspects of legitimacy. Section 7.3 provides an overview of different models of legitimacy in the context of the modern business organization and liberal economic democracies including the bourgeois political economy variant, referred to in this study as OLT. Section 7.4 explores the concept of organizational legitimacy in more detail by looking at some key contributions to this concept from CSR researchers, notably the notion of *legitimation*, i.e. the tactics which organizations take to safeguard or restore a status of legitimacy. Section 7.5 examines the various legitimation strategies which may be used as part of a business organization's attempts to manage its legitimacy in the specific context of CSR. Section 7.6 provides an analysis of prior CSR research which has used OLT to explain variations in CSR/CED. Based on this analysis,

Section 7.7 presents a set of hypotheses with which to test the OLT model of legitimacy in relation to CED. Section 7.8 provides some concluding remarks.

7.2 The modern problem of legitimacy

The concept of legitimacy has its roots in political science where it was originally defined in the context of the legitimacy of political institutions (see, for example, Apter, 1965; Friedrich, 1963; Lipset, 1960; Schaar, 1981; Selznick, 1952). In early and classical civilizations, there was no real difference between what was 'lawful' and what was 'legitimate' such that legitimate power was, to all intents and purposes, lawful power (Abercrombie *et al*., 1994). However, in modern times, the law and morality, in terms of a society's values, attitudes and norms of acceptable behaviour, have become partially separated. National governments, for example, can have *legal* authority through the ballot box without necessarily being *morally-just* governments. This implies that the law no longer necessarily serves as a valid proxy for the socio-political legitimacy of national governments. Table 7.1 below summarises the various aspects of legitimacy which may be seen as representing various states of conformity along a continuum of two opposing extremes ranging from coercion (following orders) to ideal normative agreement (Held, 1996). Although in real-life there are many different states of agreement under which a state of legitimacy exists, these aspects serve to illustrate the complexity of legitimation both in the context of parliamentary democracy and the business organization.

Table 7.1
Aspects of legitimacy

Concept	Explanation
Coercion	No choice in the matter
Tradition	Doing as was always done without considering alternatives
Apathy	No will to change
Pragmatic acquiescence	Don't like it but no better alternative
Conditional agreement	Accept it because it is to our advantage in the long run
Normative agreement	Perceived as being the right or proper thing to do
Ideal normative agreement	It is what we would have agreed to do in ideal circumstances

Source: Held (1996)

In the 1960s, the concept of institutional legitimacy was extended by sociological theorists to the analysis of organizations which operated outside the sphere of government, including business organizations (see, for example, Maurer, 1971; Parsons, 1956, 1960; Perrow, 1970; Terreberry, 1968; Thomson, 1967). Later, organizational theorists began applying the concept of organizational legitimacy specifically to private and public business organizations as the focal organization of modern liberal economic democracies (see, for example, Anshen, 1980; Dowling and Pfeffer, 1975; Epstein and Votaw, 1978; Hurst, 1970; Pfeffer and Salancik, 1978; Richardson and Dowling, 1986). Hurst (1970, p.58), for example, expressed organizational legitimacy in the following terms:

> *An institution which wields practical power – which compels men's wills or behaviour – must be accountable for its purposes and its performance by criteria not in the control of the institution itself.*

Similarly, Anshen (1980) argued that the corporation receives its permission to operate from society and thus, ultimately, is accountable to society for what it does and how it does it. The modern problem of 'legitimacy' in this context is generally seen as a problem of political representation and consent. In liberal economic (i.e. free market) democracies, the issue of political legitimacy emerged as a direct consequence of the disappearance of direct *political* relationships and their replacement by *economic* and *legal* relationships through the 'firm' with the advent of small-scale enterprises (Abercrombie *et al*., 1994). The problem of political representation under free market capitalism occupied the minds of a number of influential sociological theorists at the beginning of the twentieth century, notably Max Weber (1864-1920) and Joseph Schumpeter (1883-1950). Weber's (1922, 1946, 1966, 1978) published work on the concept of legitimacy is generally viewed as seminal in the development of theories in relation to legitimacy in the social sciences (O'Donovan, 1999a, 2002). Weber argued that, in a pluralist context, not only do most forms of power continually strive for legitimation but that the whole socio-political system requires legitimation in order to prevent crisis and degeneration[2]. In a neo-pluralist society where power asymmetries privilege one section of society over another (see Chapter 6), a basic concept of legitimacy is that such power asymmetries require *approval* from the group over whom power is exercised. In contrast to Weber, Schumpeter (1976) viewed *parliamentary democracy* (i.e. the periodic voting by citizens who are otherwise politically inert) as important because the 'right to vote' legitimises the position of those in authority. However, Held (1996) argues that Schumpeter's account of legitimation pays too little attention to 'intermediary' groups such as community associations, religious bodies, trade unions and business organizations which cut across people's lives and connect them in complex ways to a variety of types of institution. Held also argues that Schumpeter's view is over-simplistic, ignoring the fact that there are a number of different aspects to accepting or complying with something (Habermas, 1976a; Mann, 1982). Habermas (1976a), for example, argues that modern liberal economic democracies require extensive state intervention in areas of 'market failure' in order to give legitimacy through parliamentary democracy.

7.3 Models of organizational legitimacy

Under liberal economic capitalism, the growth in the business organization from small, local market traders to large global, multinational enterprises was aided by the introduction of new forms of legal entities such as the public limited liability company which allowed venture capitalists to finance large-scale business ventures using external funds. Through supportive institutions such as Western national and supra-national governments, the World Trade Organization (WTO) and the World Economic Forum (WEF), which seek to promote 'free' trade, global business organizations have become *the* dominant social, economic and political institution of the twenty first century (see, for example, Handy, 1998; Korten, 1995, 1999). Both classical and neo-classical economists posit that 'rational economic order' required that business organizations be kept free from direct control by governments and, at the same time, left to the sole and sovereign influence of the invisible hand of the market:

> *In the theory of economic liberalism, all strictly unilateral controls vanished, sweeping dominance cleanly out of every economic relationship. Control, authority, power were concepts of no theoretical significance in neoclassical theory. In the final analysis, all economic relationships dissolved into contracts freely and rationally consented to by the autonomous individuals* (Dahl 1982, p.109).

The progress, in economic terms, experienced by Western societies in moving from agrarian, mainly self-sufficiency-based economies to modern, global industrial economies, has been achieved, largely, because of the general acceptance by its peoples of the private ownership and control of common resources. However, despite the significant economic benefits that this change has brought, there remains an uneasy tension surrounding the legitimacy of a democratic ideology that allows giant business organizations to make decisions that have enormous consequences for millions of persons who have no control over those decisions (Dahl, 1982). The executive management of global business organizations are, effectively, the unelected representatives of industrial capitalism. Whilst they are legally accountable to their shareholders, such individuals do not face the possibility of being 'hired and fired' by society in the manner which befalls elected politicians. Rather, a business organization's right to sovereignty with respect to the decisions it takes derives not from the fundamental right of its management and employees but from society's acceptance of economic efficiency as the *primary* social responsibility of business. The latter is justified on the basis that a business organization's autonomy to make decisions on certain matters is, on balance, beneficial to the whole of society (see, for example, Friedman, 1962, 1970). Recourse to the law, when necessary, is usually used as a means of defining society's accepted boundary between what is considered beneficial and thus acceptable business practice and that which is considered socially harmful (Dahl, 1982)[3]. This perception of organizational legitimacy in the context of the modern business organization is one amongst many to be found in the literature (for an overview see, for example, Woodward *et al*., 1996). These range from the perspective that a business operates under a mandate from society which may be withdrawn in the event that it fails to do what is considered right and proper (Dowling and Pfeffer, 1975; Parsons, 1956, 1960; Wilkinson, 1983), to the notion that a business organization may actually be encouraged to actively engage in 'illegitimate' behaviour (Gross, 1978; Perrow, 1970).

In the specific context of corporate social accounting and accountability, Gray *et al*. (1996) posit two variants of organizational legitimacy theory, one of which is informed by bourgeois political economy and the other by classical (i.e. Marxian) political economy. The differences between these two variants are essentially to do with the focus and level of analysis. The bourgeois 'lens' of political economy employs a higher level of resolution but adopts a narrower field of analysis, focusing on the *legitimation strategies* of individual business organizations when their legitimacy under the 'social contract' with society is perceived to be under threat. Thus, in the specific context of CSR, legitimacy theory drawn from bourgeois political economy is concerned with exploring the various ways in which individual organizations employ CSR as part of an attempt to preserve legitimacy. Conversely, the 'lens' of legitimacy theory drawn from classical political economy has a wider field of vision but a lower level of resolution. Drawing on a Marxian analysis of class conflict and power, this model of legitimacy theory raises questions about the legitimacy of the system as a whole, i.e. corporate capitalism itself, rather than being concerned with the behaviour of

individual organization (for a discussion of these issues, see, for example, Arnold, 1990; Arnold and Hammond, 1994; Gray *et al*., 1995b)[4]. From this perspective, *both* the managerial model of stakeholder theory (see Chapter 6) and the bourgeois political economy variant of legitimacy theory fail "… to address the central systemic issues that initially construct the relationships or, indeed, to recognize the structural inequalities in the 'relationships" (Gray *et al*. 1995b, pp.53-4). However, whilst the bourgeois variant of political economy's analysis of conflict must be differentiated from classical political economy's exposition of the underlying structural and systemic causes of conflict within society, it does draw on some of the insights offered by classical political economy which are absent from managerial stakeholder theory (MST - see Chapter 6)[5]. The bourgeois and classical political economy perspectives may therefore be seen as offering alternative, but not completely mutually exclusive, views of what motivates corporate social activities and action:

> *In the first case, pressure comes from society at large for organizations to do the 'right thing' and report upon them; whereas in the second case, corporate executives are more likely to take the initiative to wrest control of relevant agenda away from society at large* (Woodward *et al*. 2001, p.363)[6].

Whilst classical political economy offers valuable insights into the role that accounting and CSR play in supporting existing institutional structures and related power asymmetries, the primary focus of the present study is on the behaviour of individual business organizations and thus it is the bourgeois political economy variant of legitimacy theory which informs the analysis. This variant is referred to here as organizational legitimacy theory (OLT). Both OLT and MST have been used to explore and explain CSR, but from slightly different perspectives. However, because of the 'newness' of these theories to corporate social accounting, CSR researchers are still in the early stages of drawing out these differences. Gray *et al*.'s (1996) laudable attempt, for example, at providing some form of overall context in which to visualise how legitimacy and stakeholder theories sit alongside each other, though informative, is simplistic. Indeed, as Gray *et al*. themselves acknowledge, whilst offering a variety of ways of looking at CSR, these theories are neither discrete nor wholly specified[7]. As such, theirs is a tentative schema covering a broadly similar set of theories which are concerned with:

> *… on the one hand, the power of the society (or groups within it) to pressurise organizations into disclosure (whether through legislation or the threat of legislation) while, on the other hand, the desire and ability of the organization to use information (and particularly social and environmental accountability) to legitimate, to deflect criticism and to control the debate being held in the wider community* (Gray *et al*. 1996, p.48).

Thus, both MST and OLT, as models for explaining CSR practice, focus on the power of factions within society, be they 'stakeholders', 'interest groups'[8] or 'relevant publics', to influence the disclosure of social and environmental information. As suggested by Gray *et al*. (1995b), OLT and MST may be seen as mutually supportive in the context of a neo-pluralist visualisation of society. At a relatively simple level of analysis, both theories assert that senior management is concerned primarily with maintaining control of the organizations they are hired to run and that CSR is used, actively or reactively, to the extent to which it furthers such control (Gray *et al*., 1996). However, there are some important differences which are

relevant to and which may be teased out in the present study. MST suggests that managerial control of the business organization is maintained by 'managing' (i.e. manipulating, mediating, and transforming) the organization's relationship with those stakeholders which are viewed as important in terms of the its primary goals. CSR is thus seen as one tool for *actively* managing such relationships. In contrast, whilst retaining a distinctly bourgeois, neo-pluralist visualisation of society, OLT widens the focus of analysis to recognise that social and environmental disturbances take place outside the context of stakeholder relations and that such disturbances may threaten the sovereignty of the organization.

There is clearly a large degree of overlap between a large business organization's stakeholders and the interest groups and 'relevant publics' which make up society. However, MST places the organization at the centre of analysis, suggesting that it is management which assumes the role of identifying which stakeholders are important to the firm's long-term strategic survival, with various tactics, including CSR, being used to manage stakeholders towards this objective. Hence, there is a suggestion that management is *controlling* its external environment and that rewards to the firm depend upon, *inter alia*, the quality of its management team in so doing. In contrast, under OLT, society is more centre-staged, with management depicted as having to constantly evaluate *society's* values and norms, as represented by interest groups and relevant publics. Under OLT management is not depicted as being in control of its external environment, but rather is seen as *reacting* to threats posed by external changes in society's values and expectations, with legitimacy being granted or withdrawn by those *outside* the organization. Thus, the rewards to the firm depend upon, *inter alia*, the quality of its management team in reading, evaluating and responding to these external changes. This model is explored in more detail below.

7.4 A business organizational model of legitimacy theory

Table 7.2 below provides a summary of the main features of the bourgeois model of OLT in the context of the business organization which form the subject matter of the remaining sections of this chapter. The general argument employed under OLT is that the management of large business organizations, as holders of significant economic and political power over the peoples of the societies in which they operate, *must* obtain the approval of such peoples if they are to be permitted to continue. Parsons (1960, p.175) defined legitimacy as the "… appraisal of action in terms of shared or common values in the context of the involvement of the action in the social system." Parsons' thesis is essentially pluralist in nature, based on the notion that organizations operate within an open system and form an integral part of that system, utilizing resources which might otherwise be allocated for use by other constituents. As a result, the private utilization of a society's common resources must be accepted as justifiable, i.e. legitimate, in the context of the values, norms and expectations of the social system as a whole (see also, for example, Bailey *et al*., 1994, 1998, 2000; Cannon, 1994; McChesney, 1999; Reich, 1998). Thus, for example, where society or a section of society is dissatisfied with a business organization's performance, it can bring pressure to bear on the organization to meet society's expectations or it can use the legal system to require improved performance (Preston and Post, 1975). In addition, because legitimacy is conferred and controlled by those *outside* the organization (Pfeffer and Salancik, 1978) this implies that the organization must communicate with society on its output, goals and methods of operation.

Table 7.2
Essential elements of the bourgeois model of organizational legitimacy theory

Basic concept	Explanation
Power	Power is seen as being unevenly distributed within society, creating power asymmetries (neo-pluralism). One group has power and authority over another. The group with power requires approval from the group over whom power is exercised. Legitimacy confers authority for such power.
Social values, customs, attitudes and norms	Society is depicted as possessing and conforming to certain values, customs, attitudes and norms which serve as a form of (unwritten) moral code which all sections of society are expected to observe. Importantly, this moral code is neither static nor immutable, but changes over time and may be managed, mediated and transformed by those sections of society which possess power.
The business-society 'social contract'	Business organizations are seen as operating within society under a general 'licence to operate', or social contract, the (unwritten) terms and conditions of which are determined by the prevailing values, customs, attitudes and norms of society. Thus, a socially responsible business is essentially one which operates within the boundaries of the social contract. Society is therefore seen as possessing the power to grant or withdraw legitimacy.
Interest groups and 'relevant publics'	Society is seen as neo-pluralist, made up of different interest groups, each of which may influence the norms, values, customs and attitudes of a society. In the context of the business organization, key interest groups are referred to as 'relevant publics'.
Legitimation	Management's perceptions of prevailing social values and norms provide the basis for organizational legitimacy. Business organizations are posited as adopting a legitimation process which can involve complying with society's prevailing values and norms, seeking to change those values and norms and/or seeking to change society's perceptions of the organization.
Managing impressions	Management is posited to prefer narrative to financial or non-monetary quantified disclosure in managing public impressions.
Role of the media	Media agenda-setting theory posits that the extent of media attention on issues shapes and changes society's concern for these issues. Such concerns may, in turn, lead to shifts in society's expectations or perceptions in relation to the social, environmental, ethical or economic performance of business.

Dowling and Pfeffer (1975) argue that organizations seek to establish congruence between the social values that are associated with, or implied by, their activities and the 'bounds and norms' (Brown and Deegan, 1998) of acceptable behaviour which exist within the wider social system of which they are a part:

> *Insofar as these two value systems are congruent we can speak of organizational legitimacy. When an actual or potential disparity exists between the two systems, there will exist a threat to organizational legitimacy. These threats take the form of legal, economic, and other social sanctions* (Dowling and Pfeffer 1975, p.122).

Lindblom (1994) highlights the distinction drawn by earlier writers (notably Dowling and Pfeffer, 1975) between 'legitimacy', which is as a *state or condition*, and 'legitimation', which is the *process* underlying that state. From this perspective, a business organization's legitimacy is not static but fluid, with such organizations having to continually review their legitimacy. Legitimacy in this context has a strong basis in the notion that business organizations operate in a dynamic, neo-pluralist environment where they are continually monitored by society, as constituted by a number of interest groups and 'relevant publics' (these include employees, creditors, shareholders, public interest groups, community activists, and the government), who are posited as controlling the degree of consensus granted to business organizations to operate within society (Preston and Post, 1975)[10]. This notion of society granting business organizations consent to operate is traditionally expressed in terms of a 'social contract' or a 'public licence to operate' which is said to subsist between a society's constituents and business organizations (Donaldson, 1982; Gray *et al*., 1987, 1988, 1996; Lehman, 1983; Lindblom, 1983; Mathews, 1993; Mitchell *et al*., 1997; Patten, 1991, 1992; Shocker and Sethi, 1974)[11]:

> *The arguments put forward by Lindblom connect the philosophical proposition of the social contract as put forward by Donaldson with the need for corporate social disclosures through the notion of organizational legitimacy. This pragmatic justification may be used with managers who do not necessarily accept the social contract arguments, but recognise the need to influence the general public through additional disclosures* (Mathews 1993, p.31).

Shocker and Sethi (1974) argue that social institutions, be they business or otherwise, operate in society via a social contract, expressed or implied, whereby the institution's survival depends on (i) delivering some socially-desirable ends to society in general and (ii) the distribution of economic, social or political benefits to those groups from whom it derives its power:

> *[A]n institution must constantly meet the twin tests of legitimacy and relevance by demonstrating that society requires its services and that the groups benefiting from its rewards have society's approval* (Shocker and Sethi 1974, p.67).

Thus, legitimacy is also related to issues of 'power' and 'authority' held/granted by one group over/to another. However, Mitchell *et al*. (1997) argue that, in a neo-pluralist context, power on its own is not sufficient to guarantee this authority. Rather, something more is needed for the holders of power to be legitimate, such as 'social acceptance'. Furthermore, in order to retain existing, vested power asymmetries, the group with power must continually strive to convince other sections of society that it is a fit and proper party to hold such power[12]. Thus, OLT asserts that legitimacy is dependent on much more than being 'efficient' or 'profitable', extending into areas of social policy such as health and safety, environmental protection, employment and product care (Tinker and Neimark, 1984). In the case of the modern large business organization, this is seen as implying that whilst management have, through legal and property rights, power over the means of production and distribution, society as a whole reserves the ultimate right to approve (or disprove) power and authority over how those rights are used (or abused). Hence, a business organization is argued to be

always seeking to meet the twin tests of legitimacy and relevance by demonstrating that society requires its services and that the sections of society benefiting from its existence have society's approval (Shocker and Sethi, 1974).

An alternative argument is to regard legitimacy as being defined by both free-market competition for economic resources *and* by what is legal. This is sometimes referred to as operating within the 'rules of the game' (Friedman, 1962). The neo-classical economic model of the firm, for example, as explored in Chapter 5, assumes away legitimacy under the general guise of 'efficient contracting' and the invisible hand of the market. The basic argument of this model of legitimacy is that the law serves as the source of legitimacy because of its correlation with the social values and norms of society. Hence, providing goods and services which people want and functioning within the law would serve as an indication of legitimacy (Lindblom, 1994)[13]. This would certainly be consistent with views outlined by those on the political right who regard market mechanisms as the sole source of corporate legitimacy (for example, Benston, 1982; Friedman, 1962, 1970). In the context of CSR, Lindblom (1994) argues that such a view of organizational legitimacy would in all likelihood lead to the following:

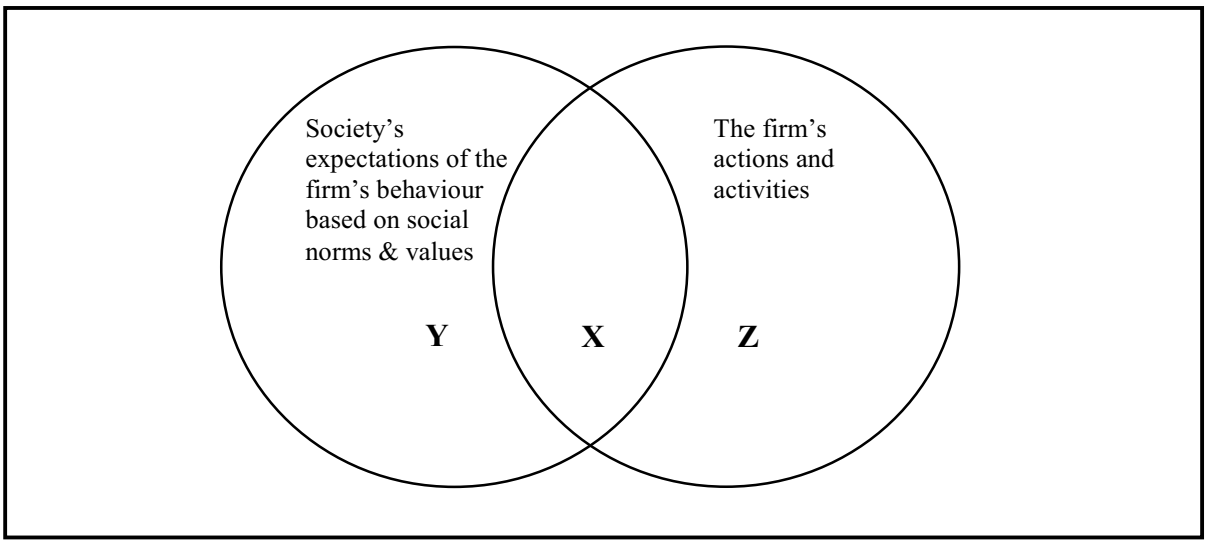
(i) the public would seek and the business organization would provide information *only* about corporate compliance with the law and or traditional accounting measures of performance; and,
(ii) assuming that the information provided under (i) was adequate, there would be no need for other non-traditional forms of performance measurement such as social and environmental accounting for the public's assessment of the legitimacy of business organizations.

However, the law is seen as an imperfect source of legitimacy due to several factors: (a) the law does not keep pace with changes in societal norms and values, but effectively plays 'catch-up'; (b) these norms and values are not consistent across society as a whole, whereas their enactment in law assumes a large degree of consensus; and (c) the public's willingness to permit certain behaviours whilst unwilling to legally sanction such behaviours (Dowling and Pfeffer, 1975). The reliance on economic success (profit) or other forms of market indicators (e.g. employment) as a surrogate for societal legitimacy is also suspect given that the market is not perfect (hence the policy of political interference in the market place in certain Western economies to correct 'market failures' in areas such as social housing, rural transport, health cover for people with serious illnesses, etc.). It is the existence of these various 'imperfections' which are posited under OLT as giving rise to voluntary corporate disclosure. In other words, a policy of corporate disclosure limited to a description of the economic (e.g. financial) success of a business organization does not necessarily result in the rendering of an account which is suitable for legitimacy assessment. Rather, for organizations to be legitimate within a society requires that they do more than just provide economic benefits (e.g. profits, dividends, wages and employment) and comply with the law. Essentially, they must also act and be seen to be acting within the bounds of what a particular society identifies as being 'socially acceptable' based on the norms, customs, attitudes and values of that society.

Moreover, as indicated in (b) above, this concept of legitimacy does not imply that there is consensual or universal agreement amongst society *as a whole*. Rather, the assessment as to

whether or not an entity is of legitimate status is performed at the level of the individual, who is said to form various relationships with the business organization. Importantly, such groups are referred to as 'relevant publics' to distinguish them from 'stakeholders', although they are composed of broadly the same constituents (Lindblom, 1994; Preston and Post, 1975)[14]. Essentially, the relevant publics represent the social conscience of a nation, giving rise to potential conflicts about the legitimacy of corporate activities. According to Lindblom (1994), for example, consensus amongst the relevant publics continues to absorb conflict until the level of conflict reaches a point at which the basic tenets underlying the business-society relationship (i.e. the social contract) are destroyed. Thus, management must be sensitive to the demands and concerns of the relevant publics and contain the level of conflict in relation to their business' legitimacy to operate. In other words, management must pay attention to the rights of the 'relevant publics', as the conscience of society, not merely its outside shareholders and bondholders (as under EAT) or its stakeholders (as under MST). This wider sensitivity is seen as necessary because, if allowed to escalate, the level of conflict can reach a point at which society effectively shows the organization the 'red card' and withdraws legitimacy. Management is argued to engage in strategies aimed at restoring the status of legitimacy when it perceives the business's legitimacy to be under threat. The extent to which such threats are perceived is likely to be evident from how the management responds to demands from the various sections of society, including those relating to social, ethical and environmental responsibility, with some responses being more forthcoming than others[15].

Figure 7.1
A diagrammatical representation of organizational legitimacy



Source: O'Donovan (1999a)

The key elements of OLT as described above, are illustrated diagrammatically in Figure 7.1 above (see O'Donovan, 1999a, 2002). The area where the two circles overlap, X, represents that part of a business organization's activities which are currently congruent with society's expectations based on society's values, attitudes, norms and expectations. Conversely, areas Y and Z represent areas of incongruence, i.e. where society's values and norms are not in line with the actions and activities of the business. Area Z is argued to be of particular concern to the management because this represents 'illegitimacy' or the 'legitimacy gap' (Lindblom,

1994; Sethi, 1978)[16]. Given that the aim of the organization is to be legitimate, i.e. to increase area X, management is said to adopt a strategy which involves one of two (or both) tactics: (i) changing its activities such that they are congruent with society's norms and values, i.e. moving area Z to the left; or (ii) seeking to alter the perceptions or expectations of society in relation to the actions and activities of the company, i.e. moving area Y to the right. These strategies are explored in more detail below. Under this model of legitimacy, for a business organization that is initially involved in activities and actions which are congruent with the social values and norms of society, legitimacy can become problematic if the organization changes its actions and activities such that they are no longer congruent with those values and norms. Similarly, the dynamic, non-static nature of society implies that a business organization's activities can, over time, come to fall outside of what the community regards as morally or socially acceptable, irrespective of any changes in the way in which a business conducts itself. These changing social norms and values are seen as representing a potential limitation on the activities of business organizations:

> *Legitimacy is a constraint, therefore, on organizational behaviour, but it is a dynamic constraint which changes as organizations adapt, and as the social values which define legitimacy change and are changed* (Dowling and Pfeffer 1975, p.126).

The various interest groups (e.g. the media, environmental pressure groups and other consumer action groups) which exist in a pluralist society become important in this context because each group is seen as reflecting the general (but shifting) values and norms of society as a whole and thus provide a cogent signal to business organizations of the *expectations* of the societies in which they operate[17]. Thus it is argued that how a business organization operates is influenced by the values and norms of the wider community in which it exists (Dowling and Pfeffer, 1975; Gray *et al*., 1995b; Guthrie and Parker, 1990; Lehman, 1992). In other words, whilst the notion of a 'social contract' between business and society does not deny the main purpose of business is to make profits, it does imply that a business organization also has an (implied moral) obligation to act in accordance with the norms and values of a particular society, including acting in a 'socially-responsible manner'[18]. From this perspective, management of business organizations must continually 'feel the pulse' of society to ensure that they are acting under the (changing) rules of the social contract and to *react* whenever there is a perception amongst the various interest groups that they are not.

But how does a business organization know when it is out of step with a society's values and norms? It is argued, for example, that the legitimacy of a business organization, from the point of view of *society*, is best assessed by reference to the willingness of the various elements within a society to participate in the exchange of resources (Terreberry, 1968). Thus, if, for example, firm A is involved in the production of product X, the willingness of employees to supply labour, of other firms to supply materials and of customers to buy the finished product is seen as conferring legitimacy on the activities of A. Similarly, Davis (1973) argues that the business-society relationship is underpinned by an implied assumption within society that business retains its social role and social power by responding to society's needs and giving society what it wants. Society's acceptance of this unwritten 'social contract' is said to be implicitly expressed in its participation in the product and resource markets in relation to the business concerned, and in acceding to a business' right to continue

its actions and activities without molestation, obstruction, or economically-damaging criticism (Campbell, 2001). In return, business is expected to pursue its actions and activities within the boundaries of what the community deems to be morally acceptable behaviour. Early systematic empirical studies of the values and norms within a society (see, for example, Rokeach, 1968; Rokeach and Parker, 1970) provided a basis on which business organizations could assess their legitimacy status. More recent empirical studies (see, for example, Elsbach, 1994; Elsbach and Sutton, 1992; Marcus and Goodman, 1991; Salancik and Meindl, 1984; Staw *et al*., 1983; Sutton and Callahan, 1987) and research which has focused on theory-building (see, for example, Ashforth and Gibbs, 1990; Lindblom, 1994; Oliver, 1991; Sethi, 1978; Suchman, 1995) have aided perceptions and understanding of what organizations can and do to preserve, restore and manage their legitimacy in the eyes of the relevant publics[19].

The key points of the preceding analysis may be summarised as follows. Firstly, a status of legitimacy is seen as essential for the survival of business organizations operating within a neo-pluralist, democratic society (Dowling and Pfeffer, 1975). Secondly, such legitimacy is not conferred merely by compliance with the 'rules of the game' in terms of economic efficiency and operating within the law. Rather, legitimacy is seen as a tripartite function of economic success, legal compliance *and* social legitimacy, the latter being dependent on the shifting values and norms of society (Dowling and Pfeffer, 1975). Thirdly, a business organization which perceives itself to be socially illegitimate or of becoming so will, it is argued, respond to this threat by seeking to restore or maintain its status of legitimacy (Suchman, 1995; Patten, 1992). The various tactics which a business organization can use to manage threats to its legitimacy are explored in the next section.

7.5 Legitimation strategies adopted by business organizations

To the extent that corporate behaviour is out of step with society's values and norms, a status of social legitimacy does not exist giving rise to a *legitimacy gap* (Lehman, 1994). Broadly speaking, a legitimacy gap in the context of the business organization can open up for a number of different reasons (O'Donovan, 1999b; Wartick and Mahon, 1994):

(i) corporate performance along various economic and non-economic fronts changes while societal expectations of corporate performance remain unchanged;
(ii) societal expectations of corporate performance change while corporate performance remains unchanged; and,
(iii) both corporate performance and societal expectations change, but they either move in different directions or they move in the same directions but not at the same rate, one lagging behind the other.

The fact that society's values, norms and attitudes are not immutable implies that a legitimacy gap can arise independently of any behaviour on the part of the business organization itself[20]. In other words, a business organization which does nothing could find itself socially *illegitimate*, irrespective of its economic performance or compliance with the law. When a legitimacy gap opens up in areas of expected non-economic performance, including corporate governance, ethical, social and environmental, health and safety performance, a business organization's legitimacy is said to be under threat. Furthermore, the legitimacy gap, if ignored, is said to widen as the level of conflict increases and the levels of positive and passive support for the business organization diminish. Thus, unless the

organization takes steps to address the legitimacy assessment by sections of society, the latter will, it is argued, impose their own penalty on the organization in whatever form is available and deemed appropriate (Lindblom, 1994). Such penalties can be economic (e.g. consumers boycotting a business organization's products or strike action by employees), legal (e.g. lawsuits), or social (negative publicity campaigns) in nature.

Whilst a business organization's operations may be accepted by the wider society as being legitimate at a particular point in time, this may not always be the case. Examples of changes in the values, attitudes and norms of a society can be found in relation to automobile safety issues (e.g. seat belts and urban speed limits), attitudes towards cigarette smoking (e.g. passive smoking in restaurants and cafés) and the growing anti-social behaviour associated with mobile telephones (e.g. on commuter trains and in cinemas). Changes in a society's values and norms are significant in the context of the present study because of the possible association between such changes and changes in the disclosure activities of business organizations. Patten (1992), for example, argues that the greater the likelihood of adverse shifts in the values, norms and attitudes of society, the greater the need for business organizations to attempt to influence the relevant publics' perceptions through social disclosure. In the specific context of CSR, Lindblom (1994) argues that if the preparation of the annual report in accordance with legal and accounting disclosure requirements is not sufficient to meet the expectations of the relevant publics, then logically business organizations will go beyond what is legally required and provide voluntary information in seeking a status of legitimacy. Simply put, Lindblom's hypothesis is that voluntary CSR represents a legitimation strategy:

> *... legitimacy is a status, and a process, legitimation, underlies that status. Much of the voluntary social disclosure issued by business organizations may be viewed as efforts at legitimation, i.e., efforts to achieve the status of legitimacy* (Lindblom 1994, p.12).

Lindblom argues that a business organization is aware of the possible negative consequences of failing to maintain the condition of legitimacy and, as a result, may either "… evaluate its legitimacy status and communicate that status to the relevant publics or they may engage in legitimation efforts" (Lindblom 1994, p.4). Where legitimacy does become problematic, then CSR is seen as a tactic available to business organizations which seek to maintain, reclaim or improve their status of legitimacy. Prior research has suggested a number of strategies which business organizations can use to influence their legitimacy status, each of which has important implications for CSR (Dowling and Pfeffer, 1975; Gray *et al*., 1995b; Guthrie and Parker, 1990; Lindblom, 1994; O'Donovan, 1999b; Oliver, 1991; Sethi, 1978, 1990):

(i) *Internal adaptations* – i.e. internal changes to the business organization's output, goals and methods of operation to conform with society's prevailing views of what is legitimate;

(ii) *Changes in external expectations* – i.e. attempts through education and information to change society's definition of what is social legitimacy such that the latter conforms to the business organization's present practices, outputs and values;

(iii) *Changes in external perceptions* – i.e. attempts to alter society's perceptions of the organization such that the latter conforms to the organization's present practices, outputs and values;

(iv) *Manipulation of external perceptions* – i.e. attempts through the management of public impressions to have the business organization's output, goals and methods of operation identified with symbols, values, or institutions which have a strong base in social legitimacy; and,

(v) *Avoidance* – i.e. purposely choosing to *avoid an issue or event* as part of a deliberate legitimation strategy.

The essential feature under each of these strategies is the need to bring the business organization's output, goals and methods of operation into line, either actually or based on perceptions, with society's expectations (Ashforth and Gibbs, 1990). These five legitimacy strategies are described in more detail below in the specific context of CSR.

(i) Internal adaptations (congruent-orientated changes in corporate behaviour)

Under the first strategy, a change in the organization's mission is seen as necessary in response to shifts in society's values, norms, customs and attitudes, the latter giving rise to a legitimacy gap[21]. The voluntary disclosure of information under this strategy, whilst not necessarily neutral or unbiased, would involve the reporting of *actual* changes in CSResp practices. This strategy is chosen in response to the firm's recognition that the legitimacy gap arose because of an actual failure of performance by the firm (Gray *et al*., 1995b). According to Lindblom (1994, p.13), the objective of CSR in this situation would be to "… educate and inform the relevant publics about the changed performance." An example of this particular strategy would be where, for example, a chemical company, wary of the relevant publics' growing hostility to the chemical industry's perceived negative environmental impacts, decides to discontinue certain product lines and to replace them with technologically-improved alternatives which are 'environmentally-friendly' and to report this change through its annual, social and environment reports;

(ii) Changes in external expectations (emphasis on re-educating and informing the public)

This second legitimation strategy involves making no internal adjustments in relation to the business organization's output, methods and goals on the basis that such adjustments are either unnecessary or uneconomic. Rather, the organization attempts to change the relevant publics' definition of social legitimacy so as to bring it more into line with the business organization's mission. This strategy is said to be chosen where the firm considers the relevant publics' expectations of the firm's responsibilities are unrealistic or 'incorrect' (Gray *et al*., 1995b). Such a strategy would tend to place heavy emphasis on using information to educate and inform the relevant publics about the appropriateness of the business organization's output, methods and goals and the positive benefits in relation to their quality of life, standard of living, etc. Information used in this way would be neither neutral nor unbiased since the organization's primary strategy is to convince various interest groups that their expectations are wrong and that by educating them the business organization can bring such expectations more into line with its performance and thus close the legitimacy gap. Under this legitimation strategy, a company may, for example, resort to using CSR to emphasise claims that it has made significant financial investment in making its products as environmentally-friendly as possible but that further improvements are either unnecessary or uneconomic or both. The economic argument is likely to be presented in terms which call into question the ability of the business organization to continue its operations if additional,

unnecessary costs are incurred, highlighting what this would mean to the local economy in terms of job losses, local taxes, etc[22].

(iii) Changing society's perceptions of the organization (emphasis on persuasion)

The third legitimation strategy also involves making no internal adjustments in relation to the business organization's output, methods and goals. Instead, the organization attempts to convince the relevant publics of the appropriateness of its output, methods and goals by using persuasive language. Essentially, the business organization attempts to identify "… organizational output, methods, and goals with the popular perception of what is appropriate without any real attempt at actual conformity" (Lindblom 1994, p.15). In this situation, the business organization seeks to close the legitimacy gap not by changing its business performance or by changing society's expectations, but by changing society's perceptions of the business organization. Thus, this strategy is said to be chosen when the organization perceives that a legitimacy gap has arisen because of misconceptions on the part of the relevant publics (Gray *et al*., 1995b). Continuing the above example of the chemical business, the latter may conclude that its particular product range differs considerably, in environmental-impact terms, from the chemical products which appear to be at the centre of the relevant publics' inimical stance towards the chemical industry[23]. As a result, the chemical business' strategy may involve voluntary disclosure of a formal product review and the basis for its decision, perhaps emphasising the organization's intention to continually review its decision in the light of any new evidence on the environmental impacts of its products. In this case, the firm is seeking not to change society's expectations of the chemical industry as a whole but to create a perception that the business is not tarred with the same brush as other, socially-unacceptable business organizations. Such a tactic is likely to involve the use of public relations 'spin' to emphasise the positive and avoid reference to the negative aspects of the business organizations output, methods, and goals.

(iv) Manipulation of external perceptions (emphasis on distraction and disguise)

The fourth legitimation strategy, whilst similar to that described in (iii) above, is much more blatant in terms of how information is used to manipulate, exploit, mediate, mystify, and transform social legitimacy. In this case, a business organization manipulates the perceptions of the relevant publics by associating itself with *emotive symbols* which have high legitimate status and which are intended to deflect attention away from a particular issue or concern. Emotive symbols in this context serve as diversions or decoys to distract attention away from issues which the business is keen to avoid, and include activities such as corporate donations to charity and non-governmental organizations and co-optations of political leaders or well-known persons of legitimate status to serve on boards of executive directors (Dowling and Pfeffer, 1975; Pfeffer, 1972; Selznick, 1949). This strategy is chosen when the organization seeks to manipulate the perceptions of the relevant publics (Gray *et al*., 1995b). Significantly, this is the area where the limitations of voluntary disclosure are most obvious and where the use of public relations 'spin' is most extreme. As an example, in the early 1990s when corporate environmental reporting through stand-alone reports was still relatively new, many such reports were seen as no more than 'green glossies full of 'nice pictures of birds and plants' (Hibbitt, 1994), devoid of any real substance. Such reports may be seen as part of a strategy designed to deliberately manipulate and exploit social legitimacy by deflecting

attention away from environmentally-harmful business practices by, for example, emphasising the firm's involvement with environmental charities.

(v) Avoidance of an issue or event as part of a deliberate legitimation strategy (active stalling or evasion)

This fifth legitimacy strategy involves an active decision on the part of management to stall or avoid discussion of a particular issue or event through tactics such as denial, decoupling, or distraction (O'Donovan, 1999a, 2002; Oliver, 1991). In the context of CSR, the avoidance strategy involves management deliberately choosing *not* to disclose any voluntary social and environmental information in their communications with society. The rationale for doing so is that the organization's legitimacy status can only be harmed or worsened by drawing the community's attention to a particular event or issue (Freedman, 1993; Guthrie and Parker, 1990; O'Dwyer, 2000)[24]. Guthrie and Parker (1990, p.170), for example, suggest that accounting report producers may selectively fail to communicate information where they perceive that such action to be against their self-interest, non-disclosure being "… just as potent a means of mediation and mystification as selected disclosure." According to O'Dwyer (2000), if the presence of CSR in annual and other reports can be rationalised on the basis of its perceived potential to legitimise corporate actions and activities, relatively low levels of CSR reporting by Irish companies would suggest that this potential is largely *unfulfilled*. However, an equally-plausible interpretation comes from perceiving the act of *non-reporting* as an active legitimising strategy in itself and that refraining from engaging in CSR could in fact fulfil its potential to confer legitimacy or reduce the possibility of social legitimacy becoming an issue. Freedman (1993), for example, studied raw water pollution data of the US pulp and paper industry which is required to provide pollution information to US government agencies and which is then made publicly available. This data enabled Freedman to construct a pollution performance rankings index to compare one firm's pollution abatement programme to another's. However, no attempt was made by the pulp and paper industry itself to construct such an index and there were no requirements for such data to be provided in the annual financial statements. Freedman argues that, in the absence of government legislation, companies will not provide this information because it would call attention to the company's pollution record, generating unwanted negative publicity.

The five legitimation strategies referred to above should not be seen as mutually exclusive. In practice, business organizations are likely to engage in various *ad hoc* legitimation strategies for addressing particular economic, social, environmental and ethical issues (Lindblom, 1994). Consequently, the overall legitimation strategy may be a complex, heterogeneous mix of individual tactics containing both genuine changes to meeting society's expectations as well as blatant attempts to mediate, mystify and transform such expectations. Factors that are likely to influence a business organization's legitimacy strategy on a particular issue include the extent to which (i) it affects the interests of the business organization as a whole, (ii) it is addressed at industry or governmental level and (iii) the demand represents a concern of the universe of relevant publics (Lindblom, 1994). Of the five strategies identified, only the first and second are likely to result in the unbiased reporting of the business organization's output, methods and goals. Conversely, the fourth strategy is the most severe form of biased reporting, being a clear attempt to manipulate perceptions and disguise the 'truth'. The view that organizations actively seek to manipulate the perceptions of society is consistent with

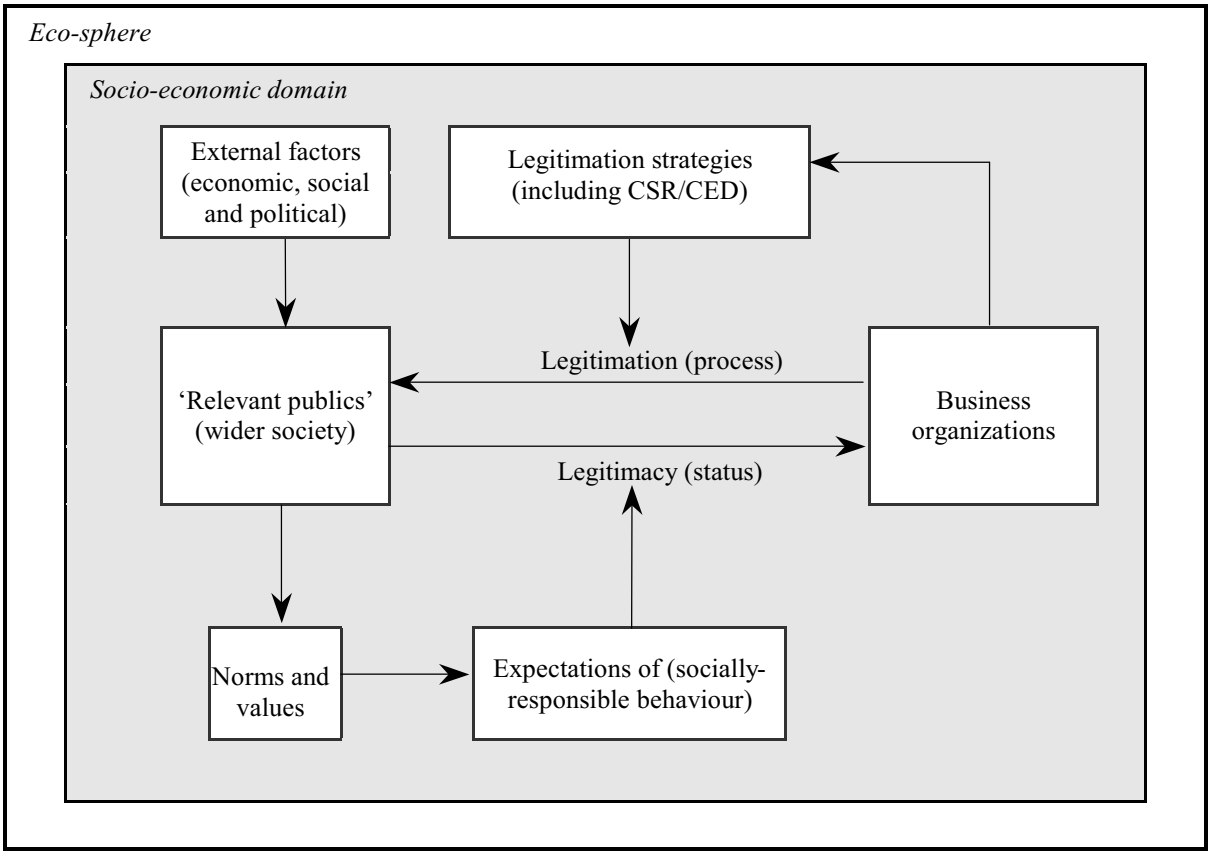
both Perrow (1986) and Gray *et al*. (1991) who argue that organizations attempt to control and manipulate their external environments[25]. Such external environments are not seen as fixed or immutable but take the form of 'negotiable instruments' (Woodward *et al*., 1996), with some organizations playing hardball when negotiating the terms of the social contract. Gray *et al*. (1991), for example, view Shocker and Sethi's (1974) argument that organizations are always seeking to meet the twin tests of legitimacy and relevance as too broad and imprecise, failing to take proper cognisance of the power wielded by organizations in actively seeking to shape their environments.

However, such arguments, whilst informative, lie at the extremities of a bourgeois political economy perspective of organizational legitimacy, encroaching into 'classical' (i.e. Marxian) political economy territory. The latter argues, for example, that management takes advantage of existing power asymmetries within society to maintain its primacy, set the agenda, propagate a set of beliefs which approves of managerial autonomy by the general public and to portray the social, political and economic world on their own terms (Guthrie and Parker, 1989, 1990; Lindblom, 1984a, 1994; McGivering *et al*., 1969). This is seen as leading to a state of 'hegemonic domination' in which a certain way of life and beliefs is diffused by powerful, dominant business organizations throughout society in all its various institutional and private manifestations and thus informing all aspects of social life including taste, fashion, beliefs, morality, customs, relations and political principles (Johnston and Gill, 1993; Williams, 1960). The central issue of such an analysis is 'power relations' in the context of an uneven distribution of power between the various constituents of a society (see, for example, Clegg, 1979) and how such power asymmetry is used to assert and re-assert control, hegemony, rule and domination which continues to *appear* as the natural order (Clegg and Dunkerley, 1980). From this perspective, only by questioning the natural order through alternative lenses do new worlds open up which offer very different meanings, perspectives and understandings of the business-society relationship in the context of CSR in liberal economic democracies (see, for example, Lehman, 1999). Whilst such perspectives are recognised here as being essential to any proper debate in relation to the business-society relationship, and thus CSResp and CSR, they do not form a central part of OLT and are thus outside the scope of the present chapter[26].

7.6 Legitimacy theory as an explicator for variations in CSR

The essential features of the bourgeois model of legitimacy theory as outlined in the preceding sections are summarised diagrammatically in Figure 7.2 below which highlights the various inputs and processes which determine the legitimacy status of business organizations in modern liberal economic democracies. Whilst still considered a relatively under-developed theory of managerial behaviour (Deegan, 2002), this model stands out as the dominant heuristic advanced so far by CSR researchers in seeking to predict, explain and understand CSR (see, for example, Adams *et al*., 1998; Buhr, 1998; Campbell, 2000, 2001; Deegan and Gordon, 1996; Deegan and Rankin, 1996; Gray *et al*., 1995b; Jantadej and Kent, 1999; O'Donovan, 1999a, 2002; Patten, 1991, 1992, 1995; Walden and Schwartz, 1997; Wilmhurst and Frost, 2000).

Figure 7.2
Organizational legitimacy and the process of legitimation



Note: Arrows indicate the assumed direction of influence

Prior CSR research which has used OLT to explain and explore the nature and causes of CED may be classified as falling into one or more of the following categories:

(i) *Event studies* –companies are observed as changing their reporting behaviour around the time, or during the course, of major global or local social and environmental events such as the *Exxon Valdez* and *Kirki* oil spills, and the Union Carbide chemical disaster in Bhopal, India (Blacconiere and Patten, 1994; Buhr, 1998; Deegan *et al*., 2000; Jantadej and Kent, 1999; Patten, 1992; Walden and Schwartz, 1997) or chairperson's term of office (Campbell, 2000);

(ii) *Print media studies* - the print media is seen as particularly influential in terms of a community's concern about the social and environmental performance of particular organizations (Adler and Milne, 1997; Brown and Deegan, 1998; Deegan *et al.,* 2002; Neu *et al*., 1998; O'Donovan, 1999a, 2002; Simmons and Neu, 1998);

(iii) *Political visibility* – changing social values are seen as giving rise to pressures which impact on companies differently, affecting those which are more 'politically visible' to a greater extent (Adams *et al*., 1998; Dowling and Pfeffer, 1975; Hackston and Milne, 1996; Kokubu *et al*., 1994; O'Dwyer, 2000, 2002; Patten, 1991);

(iv) *Social pressures* – social and environmental activists and various other groups within society are seen as signallers of the degree of social legitimacy granted to business organizations, any dissatisfaction with business performance giving rise to social

pressures from these groups on business to improve performance (Campbell, 2001; Deegan and Gordon, 1996; Patten, 1992, 1995; Preston and Post, 1995); and,

(v) *(Poor) environmental performance/breaches of environmental regulations* – poor environmental performance and prosecutions/fines for poor environmental performance are seen an indication of a failure of the companies concerned to meet society's expectations and thus giving rise to a potential threat to their legitimacy (Deegan and Rankin, 1996; Rockness, 1985; Rockness *et al*., 1986; Wiseman, 1982; Simmons and Neu, 1998).

Given the present study's focus on corporate characteristics and socio-political influences of a more general nature, the primary concern here is with the political visibility and poor environmental performance arguments (items (iii) and (v) above) to explain variations in CED across firms. Other arguments, however, are referred to below as part of a general review of prior CSR studies in this field of enquiry. The notion that CSR may be used by business organizations as part of a legitimisation strategy can be traced back to earlier studies in the late 1970s and early 1980s which suggested that CSR is associated with attempts by business organizations to improve their public image and engender greater social acceptance of its activities and behaviour (see, for example, Abbott and Monson, 1979; Brockhoff, 1979; Dierkes, 1979; Dierkes and Preston, 1977; Trotman, 1979; Trotman and Bradley, 1981; Ullmann, 1979). Such studies highlighted the socio-political changes which were seen as taking place within Western democracies at that time (see Chapter 2). Ullmann (1979), for example, argues that increased attention by society's constituent groups on non-market aspects of corporate behaviour introduced a socio-political dimension to corporate reporting, with such reporting being used by management as a means of responding to a much broader notion of legitimacy:

> *The demands business organizations are faced with can roughly be divided into 2 broad categories, namely (1) the performance of business with respect to social costs (e.g. product safety, environmental protection, and appropriate technology) and (2) the socio-political legitimacy of private business in view of its power vis-à-vis the state and society…. From the point of view of management, CSR can serve as an instrument with which to try to pacify the socio-political demands whilst at the same time playing a rôle in helping to safeguard support from other constituencies* (Ullmann 1979, p.124)

In the same vein, Abbott and Monsen (1979) argue that pressure on firms to disclose social and environmental information came from two related sources, the general public and government regulatory agencies. Citing the fact that surveys at the time had shown public confidence in business in the US to have declined by 51% in the 1960s and by 35% in the 1970s, Abbott and Monsen argue that this fall in confidence reflected a general shift in society's attitudes towards business, with many people perceiving that business was no longer delivering on its role in society through legitimate means. Abbott and Monson suggested that CSR was being used as a means to counteract the belief that many of the activities of business were *illegitimate*. Similarly, Trotman (1979) suggests that the increase in CSR by Australian companies over the period 1967 to 1977 may have been motivated by concerns with public image, being used as a sweetener to assuage the general public, generate more identification with the organization and to avoid confrontations such as strikes or

boycotts. Trotman argues that such disclosures can help a business organization in creating the perception of acting responsibly and thus assuaging calls for regulatory interference. Such a strategy would be consistent with the third legitimation strategy outlined above.

Table 7.3 below provides a chronological summary of the results of some of the more significant studies which have used OLT to explore and explain CSR from the early 1980s through to the present day. Although this list is not indented to be exhaustive, it is arguably representative and includes many of the relevant studies. Those relating to environmental disclosure only are highlighted in italics. These 23 studies, with the exception of Guthrie and Parker (1989)[27] and O'Dwyer (2002), contribute to a growing body of empirical evidence which suggests that corporate legitimation may be an important explanatory factor when seeking to understand the nature and causes of CSR. Although a majority of the 23 studies shown in Table 7.3 employed positivist research methods, a significant minority (eight out of 23, i.e. 35 per cent) conducted their research using an interpretive approach (e.g. field-based interviews). Whilst it is not possible to be definitive about the relative popularity of these two approaches (see Chapters 1 and 4), Table 7.3 clearly suggests that CSR researchers utilizing OLT to explain and interpret CSR/CED are able to do so using different research approaches and methods. As discussed previously, researchers working within the interpretive paradigm (see Chapter 4, Section 4.6) tend to be sympathetic to a subjectivist approach, allowing different rather than uni-dimensional views of phenomena to emerge. As such, it is quite common to find CSR researchers using both positivist and interpretive research methods independently in their quest to understand and explain the nature and causes of CED (see, for example, Gray *et al*., 1995, 2001). It is also the case that OLT, as a relatively new and under-developed theory of managerial behaviour (Deegan, 2002), has yet to be 'captured' by one particular research tradition.

Based on the results of the various studies summarised in Table 7.3, a number of important tentative observations may proffered in relation to the nature and causes of CED:

- there is empirical evidence to support the view that voluntary CED is included in the annual report for legitimation purposes (Buhr, 1998; Neu *et al*., 1998; O'Donovan, 1999a, 2002; Patten, 1991, 1992; Simmons and Neu, 1998; Walden and Schwartz, 1997);
- associations appear to exist between the amount of CED and the influence of specific relevant publics (Neu *et al*., 1998) and the values of society (Deegan and Gordon, 1996; Campbell, 2001);
- research has shown that management perceive CED as having some influence in terms of shaping or managing public opinion (O'Donovan, 1999a, 2002); and,
- longitudinal research provides evidence which suggests that CED may form part of a response by management to changing norms and values of society as a whole over time (Gray *et al*., 1995).

Patten (1992), for example, provided a simple but instructive study of how bourgeois legitimacy theory can be used to explain increased environmental disclosure, the general thrust of which has guided many of the subsequent studies in this area. Put simply, Patten argues that following the *Exxon Valdez* tanker disaster off the coast of Alaska in 1989, the

Table7.3
Prior CSR studies involving legitimacy theory (in chronological order)

Study (country)	Research approach	Main data sources	Variables	Role of social discl
Hogner (1982) (USA)	Interpretive	Annual reports (ARs) of US Steel 1901 – 1980	Variations in community social performance expectations. Variations in the quantity of social disclosures in ARs over time	An indicator of cor legitimacy needs re changing social for values
Guthrie and Parker (1989) (Australia)	Interpretive	ARs of Broken Hill Proprietary Company Ltd (BHP) 1885 – 1985	Major events relating directly to BHP. Quantity of social disclosures in ARs	Reactive to econon social and political to provide congrue between corporate activities and socia
Patten (1991) (USA)	Positivist	ARs for 1985 of 156 US Fortune 500 companies	Industry, profitability, size. Quantity of social and environmental disclosures in ARs	Used by business t attempt to affect pu policy; social discl response to public
Patten (1992) (USA)	*Positivist*	*ARs for 1988 and 1989 of 21 companies included in the petroleum segment of the 1989 US Fortune 500 (other than Exxon)*	*Event - Exxon Valdez oil spill off the coast of Alaska, March 24 1989. Quantity of environmental disclosures pre- and post-Exxon Valdez oil spill in ARs*	*Used to influence p policy process – ex extent to which oil companies (except increased environm disclosures post-Ex Valdez incident*

Study (country)	Research approach	Main data sources	Variables	Role of social disc
Patten (1995) (USA)	Positivist	Annual reports for 1985 of 288 Fortune 500 companies	Quantity of social and environmental disclosures in ARs	Used by business t attempt to affect pu policy. Decreases i disclosure in the 19 reflect less social p on business during Reagan administra the US
Gray *et al*. (1995b) (UK)	Interpretive	ARs for 1979 to 1991 of UK companies (comprising a haphazard sample of 444 companies for 1979-87 and a sample of the top 100 companies for 1988-91).	Quantity of social and environmental disclosures in ARs	CSR practice sugg being used as part legitimation strateg justify changing as the business-societ relationship
Deegan and Gordon (1996) (Australia)	*Positivist*	*Annual reports of 25 companies for selected years (1980, 1985, 1988, 1991)*	*Changes in the values of society using the proxy of changes in the total membership of environmental groups. Changes in quantity of 'positive' and 'negative' environmental disclosures in ARs over time*	*Environmental disc used in response to changing social va to alter society's perceptions of the organization*

Study (country)	Research approach	Main data sources	Variables	Role of social disc
Deegan and Rankin (1996) (Australia)	*Positivist*	*Annual reports of 20 companies 1990-1993*	*Quantity and quality of environmental disclosures in ARs. Number of successful environmental prosecutions by authorities*	*Environmental disc used to influence s perceptions of the organization*
Walden and Schwartz (1997) (USA)	*Positivist*	*Annual reports of 53 US Fortune 500 companies previously reported on by the Council of Economic Priorities (CEP) in 4 industries, 1988, 1989, 1990*	*Event - Exxon Valdez oil spill (1989). Quantity of environmental disclosures in ARs pre- and post-Exxon oil spill*	*Used to influence p policy process – ex extent to which qua and quality of environmental disc changed in environmentally-se industries post-Exx Valdez incident*
Brown and Deegan (1998) (Australia)	*Positivist*	*Annual reports of 27 Australian companies in 9 environmentally-sensitive industries for selected years (1981/2, 1984/5, 1987/8, 1990/1, 1993/4)*	*Community concern (as measured by the number of print media articles covering an industry's environmental implications). Quantity of 'positive' and 'negative' environmental disclosures in ARs*	*Used to influence s perceptions in resp media exposure*

Study (country)	Research approach	Main data sources	Variables	Role of social disc
Buhr (1998) (Canada)	*Interpretive*	*Annual reports of Falconbridge 1964 – 1991*	*Government regulations re SO2 abatement. Company's plans re SO2 abatement. Environmental disclosures relating to sulphur dioxide (SO2) in ARs*	*Used by manageme social construct a s meaning of the sym nature of technolog linking positive eco and environmental outcomes*
Neu et al. (1998) (Canada)	*Positivist*	*Annual reports of 33 companies in 4 industries 1982-1991*	*Negative media articles on a business organization's environmental performance (fines, etc.). Environmental concerns of various 'relevant publics'. Quantity of CED in ARs*	*CED used to mana public impressions quantity of CED po as being associated potential pressures 'relevant publics'*
Simmons and Neu (1998) (Canada)	*Positivist*	*Annual reports of 42 nature resource-based companies 1982-1991*	*Quantity of environmental fines reported in the media. Quantity of media articles criticizing the firm's environmental performance. Quantity of CED in ARs*	*CED used to mana public impressions CED posited as be associated with ext threats to the firm' legitimacy from ne media coverage*
Jantadej and Kent (1999) (Australia)	*Positivist*	*Annual and half-yearly reports of Broken Hill Proprietary Company Ltd (BHP) 1992-1996*	*Event - issue of writs against BHP in 1994 for env. damage in relation to operations at Oki copper mine. Qty of CED in ARs following a perceived environmental disaster*	*CED used to reduc adverse public opi triggered by increa public scrutiny foll media coverage in of Oki copper mine*

Study (country)	Research approach	Main data sources	Variables	Role of social disc
O'Donovan (1999a) (Australia)	*Interpretive*	*Semi-structured interviews with personnel of largest Australian public companies in three env. sensitive industries (mining, chemicals, and paper and pulp)*	*Environmental issues reported in mainstream news media. Environmental information in ARs*	*Environmental disc used by manageme shape social perce*
Campbell (2000) (UK)	Interpretive	Annual reports of Marks and Spencer plc 1969-1997	'Switch points' – i.e. points of succession of four successive company chairpersons over the 30-year period. Personal values of chairpersons. Quantity of social disclosures in ARs	Social disclosure u justify the organiza actions and activiti to garner societal s in the face of shifti public opinion
Deegan *et al*. (2000) (Australia)	Positivist	Annual reports of 41 Australian listed companies associated with five major social incidents, covering 4 years, respectively (two years either side of the incident)	Five major social incidents seen as having significant implications for the environment or the safety of both employees or community members. Quantity of CSR in ARs. 'Positive' environmental disclosures	Social disclosure u a means of influen society in relation t events that may be perceived as unfavourable to a business organizati image

Study (country)	Research approach	Main data sources	Variables	Role of social disc
Wilmhurst & Frost (2000) (Australia)	*Positivist*	*1995 annual reports of 62 Australian companies operating in environmentally-sensitive sectors. Mail questionnaire to chief financial officer of the sample companies*	*Management's perceived importance of various specific factors hypothesised as influencing management's decision to disclose environmental information. Quantity of CED (words) in ARs*	*Environmental disc employed by mana as a tool to legitim firm's activities wh management attitu also consistent wit position*
Campbell (2001) (UK)	*Positivist*	*Annual reports of ten FTSE 100 companies in five sectors 1974-2000*	*Changes in the membership of UK environmental groups as a metric for society's concerns for the natural environment. 'Environmental sensitivity' of industry. Changes in quantity of CED in ARs over time*	*Environmental disc employed to narro close a perceived legitimacy gap der from changes in 's environmental opi*
Deegan *et al*. (2002) (Australia)	Positivist	Annual reports of BHP Ltd. 1983-1997	"Public concern" as measured by the number of (favourable and unfavourable) articles in the print media mentioning the activities of BHP. Quantity of (positive/negative/neutral) social disclosures in ARs	Social and environ disclosure part of a legitimising strateg reaction to perceiv public concerns as measured by print attention

Study (country)	Research approach	Main data sources	Variables	Role of social disc
Milne and Patten (2002) *(USA)*	*Positivist*	*Experimental investment scenario involving 76 participants from 12 different US-based accounting firms*	*Participants' responses to different hypothetical investment scenarios involving environmental disclosures for firms in the chemical industry*	*Environment discl on US Superfund-r remediation expost influences investme decisions; voluntar positive disclosure such negative disc for potential invest*
O'Donovan (2002) (Australia)	*Interpretive*	*Semi-structured, open-ended interviews with personnel of largest Australian public companies in each of three environmentally-sensitive industries*	*Interviewees' responses to different hypothetical environmental issues/events and fictitious firms ('vignettes')*	*Environmental disc used by manageme part of a legitimisi strategy designed t shape social perce values and/or expectations*
O'Dwyer (2002) (Ireland)	Interpretive	Semi-structured in-depth interviews with 29 senior executives (including chairpersons, CEOs, and finance directors) of 27 Irish listed companies covering seven industry sectors	Senior executives perceptions of the motivations for the presence/absence of CSR in ARs	Social disclosure u a means of manipu society's impressio the business organi in response to perc social pressures, w underlying aim of enhancing or prote economic interests

enormous publicity generated by this event influenced the social norms and values of the 'relevant publics' (the general public and governments)[28]. Patten found that the petroleum industry significantly increased environmental disclosures in their annual reports in the aftermath of the *Exxon Valdez* incident, suggesting that this incident was perceived by the industry as having a general impact on the relevant publics' attitude towards petroleum companies. Both Guthrie and Parker (1989, 1990) and Deegan and Rankin (1996) employ a similar argument in suggesting that CSR is a *reaction* to external economic, social, political pressures, the motive for such disclosures being to legitimise the business organization's existence and actions. Guthrie and Parker (1990), for example, state that business organizations make voluntary social disclosures in order to:

> *... demonstrate a constructive response to social pressure and avoid further regulation [and] to pacify sociological demands made on business while attempting to win or maintain support from particular targeted constituencies. Such a disclosure strategy may include emphasising the business organization's positive contributions to social welfare and highlighting its attempts to minimise its harmful effects on various elements of society* (p.165).

Legitimacy management by business organizations in the specific context of environmental issues has been a popular theme in CSR research since the early 1990s (see, for example, Buhr, 1998; Campbell, 2001; Deegan and Rankin, 1996; O'Donovan, 1999a, 2002; Patten, 1992; Wilmhurst and Frost, 2000). These studies are generally motivated by a perception that society's values and attitudes to the natural environment shifted in the 1960s and 1970s, effectively changing the terms of the 'social contract' between business and society on the issue of environmental stewardship. As a consequence, a 'legitimacy gap' is seen as having emerged in the 1980s and 1990s either because a business organization's actions and activities are no longer considered by society to be legitimate, or because the company's level of performance, for example, through malpractice or some other negative environmental event, threatens the company's legitimacy. It is in this context that prior studies have assumed that environmental disclosures can be used to close or narrow a legitimacy gap (see, for example, Campbell, 2001). CSR researchers have also sought to explore the views, perceptions, attitudes and actions of management in this context (Buhr, 1998; O'Donovan, 1999a, 2002; O'Dwyer, 2000, 2002). O'Donovan (1999a, p.76), for example, argues that "… in order to test for the existence or otherwise of legitimacy theory, one needs to discover management thought and perceptions in regard to reasons environmental information is being disclosed"[29].

Buhr's (1998) longitudinal, historical study, spanning the emissions of sulphur dioxide over time by Falconbridge, a Canadian company, provides an insightful case-study approach to OLT. Using information in the public domain and semi-structured on-site interviews with company and government representatives, Buhr concluded that environmental disclosures in annual reports are used by management to socially construct a shared meaning of the symbolic nature of technology in linking positive economic and environmental outcomes. Buhr's study illustrates how company reports may be used both to report changing business practices and to influence public opinion. Similarly, O'Donovan (1999a) carried out semi-structured interviews with the senior management of three large Australian companies operating in environmentally-sensitive industries to research whether environmental issues

reported in mainstream news media and linked to the company, or the industry in which it operates, influence the disclosure of environmental information in the annual report. Research evidence suggests that the media, particularly the print media, positively influences the way most people decide what is an important public policy issue (Ader, 1993; Mayer, 1980; McCombs, 1981). Ader (1993), for example, found that the extent of media coverage of pollution issues positively affects community concerns for these issues. Such media coverage can translate into public pressure or expectations of certain standards of behaviour and, ultimately, a loss of legitimacy for business organizations which fail to meet society's expectations. Based on his results, O'Donovan (1999a p.80, original emphasis) concludes: "… it is clear that management believe media reports of a continuining nature, which link the *company* in which they operate to significant environmental issues, were most likely to elicit a response in the annual report." The description 'continuing nature' is important because it suggests that management are monitoring media developments and thus may respond to them. As noted by O'Donovan, this finding suggests that what management perceive as important in relation to environmental issues may well be determined by what the media and other sections of society regard as important, irrespective of whether or not these issues are ultimately reported in the annual report.

O'Donovan (1999a) also suggests that disclosure in the annual report may be *issues-driven* rather than *user-driven*. In other words, what is included in the annual report may be the result of a prior assessment of the issues which management considers the company needs to focus on. This does not imply that management is unaware of the need to indulge in some form of legitimacy restoration following a piece of 'bad' press coverage, but rather that any response via the annual report is much more considered. O'Donovan also found evidence which suggests that management is prepared to use annual reports to correct what they regard as misconceptions formed by the general public about the company or the industry in which it operates in relation to environmental issues. This need to 're-educate the public' may be seen as part of a legitimation strategy aimed at changing society's expectations about the company (legitimation strategy (ii) above) or indeed society's perceptions of it (legitimation strategy (iii))[30]. Importantly, this also illustrates that corporate management is prepared to use annual reports to influence public impressions rather than just to provide some form of accountability by which society can evaluate the company's environmental performance[31]. Such findings have important implications when contrasted with those of other researchers such as Tilt (1994). Tilt's research into the use of the annual report to obtain environmental information by the users of these reports presupposes that management is seeking to provide 'useful' information to such users. However, research evidence provided by Brown and Deegan (1997), Buhr (1998) and O'Donovan (1999a, 2002) suggests that management uses CSR disclosures to influence public impressions. As such, the degree to which social and environmental information provided in annual reports is useful in terms of evaluating corporate social and environmental performance is questionable.

The use of annual reports as mediums for influencing society's impressions of a company rather than informing society is a central theme of much of prior CSR research in this field. Gray *et al*. (1995b), for example, suggest that there is evidence of firms using CSR as an instrument to negotiate the concept of CSR and to determine the firm's relationship with society[32]. In other words, corporate communications through annual and other reports are

perceived to serve a much wider socio-political role than merely to inform shareholders and other users (Guthrie and Parker 1990). As such, far from being neutral, annual reports:

> *... serve as tools for constructing, sustaining, and legitimising economic and political arrangements, institutions and ideological themes which contribute to the business organization's private interests. … [T]hey do not constitute the neutral documents that some report producers suggest. They are a product of interchange between the business organization and its environments and attempt to mediate and accommodate a variety of sectional interests* (Guthrie and Parker 1990, p.166).

For example, if a business organization feels that its legitimacy is being threatened by a poor public image in the media, it may seek to minimise the effects of this threat by voluntarily disclosing information to society through various media, including the corporate annual report (O'Donovan (1999a, 2002; Neu *et al*., 1998; Simmons and Neu, 1998; Zéghal and Ahmed, 1990). Simmons and Neu (1998) concluded that the annual report is used as a medium to respond to public pressure, particularly pressure that comes via the media. Neu *et al*. (1998) also found that management prefers narrative rather than financial or non-monetary quantified disclosure in annual reports because narrative can be targeted at specific audiences in a way that is effective for managing public impressions. Management's use of annual reports to influence societies' perceptions of the social and environmental activities of business organizations is also supported by the results of Brown and Deegan's (1997) study which found a positive relationship between levels of *negative* media attention devoted to environmental issues (i.e. news which reflects unfavourably on a company) and *positive* environmental disclosures (i.e. disclosure which presents the company in a favourable, positive light) in corporate annual reports.

From this perspective, corporate annual and other reports become vehicles through which a business organization seeks to socially-construct and define itself and to project its beliefs, norms, values and perceptions onto society. As such, CSR is seen neither as a 'rational' opportunistic response to market pressures from shareholders and bondholders (as under EAT), nor as part of a strategic policy to manage stakeholder groups (as under MST). Rather, CSR forms part of the hegemonic discourse between organizations and society through which management seeks to re-define the terms of the social contract, to manage public impressions, reduce the business organization's exposure to the social and political environment and to legitimise corporate activities and performance in the context of a set of values, attitudes and norms held and expected by the larger social system of which the business organization is a part (Gray *et al*., 1995b; Lindblom, 1994; Miles, 1987; Neu *et al*., 1998). The extent to which one is convinced by OLT in this context depends to a large part on the degree to which one accepts, ideologically, the various meta-theoretical issues set out in Table 4.3 (Chapter 4). Nevertheless, evidence in support of OLT has been gained through formal empirical analysis, including the use of hypotheses which test for the existence of putative associations between CSR/CED and other variables (see Table 7.3 above). The development of a set of hypotheses with which to test OLT in the context of the present study is set out in the next section.

7.7 Development and statement of hypotheses

Based on the preceding analysis, three variables have been selected to explain variations in CED across firms in the specific context of OLT: (i) political visibility; (ii) pressure from social activists; and (iii) negative (i.e. poor) environmental performance. The basis for their selection, together with details of the hypothesis in each case, is set out below.

(i) Political visibility (the size-industry-disclosure relationship)

Under EAT (Chapter 5), political visibility was presented as one of the variables for predicting variations in CSR across firms. The basic premise underlying this argument is that politically visible firms are targets for criticism from the political sector, particularly regulatory authorities (Watts, 1977; Watts and Zimmerman, 1978). Such firms are said to use various strategies designed to reduce the threat of political interference from the political sector, including CSR. Researchers have reinforced this argument by successfully predicting an association between political visibility and CSR (see, for example, Belkaoui and Karpik, 1989; Ness and Mirza, 1991; Trotman and Bradley, 1981). Under OLT, the concept of political visibility is viewed differently, reflecting a wider socio-political perspective on the relationship between business and society (see Table 4.3, Chapter 4). Essentially, certain business organizations, notably those which are large in size or operating in socially-sensitive industries, are seen as more exposed (i.e. politically visible) to social pressures from various interest groups. This exposure is said to make such organizations easy targets for criticism from such interest groups, particularly social activist and campaign groups that seek socially-responsible behaviour. Such criticisms effectively represent challenges to the organization's social legitimacy (see Section 7.4 above). Politically visible organizations are seen as responding to such challenges by using, *inter alia*, CSR to re-define the terms of the social contract, to manage public impressions and reduce the business organization's exposure to the social and political environment under one or more of the legitimation strategies identified above (see Section 7.5).

Whilst social legitimacy represents a potential threat to and constraint on all business organizations, it is said to affect some more than others. Dowling and Pfeffer (1975) for example, argue that larger (i.e. those bigger in size) organizations, being considerably more visible than others, are likely to engage more heavily in legitimising behaviour[33]. Dowling and Pfeffer also argue that larger organizations, having a more visible public profile, are more dependent on social and political support from society as a whole and are thus more sensitive to the norms and values of society. Suda and Kokubu (1994) used OLT as support for the existence of a positive association between environmental disclosure and the size of a business organization, their basic hypothesis being that larger organizations use positive environmental information in order to reduce or avoid political costs and legitimate themselves. Political visibility under OLT is normally associated with size, although other factors such as culture, economic success (i.e. profitability) and industry sector are also seen as relevant (see, for example, Adams *et al.*, 1998; Campbell, 2001; Deegan and Gordon, 1996; Hackston and Milne, 1996; Lewis and Unerman, 1999; O'Dwyer, 2000; Patten, 1991). Patten (1991), for example, using the annual reports for 1985 of 156 US *Fortune* 500 companies, reports a positive association between CSR and politically visibility, where the latter was based on size and industry, both of which were shown to be statistically significant.

O'Dwyer (2000, 2002), based on a series of semi-structured interviews with the senior management of 27 Irish listed companies, reports management's perceptions of themselves as much more politically visible, and thus under greater social pressure, compared to listed companies in other countries such as the UK. O'Dwyer suggests that such visibility encouraged more socially-responsive managerial behaviour though actively engaging in forms of CSR, particularly in relation to environmental issues, with legitimation being the underlying objective:

> *This form of response appears to have had the primary aim of legitimising corporate activities in order to defend against possible threats or interference to business operations. ... [P]erceptions of recent increased public and industry awareness of the environment in Ireland had apparently impacted on the decisions of some companies to disclose environmental information in their annual reports* (O'Dwyer 2000, p.12).

O'Dwyer reports that political visibility was also perceived by interviewees' to be related to economic success (i.e. profitability) with the more successful companies coming under more intense societal scrutiny, resulting in a greater desire to legitimise their activities. O'Dwyer also refers to interviewees' perceptions that being in a less environmentally-sensitive industry protected them from social pressures. Similarly, Campbell (2001) argues that:

> *The nature of legitimacy theory as it relates to environmental disclosure suggests that disclosure is a partial response to changing [societal] opinion and, because changing opinion will not affect all sectors equally, different responses should be evident between sectors* (p.14).

The reference to industry sector represents a logical development of the political visibility argument under OLT. In short, certain industry sectors are seen as susceptible to higher levels of criticism from social activist and campaign groups that seek socially-responsible behaviour. In the case of the natural environment, environmentally-sensitive industries such as chemicals, oil and gas and pulp and paper are said to have higher public profiles (i.e. are more politically visible) than less environmentally-sensitive sectors such as retail and leisure and banking and insurance (Hackston and Milne, 1996). In this context, large companies in environmentally-sensitive industries are said to use CSR to counteract the belief that business' actions are illegitimate (see, for example, Abbott and Monsoon, 1979; Adams *et al*., 1998; Deegan and Gordon, 1996; Dierkes and Preston, 1977; Cowen *et al*., 1987; Hackston and Milne, 1996; Patten, 1991; Epstein *et al*., 1976). Hackston and Milne (1996) specifically explored the size-industry-disclosure hypothesis based on a sample of the top 50 listed companies in New Zealand. They suggest that large companies operating in socially-sensitive industries may be using CSR to mitigate the social and environmental impacts of their business operations on society and the environment, impacts which are more visible in the case of larger companies than smaller ones. Hackston and Milne report much higher correlations between size and CSR for 'high-profile' industries but lower, in many cases insignificant, correlations for 'low-profile' industries. Based on their findings, the authors suggest that industry sector may moderate the size-disclosure relationship:

> *... [b]eing a larger company is likely to indicate a larger discloser of social and environmental information, if the company is in a high-profile industry.*

> *For low-profile industry companies, relative size is not such a good indicator of disclosure amount* (Hackston and Milne 1996, p.97).

In other words, size may be much more important as a moderator of social and environmental disclosure in the case of companies in socially- and environmentally-sensitive industries compared to companies in less socially- and environmentally-sensitive industries. Deegan and Gordon (1996) provide evidence which lends support to Hackston and Milne's hypothesis. Deegan and Gordon tested the association between firm size and the amount of 'positive' environmental disclosure (using turnover as a proxy for size) for a sample of 197 Australian firms. They report a significant positive association between size and 'positive' environmental disclosure for all firms and for firms in the nine most environmentally-sensitive industries[34], but the correlation coefficient was negative for firms in the nine *least* environmentally sensitive industries. In interpreting their results, Deegan and Gordon suggest that once an industry is perceived by the relevant publics to be environmentally-damaging, *ceteris paribus*, larger firms would be assumed to create more environmental costs than smaller ones, and hence are under greater threat of being perceived as socially illegitimate. Similarly, Campbell (2001) argues that consistently higher levels of environmental disclosure amongst companies from the more environmentally-sensitive industries provides support for the argument under OLT that such disclosures are used by companies in reacting to a perceived legitimacy gap which has opened up due to a change in the values, norms and attitudes of society as a whole towards the natural environment. Moreover, the extent of this gap is argued to vary from one sector to another, the amount of environmental disclosure needed to close the gap (or prevent it from opening) bring greater for *large* companies operating in *sensitive* (i.e. high profile) industries. There is also some evidence to suggest that the industry effect is not the same for all types of social information. Adams *et al*. (1998) found that the association between industry sector and CSR was more significant for environmental and employee disclosures than for disclosure of ethical information. Moreover, the authors report a statistically significant inter-relationship between size and industry in the case of environmental and employee disclosures, with industry effects being more pronounced in the case of larger companies.

Based on the preceding analysis, using the political visibility argument under OLT, it is hypothesised: (i) that there is a positive association between political visibility (using the proxies of size and profitability) and the volume of CED; (ii) that there is a positive association between industry environmental sensitivity and the volume of CED; and, (iii) that the political visibility-disclosure association is stronger in the case of companies operating in environmentally-sensitive industries compared to those operating in less environmentally-sensitive industries[35]. In addition, it is also hypothesised that CED will form part of a business organization's social legitimation strategy aimed at changing society's *perceptions* of the organization (i.e. the third legitimising strategy, see Section 7.5 above). As such, CED is predicted to be predominantly favourable to the business organization in terms of presenting itself as acting responsibly in relation to environment issues, i.e. a focus on 'good news' rather than 'bad news'[36]. Campbell (2001), for example, asserts that large companies operating in environmentally-sensitive industries use environmental disclosure in an attempt to close a legitimacy gap, whether real or perceived, not by changing their business performance or by changing society's expectations, but by *changing society's perceptions* of

the business organization. Such a strategy is consistent with the work of O'Dwyer (2000, 2002) who concludes that, in the main, corporate social *obligations* appeared to be disregarded, with CSR practice often rationalised as a potential means of portraying a *potentially* false reality that the organization has operated in a way that society would regard as good, thereby portraying a socially-responsible image *irrespective* of actual behaviour (see, for example, Lewis and Unerman, 1999). The formal hypotheses are stated below in alternative form, the null hypothesis (H_0) in each case being the hypothesis of no difference[37]:

H_{7a}: There is a positive association between political visibility and the volume of CED.

H_{7b}: There is a positive association between industry environmental sensitivity and the volume of CED.

H_{7c}: The political visibility-disclosure relationship is stronger in the case of companies operating in environmentally-sensitive industries compared to those operating in less-environmentally sensitive industries.

H_{7d}: CED will form part of a corporation's public relations machinery aimed at influencing society's perceptions by biasing disclosures away from information which presents the firm as acting irresponsibly in relation to environment issues.

(ii) Pressure from social activists

As outlined previously, a business organization's social legitimacy is argued to be dependent on the degree to which its activities are perceived by society as being congruent with the values, attitudes and norms of that society. In pluralist societies, business organizations are seen as being constantly monitored by society through its various constituent groups ('relevant publics') who act as representatives and signallers of the degree of consensus (and thus social legitimacy) granted to business organizations to operate within society (Preston and Post, 1975). The values, attitudes and norms of a society are not immutable, but change over time (see, for example, Gray *et al.*, 1995b). These changes are seen as giving rise to shifts in the prominence and prevalence of specific public interests groups who act on behalf of society to preserve, restore and protect a society's values and norms[38]. Heard and Bolce (1981), for example, argue that through research, litigation, and lobbying, social activists organizations were instrumental in the 1960s and 1970s in calling attention to issues such as product quality and safety, environmental protection, employment discrimination, and occupational health and safety. In the specific context of environmental issues, the most visible relevant public who act to protect a society's values and norms are the non-governmental environmental pressure groups (hereafter, ENGOs – these are defined in Chapter 8) such as Greenpeace and Friends of the Earth. The voluntary funding of ENGOs by society is argued to be not only an indication of society's approval of their activities but also of the underlying values and attitudes of that society (Campbell, 2001; Deegan and Gordon, 1996)[39].

The 'public pressures' argument under OLT has been explored by a number of CSR researchers, most notably Patten (1991, 1992, 1995). Patten's general argument in developing a legitimacy theory of social disclosure relied upon the interpenetrating systems format of Preston and Post (1995) which Patten, drawing on Post (1978), stated to be as follows:

> *According to the interpenetrating systems development, the relationship between business organizations and other sections of society is defined by an ever-changing boundary that is addressed through the public policy arena. Whenever a relevant public is dissatisfied with the performance of a business organization, it can apply pressure to the firm to meet expectations or it can use the legal system to require improved performance. ...* (Patten 1995, p.277).

Patten's (1991, 1995) argument is that CSR is used by business organizations to legitimise business activities, the *social* (as opposed to legal or economic) legitimacy of business being monitored through the public policy arena not the market-place[40]. Social disclosure in this context is seen as influential in the public policy process because of its ability to shape the perceptions of the relevant publics (Patten, 1995). Prior CSR research (see, for example, Brown and Deegan, 1997; Trotman and Bradley, 1981; O'Dwyer, 2000, 2002) appears to reinforce the argument that companies respond to social pressures. O'Dwyer (2000), for example, based on a series of semi-structured interviews with senior management of Irish listed companies, reports that 28 out of the 29 interviewees (97%) stressed the need to respond to social pressures from communities, pressure groups and the media. In the particular context of CSR, a number of researchers have made specific reference to the influence of 'environmentalists' (Dierkes and Antal, 1985), 'lobby groups' (Parker, 1986), 'advocacy groups' (Patten, 1992), 'environmental lobbying organizations' (Deegan and Gordon, 1996). Although measuring the *direct* impact of ENGOs' campaign activities is problematic, such groups may conceivably be wholly or partly responsible for bringing about change in both the public policy arena and in some areas of corporate behaviour. Moreover, society's support for social activist groups, as evidenced by, for example, financial donations, campaign support and formal membership, may be regarded as a 'seal of approval' from society in relation to such activities. Prior CSR research in this area can be broadly categorised into three distinct types:

(i) studies which explore the relationship between changes in the membership of social and environmental activist groups and CSR over time (e.g. Campbell, 2001; Deegan and Gordon, 1996);
(ii) studies which explore the relationship between the campaign activities of these groups and CSR (e.g. Deegan and Gordon, 1996); and,
(iii) studies which explore the sources of information, including corporate annual reports, used by various sections of society in order to become informed about the social and environmental performance of companies (e.g. Tilt, 1994).

Studies which fall under item (i), although few in number, have been successful in terms of finding a positive association between the growth in the membership of environmental pressure groups and increases in the level of CED over time[41]. However, both Deegan and Gordon (1996) and Campbell (2001) refer to problems in obtaining ENGO membership figures which effectively restricted their research to periods when such data was available (Deegan and Gordon, 1996) or to relying on data provided by a limited number of ENGOs (Campbell, 2001)[42]. In the context of the present study, preliminary attempts to obtain membership data for European ENGOs from a single, reliable source revealed that such data, even if available, is not made public[43]. Moreover, in some EU countries, environmental

pressure groups also function as non-membership organizations, operating either as foundations which are funded by the public or the state, or both, or as action networks formed via the Internet to campaign on specific issues. These factors suggest that membership details, even if available, would not necessarily provide a reliable proxy for either an indication of the level of public support for such organizations or of changing social values (see Chapter 8). Hence, this approach was not adopted in the present study.

In relation to studies falling under item (ii) above, there is a presumption in the CSR literature that community lobby and pressure groups are a major socio-political influence on CSR practices. Whilst prior research suggests that pressure groups exert *direct* pressure on individual companies (Deegan and Gordon, 1996; Guthrie and Parker, 1989; Patten, 1992), the extent to which CSR represents a *response* to such pressures is still relatively under-researched[44]. Community lobby groups and pressure groups are generally seen as undertaking a number of activities that can, potentially at least, influence a business organization's operations and costs, including the publication of social audits[45] and the direct lobbying of governments for changes in legislation or product standards (Deegan and Gordon, 1996). Guthrie and Parker (1989), for example, in examining the social disclosure practices of BHP, one of Australia's largest organizations, over the 100-year period 1885 to 1995, found that such disclosures peaked at a time when the mining, steel and oil industries were targets for criticism from environmental groups. Guthrie and Parker suggest that the increase in environmental disclosure by BHP may have been part of a strategic attempt to counter these criticisms. Deegan and Gordon (1996), in a development of the earlier studies of both Guthrie and Parker (1989) and Patten (1992), report a positive association between the extent of environmental groups' concerns and the amount of *positive* (i.e. good news) environmental information disclosed. These findings supported the hypothesis under OLT that *positive* (i.e. 'good' news) CED is used to legitimise the operations of firms that operate in industries of concern to environmental groups.

In relation to item (iii) above, various studies have provided insights into the way in which sections of society view information contained in corporate annual reports. In particular, these prior studies suggest that: (i) user groups consider the annual report to be a major source of information about a business organization's social and environmental performance (Anderson and Epstein, 1995; Deegan and Rankin, 1997; Epstein and Freeman, 1994; Harte *et al.*, 1991; Tilt, 1994)[46]; and (ii) annual reports are targeted at specific audiences with the aim of legitimising corporate social and environmental activities (Ullmann, 1985; Neu *et al.*, 1998). Tilt (1994) investigated the potential influence of pressure groups over companies' disclosure practices. Her findings provide evidence which suggests that lobby groups *do* use CSR in annual reports, that annual reports are the most commonly used medium for CSR and that lobby groups tended to support companies with good (i.e. complete and fair) disclosure practices. Tilt also reports that companies perceive the greatest influence on their *environmental* activities to come from (in descending order) (i) government, (ii) the public, (iii) consumers, insurance companies, shareholders and (iv) lobby groups, banks, suppliers, and the media[47]. Empirical evidence provided by Deegan and Rankin (1997) also indicates that environmental information is important to various groups in society in the context that such disclosure has an impact on the various decisions made by these user groups[48]. The evidence provided by these various studies is important in the context of legitimacy theory

since the ability to manage, shape or manipulate the perceptions of the relevant publics through report disclosure is clearly only possible if those relevant publics actually monitor the reported information (Deegan and Rankin, 1997). Tilt (1994), for example, reports that the source of information most actively sought by Australian environmental groups in relation to a business organization's environmental performance is the company's annual report. Such evidence lends weight to the assumption that some groups within society perceive environmental information to be important and actively seek out such information concerning these activities. Consequently, if reporting organizations are aware of this fact, incentives may exist for management to use corporate reports as a means of communicating *positive* environmental information to society for the purposes of legitimation.

Based on the above analysis, the present study explores: (i) the association between the campaign activities of ENGOs and CED; and, (ii) the extent to which ENGOs attempt to influence and review environmental information disclosed by companies. Furthermore, CED disclosures are posited as forming part of a legitimation strategy which aims to present the firm as acting in harmony with the environment and not detrimental to it. In relation to item (i), the formal hypothesis is stated below, the null hypothesis (H_0) being the hypothesis of no difference:

$H_{8a:}$ There is a positive association between social pressures, as measured by the extent of campaigns by environmental pressure groups, and the volume of CED.

$H_{8b:}$ CED will form part of a corporation's public relations machinery aimed at influencing society's perceptions by biasing disclosures away from information which presents the firm as acting irresponsibly in relation to environment issues.

The argument used under hypothesis H_{7d} above (i.e. that CED is used as part of a legitimation strategy to change society's perception's of the organization) also applies to the social pressures argument (hypothesis H_{8a}). In relation to item (ii), although prior research exists in relation to the influence and activities of social and environmental pressure groups in Australia (Tilt, 1994) and the UK (Campbell, 2001), little evidence has been provided in relation to mainland Europe. In seeking to fill this void, the present study includes a survey of the activities, perceptions and views of European ENGOs in the context of CED (see Chapter 8 for details).

(iii)Poor environmental performance

Both the political visibility and social pressures arguments under OLT, as outlined above, suggest that CSR/CED is used in response to perceived threats to a business organization's social legitimacy. CSR/CED in this context is said to be predominantly aimed at changing society's perception of the organization, and thus places heavy emphasis on positive (i.e. good news). Threats to social legitimacy can also arise where aspects of an organization's economic, social or environmental performance come under scrutiny from sections of society such as the media and social pressure groups. OLT posits that a business organization must at least *appear* to be concerned with the values, norms and expectations of the societies within which it operates. Failure to do so is seen as giving rise to inappropriate behaviour with the possibility that society may act to remove the organization's legitimacy status (Deegan and

Rankin, 1997). Consequently, if society expects organizations to maintain a certain standard of environmental care, for example, a business organization with a poor environmental performance record may face a threat to its legitimacy status from its 'relevant publics' in terms of the resources and support necessary for its continued operations. In other words, society may revoke their social contract unless the organization (appears to) carry out particular strategies, including providing information to nullify or reject negative news which may be publicly available (Deegan and Rankin, 1997). Studies into *negative* media articles, for example, linking a company to the environment have consistently demonstrated an association between the extent of negative news coverage and 'positive' CED in annual reports (see, for example, Brown and Deegan, 1998; Deegan *et al*., 2002; Neu *et al*., 1998; O'Donovan, 1999a, 2002; Simmons and Neu, 1998)[49]. Brown and Deegan (1998), for example, in testing for a relationship between the level of *negative* print media coverage given to an industry's environmental implications and the level of *positive* environmental disclosures made by companies within that industry, report a significant association for five out of the nine selected industries. Similarly, there have been a number of studies which have looked at fines imposed on companies for breaches of environmental regulations, such studies also reporting an association between the extent of such fines and 'positive' CED in annual reports (see, for example, Deegan and Rankin, 1996; Neu *et al*., 1998; Simmons and Neu, 1998). Simmons and Neu (1998), for example, in studying the annual reports of 42 nature resource-based companies over the period 1982-1991, found negative media reporting of fines and environmental performance to be associated with higher levels of environmental disclosures.

The results of these studies are seen as providing evidence of the use of CSR in corporate annual reports which goes beyond merely trying to influence society's perceptions but of seeking to *manipulate* public impressions in the face of bad news (Neu *et al*., 1998). That is, business organizations are seen as employing CSR as a means of exploitation, mediation, mystification and transformation by deflecting attention away from issues of public concern to issues which present the company as socially-responsible, emphasising aspects of social responsiveness which have no real impact on the underlying terms on which they do business, such that society is misled into thinking that there is no legitimacy gap (Woodward *et al*., 2001)[50]. This analysis is consistent with the fourth legitimation strategy identified in Section 7.5 above. Moreover, as noted above, those companies which are seen as the worst offenders or which receive the most media criticism have been shown to use positive social and environmental disclosure to a greater extent, suggesting that efforts at misleading society are linked to the degree to which a company's social responsibility is being challenged. The extent to which CSR can be linked to specific measures of environmental performance has been explored by a number of researchers (see, for example, Wiseman, 1982; Rockness, 1985; Rockness *et al*., 1986). The basic hypothesis under OLT in this context is that the worst performers disclose more CED as part of a more intense strategy to restore or maintain social legitimacy. However, this line of research is problematic because of the lack of reliable measures of a business organization's environmental performance. Media articles, for example, cannot be assumed to provide reliable, unbiased accounts of a business organization's environmental performance. Similarly, publicly-disclosed fines for breaches of environmental regulations are influenced by socio-political considerations, notably that there

is some pre-determined politically-agreed cut-off point between what is considered an acceptable level of pollution and what is not.

Nor is it fair to assume that all reportable (by the company to the authorities) breaches of environmental regulations are necessarily made known to the general public. Some environmental disclosures may provide a reliable indication of environmental performance, such as, for example, pollution disclosures in 10K reports and annual reports to shareholders in the case of US listed companies (see, for example, Cunningham, 1980; Freedman and Jaggi, 1982a; Freedman and Wasley, 1990). Third-party social audits performed by the Council on Economic Priorities (CEP, 1977) in the US have also provided a valuable source of data on corporate environmental performance. Such audits included third party pollution performance ratings based on CEP's own independent investigations of pollution control records of environmentally-sensitive industries. These ratings have been used in a number of studies to explore relationships among social performance, social disclosure and economic performance (Bowman and Haire, 1975; Chen and Metcalf, 1980; Fogler and Nutt, 1975; Freedman and Jaggi, 1982a; Freedman and Wasley, 1990; Ingram and Frazier, 1980; Spicer, 1978a, b; Wiseman, 1982). Notwithstanding the fact that the quality of the CEP reports varied significantly (Ullmann, 1985), the results of these studies was consistent, i.e. that *no* correlation could be found between a business organization's environmental performance based on the CEP pollution performance index and annual report environmental disclosures. A number of other CSR studies (Halme and Huse, 1997; Wiseman, 1982; Rockness, 1985; and Rockness *et al*., 1986) provide evidence which suggest that the *quantity* of environmental disclosures by companies may be *inversely* related to environmental performance. CEP's environmental performance rankings have also been used to assess the degree to which the same performance rankings could be obtained from reading the respective corporate annual reports. Rockness (1985), for example, conducted a field experiment in which 32 subjects from each of four groups (financial analysts, MBA students, environmental activists and environmental regulators) were asked to evaluate the environmental performance of 26 companies based on actual annual report disclosures. Rockness reports that none of the subjects groups' environmental performance rankings showed significant positive correlation with CEP's rankings for any industry, suggesting that environmental performance evaluations based on annual report disclosures resulted in *inaccurate* assessments of actual environmental performance. Moreover, the majority (13 out of 20) of the correlation coefficients were negative, implying that subjects evaluated the worst environmental performance as *best* and vice-versa. These results suggest that the subjects were being misled by the disclosures in the annual report when assessing environmental performance. Although Rockness was not able to confirm whether the firms were *deliberately* misrepresenting their environmental performance, the finding that subjects were unable to accurately make comparative judgements about firms' environmental performance from annual report disclosures is consistent with earlier literature which criticised environmental disclosures for being self-serving and inaccurate accounts of performance (Churchill, 1978; Dierkes and Preston, 1977; Nader, 1978).

However, the lack of reliable, publicly available data on the environmental performance of European companies[51] means that tests for an association between CED and environmental performance must be based on alternative proxies for such performance. One approach is to

perceive organizational social and environmental performance as an indistinguishable component of a business organization's effectiveness, representing the extent to which a business organization's meets anticipated or existing social needs, expectations or demands from certain external constituencies beyond those which are linked directly to its products or markets (Strand, 1983). Thus, in terms of environmental issues, environmental performance may be construed as representing the extent to which a business organization meets, or seeks to meet, the needs, expectations or demands of those external constituents who are concerned with its environmental performance. This implies that testing the extent to which the organization is seen to meets such demands involves (i) identifying the organization's external constituents who are concerned with environmental issues and (ii) measuring the latter's degree of satisfaction using one or more methods which enables some form of overall index by which organizations can be ranked in terms of their overall environmental performance (Ullmann, 1985). Studies which have attempted to measure social or environmental performance in this way have tended to use reputational indices (see, for example, Cochran and Wood, 1984; Fry and Hock, 1976; Heinze, 1976; Moskowitz, 1975; Sturdivant and Ginter, 1977; Vance, 1975)[52]. Fry and Hock (1976), for example, in their study of 135 firms in 15 industries using students' evaluation of industry reputation, found a negative correlation between social performance and the quantity of social disclosures in annual reports, i.e. companies in industries with the worst public image gave the greatest emphasis on social-responsiveness. Given the lack of publicly-available environmental performance data on European companies, the reputational index approach was adopted for the purposes of obtaining an environmental performance rating ('eco-rating') from ENGOs, the latter meeting Ullmann's (1985) definition of an external constituent clearly concerned with environmental issues, such groups also representing the general views of society (Deegan and Rankin, 1996). Details of the research approach are set out in Chapter 8.

The value of the various studies referred to above into the relationship between corporate social performance and CSR is the fact that annual report social disclosures may not be a reliable basis for assessing corporate social performance, thus adding weight to the argument that social disclosures are self-serving rather than neutral or unbiased reflections of actual performance. As was shown in Chapter 2, there are few regulations which require European companies to report on aspects of their environmental performance at corporate level. Thus, management has considerable scope for choosing when, what and how to report on aspects of its social and environmental performance in the annual report and corporate-level social and environment reports. This includes the degree to which management chooses to focus on 'positive' environmental news (i.e. CED which presents the company as operating in harmony with the environment – 'good news') and 'negative' environmental news (i.e. CED which presents the company as not operating in harmony with the environment – 'bad' news'). Prior research provides evidence to support the existence of a positive relationship between 'good' environmental news as disclosed in annual reports and 'bad' environmental performance, i.e. that firms which disclose the greatest amount of positive environmental news are typically the worst environmental performers (Wiseman, 1982; Rockness, 1985; Deegan and Rankin, 1996). Prior studies which have classified CED as between 'good' and 'bad' news also provide evidence which suggests that management use corporate annual reports to report information which is biased and self-laudatory with minimal disclosure of negative environmental information (Deegan and Gordon, 1996; Deegan and Rankin, 1997;

Guthrie and Parker, 1990). Guthrie and Parker (1990), for example, in their study of corporate social disclosures by the 50 largest companies in the USA, the UK and Australia for the year 1983, found no company provided negative information in relation to its environmental performance. Deegan and Gordon (1996), in their cross-sectional study of the environmental disclosures of 197 Australian companies using their 1991 annual reports, found only 14 (7 per cent) companies provided negative environmental information. In particular, the mean amount of positive environmental disclosures was 180.7 words compared to a mere 5.7 words of negative environmental disclosures (Deegan and Gordon, 1996).

The results reported by Deegan and Gordon (1996) and Guthrie and Parker (1990) could have been due to the fact that the companies examined had only positive environmental information to report[53]. However, a study by Deegan and Rankin (1996) of the disclosure practices of 20 Australian companies known *ex ante* to have negative environmental information available to disclose appears to refute this. Based on evidence provided by the New South Wales and Victorian Environmental Protection Agency in relation to successful corporate prosecutions for breaches of environmental protection laws, Deegan and Rankin found that only two of the 20 companies reported their breach of the law. Their results provide two important pieces of empirical evidence which tend to support a legitimation perspective: firstly, there was a significant increase in the reporting of environmental information in the year in which prosecutions were proven; and, secondly, firms which had been successfully prosecuted failed to disclose these prosecutions but instead chose to provide details on environmental awards. The latter tactic is consistent with the legitimation strategy suggested by Dowling and Pfeffer (1975) in which a business organization seeks to manipulate the perceptions of the relevant publics, rather than educate or inform them, by associating itself with *emotive symbols* which have high legitimate status and which are intended to deflect attention away from a particular issue or concern (the fourth legitimation strategy identified above)[54].

Based on the foregoing analysis, the association to be tested under OLT is that the eco-rating of a business organization (as a proxy for environmental performance) is *negatively* related to the amount of CED. In other words, the worst corporate environmental performers (as judged by society) use environmental disclosure as a legitimising strategy to a greater extent than companies with a better eco-rating. In addition, CED is predicted to be predominantly in the form of 'good' news rather than 'bad' news. The formal hypotheses are stated below, the null hypothesis (H_0) in each case being the hypothesis of no difference:

H_{9a}: There is a negative association between environmental performance, as measured by the eco-ratings of environmental pressure groups, and the volume of CED.

H_{9b}: CED will form part of a corporation's public relations machinery aimed at influencing society's perceptions by biasing disclosures away from information which presents the firm as acting irresponsibly in relation to environment issues.

7.8 Some concluding remarks

In seeking to increase our knowledge and understanding of managerial behaviour in the context of CSR, organizational (or bourgeois) legitimacy theory (OLT) has become one of, if not *the*, most popular theories amongst CSR researchers at the present time. Recently, perhaps in recognition of this trend, the *Accounting, Auditing & Accountability Journal* (AAAJ) devoted a special issue to embracing themes associated with social and environmental reporting and its role in maintaining or creating organizational legitimacy (Deegan, 2002). Whilst the popularity of a theory may not, in itself, confer intellectual authority, the considerable attention now being paid to OLT has created a context within which the role and purpose of CSR is becoming gradually more removed from a simple neo-classical economics or managerial stakeholder perspective. Rather, the lens provided by OLT suggests that corporate social and environmental reporting, against the backdrop of a mutable, fluctuating 'social contract' between business and society, is used to legitimise certain aspects of an organization's operations. If true, this interpretation of CSR in general and CED in particular is arguably problematic because it challenges some of the more insipid and rather anodyne perspectives traditionally offered for explaining managerial disclosure strategies. If, indeed, CSR/CED is used by management as a sophisticated form of public relations to manage society's perceptions or impressions of the firm, then we are in a very different ball game compared to that where such reporting is seen to have a primarily technical (e.g. environmental performance reporting) or social (e.g. social responsibility) role. Rather, as Deegan (2002) argues, we should begin to question whether legitimising activities, such as those relating to social and environmental disclosure, are beneficial to the community:

> *Disclosure decisions driven by the desire to be legitimate are not the same as disclosure policies driven by a management view that the community has a right-to-know about certain aspects of an organization's operations. One motivation relates to survival, whereas the other relates to responsibility* (Deegan 2002, p.334).

It is in that context that OLT starts to take on a serious socio-political role in the wider debate surrounding important issues such as corporate social and environmental responsibility (CSResp), corporate governance and corporate sustainability. As such, OLT, despite its relative youth, may have much to offer not only in terms of explaining and understanding managerial behaviour but also in relation to public interest and regulatory issues (see Chapter 11).

Notes

1. For a discussion of values, attitudes and norms in the context of organizational legitimacy, see, for example, Boulding (1978). According to Boulding (1978), business organizations operating in pluralistic societies (see Chapter 6) are subjected to public policy pressures consisting of three non-market environments: the cultural environment which consists of values and attitudes of the general population; the political environment, which constantly creates new laws and new sanctions; and, the legal environment which encompasses the laws, regulations and possible sanctions under which it operates. These cultural, political and legal environments are seen as interacting with each other such that cultural changes can have a significant impact on political action and, subsequently, on the legal structure (Boulding, 1978). In the 1990s, for example, the

growth of the 'green' movement, notably environmentalists, and the reaction of a broad cross-section of society including customers, investors, governments to environmental disasters such as the *Exxon Valdez* incident indicated that concerns about the environment were no longer limited to fringe political groups but had entered the consciousness of the wider community (Freedman, 1993).

2. Weber's (1922) theory of legitimacy stresses the importance of followers' beliefs and draws on the notion that there are three ideological bases to legitimacy (traditional; charismatic; and, legal-rational) which may confer authority, and thus power, on rulers. Legal-rational authority was for Weber (1922) the characteristic form of authority in modern bureaucratic societies comprised of large, private organizations pursuing a variety of goals. Under this notion of authority, a command or instruction is seen as legitimate and authoritative if it is issued by the correct office, under the appropriate regulations and according to appropriate procedures (Abercrombie *et al*., 1994). Hence, the authority of corporate officials came to depend not on their charisma or any tradition, but on a consensus as to the validity of a set or rules and procedures which are perceived as being fair, rational and impartial (Abercrombie *et al*., 1994). This subjectivist approach to legitimacy led Weber to argue that a state could not be legitimated simply by reference to the rule of law and that states which acted beyond the scope of public consent had a 'legitimation deficit'. More recently, Habermas (1976a) introduced the term 'legitimation crisis' as part of his general argument that all social systems require some mechanism which gives them legitimacy.
3. Dahl (1982) asserts that, in a democratic order, judgements as to what is beneficial and what is harmful should rest with the relevant demos and its representatives, acting through democratic procedures and institutions. Such an assertion represents one model of democracy. Other models exist, all of which wrestle with how to balance the competing claims, rights and responsibilities of the constituent elements of a society (see, for example, Held, 1996).
4. Thus, this model of legitimacy theory moves closer to a classical political economy visualization of society, one in which society, politics and economics are considered inseparable elements of the social world in which human action takes place. For examples of the application of political economy in accounting, see Cooper and Sherer (1984).
5. The same argument applies of course to economic agency theory (see Chapter 5). For a more detailed discussion of how classical political economy differs from bourgeois political economy in the context of legitimacy theory and CSR, see, for example, Arnold, 1990; Guthrie and Parker, 1990; Lehman, 1992; Neimark, 1992; Tinker *et al*., 1991.
6. Woodward *et al*.'s (2001) useful contribution to accountability theory, agency theory, stakeholder theory, organizational legitimacy theory and political economy of accounting theory is not explored in this study. Their model of corporate social responsibility essentially draws together these various theories to explore and explain how CSR may involve both attempts at agenda setting (proactive) and legitimacy (reactive) in a principal-agent/neo-pluralist/accountability context where different stakeholder groups are seen as becoming more demanding in terms of their expectations of business. The extent to which these various theories are seen as overlapping and thus subsumable within a single model is, arguably, a *mélange* of empirical evidence, social construction and personal conviction. For the purposes of the present study, these various theories are treated as (predominantly) separate and separable since it is the author's perspective that by doing so it is possible to draw out more clearly the distinguishing features of each theory in the context of CSR. Hence, whilst CSR may be used for legitimising ends, other tactics (e.g. lobbying of government bodies) may be used for agenda-setting. Thus, it is important to keep in mind that powerful organizations may employ a range of tactics with which to both manage public perceptions and control political (i.e. government) agendas.
7. Stakeholder and legitimacy theories are still very new to CSR and far from fully-fledged theories. In that context, they are seen as providing useful frameworks for studying CSR practice but it is important to appreciate that "… we are a very long way from any complete understanding of why organizations do (and do not) undertake social and environmental accounting and disclosure" (Gray *et al*. 1996, p.49).
8. Numerous terms are used in everyday language to describe 'interest groups', including also 'special interest groups', 'pressure groups' and 'lobby organizations'. The European Commission

(CEC, 1993a), for example, makes a distinction between two categories of interest groups: not-for-profit organizations and profit-making organizations. The focus of the present study is on the former, which comprise European, international and national federations and associations. Within the legitimacy theory literature, 'interest groups' are given different labels, including 'conferring publics' (O'Donovan, 1999b), 'relevant publics' (Buhr, 1998; Lindblom, 1994; Neu *et al*., 1998), 'constituents' (Bansal, 1995), and 'social actors' (Ashforth and Gibbs, 1990; Deephouse, 1996; Pfeffer and Salancik, 1978). Essentially, these different labels have the same meaning.

9. The reference to 'peer' or 'superordinate' systems is consistent with the earlier work of both Parsons (1971) and Thompson (1967) who argued that legitimation takes place at the institutional level of formal organizations. Such notions of legitimacy also tie in with the general reassessment of the relationship between business and society and the debate over corporate social responsibility which took place in the 1960s and 1970s, as presented in Chapter 2. Until relatively recently, legitimacy was generally regarded as relating to only *economic* performance, such that as long as a firm was economically successful (i.e. profitable) it was rewarded with legitimation (Patten, 1992). In other words, so long as a company was profitable, it legitimised itself (De Villiers and Barnard, 2000). However, proponents of legitimacy theory argue that society's perceptions of the social responsibilities of business *changed* in the 1960s and 1970s, requiring business to pay much more attention to non-economic issues, including ethical, social and environmental matters.
10. However, no attempt is made under the bourgeois model of legitimacy to explore the way in which the values, norms and expectations of society are influenced by large business organizations. In effect, these values and norms do not form part of the analysis other than to serve as a reference point, with organizations depicted as reacting to a changing set of values and expectations. A central critique of classical political economy is that large business organizations have the power and resources to manage and control a society's values, norms and expectations and do so through a process of domination, exploitation, deprivation, manipulation, mediation, suppression, mystification and obfuscation (see Table 4.3 Chapter 4). From this perspective, accounting is just part of such a process. It should be evident, then, why the Marxian analysis is not so much concerned with how business organizations react through social disclosure policies given that its concern is with a much more disturbing agenda, one in which elected governments are seen as no more than puppets of the capitalist system. In the specific context of social and environmental issues, it is suggested that this analysis has much to offer (see Chapter 10 and 11).
11. The notion that organizations exist in society under an expressed or implied contract is nothing new, being a development of out a branch of political philosophy which viewed the social contract primarily as a political theory in terms of explaining the supposed relationship between a government and its peoples (see, for example, Thomas Hobbes (1588-1679), John Locke (1632-1704) and Jean-Jacques Rousseau (1712-78)). Such writers argued that society in general accepts an overriding control over individual freedoms in order to achieve collective goals (Mathews, 1993). However, it is only recently that this notion has been used in a business and accounting context (see, for example, Shocker and Sethi, 1974). The latter concept views society as a collection of individuals and factions which provides business organizations with their legal standing, attributes and authority to own and use common resources and to hire employees. The business organization is seen as having no inherent rights to the benefits derived from the use of these goods and services; rather, in order to permit their use, society is argued to expect certain benefits which are presumed to exceed the costs to society (Mathews, 1993).
12. In other words, a people's surrender of control over their environments is made on the pre-condition that business delivers on its social contract. Social benefits and costs in this context include material benefits such as employment and wages, as well as social costs such as alienation, loss of control over working conditions and working practices, and environmental costs due to pollution and depletion of the earth's natural resources. In that context, it may be seen why the present crisis in relation to 'sustainability' is one which business has to win and seeks to do so by presenting itself as being 'sustainable' from a 'business-as-usual' perspective.
13. Such a position would seem to have been adopted by the US Securities and Exchange Commission's (SEC) reporting requirements for environmental disclosure (SEC, 1973, 1979).

14. In the previous chapter, managerial stakeholder theory (MST) was used to define stakeholders from the perspective of the *organization*. Here, an organizational legitimacy theory (OLT) is used to define the 'relevant publics' from the perspective of *society*. The latter theory's reference to 'relevant publics' rather than 'stakeholders' is both deliberate and instructive. Although a link can be drawn between OLT and MST in the sense that both theories recognize the existence of multiple constituencies within society (Campbell, 2001), the nature of these constituencies under the two theories is quite different. Under MST, stakeholder groups are defined by the organization which is depicted as actively intent on managing their various interests from the perspective of the organization's goals as a whole. Under OLT, society itself is seen as made up of various constituencies which have the power to grant or withhold legitimacy (see, for example, Elsbach, 1994), with organizations reacting to any threats to their legitimacy. Moreover, legitimacy theory argues that societies can be seen as adhering to a set of norms and values which establish what is considered permissible and what is not. The values and norms of society as a whole are a fundamental attribute of legitimacy theory and clearly distinguish it from the managerial model of stakeholder theory. Business organizations, as with any other institution or individual are not above these norms and values but must be seen to be operating within the (unwritten) terms of the social contract between business and society. Whereas MST focuses on how the organization manages its relationship with its groups of stakeholders whose relative interests, needs and wants are often in conflict with one another and with the organization, OLT is concerned with how an organization seeks to preserve the status of legitimacy in the eyes of society as a whole.
15. Woodward *et al*. (2001), for example, provide evidence which suggests that large business organizations may be moving towards the view that expectations about social and environmental performance are closing between the nations throughout the world, and thus of the conduct which societies everywhere deem acceptable.
16. The concept of a legitimacy 'gap' is far from new. Weber (1922), for example, argued that nation states which acted beyond the scope of public consent had a 'legitimation deficit'. The concept of a 'legitimacy gap' in the case of organizations is no different.
17. Richardson (1993) emphasises the growing centrality of pressure groups throughout the processes of industrialization and democratisation, particularly in post-industrial societies where pressure groups are seen as "… the new barons which governments have to deal. In this latter stage, interests which were previously ignored or were unorganised have mobilized to a degree which often equals that of traditional producer groups" (pp. 10-11)
18. The debate about the social responsibilities of business is outside the scope of the present study but we may note that arguments from all sides are based, essentially, on personal values and beliefs and as such should be seen in terms of ideology.
19. Nevertheless, there is some disagreement in the literature on whether or not business organizations are able to manage legitimacy in any real sense. One viewpoint is that they cannot, nor do they try to do so (O'Donovan, 1999b). Rather than trying to identify or manage *all* of society's values or to manage *all* issues and events that are important to its legitimacy at any point in time, research suggests that organizations focus on those issues and events which are judged as most important in relation to the organization's survival at a particular time (see, for example, Greening and Gray, 1994; Meznar and Nigh, 1995; Mitchell *et al*., 1997; Nasi *et al*., 1997). Thus, business organizations are seen as managing legitimacy by identifying and managing legitimacy gaps with different groups of relevant publics based on a *perceived* threat to legitimacy in each case. From this perspective, "… if legitimacy threats are linked to issues or events, which create public pressure and influence social values, no firm can address in any meaningful way, all of the hundreds of issues/events that may have some impact on it. The firm must rank the issues it has identified so that it can devote its resources to those that are likely to have the greatest effect on its future survival and viability" (O'Donovan 1999b, p.90). Moreover, at the same time as being aware of important issues/events, it is argued that organizations must also identify those sections of society who possess the power to confer or withdraw legitimacy in respect of those issues/events (O'Donovan, 1999b). Organizational legitimacy is said to be more effectively managed by focusing on the values and norms of those sections of society who possess the power to confer or withdraw legitimacy rather than on society's values and norms as a whole. Thus,

O'Donovan (1999b) argues that a company whose legitimacy becomes problematic will act primarily by targeting its communications at those relevant publics perceived as being the most important in influencing its legitimacy status.

20. Dowling and Pfeffer (1975) suggest that the process is more complicated than is suggested here, with legitimacy being the outcome of two related activities: firstly, the legitimation strategies adopted by a business organization and, secondly, *the actions* affecting a society's norms and values taken by other groups and organizations within that society. The extent to which other interest groups can and do *influence* rather then just reflect the conscience of a nation state is an important issue, particularly in relation to pressure groups and political lobbying by professional lobby organizations, but one which lies outside the scope of the present study.
21. Specific examples of this strategy to be found in the literature include: Buhr's (1998) study of Falconbridge, an international resource company involved in mining and smelting in Ontario, Canada, which used taller smokestacks in the late 1960s and early 1970s to disperse SO_2 emissions further way from their source; Dowling and Pfeffer's (1975) study of the American Institute for Foreign Study which, faced with a problem of legitimacy because of critiques of methods of operation, engaged in a variety of legitimising tactics including the co-opting of prominent educational and political leaders, the use of legitimate organizations as sites for its operations and the identification of its output with other legitimate organizations; Zald and Denton's (1963) history of the YMCA which changed the focus of its operations to bring them into line with a more secularised American society.
22. This issue is explored in Chapter 10, Section 10.6 based on a review of company reports included in the present study but in a slightly different context.
23. See, for example, Deegan *et al*. (2000) who refer to the Union Carbide Australia and New Zealand Ltd. Group of companies' statement in its 1984 annual report, which distanced itself from the Union Carbide disaster in Bhopal, India.
24. Based on semi-structured interviews with 29 senior executives of Irish listed companies, O'Dwyer (2000) reports a dominant perception amongst those interviewed that the annual report is not an appropriate place to include CSR where a company is seeking to legitimise its activities, with 20 out of 29 interviewees expressing concerns about the potentially counter-productive nature of CSR. O'Dwyer (2000) reports his interviewees as offering two leading explanations for this view: (i) CSR would not be viewed favourably or convincing by its intended target audience; (ii) CSR tended to leave the company open to attack or negative reactions as it could create heightened expectations that remain unfulfilled. The second explanation appears to be based on experience, many of O'Dwyer's interviewees stating that their CSR reporting via the annual report had backfired due to these disclosures being used as a 'stick with which to beat them'.
25. The notion that organizations are constantly reacting to threats to their legitimacy does not necessarily imply complete organizational impotence in the context of the business-society relationship. Perrow (1986), for example, argues that whilst organizations do adjust to changes in the external environment, their main impetus is directed at efforts to control and manipulate that environment.
26. Corporate disclosures can be used in a political economy analysis (see, for example, Neimark, 1992; Buhr, 1998) in exploring how corporate reports are used to influence distribution of income power and wealth at an institutional level (this issue is explored in Chapter 10). Such studies focus on the way in which information is used in a socio-political sense to mediate, modify and transform structural conflict (such as for example, in terms of the tension between corporate profits and environmental pollution). In comparison, the use of OLT to study corporate disclosures focuses more on the use of such disclosures in legitimising the organization in the eyes of the 'relevant publics', such disclosures forming part of the symbolic language used to socially construct an impression of the organization in a socio-economic context in relation to activities which have both economic (mostly positive) and social and environmental (often negative) impacts.
27. Guthrie and Parker's (1989) study was an early test of legitimacy theory within the CSR literature. The authors identified social disclosures in the annual and semi-annual reports of BHP Ltd over one hundred years and sought to find an association between these disclosures and

specific societal forces and behaviours, proxies for which were based on key economic data. The authors were not able to support their legitimation hypothesis for five out of the six categories of social disclosures, the only exception being in relation to environmental disclosures.

28. Patten's (1992) argument here is essentially that the *Exxon Valdez* incident was so dramatic in terms of its impact on the attitude of the general public towards petroleum companies, particularly in North America, as to threaten the legitimacy of the petroleum industry as a whole. Such events are seminal and extraordinary in this context since their effect is posited as giving rise to a wholesale shift in the general public's perceptions and (perhaps) expectations of whole industries. However, it is not clear whether such impacts are permanent or simply temporary. The *Exxon Valdez* incident, though highly publicised, was not the first of its kind with similar major oil spills occurring both before and after 1989, notably the *Torrey Canyon* (1967, UK), the *Amoco Cadiz* (1978, France), the *Atlantic Express* (1979, West Indies), the *Braer* (1993, Scotland, UK) and the *Prestige* (2002, Spain).
29. O'Donovan's (1999a) argument is premised on the view that legitimacy theory is "… dependent upon understanding management's thoughts and perceptions about issues and any possible impacts management believe its activities may have on external perceptions of the company's social performance" (p.77). This argument, which clearly reflects an interpretive approach to research by emphasising understanding rather than prediction and explanation, is, nonetheless, couched in an epistemological position which assumes that we can indeed 'get inside' the minds of management through the use of semi-structured interviews. Whilst it may be possible to have a better understanding of the perceptions and attitudes of management by asking them directly, interviews are themselves problematic since management may choose to tell a story which they want others to believe. A more detailed and insightful understanding of management's perceptions, views and thoughts may require the use of phenomenological research techniques (e.g. critical ethnography) through which the researcher effectively immerses herself/himself in a specific situation and then seeks to construct meaning and understanding based on personal observations and experiences within that setting (see, for example, Barley, 1986). For more details of this approach in the context of social accounting see, for example, Dey (2000, 2002).
30. A more detailed investigation would be necessary to determine whether the companies in question were seeking to change the public's *expectations* or to manage or manipulate the public's *perceptions*. The key difference between these legitimation strategies lies in the extent to which the company is seeking to 'inform and educate' the public in an honest, credible way due to some real or perceived 'information gap' or to influence perceptions acquired as the result of false or incomplete information from other sources. However, the more important point in the present context is that annual reports should not be seen as neutral documents.
31. As noted by O'Donovan, (1999a) this latter purpose could well be served by separate stand-alone environment reports which provide companies with the time and space to report detailed environmental performance information to *target* audiences.
32. Gray *et al*.'s (1995) longitudinal study suggests that society's values are not perceived as constant but change over time, thus changing the terms of the 'social contract' between business and society. However, whilst the concept of a social contract may be helpful in a theoretical sense, it leaves open the very practical issue of identifying the terms and conditions of that contract. Indeed, the very fact that the terms of corporate accountability under the social contract argument are obscure provides management with the latitude to use CSR/CED as a legitimation device (Kokubu *et al*., 1994). For a discussion of these issues in the wider context of 'social permission theory', see, for example, Mathews, 1993 (p.31 *et seq*.). Essentially, the various models of social permission theory, including the social contract, notions of organizational legitimacy, government regulation and social audits, are based upon a consensus or harmonious view of the nature of society – i.e. consensus politics. In that context, organizational legitimacy theory may be seen as "… the practical expression of the philosophical position adopted by the social permission theorists. The norms of society change continually and organizational management must adapt to these changes" (Mathews 1993, p.36).
33. Lentz and Tschirgi (1963), in their analysis of the ethical statements (defined as statements which included any favourable recognition of a corporate goal other than the narrow pursuit of profit) in

the annual reports of 219 companies, found a positive association between the size of a business organization (in terms of US dollar ($) assets) and the percentage of firms with ethical statements in their annual reports. This association was suggested as supporting the hypothesis that size increases the problem of legitimacy and thus elicits more stated concern with socially-relevant goals.

34. Deegan and Gordon (1996) used a questionnaire to environmental groups to measure the 'environmental sensitivity' of each industry sector, this measurement being based on extent to which such groups were concerned about the activities of each industry sector in relation to environmental issues.
35. A discussion of the classification of industry sectors as between 'environmentally-sensitive' (ES) and 'less environmentally-sensitive' (LES) is provided at Chapter 8.
36. The research method used to capture CED is defined in detail at Chapter 8. This method focuses predominantly on the *volume* of CED rather than its qualitative characteristics. However, some qualitative characteristics of CED are captured, including its 'news value', i.e. whether the item of disclosure reflects favourably or unfavourably on the organization. Using this information, it is possible to test the extent to which CED is used *persuasively*, rather than objectively, the argument being that a legitimation strategy based on changing public perceptions will be heavily weighted towards projecting a positive image of the organization. This is not to say that there will be an absence of useful, factual environmental data which would form part of any attempt to evaluate environmental performance. Rather, that such information where presented, is contextual, i.e. that it is presented within an overall social construction which is favourable to the organization. This issue is particularly relevant in the context of corporate environment reports and the verification of such reports which almost without exception present corporations in a 'positive' light.
37. These hypotheses are not necessarily unique to OLT. They could, for example, conceivably be derived using other theories such as EAT. The difference, however, lies in the underlying explanation provided by each theory (see Chapter 9 and 10).
38. See Chapter 6 (Section 6.2) for a more detailed discussion of 'public interest groups' or 'pressure groups'.
39. A detailed discussion of the history, development and activities of environmental pressure groups within European society is outside the scope of the present study. Readers wishing to learn more about pressure groups in this context may find the following list of references helpful: Buksti, 1993; Edinger, 1993; Forrester, 1990; Lowe and Goyder, 1983; Mazey and Richardson, 1993; Richardson, 1993; Rüdig, 1991; Van Heeren, 1996.
40. Thus, Patten (1991, 1995) argues that variations in CSR across companies are more closely related to public pressure variables, such as size and industry, rather than market variables such as profitability. Whilst the present author has much sympathy with this perspective, the suggestion that profitability is solely a market variable is questionable given that companies which earn abnormally high levels of profits, (i.e. 'super' profits) are arguably just as exposed to public pressures from the relevant publics as those of abnormally large size or which operate in socially-sensitive industries. The experience of the electricity supply industry in the UK, for example, where 'super' profits amongst companies in the post-1990 privatized electricity supply industry led to the imposition of special government one-off taxes to redistribute wealth, is a case in point.
41. Deegan and Gordon (1996), following Guthrie and Parker's (1989) earlier study, adopted a legitimization perspective to explain changes in corporate environmental disclosures (CED) over time. Based on a sample of 25 large Australian companies, they compared environmental disclosures in the annual reports of these companies for four selected years (1980, 1985, 1988 and 1991) to test for association between changes in CED and changes in community values as measured by changes in the membership of environmental pressure groups. They found a positive association between the changes in the membership of leading environmental groups in Australia over the period 1980 to 1991 and the amount of environmental disclosures, suggesting that this association may be due to a realignment of the organization's disclosure policies to bring them closer to society's priorities and expectations.

42. Campbell (2001) contacted only four UK environmental organizations – Greenpeace, Campaign for the Protection of Rural England (CPRE), Friends of the Earth (FoE) and Worldwide Fund for Nature (WWF) – of which only three out of the four responded to his request for membership data (the non-responder being WWF). Campbell readily acknowledges that he was unable to establish whether trend data for these three groups was representative of UK ENGOS as a whole due to a lack of publicly-available data.
43. Significant effort was expended during the early stages of the study in trying to obtain membership figures of environmental pressure groups from a single, reliable source (see Chapter 8). Such efforts were unsuccessful. Consequently, in anticipating the considerable problems that would be required to obtain reliable information in relation to the total membership of environmental pressure groups, and annual membership figures of each organization for all six years of the present study (1989 to 1995), this line of research is not employed in the present study. Some evidence is available, although not from an independent source. Greenpeace Belgium (2003), for example, discloses that their number of supporters varied substantially over the period from 1988 to 2002. Numbers increased steadily from 30,000 in 1988 to a peak of 77,000 in 1992. However, numbers declined steadily between 1992 and 1997, reaching a low of 48,000 in 1997. Thereafter, the membership rose again steadily between 1997 and 2002 to reach 100,000, its highest ever.
44. The *direct* impact of ENGOs on managerial behaviour is difficult to assess. Prior research in this area looks at the association between changes in CSR and changes in the membership of ENGOs over time (Campbell, 2001; Deegan and Gordon, 1996), the basic premise being that a statistically significant positive correlation between the two supports the hypothesis that business organizations are responding to changes in the values and attitudes of society. Thus, changes in the membership of ENGOs and CSR are *both* perceived as reflections of the same underlying phenomena. The latter interpretation would imply that the *cause* of any change in managerial behaviour is not the activities of ENGOs themselves, but the changing values of society, with ENGOs' activities merely reflecting those changing values. Gray *et al.* (1995b), for example, argue that there is considerable *circumstantial* evidence to support the belief that environmental campaign groups have been a stimulating force behind many of the major environmental reporting initiatives in the 1990s. The influence of ENGOs on managerial behaviour is explored in Chapter 9.
45. Social pressure groups are responsible for so-called 'social audits' by which organizations are held accountable to society for their actions and activities beyond the legal requirements concerning the disclosure of information to society. For an introduction to external social audits and a brief overview of their background and history, see, for example, Geddes, 1992; Gray and Bebbington, 2001.
46. Early studies (e.g. Longstreth and Rosenbloom, 1973; Buzby and Falk, 1978, 1979) failed to clearly document a demand for information about a firm's environmental performance by investors. However, it may be that, as environmental issues have become of greater concern to society since the mid-1980s, these early studies no longer reflect users' perspectives.
47. The public is a general catch-all definition and in the context of Tilt's (1994) research is best perceived as referring to any influences other than those of the specific categories listed.
48. Deegan and Rankin (1997) also found that environmental information was material to the particular decisions undertaken by these various user groups, although stockbrokers and analysts downplayed the materiality of environmental information. However, with the exception of the reviewer group, the other user groups placed greater importance on financial indicators than environmental performance. The most important item of information across the user groups was profit (mean score of 4.50 using a five-point Likert scale), with other important items being (in descending order of importance): net assets (4.43); cash flow disclosures (4.33); dividend payments (4.30); environmental performance (3.62); health and safety issues (3.51); environmental policies (3.48).
49. These studies employ media agenda-setting theory (see, for example, Ader, 1993; McCombs and Shaw, 1972; McCombs *et al*., 1995; McQuail, 1994; Smith, 1987; Zucker, 1978) which posits that there is a causal relationship between what the media elects to cover (the media agenda) and the

public's concern for certain issues (the public agenda), with the former influencing the latter. Although some researchers argue that the casual relationship flows the other way (i.e. that the public agenda drives the media agenda), there is evidence to suggest that media attention to an issue leads to an increase in public concern over that issue (see, for example, Griffin, 1994).

50. This is not to say that there will be a total absence of useful, factual environmental data which would form part of any attempt to evaluate environmental performance. Rather, that such information, where presented, is contextual, i.e. that it is presented within an overall social construction which deflects criticism away from the areas of social concern to areas which present the organization as socially-responsible.
51. In the USA, the mandate by the SEC that, as from 1973, companies must report pollution information in 10K reports (Cunningham, 1980; Freedman and Jaggi, 1982b) provided researchers with a valuable proxy for environmental performance. However, no such data is available in relation to European companies other than those required to do so under the US reporting requirements. Over the period of performing the present empirical study (1994-2000), there were no European-wide independent environmental performance rankings or pollution emissions data or records of successful prosecutions for breaches of environmental law for Europe's top companies (such as the Toxic Release Inventory database held on public record by the Environmental Protection Agency in the US). Indeed, environmental data is probably easier to obtain in the US than it is in any other country (see, for example, Freedman, 1993).
52. The use of reputational indices was first developed by Moskowitz (1972, 1975), and updated by him over several years; the second (1975) was based on two surveys conducted by *Business and Society Review* and the *National Affiliation of Concerned Business Students*, respectively, among business students and business people, in which 50 and 45 leading business organizations, respectively, were rated in terms of social performance ("Industry Rates Itself", 1972; "How Business School Students Rate Business organizations", 1975) (Ullmann, 1985). These ratings have been used in a number of subsequent studies in exploring social disclosures in annual reports (see, for example, Abbott and Monson, 1975; Alexander and Buchholz, 1978; Bowman and Haire, 1975; Cochran and Wood, 1984; Fry and Hock, 1976; Preston, 1978; Sturdivant and Ginter, 1977; Vance, 1975).
53. Whilst valid in a purely theoretical sense, this argument is simply not credible in the real world. Any large business organization has significant direct and indirect environmental impacts, whether or not such impacts are deemed legally, economically or socially acceptable. As such, the construction of corporate annual reports in relation to environmental issues is always values-driven and, in the context of sustainability, can *never* be 'true and fair'.
54. Environmental awards, for example, may perform the role of an emotive symbol, presenting the organization in a favourable light and acting as a decoy for unpalatable aspects of environmental performance which go unreported in corporate annual reports and society generally.

Chapter 8

Research design and research method

8.1 Introduction

This chapter describes the research design and method, research instruments and various decision rules employed for the purposes of data measurement, data capture and subsequent statistical and interpretive analysis. Research design may be said to comprise the "… procedural network of analytical steps through which scientific information is processed" (Krippendorff 1980, p.49). In essence, it accounts for the way in which data are obtained, what was done with them in the course of collection and analysis, and provides others with instructions as to what to do in order to replicate the results. The present chapter seeks to provide details of these processes, not only in the context of the present study but also for those interested in the findings, replicating the analysis or further developing the techniques employed. The research instruments and method employed are drawn primarily from those developed by Gray *et al*. (1995c). The latter's approach, which is also both cross-sectional and longitudinal, was motivated by a concern to address various methodological issues raised by other CSR researchers (notably, Guthrie and Mathews, 1985; Guthrie and Parker, 1989, 1990; Mathews, 1983) in researching CSR. The Gray *et al.* (1990d, 1995b, c, 2001) project was directed at the development of a social and environmental disclosure database for large UK companies. The approach set out in the present study should be seen as an attempt to replicate to some degree the Gray *et al*. project in the specific context of corporate environmental disclosure (CED). However, due reverence is also accorded to the programme of CSR research initiated by Guthrie *et al*. in the late 1980s and early 1990s.

Whilst every effort is made to keep the description of the process of data capture and measurement as transparent and as close to the researcher's interpretation of the definition of CED as possible, all methods of data collection must, out of necessity, impose some structure on, and involve some simplification of, the phenomenon under investigation (Gray *et al*., 1995c). Even though steps can be taken to improve the reliability of coding instructions and their application by coders, such reliability measures can do little more than indicate the degree of consensus reached amongst the researchers employed in a particular study (Krippendorff, 1980). This is because data, even when defined and measured according to detailed rules and procedures, are not absolute, objective facts but are cast into a particular form for some particular purpose. To achieve this, the researcher employs one or more tools or techniques to bring unstructured and vicarious information (i.e. information over phenomena which the user has not experienced or observed first-hand) into an analysable form (Krippendorff, 1980). Consequently, the researcher effectively constructs some (new) version of social reality (Hines, 1988a) which, even though strongly based on or corresponding to certain 'facts', may nevertheless reveal more about the researcher's own conception (and thus construction) of reality than about any potential objective reality which underlies it (see, for example, Burrell and Morgan, 1979; Morgan, 1983, 1986, 1988).

Recognising the potential difficulties that could arise in the various processes of data capture and measurement, a pilot study was carried out between March and July 1996 which sought to replicate Gray *et al.*'s (1995b, c) UK study to a sample of 15 Dutch and 15 UK companies across six industry sectors (three 'environmentally-sensitive' and three 'less environmentally-sensitive') covering six consecutive years from 1989 to 1994. In particular, the pilot study provided an opportunity to test the reliability and validity of the research method and design, on completion of which a short report was prepared for discussion with the project's supervisors (Hibbitt and Ursem, 1996). During this discussion, both supervisors expressed a number of meta-theoretical concerns over the research approach. In particular, Gray *et al.*'s (1995b) use of 'soft', broad hypotheses from within an interpretive research methodology was perceived by the supervisors as not sufficiently robust[1]. To assuage these concerns, major revisions to the research method and approach were made and a revised research proposal, involving the use of specific 'hard' hypotheses under the hypothetico-deductive method, was submitted to the supervisors in March 1997. The supervisors accepted this revised approach and the full project commenced formerly in September 1997. The detailed method, procedures and decisions rules of the full project are reported in more detail below.

The rest of this chapter is structured as follows. Section 8.2 describes content analysis, a research technique for data capture and analysis. This section includes a discussion of the key distinguishing characteristics of content analysis which serve as a basis for defining the research method employed in the present study. Section 8.3 sets out the seven testable dimensions and 18 content categories of CED that are used for the purposes of defining the scope and form of CED. These dimensions and categories are described in more detail in the following sections. Section 8.4 identifies the various sub-categories of CED which provide the basic structure for defining what is and what is not CED for the purposes of the study. Sections 8.5, 8.6 and 8.7 address the issues of which documents to include, how items of CED are measured, and how the various non-quantitative characteristics which define the nature of CED are to be captured, respectively. Section 8.8 describes the interrogation instrument used for data capture and recording, including a discussion of the database which was used to store the data and the checks carried out to control the overall completeness and reliability of this database. Section 8.9 addresses the important issues of intra- and inter-coder agreement in the context of content analysis and describes the various steps that were taken to ensure inter-coder reliability. The basis for selecting the sample of companies used in the study is explained in Section 8.10, including issues of industry sector and country composition. Section 8.11 describes the sample period. Various procedural matters and decision rules in relation to the obtaining of company reports are described in Section 8.12. Descriptive statistics and analyses of the total number of reports and pages therein obtained for content analysis purposes is presented in Section 8.13, together with a summary of the total number of reports by type, year and industry sector. This section also identifies the sample companies that published their first corporate environment report over the period of the study, by year. Additional items of company data in relation to various firm characteristics are described in Section 8.14. The use of mailed questionnaires to the sample companies and to environmental NGOs (ENGOs), respectively, for the purposes of measuring certain firm and non-firm characteristics are discussed in Section 8.15, together with details of the response rates in each case. The related issue of non-response bias is addressed in Section 8.16.

8.2 Content analysis

Content analysis falls within the broader, social study of communication through messages and the meanings of such messages known in sociology as *semiotics*, the latter being concerned with communications in any form and which seeks to provide a method for the analysis of messages (see, for example, Budd *et al*., 1967; Hawkes, 1977; Kassarjian, 1977; Kerlinger, 1973; Krippendorff, 1980; Weber, 1990). In essence, content analysis is an analytical tool used to investigate the content of communication, the latter being seen as the most basic form of human interaction which lies at the heart of any civilisation (Holsti, 1969). In this context, an extensive concern with the content of communication is seen as a reflection of the fundamental importance of communication between individuals, groups, institutions, organizations and nations in the context of the human agency (Holsti, 1969). Amongst other things, content analysis has been used to reflect cultural indicators of the belief systems, values and ideologies of groups, institutions and societies (Weber, 1990)[2]. More recently, content analysis has evolved into a scientific method for yielding inferences from verbal, symbolic or communicative data that is widely employed in the social sciences and humanities, including psychology, psychiatry, political science, literature, history, anthropology, linguistics and CSR (see, for example, Bouwman, 1985; Easterby-Smith *et al*., 1991; Stone *et al*., 1966; Unerman, 2000). It is the latter form of content analysis which is employed in the present study. Content analysis in this context is concerned not merely with the meaning of messages in isolation, but also with the *processes* involved in analyzing data as *symbolic communications*, i.e. as an inquiry into the symbolic meaning of messages (Krippendorff, 1980).

Prior CSR studies into the analysis of corporate reports have established a rigorous method of content analysis for analyzing corporate social and environmental accounting and reporting. One such method involves the use of a traditional, functional form of content analysis to measure each company's CSR (Guthrie, 1983; Guthrie and Mathews, 1985). Essentially, this form of content analysis involves (i) the selection of analytical categories to characterize the *content* of written material and (ii) the use of research instruments to capture a *quantitative* measure of CSR (Guthrie and Mathews, 1985)[3]. Among the more common definitions of content analysis, that of Abbott and Monson (1979) is probably the most widely quoted in the CSR literature. Abbott and Monson define content analysis as:

> *... a technique for gathering data that consists of codifying qualitative information in anecdotal and literary form into categories in order to derive quantitative scales of varying levels of complexity* (1979, p.504).

Since the mid-1970s, content analysis has been widely employed in CSR research (see, for example, Adams *et al*., 1995a; Adams *et al*., 1998; Bowman and Haire 1975; Buhr, 1998; Campbell, 2000, 2001; Deegan and Gordon, 1996; Deegan *et al*., 2000, 2002; Ernst & Ernst, 1972-1978; Fry and Hock, 1976; Gibson and O'Donovan, 1994, 2000; Hackston and Milne, 1996; Ince and Gifford-Gifford, 1996; Maxwell and Mason, 1976; O'Dwyer and Gray, 1998; Preston, 1978; Walden and Schwartz, 1997; Zéghal and Ahmed, 1990). Unfortunately, however, there has been little attempt at methodological consistency or replication across these different studies (Milne and Adler, 1999; Unerman, 2000)[4]. Nevertheless, three distinguishing characteristics of content analysis are generally regarded as necessary for the results to be empirically meaningful (Berelson, 1952):

(i) the need for *objectivity* – variables should be defined so precisely as to permit any item to be judged as either belonging or not belonging to a particular category;
(ii) the need to be *systematic* – the inclusion and exclusion of categories must be done in accordance with developed and applied rules;
(iii) the need for *quantification* – items of disclosure should be quantified according to certain specified measurement rules.

Krippendorff (1980) argues that Berelson's definition fails to specify what 'content' is or what the objective of content analysis should be. In attempting to be explicit about the latter, Krippendorff (1980, p.21) defines content analysis as a "… research technique for making replicable and valid inferences from data according to their context." The emphasis on replication reflects Krippendorff's concern with reliability, i.e. when different researchers at different points in time apply the same technique to the same data and arrive at the same results. Replication is argued by Krippendorff to also include Berelson's requirements that the tool be both objective and systematic. However, there is arguably sufficient overlap between Krippendorff's concept of replication and Berelson's three distinguishing characteristics so as to be able to use the latter as a basis for defining the research method employed in the present study. The first characteristic of *objectivity* requires that the categories chosen for characterising the content of CED should be defined with such accuracy as to enable independent judges applying them to achieve the same results from the same messages (Guthrie and Mathews, 1985). Put simply, using systematic categories and consistent application of the criteria for measurement, any study should be capable of replication with similar results. The second category, i.e. the need for a systematic approach, requires that the inclusion and exclusion of categories must be done in accordance with applied rules (Holsti, 1969). This means that, using a pre-defined taxonomy of disclosures, each category should be exhaustive and mutually exclusive, and defined such that the allocation of an item of CED to each category is not a discretionary process. The third characteristic, quantification, has been argued to be the most distinguishing feature of content analysis in comparison to ordinary critical reading (Guthrie and Mathews, 1985). These issues are addressed below. A fourth principal requirement for data reliability relates to what is known in the content analysis literature as 'shared meanings' (see, for example, Krippendorff, 1980). 'Shared meanings' imply that the definitions employed in the data collection – such as the taxonomy of CED as employed here (see Section 8.4 below) – and data analysis are negotiated to achieve consistent understanding such that it recreates the same referents in all the associated researchers (Gray *et al*., 1995c). These issues are addressed in the present study by making the definitions explicit, and through the adoption, as far as is possible and practicable, of definitions that are widely acceptable. These definitions have been based largely on those employed in the Gray *et al*. (1995b, c) study and as such, given that the latter was itself following a line of reasoning developed in earlier studies, a reasonably high degree of 'shared meaning' is assured in the present study.

Nevertheless, the ability to which such 'shared meanings' can be realized is problematic for two reasons (Krippendorff, 1980). Firstly, messages do not have a single meaning that needs to be 'unwrapped' but rather can be looked at from a number of different perspectives, particularly when they are symbolic in nature[5]. Secondly, meanings are always relative to a communicator, conveying different things to different people. These factors imply that

researchers using content analysis are unlikely to share the same meanings without some form of shared cultural and socio-economic-political perspective. Hence, there is the need for some form of negotiation between researchers during which these 'shared meanings' can emerge through a process of dialogue, reiteration and reflection (Gray *et al.*, 1995c). This need for negotiation applies particularly to CSR studies where there is an unavoidable element of subjectivity involved in determining what constitutes a particular type of disclosure (Zéghal and Ahmed, 1990). In prior studies, the latter issue has been mitigated either through the use of periodic spot checks on the content analysis work itself or by the reports in question being content analysed by more than one researcher (see, for example, Deegan and Gordon, 1996; Gibson and O'Donovan, 2000). Both types of control were used in the present study (see Section 8.9 below).

8.3 Seven testable dimensions of environmental disclosure

To capture the volume and aspects of the nature of CED in an objective manner, seven testable dimensions were used: (1) Theme, (2) Location, (3) Amount, (4) Evidence, (5) Auditability, (6) 'News' type, and (7) Compliance. From within these seven testable dimensions, 18 content categories were selected which form the basis of the research method and approach used in the research[6]. These categories and associated dimensions are shown in Table 8.1 below.

Table 8.1
Seven testable dimensions and 18 content categories of environmental disclosure

Testable dimension	Content categories
1. Theme	► Environment ► Energy ► Health and Safety
2. Location	► Annual report and accounts ► Social report ► Environment report ► Other reports forming part of the company's annual reporting cycle
3. Amount	► Percentage of the page (A4)
4. Evidence	► Monetary ► Non-monetary quantitative ► Declarative
5. Auditability	► Auditable ► Non-auditable
6. 'News' type	► Good ► Bad ► Neutral
7. Compliance	► Voluntary ► Required

Both Krippendorff (1980) and Holsti (1969) refer to a number of options available for the enumeration of content analysis and in practice there are considerable differences in the level

of sophistication in the application of content analysis to CSR. Some (see, for example, Abbott and Monson, 1979; Belkaoui, 1976; Bowman, 1978; Bowman and Haire, 1975; Fry and Hock, 1976) performed simple dichotomic analyses (i.e. 'yes' or 'no'). Others, such as in the case of the Ernst & Ernst studies (1976, *et seq*.) simply undertook to count the number of instances a particular item of CSR was disclosed. Several CSR researchers (e.g. Anderson and Frankle, 1980; Gray *et al*., 1995b, c; Ingram, 1978; Jaggi and Freeman, 1975) chose to analyse the nature of social disclosures according to *theme* – e.g. community involvement, product safety, human resources and environmental protection – and *form* – e.g. descriptive, non-financial and financial. Drawing on earlier CSR research ideas, particularly those of Guthrie and Mathews (1985) and Gray *et al*. (1995c), a method of recording and quantification of the seven dimensions as shown in Table 8.1 above was chosen for the present study. In particular, two research instruments were used for data recording, based largely on Guthrie and Mathews (1985) and Gray *et al*. (1995c) but with some minor adaptations to meet the specific objectives of the present study. These two instruments and the items shown in Table 8.1 are described in more detail below.

8.4 A taxonomy of corporate environmental disclosure

As with all research, the researcher is required to provide a definition of the phenomenon under investigation. Such definitions should normally be established prior to data capture (Jupe, 1994; Wiseman, 1982). These definitions play a pivotal role in research which employs content analysis given that, in effect, the syntax and semantics of a data language are constructed by the rules governing the classification, categorisation and coding of that data (Krippendorff, 1980). For this process to be reliable, it must be replicable and for a process to be replicable the rules that govern it must be explicit and applicable to all units of analysis (Krippendorff, 1980). However, the raw data in company reports are not in a state that makes them useable for immediate use in research (Abbott and Monson, 1979). Thus, to use this raw data it is necessary to formulate a disclosure taxonomy based on defined categories of disclosure and then to code the raw data in terms of these different categories.

Ideally, categories of data, such as categories of CSR/CED, used in content analysis should result from a systematic application of a set of rules which render such categories both exhaustive and mutually exclusive (Ingram and Frazier, 1980). 'Exhaustive' in this context refers to the ability of a data language to represent all recording units without exception, i.e. no item of data should be excluded for reasons of lack of descriptive terms available (Krippendorff, 1980). Similarly, 'mutually exclusive' refers to the ability of a data language to make clear distinctions among the phenomena to be recorded, i.e. no item of data should fall between two categories or be represented by two or more categories (Krippendorff, 1980). Thus, in the context of CSR, the "… systematic criterion requires a set of exhaustive rules which will determine the category "CSR" and the sub-categories (if any) in a mutually exclusive and all-embracing manner" (Gray *et al*. 1995c, p.81). In practice, within the mainstream CSR literature the generally-accepted approach to these issue involves a two-stage procedure: firstly, a set of rules is developed which define what is and what is not CSR; and secondly, the validity of those rules and the subsequent definition is then debated (i.e. negotiated) amongst the scientists working in that paradigm. In relation to the set of rules which define CSR, these rules are somewhat tautological in the sense that what falls within

the rules is, by definition, CSR and that which falls outside them is not. Hence, in effect, the definition of CSR, *by itself*, partitions the corporate reporting and disclosure universe into two distinct and mutually exclusive classes – CSR and non-CSR[7]. In addition, these categories are made exhaustive by the inclusion of a category that represents all units of CSR data not represented in any of the other categories, such categories being labelled as 'other'. This approach is followed in the present study.

Based on the general definition provided in Chapter 1 (Table 1.5), CED is classified into seven mutually exclusive categories. These categories are based very closely on the sub-categories of 'environment' as defined by Gray *et al.* (1995c), the latters' study being as comparable as possible to the social disclosure categories used in the Ernst & Ernst (1978) study[8]. Following both Gray *et al*. (1995c) and Kokubu and Yamagami (1991), 'environmental disclosure' is defined as the sum of 'environment', 'energy' and 'health and safety', with the sub-category 'environment' further categorised into seven sub-categories. The resultant set of nine subcategories of CED are as follows: (i) environmental policy; (ii) environmental management, systems and audit; (iii) environmental-product and process-related; (iv) environmental financially–related data; (v) stakeholder relations; (vi) sustainability; (vii) environment – other; (viii) energy; and (ix) health and safety. These categories are defined by the decision rules set out in Appendix 2, which also provides an illustration of the type of CED which falls within each category[9]. These examples are not intended to be exhaustive. Their primary purpose is to serve as guidance for deciding whether or not a specific item of disclosure falls within the definition of CED as used in the present study. One of the principal purposes of content analysis in this context is to place items of disclosure into categories in order to derive conclusions about *thematic* content. However, even with the nine categories of CED as shown above, an element of judgment is unavoidable in classifying items of CED. The various decision rules in relation to the categories of environmental disclosure as set out in Appendix 2 are derived from those set out in Gray *et al*. (1995c, Appendix 4). However, the number of decision rules has been expanded to take into account the present study's inclusion of social and environment reports (the Gray *et al*. study was limited to annual reports only)[10]. The definition of 'environmental disclosure', whilst necessarily arbitrary in nature, has thus been afforded some degree of precision and uniqueness through the use of categories and decision rules. The result, as with the Gray *et al*. (1995c, p.82) study is argued to be "… at least, transparent and replicable, even if it fails to meet an ideal of a fixed and perfect definition."

The actual process of classifying items of CED involved examining each company report page-by-page. Any disclosure item which was deemed to fall within the definition of CED was captured and ascribed values in relation to both volume and character (see below at sections 8.6 and 8.7, respectively). As a result, all other disclosure items which did not fall into the categories shown above were defined as being not CED and therefore excluded from the study. Disclosures relating to community involvement issues in general are excluded on the basis that such issues are not specifically related to environment, health and safety but fall within the wider ambit of CSR. Similarly, disclosures which clearly related to part of a company's normal business operations, for example, where the company is involved in waste disposal, environmental technology or energy efficiency, were excluded. Thus, for example, where a company has a division whose business is the recycling of other people's waste,

disclosures relating to the business aspects of its operations (e.g. financial and operational performance) would not be classified as 'CED'. However, any disclosures which referred to, for example, the introduction of an environmental plan or environmental management systems to reduce the division's environmental impacts, would normally be treated as 'CED'.

8.5 Location of environmental disclosure

Method issues concerning the location of data focus on two major concerns. The first relates to the question of which corporate communications are to be used and what importance (if any) is to be placed on each. The second aspect relates to where in a particular document a piece of data resides and what importance this has (if any) for subsequent analysis. In the case of the present study, CED is distinguished in terms of which report it appears in but no distinction is made in terms of the *location* of the data within that report[11]. The process of deciding which communications to include in any study of CSR is problematic in itself (see, for example, Guthrie and Mathews, 1985; Hackston and Milne, 1996; Hardewijk, 1993; Milne and Adler, 1999; Piet, 1993; Unerman, 2000; Zéghal and Ahmed, 1990). This is because, *en principe*, all forms of data reaching the public domain can be considered part of the organization-society dialogue and thus part of a study of CSR (Gray *et al*., 1995c). Hence, in an ideal world, all communications by a corporation would need to be included as source documents if the goal is to capture *all* CED. In practice, there are many different ways in which corporations choose to communicate social and environmental responsibility information to society. These include (but are not limited to)[12]:

(i) reporting through the annual accounts (i.e. the balance sheet, profit and loss account, or the notes, or other supplementary material included as part of them) in the statutory annual report;
(ii) reporting through other parts of the statutory annual report (and associated documents), such as president's or chairman's letter to shareholders;
(iii) reporting through other formal reports, such as stand-alone environment reports and social reports; and,
(iv) other forms of self-reporting through brochures, pamphlets and educational material, company videos, advertising, internet web sites, product packaging and labelling, conferences, employee training programmes, shareholder road shows, stakeholder focus group meetings and open days.

In practice it is almost impossible to be certain that all such communications are identified and captured (Zéghal and Ahmed, 1990). Faced with this dilemma, an overwhelming majority of CSR researchers take a pragmatic approach by viewing the annual report and accounts to shareholders as an appropriate source for social and environmental responsibility information (Unerman, 2000). Adams *et al.* (1995a), for example, chose to focus solely on annual reports on the basis that such reports represent the single most important source of information on corporate activities and the one which any general inquirer would tend to consult first. Annual reports are seen as a particularly effective legitimating medium by virtue of their widespread use, acceptance and recognition by investors, creditors, employees, pressure groups and government (Bay and Petit, 1998; Deegan and Rankin, 1997; Neu *et al*., 1998; O'Dwyer, 2000)[13]. As such, annual reports are seen as the most important document in terms of the organization's construction of its own social imagery (Hines, 1988a; Neimark,

1992). Indeed, much of the interest in social and environmental reporting lies in the construction of 'accounts' of the organization's social and environmental activities in the company's principal accountability document, the annual report (Gray *et al*., 2001). This latter argument proved persuasive in the case of the Gray *et al.* study:

> *The construction of the organization is critical in terms of how the organization is seen and judged. The social and environmental factors frequently will produce conflicts with the financial ambitions of the organization and its owners. The presentation, within the same document or reporting process, of the financial on the one hand and the social and environmental on the other, becomes an important element in demonstrating the extent (if at all) to which the organization reconciles these matters* (1995c, p.82).

Thus, the annual report can be seen as an important means of both *communication* and *social construction*. Others (see, for example, Campbell, 2001; Wilmhurst and Frost, 2000; Wiseman, 1982) have employed the same argument, viewing the annual report as one over which, given their almost complete editorial control, management is able to select what is communicated, and thus the social construction which management seeks to present, to society. Other CSR researchers argue that although there are many other communication vehicles employed by a corporation (e.g. verbal communication, advertising, public relations brochures, and employee newsletters) none of these has the legitimacy (Buhr, 1998) or the influence (Adams and Harte, 1998) of the annual report. However, this issue is far from clear-cut and there are weaknesses in relying solely on the annual report. Most significantly, an exclusive focus on annual reports to the exclusion of other information sources is likely to result in an incomplete picture of disclosure and reporting practices (Roberts, C., 1991; Unerman, 2000; Van Nuffel *et al.*, 1994). In the same vein, both Deegan *et al*. (2002) and Zéghal and Ahmed (1990) argue that other forms of media should be recognised in order to obtain a more complete picture of the social and environmental information disclosure activities of an organization. Deegan *et al*. (2002), for example, discovered significant amounts of environmental disclosures in other reports and thus question the usefulness of 'annual report only' content analysis studies in explaining CSR. Recent empirical evidence provided by Unerman (2000), based on a content analysis of annual and other reports which formed part of the Shell Transport and Trading Co. Ltd.'s regular reporting cycle, clearly demonstrates that a large part of Shell's CSR would have been missed had the study focused exclusively on annual reports[14]. Lindblom (1994) argues that legitimation strategies (see Chapter 7) by corporations may involve the use of other vehicles for CSR not just the annual report. In her view, the annual report may not be the best vehicle for disclosure to certain of the relevant publics. Similarly, O'Dwyer's (2000) research study suggests that the annual report may not be the prime vehicle through which all companies seek to communicate with society on social and environmental issues. Based on a series of 29 semi-structured interviews with senior executives of Irish listed companies across seven industry sectors, O'Dwyer reports that 15 interviewees:

> *... expressed concern at the increasing length of the annual report and the cost arising from the production of what was often seen as an overly long document. This appeared to imply that numerous companies would be*

> *deterred from using the annual report for CSR, as there were already so many statutory and other reporting guidelines to be followed therein. Also, if social disclosure was to be included, it was perceived that there would be little room to deal with it in any depth due to space and cost constraints* (2000, p.20).

There is also evidence to suggest that corporate environment reports are reducing the amount of environmental information appearing in the annual report and accounts. Akzo Nobel, a large Dutch-based chemicals company, referred to the role of annual and environment reports in its 1993 annual report and accounts as follows:

> *By mid-1994 we will also publish our first corporate environmental annual report. This report will deal with such issues as the environmental efforts made by Akzo during 1993 ... This is the reason why environmental issues are given less prominence here* (p.20).

A key issue here is that, in the context of the various business-society issues addressed previously in Chapters 6 and 7, relying only on annual reports exposes CSR researchers to the risk of excluding large and potentially influential proportions of environmental disclosure, particularly that released through environmental and social reports. However, to date *very few* CSR studies have attempted to incorporate data sources other than the annual report (notable exceptions being: Buhr and Freedman (1996), who analysed annual reports, securities exchange filings and environment reports; Harte and Owen (1991) and Pföhler (1996) who analysed annual reports and environment reports; Unerman (2000), who analysed documents published as part of a regular reporting cycle; Zéghal and Ahmed, (1990), who analysed annual reports, corporate advertisements and brochures)[15]. Whilst there would seem to be no right or wrong answers to this particular issue, a decision was taken to include reports other than just the annual report and accounts[16]. Notwithstanding the importance of annual reports, the exclusion of other reports, particularly stand-alone environment reports (see Chapter 2), was considered too limiting in terms of the volume of CED that would fall outside the scope of the study. The following decisions rules were therefore adopted for the purposes of identifying which source documents to include in the study:

(i) company reports which meet *all* of the following criteria are to be included:
  (a) the document is company-wide;
  (b) it is in the public domain;
  (c) it is part of a regular and on-going reporting cycle; and
  (d) the period covered by the report is at least one year (i.e. twelve months)[17];

(ii) where a document is provided with or which accompanies a report identified under (i), such document is to be included in the study;

(iii) where separate documents are referred to as being available on request, such reports are also to be included in the study; and,

(iv) other environmental information which is published separately elsewhere, but which does *not* meet the criteria set out above are *excluded* from the study.

The criteria set out in (i) above are designed specifically to capture reports which have features similar to the annual report (i.e. company-wide, in the public domain, part of a regular reporting cycle and (usually) cover a period of at least twelve months) but which also reflect a growing trend on the part of large companies to issue social and environment reports

as part of a programme of communicating formally and regularly to their different stakeholders. The term 'company-wide' refers to reports that cover the activities of the organization as a whole rather than just a specific operating site, country or region (see below). Information that is produced by but is retained within the company for internal use only or which is produced for compliance with regulatory requirements and which is not placed in the public domain is excluded from the study[18]. Based on the criteria set out in (i) to (iii) above, the following reports are treated as source documents for the purpose of the present study (this list in not intended to be exhaustive - see the sections on 'language' and 'completeness' below for some practical considerations which arise as a result of adopting these criteria):

(i) *Annual Reports* (hereafter AR) containing the annual financial statements, chairpersons or chief executive officer's (CEO) statement, the report of the executive board (i.e. executive directors), report of the supervisory board of non-executive directors;
(ii) *Corporate Social (and Community) Reports* (hereafter SR), including employee reports;
(iii) *Corporate Environment reports* (hereafter ER);
(iv) *Summary Financial Statements* (hereafter SFS) and similar reviews and summaries of the year; and,
(v) *Any other report* (hereafter OR) which is company-wide, in the public domain and part of a regular (e.g. annual, but not necessarily) reporting cycle, such as (for example) the financial statements of the holding company in the case of German companies, the group accounts of which often include only those of the group and not the holding company (see, for example, Volkswagen annual reports 1990 to 1995).

As a result of these decision rules, other forms of corporate communication have been excluded from the study. These include interim reports (half-yearly and quarterly), internal company newsletters and magazines, one-off environment reports and environmental policy statements (unless falling within (ii) above), site-based or regional environmental or social reports, press notices, press interviews and media advertisements, company web site pages, CD ROMs and corporate videos[19]. Whilst these other forms of corporate communication can form an important part of a company's environmental disclosure strategy (Zéghal and Ahmed, 1990), their exclusion from the present study is predicated on both pragmatic and theoretical arguments. From a pragmatic perspective, (i) it is simply impossible to be certain that all CSR communications have been captured (Zéghal and Ahmed, 1990) and (ii) a limit must be set on the variety of source documents otherwise the researcher risks being overwhelmed by the sheer number of documents (Unerman, 2000). Hence, some form of closure is both necessary and unavoidable. That said, from a theoretical perspective it can be argued that by focusing on reports which are part of a regular reporting cycle, the study captures environmental disclosure which is subject to the same forms of pressures (e.g. preparation, timing, publication, expectations of shareholders) associated with annual reports (Unerman, 2000). By doing so, the present study may also provide valuable input into the debate over the relative importance of CSR contained within annual reports vis-à-vis CSR contained in other reports.

8.6 Data measurement

Traditional, functional content analysis (see Section 8.2 above) requires the quantification and categorisation of content elements. Content analysis stands or falls by its categories which must be clearly formulated and well adapted to both the research problem and the particular content under investigation (Parker, 1986). Studies which employ content analysis to quantify and categorise social and environmental disclosure are presented with a number of choices, or decision rules. Two key decisions rules concern:

(i) the choice between the *number* of disclosures and *amount* of disclosure; and,
(ii) the choice of the unit of analysis.

In relation to item (i), this decision revolves around whether to focus on the number of items of social disclosure that are to be found in corporate reports, with each item of disclosure being accorded the same value (i.e. the frequency of mentions of category x – see, for example, Ernst & Ernst, 1972-1978), or whether to focus on measuring the quantity of disclosure with each item being given a value relative to its volume (i.e. the amount of category x - see, for example, Gray *et al*., 1995b; Guthrie and Parker, 1989, 1990; Deegan and Gordon, 1996). In practice, the majority of researchers in the CSR field have chosen to capture data based upon the latter approach primarily because it gives a richer data set (Cowen *et al*., 1987; Gray *et al*., 1995b, c; Guthrie and Mathews, 1985). Moreover, the *extent* of disclosure is considered to provide an indication of the importance of an issue to the reporting entity (Krippendorff, 1980). This would appear to be a reasonable assumption bearing in mind that management has significant editorial control over the contents of the annual report (other than the auditor's report) (Guthrie and Parker, 1989) and the constraints, in terms of time, cost and space, which require that space in the annual report is allocated on the basis of some overall perception of what is important (O'Donovan, 1999a; Deegan et al., 2000). This argument is considered persuasive in the context of the present study.

The second decision rule (item (ii) above) concerns the basic unit of measurement. The most systematic analysis of this issue in accounting is to be found in Neimark (1983) and Parker (1986) as summarised in Guthrie and Mathews (1985) and Gray *et al*. (1995c)[20]. Essentially, there are three choices for the unit of analysis:

- the number of *words* (see, for example, Campbell, 2001; Deegan and Gordon, 1996; Deegan and Rankin, 1996; Hogner, 1982; Neu *et al*., 1998; Wilmhurst and Frost, 2000; Zéghal and Ahmed, 1990);
- the number of *sentences* (see, for example, Buhr, 1998; Deegan *et al*., 2000, 2002; Hackston and Milne, 1996); or,
- the number of *pages or proportions of a page* (e.g. Adams *et al*., 1995, 1998; Campbell, 2000; Cowen *et al*., 1987; Gray *et al*., 1995b; Guthrie and Parker, 1989, 1990; O'Dwyer and Gray, 1998; Patten, 1992; Rockness, 1985; Trotman, 1979).

Words are the smallest unit generally applied in content analysis with sentences being the next larger unit, the latter being used when focusing on themes or issues. Using words or sentences as the unit of analysis has a number of advantages over other measures, notably that they are easily identified, are less subject to inter-coder variation and allow more detailed analysis of specific issues and themes (Deegan *et al*., 2002). However, the coding of words or sentences only lacks a proper context for social and environmental disclosures (Adler and

Milne, 1999). In addition, there is no allowance for their relative size, each word or sentence being accorded the same prominence. In practice, pages tend to be the most preferred unit of analysis amongst CSR researchers because (i) this reflects the total amount of space given to a topic and therefore, by inference, its importance (Krippendorff, 1980; Neu *et al*., 1998; Unerman, 2000) and (ii) pages are the easier unit to measure by hand (Gray *et al*., 1995c; Guthrie and Parker, 1989, 1990). The quantity of disclosure devoted to a particular topic may be assumed to signify the importance of that topic in the context of corporate reporting as a whole. Given the time and cost constraints involved, management must focus on delivering a clear, concise and consistent message (Clifton, 1998) whilst rationalising competing demands for space (Wilmhurst and Frost, 2000). Thus, space is assumed to be allocated on the basis of some perception on behalf of management as to the relative importance of information in terms of their overall communications with society. Moreover, an argument against measuring CED in terms of words or sentences is that no account is taken of the use of different typeface sizes to give emphasis to different parts or sections of a report and leads to the exclusion of non-narrative forms of disclosures such as photographs, charts, pictures and diagrams (Unerman, 2000).

The latter point is particularly important given that one of the key assumptions underlying content analysis is that the volume of disclosure is a surrogate for the importance attached by the communicator to the items being disclosed. That being true, any unit of measurement which omits non-narrative forms of reporting risks excluding potentially powerful and highly influential forms of communication (Beattie and Jones, 1992, 1994; Preston *et al*., 1996). Indeed, photographs may be a more powerful CSR tool than narrative disclosures, particularly in the case of stakeholders who, pressed for time, simply skim through reports looking only at the pictures and reading the chairman's statement (Unerman, 2000). Moreover, research based on an analysis of the *Financial Times* European Top 100 has shown that large European companies use photographs as a vital part of the annual report, each report containing an average of 35 photographs (Clifton, 1998)[21]. The above arguments are considered persuasive in the content of the aims and objectives of the present study. Accordingly, the amount of each item of environmental disclosure (CED) was measured using a transparent A4 template with a standard margin, divided into 100 rectangles (25 rows of equal height and four columns of equal width) of equal size, to quantify the proportion of a page taken up by each item of CED. This task was carried out by laying the template across each item of CED, which was then quantified by counting the number of complete and partially-complete cells, allowing for any blank parts of a page, each complete cell having a value of 0.01[22].

8.7 Data characteristics

Views on whether or not researchers can or should seek to evaluate the *qualitative* aspects of social and environmental disclosures vary. Campbell (2000) argues that the normal surrogate for measuring a company's response to social and environmental issues is simply to assess whether the company makes such disclosures at all and, if so, how much. Campbell suggests that the fact that this surrogate does not account for the qualitative characteristics of such disclosures has come to be regarded as an acceptable limitation in empirical CSR work. However, ignoring qualitative aspects of CSR limits the degree of sophistication of any resulting analysis. Zéghal and Ahmed (1990), for example, report that companies used

narrative words as the predominant form of communication rather than hard, factual quantitative and/or monetary quantitative forms of communication. Such findings may suggest that disclosures are aimed more at persuading rather than informing their intended audience. Similarly, Patten (1995), refers to the Ernst & Ernst surveys of the 1970s in which monetary and quantitative CSR was viewed by Ernst & Ernst (1977) as providing a better specification of the efforts of companies in a given social area. Thus, merely studying the *quantity* of what was disclosed may not adequately convey the intention underlying *how* something was said. Guthrie and Parker (1990), for example, studied categories of environmental disclosure by focusing primarily on what was said and how it was said through *qualitative* analysis, notably the classification of 'news' type into 'good news', 'bad news' and 'neutral news' (Guthrie and Parker, 1990). This concern with trying to uncover the intentions and predispositions of communicators underlies much of the argument for seeking to attribute qualitative characteristics to items of social disclosure. Guthrie and Mathews (1985) in their review of prior CSR literature, identified two factors for measuring the 'quality' of the data: (i) *evidence*, i.e. some sense of quality can be gained from whether the statements made are quantitative (financial or other numeric) or declarative (i.e. descriptive); and (ii) *news*, i.e. is the information reflecting 'well' or 'badly' on the reporting organization? 'Evidence' in this context refers to the notion of being able to gain some indication of the quality of disclosures according to whether such disclosures are presented in quantified (financial or other numeric) or declarative (i.e. descriptive) form, the implied assumption being that quantified information is of a higher quality than descriptive information. 'News' value refers to whether the item of disclosure presents the reporting company in a favourable or unfavourable light (see, for example, Brown and Deegan, 1998; Deegan and Gordon, 1996; Deegan *et al*., 2000, 2002; Hogner, 1982)[23].

In the specific context of CED, *good news* refers to items of disclosure which present the company as being environmentally benign or indicates that the company undertakes activities which provide beneficial outcomes to the company, its constituencies or the environment in relation to environmental issues. Thus, CED was coded as 'good news' where, for example, it concerned: the introduction of an environmental policy, programme or action plan; an improvement in the environmental, energy or health and safety performance of a product, process or operating unit; the introduction of and/or improvements to existing environmental management and control systems; the publication of an environment report; an environmental, health and safety or energy savings award; or, actions taken by the company to protect, improve or restore local wildlife and bio-diversity. Conversely, *bad news* refers to items of disclosure which present the company as being harmful to the environment or which indicate that the company's activities resulted in negative outcomes, either to the company or to its constituencies, in relation to environmental issues. Thus, CED was treated as 'bad' news if it related to, for example: conflicts between the company and regulatory authorities on the former's environmental performance; concerns over the possible financial implications for the company of developments in public policy towards environmental protection; fines or penalties for breaches of environmental laws and/or regulations; admissions of causing environmental and/or health-related problems for residents through the company's environmental activities, explicit admission of excessive pollutive emissions; waste disposal problems; or acknowledgement or admission of environmental or health and safety problems associated with the company's past, present or future activities. An item of disclosure was not

coded as bad news, however, merely on the basis of the subject matter but in the overall context of how the issue was conveyed to the reader[24]. Although this approach obviously introduces an element of subjectivity into the analysis, it has the important advantage of giving meaning to 'softer' environmental disclosures, particularly descriptive and anecdotal disclosures reported outside the audited financial statements.

Two further elements are added to the data analysis by distinguishing (i) between 'auditable' and 'non-auditable' disclosures and (ii) between 'voluntary' and 'mandatory' disclosures. 'Auditable data' is defined as data which could, in principle, be verified by an independent third party given free access to the company's records, management, etc., with 'unauditable data' being defined as an assertion that is not capable of verification. The distinction between voluntary and mandatory information (see, for example, Buhr and Freedman, 1996; Guthrie and Parker, 1990) refers to the fact that certain information is required to be disclosed in corporate annual reports, notably accounting and reporting disclosures required under the Fourth and Seventh EC Accounting Directives, and reporting disclosure requirements under national accounting laws and practices and stock exchange disclosure requirements. Prior studies have stressed the importance of this distinction in analysing CSR (see, for example, Gray *et al*., 1995c, 2001) although, as described in Chapter 2, in the context of the present study, there are very few reporting requirements which specifically relate to environmental, health and safety issues. Hence this distinction may not be so important in the present case.

8.8 Interrogation instrument, data capture and recording

An interrogation instrument in the form of a pro-forma input form was prepared for use in the present study on which to manually record all captured CED data prior to their entry into a database[25]. To assist the data recording process, detailed guidance notes were developed prior to data capture. The interrogation instrument enables the systematic measurement and recording of each item of CED. Items of CED identified in a report were entered on the interrogation instrument under the appropriate sub-heading, after being measured using the using the standard A4 template, and then coded according to the various qualitative characteristics of the data. A memo column and page reference column are included on the interrogation instrument to permit the recording of useful information and to trace back to the source, respectively. Page referencing is considered to be important because it permits cross-referencing to the original source for each item of coded data. The interrogation instrument also serves to provide a permanent manual record of the content analysis work performed in relation to the sample of companies included in the present study with one form being completed for each company report[26]. The various sub-headings on the interrogation instrument were manually totalled prior to entering a data computer database (see below). A final overall total was also recorded on the interrogation instrument, which summarises the qualitative aspects of the data, i.e. 'auditability', 'news' and 'quantifications'. In relation to the latter, a categorisation system was used, following Trotman (1979), whereby a report is classified along a range of discrete values from A to E according to the degree to which items of information are expressed in financial or other non-monetary terms. This information was used to codify companies based on the classification of all the reports for each company for each year. A decision rule was applied whereby a company receives the highest classification (where A is the highest and E the lowest) by reference to all reports included in the study for

each company for each year. Thus, if one of the reports of Company X in 1990 contains financially quantified data (classification A), that company received classification "A" for 1990. The results of this analysis are presented in Chapter 10.

The content analysis data as recorded and summarised on the interrogation instrument was recorded in a bespoke database *Content1*, using a statistical package (SPSS) to permit statistical analysis[27]. *Content1* was formatted such that each content analysed document was entered as one computer record, each such record consisting of a large number of fields which included the interrogation instrument and various background data (see Section 8.10 below). This structure thus permitted any number of records to be entered for a particular company in a particular year. A second aggregate database, *COY1* was then derived from *Content1* which provided one cumulative total of CED for each company for each year based on the total number of documents pertaining to each company in each year. *COY1* served as the main data source for hypothetico-deductive analysis (Chapter 9). Data were entered into *Content1* by one research assistant, normally on a company-by-company basis, at the time all or most of each company's reports had been content analysed. Checks on the overall accuracy, completeness and reliability of the data recorded in *Company1* were performed by the author, as follows: (i) the number of records as recorded in *Company1* was agreed to the number of reports recorded on *Company Control Schedules* (not reproduced here) which provided a manual record of the number of reports to be content analysed for each company by type and year; (ii) details of the number and type of reports, as recorded on the *Company Control Schedules*, were agreed to the interrogation instrument forms and to the *Company1* database on a company-by-company basis; and (iii) a random sample of 25 manual input forms and background data sheets were checked and agreed to the records in the *Company1* database[28]. The related issues of content analysis reliability and inter-coder agreement are discussed in the next sub-section.

8.9 Reliability of content analysis and inter-coder agreement

A key element of content analysis-based research is the ability of the interrogation instrument and specifications for recording data to be reliable and reproducible (Guthrie and Mathews, 1985). Reliability in this context rests on the ability of these two instruments to yield similar results when employed repeatedly on a given company report. Krippendorff (1980, pp.130-2) identifies three types of reliability for content analysis: (i) stability; (ii) reproducibility; and (iii) accuracy.

Stability, or intra-observer reliability, refers to the degree to which the *same* coder content analyses the same data set over time. In this situation, data would be considered reliable if there were no major deviations between the respective results. Thus, stability was established in the Guthrie and Mathews (1985) study by using a test-retest procedure under which four annual reports were selected and the interrogation instrument applied by the same researcher twice at a two-week interval. A similar procedure was employed in the present study (see below), whereby a small sample of annual and environment reports was subjected to the test-retest situation at various times during the course of the project. However, even where there is a high level of intra-coder agreement, tests of stability are the weakest form of reliability testing because they only establish that a recorder is consistent in relation to the use and interpretation of the interrogation instrument and recording instructions (Guthrie and

Mathews, 1985). Moreover, it is weakened further by the fact that it may become necessary to revise these recording instructions during the course of the research. In view of the degree of subjectivity involved in the classification of items of CED, detailed coding rules were developed for the pilot study (see Section 8.1 above), on the completion of which these rules were then updated and amended as appropriate prior to the commencement of the present study[29]. During the content analysis phase, these coding rules were continually re-assessed and, where necessary, elaborated upon to provide clearer, more detailed guidelines. As was also the case with the Gray *et al.* (1995c) study, during the early stages of the content analysis phase it was still necessary to revisit, and in some cases revise, definitions and associated decision rules to arrive at a set of definitions which felt comfortable and which were workable in terms of being able to perform the content analysis reliably, consistently and efficiently[30]. Although it is impracticable to comment here on all such issues and questions which arose, the general approach adopted in each case was to discuss the matter with the other researcher(s) involved, to apply decision rules based on underlying principles, to revise and or elaborate on the definitions and decisions rules where appropriate, and to re-do the data collection and database if necessary. Such revisions and the reasoning thereto were noted down and, where practicable, incorporated into the various definitions and decision rules.

Reproducibility, or inter-coder agreement, refers to the degree to which a process can be recreated under different conditions, at different locations, using different coders. Krippendorff's (1980) test-test approach, for example, can be applied to CSR research by having two or more independent judges complete the content analysis of a sample of reports in different locations with a minimum of contact. A high level of agreement amongst multiple coders in relation to the way coding and measurement instructions are interpreted and applied would suggest that the results are reliable. In the present study, the content analysis phase was performed with the support of a number of different assistants at various times and stages of the project, depending on the availability of personnel and funding. This was necessary because of the large number of reports to be content analyzed, the amount of labour required to obtain these reports, and the length of time required to perform the content analysis work. There are a number of methodological issues which arise when employing multiple coders (for a detailed consideration, see for example, Krippendorff, 1980, chapter 7; Milne and Adler, 1999; Unerman, 2000). These issues are not addressed here other than to describe their general characteristics, training procedures and the procedures employed in data gathering and data processing[31]. As noted above, explicit definitions and instructions were developed in advance of the content analysis phase. In practice, these definitions and instructions were continually negotiated between coders in arriving at outcomes which 'felt right' in the context of the overall aims of the study. As far as practicable, these outcomes are reflected in the various definitions, guidelines and forms used in the study.

Six persons, including the author, over a period of several years, coded the company reports used in the present study[32]. A number of steps were taken to ensure inter-coder reliability. Firstly, each coder received a short (at least one day) introduction to CSR research, prior studies, the aims of the study, the research method and approach, and content analysis methodology. Secondly, coders were each supplied with various published research material which they were asked to become familiar with prior to coding the reports[33]. Thirdly, each coder received in-depth, one-to-one training in how to perform content analysis in accordance

with the guidelines and definitions developed for the study. This training consisted of the author and the coder content analyzing a sample of annual reports and one environment report, together and separately. This duplication of effort was considered essential, not only in terms of the required training but also from the point of view of reliability. For a procedure to be reliable it should give rise to the same data set irrespective of the person performing the content analysis or the timing of its performance (Kaplan and Goldsen, 1965). Thus, reliability in the context of content analysis is expressed as a function of the agreement achieved amongst coders in relation to the assignment of units of data to categories of CSR, the measurement and attribution of qualitative characteristics to such units (for a more detailed discussion of inter-coder reliability in the context of content analysis, see, for example, Hughes and Garrett, 1990; Milne and Adler, 1999)[34]. The author and the respective coder discussed any discrepancies which arose between one another's work, a consensus was reached and the coding adjusted to reflect 100 per cent agreement. Once the author was satisfied that the assistant was coding the reports in a consistent and reliable manner, further reports were coded by the assistant only. Consistency was maintained throughout the project by ensuring that any parts of a report which gave coding problems were discussed with the author at the time. In the case of environmental and social reports, all codings were carefully reviewed page-by-page by the author. Any ambiguities or concerns which arose during this review were discussed with the respective coders to ensure, as far as is practicable, that all coders used the same coding rules[35].

The final type and higher order of reliability, that of *accuracy*, seeks to assess coder performance against some pre-determined standard, known as a test-standard, set by a panel of experts or based on prior experiments and studies (Guthrie and Mathews, 1985). However, there are at present no universal rules of thumb or universal minimum standards that could be adopted for the reliability of CSR content analysis. Thus, it is not possible to employ this reliability test in the present study. Indeed, Unerman (2000) notes that there is no single criterion of adequate reliability within any of the tests of reliability and that researchers must therefore choose the criteria of reliability they consider to be most appropriate to their particular study. As such, the best practical advice may be that researchers should understand the research tools, their limits and the research context before making a careful interpretation of results (Adler and Milne, 1999).

8.10 Sample size, composition and basis of selection

While the principles of sampling a population for the purposes of drawing inferences about a population as a whole are well-established, the actual practice of sample selection is often much more difficult. In addition, the accounting literature is generally silent on the issues of population identification, stratification, homogeneity and sample bias (Gray *et al*. (1995c). Rather than attempting to draw a sample which is representative of the population of companies as a whole, the present study follows prior research in focusing on large companies (see, for example, Gray *et al.*, 1995c, 2001; Guthrie and Parker, 1990; Hall and Jones, 1991, Litvak and Banting, 1971; Roberts, 1990)[36]. The inclusion of large companies only obviously introduces an element of bias into the study. This approach can be justified on a number of grounds (Gray *et al*., 1995c): (i) a sample of large companies is more likely to demonstrate examples of environmental disclosure compared to an equivalent sample of

medium-sized or small companies; (ii) a sample of the largest companies would be more comparable – on size at least – with a majority of other studies which sample from the largest companies; and (iii) obtaining annual reports and other reports and documents from the largest companies is likely to prove more successful than for other samples. Other arguments for focusing on large companies are grounded in the nature of the business-society relationship as referred to in earlier chapters, notably that larger companies tend to be the object of most societal pressure (Litvak and Banting, 1971), the environment of CSR is that of large business enterprises (Johnson, 1979), CSResp is about relationships between 'big' business and society (Moore and Richardson, 1988) and larger organizations tend to engage more heavily in legitimising behaviour (Dowling and Pfeffer, 1975).

A form of structured, multi-stage sampling procedure was employed to select a sample of 90 companies[37]. This sample was drawn from a single source, *The Times 1000 1997* (Barrow, 1996) reference book, which annually lists the 1,000 largest European companies, ranked by capital employed. The rankings in the 1997 edition of *The Times 1000* are based on company data closest to that of the final year of the study (i.e. 1995), these same companies forming the database for each of the seven years from 1989 to 1995 (see below). Rather than select companies completely at random, the sample was structured to provide a minimum number of sample items in terms of industry sector and geographical area (see below). These two pre-sampling conditions established a chosen number of companies from each geographical region and an equal distribution between the environmentally-sensitive (ES) and less environmentally sensitive (LES) industry sectors at country level.

Table 8.2
Sample of companies by geographical region and industry environmental sensitivity

Population/Sample	Benelux	Germany	Total
Total population by source:			
Sectors 1 to 4 (ES)	21	74	95
Sectors 5 to 8 (LES)	34	43	77
Total	55	117	172
Primary sample:			
Sectors 1 to 4 (ES)	20	25	45
Sectors 5 to 8 (LES)	20	25	45
Total	40	50	90

Notes: The above sample was sourced from *The Times 1000 1997* list of top 1,000 European companies, ranked by capital employed. Where: Sectors 1 to 4 (ES) = Environmentally-sensitive industry sectors (chemicals; extractive; mechanical engineering and metallurgy; energy utilities); Sectors 5 to 8 (LES) = Less Environmentally-sensitive industry sectors (banking and insurance; consumer goods; travel, tourism and transport services; retail and leisure); "Total population by source" indicates the total number of Benelux and German companies from these 8 industry sectors, respectively, which appear in *The Times 1000 1997* list of top 1,000 European companies; Benelux = Belgium, Luxembourg and the Netherlands.

However, a degree of randomness was introduced by selecting sample items according to the order in which they are appear in *The Times 1000*, items being listed in rank order, i.e. the largest company (in terms of capital employed) appearing at the top of the list and the smallest company at the bottom. The 90 companies were selected by starting from the top of *The Times 1000* list and selecting a company each time the two conditions of industry sector and geographical area was satisfied. This procedure was continued until the required number of companies from industry sector and geographical area had been selected. A prior analysis was carried out to establish the existence of a sufficient number of companies in *The Times 1000 1997* to provide the required sample (Table 8.2). Details of the processes employed for requesting copies of the sampled companies' relevant reports and the decision rules applied to non-responses are given in Section 8.12 below.

An additional consideration which had to be taken into account was the fact that the study covers a number of years (see Section 8.11 below). For longitudinal studies, there are primarily two ways of drawing a sample from published lists such as *The Times 1000.* The first is to establish a database of companies based on the same *number* of companies in each year of the longitudinal analysis, for example, the top 100, irrespective of whether or not the *identity* of companies selected in the first (base) year is the same as those in subsequent years. Although this approach takes into account changes in the absolute size of companies over time, the disadvantage is that the database of companies becomes unstable over time, with some companies dropping out of the rankings as their relative size falls and others entering the rakings as their relative size increases (Gray *et al*., 2001). An alternative approach is to select a sample of companies using a base year and to build up the database using the *same* companies for each year of the study. Using this approach, the sample of 90 Benelux and German companies was selected from *The Times 1000 1997* (Barrow, 1996) which provided data on companies using the latest available set of financial statements. In most cases this is the financial year ended in the calendar year 1995. This approach has the advantage of providing a complete data set for the purposes of hypothesis testing whilst also reflecting, assuming that the sample is representative of changes at a macro-economic level, changes in absolute levels of size and profitability, for example, over time. It is the latter approach which has been adopted in the present study. However, this approach has the disadvantage of selecting companies which might not exist, or which were the subject of acquisitions or mergers, in earlier periods.

In the case of the present study, no company was selected which could not be traced back to 1989 in some form or other. Two companies (ING Group and Akzo Nobel[38]) were selected using 1995 as the basis period but which had been the subject of a significant takeover/merger in the period since 1989. In both cases, a decision was taken to include the companies on the basis of the accounting treatment applied for group accounting purposes. Thus, where the company was the result of a merger of two companies (as is the case of ING which had been treated as such for group accounting purposes), the two merged companies were included in the sample for the years prior to the merger; conversely, where the company was the result of an acquisition (for group accounting purposes) of one company by another (as in the case of Akzo's acquisition of Nobel) which resulted in a change of name for the acquiring company, the acquired company (Nobel) was ignored and the period prior to the merger based on that of the acquiring company only (Akzo). The 90 companies selected on

the basis described above represent the primary sample for the purposes of the statistical and descriptive results reported in Chapters 9 and 10, respectively. A full listing of these 90 companies is provided at Appendix 4. The resulting sample of 40 Benelux and 50 German companies (Table 8.2) represent some of the largest corporate entities in Europe, many of whom employ large numbers of people, consume large quantities of energy and other resources, and have a considerable impact on both the social and physical environment.

A further sampling issue of relevance to studies which test for associations between CSR/CED and other variables is the degree to which the sample maximises the variance of these other variables. That is, if certain variables which are assumed to influence CED are known in advance, then the sample may be selected on a basis which maximises the variance of these variables. As discussed in Chapter 3, and subsequently in Chapters 5 and 7, a number of key corporate characteristics were identified as being associated with variations of CED across firms. Three such characteristics are relevant in the context of the present study, viz.: size, industry sector and country. Variance in the size characteristic was achieved by the sampling procedure described above, with the resulting sample containing companies which differed significantly in terms of their total assets, capital employed, profits and number of employees (Table 8.3). Variance in the industry sector characteristic was achieved by selecting companies from a number of different industry sectors which, *a priori*, had been identified as being perceived differently in relation to their environmental impacts (see below). Variance in the country characteristic was limited for the reasons explained below, although some country variance was present by specifically biasing the sample to include companies from number of different countries.

Table 8.3
Sample population (90 companies) by size (year = 1995)

Firm characteristic	Highest value	Lowest value	Mean value
Total assets (DM 000s)	721,665,000	2,334,727	77,805,696
Capital employed (DM 000s)	194,502,339	391,049	10,677,679
Profit (EBIT) (DM 000s)	11,609,130	-3,511,000	1,388,602
Number of employees (units)	321,222	453	43,367

Industry sector composition

An industry classification system was developed based on that provided in *The Times 1000 1997* (Barrow, 1996), which classifies companies according to their primary field of activity, but with adaptations using a number of other sources (viz.: Deloitte & Touche Miljø, 1996; Gray *et al*., 1995c; UNEP IE, 1994; DTTI, IISD and SustainAbility Ltd., 1993). Given that firms operate in more than one industry, it is the primary industrial classification based on *The Times 1000 1997* that is used in the study[39]. Based on this adapted classification system, eight industry sectors were selected which were classified as comprising four environmentally-sensitive (ES) and four less environmentally-sensitive (LES) sectors. For ease of reference, these eight sectors are numbered numerically from 1 to 8 (Table 8.4 below). A more detailed description of these sectors is provided at Appendix 5, together with

a list of the sectors which were excluded, the latter comprising all other sectors other than the eight listed above.

Table 8.4
Selected industry sectors

Environmentally-sensitive (ES)	Less environmentally-sensitive (LES)
1. Chemicals	5. Banking and insurance
2. Extractive	6. Consumer goods
3. Mechanical Engineering and Metallurgy	7. Travel, tourism and transport services
4. Energy utilities	8. Retail and leisure

The principal rationale for choosing these eight sectors is that industry sector is a seen as a significant issue in the context of environmental disclosure. Put simply, prior research has shown industry sector to be a significant firm characteristic when seeking to explain or predict variations of CED across firms (see Chapter 3). Hence, the variance associated with industry sector may be maximised by selecting samples which include both ES and LES companies. In practice, this requires some *a priori* classification of industry sectors as between ES (or, more crudely, 'dirty') industries and LES (or, more crudely, 'clean') industries (see, for example, UNEP IE, 1994). Importantly, the key issue here is not the degree to which one industry is seen as more environmentally-sensitive compared to another based on certain 'objective' (e.g. pollution) criteria (although the latter is relevant in terms of how it influences behaviour)[40]. Rather, it is the *perception* amongst society, through the activities of certain interest groups which is seen as giving rise to challenges to a business organization's sovereignty, whether in the context of legal, economic relationships (as under EAT), socio-economic (as under MST), or socio-political (as under OLT) relationships. As such, in the context of CED, it is the *postures* of different industry sectors in relation to environmental issues which are seen as important.

There are *a priori* grounds for believing that sectors 1 to 4 will have different postures from sectors 5 to 8 in relation to the natural environment. Extractive companies, notably those involved in oil and gas exploration and refining, extract a non-renewable resource and refine it into a fuel which generates environmentally-sensitive substances such as greenhouse gases; aggregates companies are involved in the consumption of large quantities of primary resources extracted from the ground for the production of cement and cementitious-related products from the sourced intermediates; chemical companies also consume large quantities of non-renewable intermediates and are involved in the production of products such as agrochemicals, organic solvents, gases, etc. that have perceived (and demonstrable) polluting effects (Campbell, 2001). There is also considerable discussion of industry environmental sensitivity in prior CSR research (see, for example, Chastain, 1973; Cowen *et al*., 1987; Dierkes and Preston, 1977; Freedman and Jaggi, 1988; Gibson and O'Donovan, 2000; Hackston and Milne, 1996; Niskala and Pretes, 1995; Patten, 1991, 1992; Roberts, R., 1992). Chastain (1973), in one of the earlier references to polluting industries, describes the chemicals, energy, forestry and packaging, and utilities industries as being amongst the

'heavier polluting' sectors. Dierkes and Preston (1977) contend that the activities of the organization itself are one of the factors which distinguish 'clean' industries from 'dirty' industries[41]. On this basis, companies whose activities modify the environment, such as extractive industries (e.g. open cast mining) were seen as 'dirty'. Hackston and Milne (1996) distinguish a 'dirty' industry from a 'clean' industry by suggesting that a 'dirty' industry is one which creates environmental problems, including pollution, resource depletion and waste. Gibson and O'Donovan (2000) selected industry sectors based on evidence which suggested that *social perceptions* of companies operating in these industries meant that such companies were likely to be considered 'dirty' or environmentally damaging.

Other literature also supports the dichotomous classification of the eight industry sectors as between ES and LES based upon perceived sensitivity to environmental issues. The United Nations World Commission on Environment and Development in its seminal report *Our Common Future* (UNWCED, 1987), identified the most polluting industries as being chemicals, utilities, pulp and paper and metals. Elkington (1994) asserts that stakeholders and environmentalists in particular view certain industry groupings, including chemicals, paper and packaging, engineering, mining, oil and gas, solid fuels, as being amongst the most likely to have a detrimental impact on the environment. Nevertheless, classifications of this nature are, to an extent, subjective and *ad hoc* (Hackston and Milne, 1996)[42]. It is also the case that certain groups within society, such as ENGOs, may not perceive the distinction between ES and LES as meaningful. Firstly, all large, transnational companies (TNCs) are, by virtue of the scale and global operations, environmentally-intensive relative to small and medium-sized companies and generate significant environmental impacts in the course of their routine operations (Dierkes and Preston, 1977; Roberts, 1990). Secondly, the *indirect* activities of certain industry sectors, such as the investment policies of banking and insurance companies, may be perceived as equally environmentally-sensitive in comparison to the *direct* impacts of companies in high profile, polluting industries[43]. The extent to which such views are representative of the views of society as a whole is, however, unclear such that prevailing societal opinion on what is and what is not an environmentally-sensitive industry is likely to be influenced by other sources, including the media. The approach adopted in the present study has therefore been to use an *a priori* classification of industrial sectors based on a review of the literature referred to above, but to compare this with the views of both ENGOs and the management of the sample companies themselves (see Section 8.14 below).

Country composition

There is also increasing evidence which suggests that CSR is influenced by the home country of the reporting entity (see, for example, Adams *et al*., 1995b, 1998; Azzone *et al*., 1996; Fekrat *et al*., 1996; Gamble *et al*., 1996; Guthrie and Parker, 1990; Hibbitt and Ursem, 2000; Roberts, 1990; Teoh and Thong, 1984). Notwithstanding the fact that the existence of putative relationships between disclosure and corporate characteristics has yet to be demonstrated to exist consistently across different countries (Gray *et al*., 2001), international cross-country longitudinal studies remain a fertile area for CSR researchers. Hence, a decision was taken to include companies from a number of different European companies in the study. This decision was influenced by a number of factors, some theoretical and some practical[44]. From a theoretical perspective, maximisation of variance due to home country is likely to be achieved by maximising the number of countries in the study. Similarly, in

relation to the longitudinal aspect, the more European countries that can be included, the more representative the results will be of trends in Europe as a whole. Secondly however, from a practical point of view, some European countries are simply too small to include on their own because their industries have fewer of the large, multinational companies and hence do not contain sufficient entries in *The Times 1000*[45]. Thus, in the case of the Benelux countries, it was decided to treat these as one geographical region. Thirdly, there is the issue of language, an obvious one in the context of European studies and one which has yet to be fully acknowledged in pan-European CSR surveys. As noted by Gray *et al*. (1996) language represents a barrier to those working only in the English language given that such surveys are restricted to companies who report in the English language, thereby introducing an element of bias into any resulting sample (as in the case of Adams *et al*., 1998). The inclusion of southern European countries (Italy, Spain, Portugal and, to a lesser extent, France, for example) presents a problem because there is less likelihood of these countries producing annual reports in English, Dutch and/or German (these being the principal chosen languages of the present study) in comparison to northern European countries (see below).

Taking into account the issues described above, five geographical regions were initially adopted for inclusion in the study, viz.: Benelux (i.e. Belgium, Luxembourg and the Netherlands); Germany; Nordic (i.e. Denmark, Finland , Norway and Sweden); Switzerland; and the UK. These regions were believed to be sufficiently different from one another, economically and socio-politically, to bring out any cross-country variations in statistical tests of association. However, as noted above, due to time and labour constraints, all but the Benelux and German companies were excluded from the content analysis part of the study. Thus, the present study is restricted to an examination of CED in the four countries of Belgium, Germany, Luxembourg and the Netherlands. These countries are not only in close geographic proximity to one another but also economically very similar, having tied their national currencies to the German mark prior to the adoption of the Euro (€) as an electronic currency on 1 January 1999 and as official legal tender on 1 January 2002. As such, Benelux and German companies are likely to be influenced by some common factors (Adams *et al*., 1998; Gray *et al*., 1996). However, notwithstanding these geo-political and macro-economic similarities, prior research has identified some notable differences across European countries, particularly in terms of accounting systems, banking and finance systems, government and legislative systems, key economic sectors, social and political factors, culture, the role and responsibilities of business in society, the resolution of conflict and the influence of social and environmental pressure groups (see, for example, Brockhoff, 1979; Henderson, 1993; Hofstede, 1980, 1991; Keating, 1993; Nobes and Parker, 1995; Richardson, 1993; Schreuder, 1979, 1981; Tucker, 1994). Hence, although the number of countries included in the study is less than was originally intended, these various country-specific cultural and socio-political differences are assumed to be strong enough as to create variations in corporate environmental disclosure practices across the sample[46].

8.11 Sample period

Prior CSR research has highlighted the need for and value of longitudinal studies, i.e. multi-period studies covering at least three (preferably) consecutive years (see, for example, Cowen *et al*., 1987; Deegan and Gordon, 1996; Gray *et al*., 1995b; Guthrie and Mathews, 1985;

Guthrie and Parker, 1989, 1990; Mathews, 1993; Neimark, 1992; O'Dwyer and Gray, 1998; Tinker and Neimark, 1987). Such studies are seen as important in the context of CSR because they provide an opportunity to draw out trends in CSR over time by tracing the same company or companies longitudinally, and to comment on those trends from different theoretical perspectives. Moreover, such trends are not necessarily evident from cross-sectional, single-period studies which search for putative associations between two or more variables. As noted in Chapter 1, one of the objectives of the present study is to be able to perform longitudinal analysis for the purposes of commenting on and interpreting trends in CED by large European companies over time. This then raises the question of what years to include. Prior research suggests that the period chosen should be determined by reference to the overall objectives of the study or the theoretical insights which the study seeks to develop. Gray *et al*. (1995b, c), for example, in employing a political economy of accounting perspective, draw their longitudinal UK sample from 1979 onwards on the basis of the hypothesis that the years of the Thatcher governments in the UK (1979 to 1990) would lead to a significant change in organization-society relationships given the political agenda of the Thatcher governments (with their focus on rolling back the State, privatisation of the public sector, a private enterprise culture, etc.). Similarly, Deegan and Gordon (1996) and Campbell (2001) chose to look at periods during which there have been observable changes in the values, traditions and norms of society as represented by the changed membership of environmental groups during the 1990s.

In the specific context of CED, if the goal is to focus on trends over time then an argument can be made for selecting a period during which those trends are likely to be most evident, not least because this provides a more interesting backdrop against which to explore the reasons for such trends. From this perspective, the year 1989 is seen as pivotal given that this marks the beginning of the environmental movement of the late 1980s (see Chapter 2) and, by extension, much of the resurgent interest in corporate environmental (as well as social and sustainability) reporting which has followed (see Chapter 3). Elkington (1997), for example, marks 1990 as the start of a new trend in corporate environmental reporting. Empirical evidence would also seem to support the view that there was a step-change in the level of CED post 1989 (see, for example, Campbell, 2000; Gray *et al*., 1995c; Hibbitt and Ursem, 1996). The pilot study (Hibbitt and Ursem, 1996) carried out for a sample of 30 UK and Dutch companies' annual reports over the period 1989 to 1994 revealed that the percentage of companies disclosing CED rose sharply between 1989 and 1992 with all 30 companies disclosing on CED in 1992. Moreover, the amount of CED increased dramatically during the six year period. This was the also the case for both the UK and the Netherlands as well as for both the 'clean' and 'dirty' industry categories (Hibbitt and Ursem, 1996). The pilot study thus provided some evidence to suggest that interesting CED data would result from a study which focused upon a similar longitudinal period. Similarly, Campbell (2000) in his study of social reporting by the UK retailer Marks and Spencer plc over the period 1969 to 1997 reports that the first explicit disclosure on the environmental behaviour of the company was in 1989. The period from 1989 also offers an opportunity to examine changes in the levels of CED during a period when corporations were having to deal with growing public awareness of environmental issues and a growing array of regulatory requirements (Walden and Schultz, 1997). Post (1991) argues that from this time on, corporations could no longer ignore environmental issues and that businesses had to be managed as if the environment mattered.

The significant increase in CED across the board after 1989 has also been linked to the worldwide attention given to corporate environmental behaviour as a result of the *Exxon Valdez* oil spill in Alaska Sound in March 1989 (Patten, 1992; Walden and Schwartz, 1997) and to the Code Island chemical explosion near Melbourne in 1991 (Gibson and O'Donovan, 2000). Based on the results of the pilot study and the prior research referred to above, 1989 was chosen as the basis year. Extending the period of the study as far forward as possible to provide the maximum number of years resulted in selecting a seven-year period from 1989 to 1995[47].

8.12 Requests for company reports

Having identified the sample companies and the sample period, the next stage of the project involved contacting each company to obtain copies of the relevant reports. Two decision rules were adopted to assist in this task:

(i) *languages* – companies were requested to provide copies of their reports in one of three languages – Dutch, English or German, with a preference being expressed for reports in English (reports in French were also used where such reports were not available in Dutch, English or German)[48]; and,

(ii) *completeness* – companies were included in the study only if they were able to provide a full complement of reports for each of the years from 1989 to 1995, inclusive. If a report such as an annual, social or environment report existed but was either not available in one of the four languages referred to above, or was no longer available, the company was excluded from the study and replaced by another company from the same country and industry using the rakings provided in *The Times 1000 1997*.

Item (i) above was addressed previously at Section 8.10 above. In relation to item (ii), research protocol requires that a company be excluded from the sample if it is unable, for whatever reason, to supply all the relevant documents for the years 1989 to 1995. This procedure is problematic in that the researcher must know in advance the total number of reports a company has issued which meet the criteria set out above (Section 8.4). Without this knowledge, it is not possible to be certain that all the relevant data has been captured and thus the research could be seriously compromised (Gray *et al*., 1995c; Zéghal and Ahmed, 1990). For most studies, given their focus on annual reports only, completeness is not a serious issue since in most cases these reports are readily available either from the company or from independent archives. However, in the context of the present study, completeness of reports appeared, *a priori,* to be a much more significant issue. To address this issue three decision rules were employed:

(a) sample companies were requested to indicate their total number of annual, social, environmental and review of the year reports for each of the years 1989 to 1995;
(b) simultaneously, these companies were also asked to provide copies of their annual reports, social reports, environment reports and other reports which meet the criteria set in Section 8.5 out above; and,
(c) alternative procedures were carried out which serve as independent checks on completeness, including reviewing the financial, environmental, social and employee reporting requirements in each country and a scan of relevant publications and other

sources to identify companies which had published a company-wide environment report[49].

For the purposes of item (a) above, a pro-forma reply form was designed for the purposes of obtaining confirmation of the total complement of reports that had been published by each sample company for each year of the study. Copies of the pro-forma reply form were sent to the external public relations department of the 90 Benelux and German companies (as well as the 130 Nordic, Swiss and UK companies) in May 1997, together with a covering letter, written in Dutch, English, French or German, as appropriate, requesting that the company complete and return the form together with copies of the relevant reports. Although all companies replied eventually, this work was extremely laborious with the initial level of response being slow and haphazard[50].

In accordance with the decision rule under item (ii) above, companies which were not able to provide copies of all the required reports were excluded from the study and replaced by another company in accordance with the research protocol described above. As a result of this rule, two Benelux companies and seven German companies were excluded from the study. In each case, a replacement company was selected using the same selection criteria, proceeding down *The Times 1000 1997* ranking of European companies until an appropriate replacement was identified[51]. Further analysis of the reports by industry and by year is given in Chapter 10.

8.13 Company reports for content analysis

In accordance with the research protocol referred to above, for the sample of 90 Benelux and German companies the total number of reports obtained for content analysis purposes was 1,011. The make-up of these reports is summarised in Tables 8.5 and 8.6 below. The type and number of reports on a company-by-company basis is given in Appendix 4. A key characteristic to be discerned from Table 8.5 is a strong upward trend in the number of reports published by Benelux and German companies over the period from 1989 to 1995, with the total number of pages in these reports increasing from 8,853 pages in 1989 to 11,388 pages in 1995, a rise of 28.6 per cent over the period. Given that each company produces an annual report, the number of annual reports is constant although it should be remembered that the number of pages in each report varies. As shown in Table 8.5, the mean number of pages devoted by Benelux and German companies to their annual reports grew steadily throughout the period from an average of 86.4 pages in 1989 to 93.2 pages in 1995, an increase of 7.87% over the period (the mean being based on the number of reports by type published in each year not the number of companies in the sample). In contrast, the average number of pages contained in social reports declined over the period, falling from 45.1 pages in 1989 to 35.8 pages in 1995. The number of pages devoted to reviews of the year was relatively stable throughout the period, whereas the number of pages contained in the other reports was rather erratic, the latter perhaps being a reflection of the irregular nature of such reports. Environment reports showed the most dramatic increase over the period in terms of average page numbers, growing from 23.0 pages in 1989 to 53.6 pages in 1995, an increase of 133%. The 70 social reports were published by four Benelux companies and 10 German companies, respectively, of which two Benelux companies (ING and Royal Pakhoed) and six German

companies (BEWAG, Dyckerhoff, RAG, Saarberg, Schering and Wacker Chemie) produced a social report in each of the seven years 1989 to 1995[52].

Table 8.5
Summary of total number of reports by type and year

Type of report/Year	1989	1990	1991	1992	1993	1994	1995	Total
Annual Reports	90	90	90	90	90	90	90	630
Mean no. of pages*	86.4	88.8	90.7	89.7	89.4	91.6	93.2	
Social Reports	8	10	9	10	9	12	12	70
Mean no. of pages	45.1	44.4	41.6	39.7	35.2	39.0	35.8	
Environment Reports	2	2	3	5	6	8	24	50
Mean no. of pages	23.0	38.0	25.0	44.2	38.7	52.0	53.6	
Reviews of the Year	15	20	20	20	21	21	20	137
Mean no. of pages	15.8	20.4	15.4	16.4	13.9	15.5	15.7	
Other Reports	11	8	17	13	19	18	38	124
Mean no. of pages	39.7	29.3	29.1	20.8	28.0	20.4	27.6	
Total no. of reports	126	130	139	138	145	149	184	1,011
Total no. of pages	8,853	9,150	9,417	9,293	9,418	9,818	11,388	67,337

Notes: *Mean number of pages is based on the total number of reports, respectively, not the number of companies

The 50 corporate (i.e. group-wide) environment reports were published by 8 Benelux companies and 20 German companies, respectively. Of the sample companies, only BASF (a German chemical company) produced a corporate environment report prior to 1989 *and* in each year from 1989 to 1995[53]. Of the other German companies in the sample, Hoechst (five environment reports) and Henkel (four) produced four or more corporate environment reports throughout the period of the study. Of the Benelux companies, Akzo Nobel produced the highest number of corporate environment reports, publishing three such reports over the period. These figures are consistent with prior expectations, group environment reports being, generally speaking, a more recent European phenomenon than social reports, the latter having a longer history notably in the context of Works' Councils and employee reporting. The 137 reports classified under "Reviews of the Year" (RY) represent summary financial statements, overviews of the financial year and other similar statements published as short-form versions of the full group annual report and accounts. These 137 reports are spread across all eight sectors included in the study and represent a significant minority of the companies in the sample (17 companies out of 90, i.e. 19%), with 12 of the 17 (i.e. 71%) sample companies publishing such reports in all seven of the years covered in the study. These results are consistent with the widespread practice amongst the larger, stock-exchange listed companies of publishing short-form versions of their full annual report and accounts.

Table 8.6
Summary of reports by industry sector

Industry sector	Number of companies	Type of report					
		Total	AR	SR	ER	RY	OR
Chemicals	11	151	77	11	27	21	15
Extractive	10	108	70	16	1	10	11
Mechanical Eng. & Metall.	14	152	98	6	3	15	30
Energy utilities	10	132	70	14	1	17	30
Sub-total	45	543	315	47	32	63	86
Banking & insurance	13	142	91	9	7	27	8
Consumer goods	16	185	112	7	8	32	26
Travel & transport	7	66	49	7	1	8	1
Retail and leisure	9	75	63	0	2	7	3
Sub-total	45	468	315	23	18	74	38
Totals	90	1,011	630	70	50	137	124

Notes: AR = Annual Report; SR = Social Report; ER = Environment Report; RY = Review of the Year/Summary Financial Statements; OR = Other Reports.

The 124 "Other Reports" represent reports which fall within the definition of reports to be included in the study, notably documents provided with or which accompany a report and separate documents referred to as being available on request (see the criteria for inclusion of reports in Section 8.5 above). These "Other reports" vary in terms of their subject, content and length and include press reports, environmental policy statements, financial statements of the holding (i.e. parent) company and one-off documents. A number of companies were active in publishing these other reports, notably Volkswagen (17 other reports), SEP (15), Schering (10), Bayer (9) and Royal Dutch/Shell (9) (see Appendix 4). One of the notable features of these other reports is their size, with some reports, such as Bayer AG's *Chemistry with Chlorine. Opportunities – Risks - Perspectives* (99 pages) and Royal Dutch/Shell's *Shell Chemicals Information Handbook* (61pp), representing substantial documents. Among some of the other more significant reports falling within this category are:

- Akzo's *Chlorine and society. The role of Akzo* (1990, 40 pages);
- Bayer AG's *Bayer's Perspective on Ecology* (1995, 71pp);
- Deutsche Bank's *Environment & Entrepreneurs – In the same crisis?*", the last in a series of articles on problems of general socio-political significance (special supplement to the 1989 annual report of Deutsche Bank AG, 10pp);
- DSM's *DSM Profile. Chemicals and Materials* (1995, 44pp);
- European Investment Bank's *Protection of the Environment* (1991, 8pp);
- VEBA's *Environmental Guidelines* (1995, 25pp); and,

- Volkswagen's *Corporate Task. Environmental Protection* (1991, 42pp).

The likelihood that Tables 8.5 and 8.6 represent a complete and accurate record of the number and type of reports published by the sample companies is claimed to be high but not 100 per cent for the following reasons. Firstly, steps were taken to provide the highest level of reliability as is practicable. This included ensuring that the list of reports provided by each company was as accurate as possible[54]. Although it is necessary to rely on the information provided by companies, two research assistants were employed, one of Dutch nationality and another of German nationality, to contact the Benelux and German companies, respectively, to confirm the completeness and accuracy of the completed reply forms and to address any inconsistencies or oversights. The use of assistants whose mother tongue was the same as that of the company in question proved essential and invaluable. Without this, the risk of including a report when it should have been excluded, and vice versa, would have been much higher. Secondly, even though a definition has been provided of the reports to be included in the study (see Section 8.5 above), in many cases it was not immediately apparent whether a particular report met the criteria for inclusion in the study or not. These cases were resolved by detailed discussion with the respective research assistant on a case-by-case basis. The primary goal in these instances was to apply the rules consistently. However, in the event it became necessary to adopt new (minor) decision rules on an on-going basis. Any new decision rule was discussed and clarified with the research assistant and documented to ensure consistent application across the entire sample. Finally, it proved impossible, for various reasons, to obtain all the reports that would otherwise have been included in the study. However, based on information and explanations obtained (not included here), the amount of data that has been potentially lost due to the unintended exclusion of these missing reports is judged to be negligible in an overall context.

The 50 environment reports published by the sample companies represented only 5% of the total number of reports included in the research but contained 51% of the total amount of environmental disclosures by Benelux and German companies over the period 1989 to 1995. Environment reports thus constitute a significant element of corporate environmental disclosures throughout the period, even though they are a fairly recent phenomenon. Table 8.7 below summarises the year in which sample companies published their first corporate environment report in the period of the study[55]. These 27 companies represent 30% of the sample companies, of which eight are Benelux companies (29.6%) and 19 are German companies (70.4%). Two features of Table 8.7 are worthy of note. Firstly, six of the eight companies that produced a group-wide environment report for the first time prior to 1994 are chemicals companies. The only non-chemicals companies were Henkel ("health and household" i.e. "consumer goods"), which in fact specialises in applied chemical products and detergents, and Bayerische Landesbank Girozentrale a German bank. Secondly, something clearly changed in 1995 when the number of companies producing group-wide environment reports for the first time rose sharply from only 3 in 1994 to 16 in 1995, an increase of 433%. Interestingly, this step-change was systematic with companies from the mechanical engineering and metallurgy (e.g. Volkswagen, Daimler-Benz, Thyssen), energy utility (e.g. Electrobel), banking and insurance (e.g. Allianz, Bayerische Hypotheke-und Wechsel-Bank, ING, Deutsche Bank), consumer goods (e.g. Beiersdorf, Unilever) and retail

and leisure (e.g. Otto Versand) sectors all producing environment reports for the first time in 1995.

Table 8.7
First corporate environment report by sample companies, by year

Year	Number of companies	Benelux	Germany
1989	1	-	Wacker Chemie
1990	1	-	Hoechst
1991	1	-	Merck
1992	2	Solvay	Henkel
1993	3	Akzo Nobel	Goldschmidt; Bayerische Landesbank Girozentrale
1994	3	DSM; Petrofina	Lufthansa
1995	16	Electrabel; Heineken; ING; Unilever	Allianz; Bayer; Bayerische Hypotheke-und Wechsel-Bank; Bayerische Vereinsbank; Beiersdorf; Daimler-Benz; Deutsche Bank; Herlitz; Otto Versand; Schering; Thyssen; Volkswagen
Totals	27	8	19

8.14 Company background data and currency translation

Previously, Chapters 5 to 7 identified a number of corporate characteristics and external influences that are suggested by the respective theory as possessing explanatory power in relation to variations in CED across firms. In practice, CSR researchers tend to use company background data that is readily available in the public domain, such as that published in *The Times 1000* (see, for example, Adams *et al*., 1995, 1998; Gray *et al*., 1995b, c, 2001; O'Dwyer and Gray, 1998). Information provided in *The Times 1000* is sourced from a database held by *Extel* (part of Financial Times Information) and based on the latest information from annual reports and accounts. Thus, company background data information as provided in *The Times 1000 1997* (which was published in 1996) is based largely on information extracted from the financial statements of each company for the year ended 31 March or 31 December 1995. Whilst such data is easily accessible, attempts to match the figures reported in *The Times 1000 1997* with those reported in the respective company's 1995 annual report and accounts for a small sample of companies proved unsuccessful in a number of cases. There are a number of possible explanations for this, notably differences in definition and the use of different exchange rates (the figures reported in *The Times 1000* are in pounds sterling (GBP)).

To avoid such differences and to improve reliability, company accounting data relating to corporate characteristics was taken directly from each company's annual report and accounts.

A pro-forma input document, *Company Background Data*, was designed specifically for this purpose. A total of 16 items are listed on the research instrument. Of these, the first four deal with general background information which was used to identify the company, the year, the report and the reporting currency. The next five items relate to financial accounting data which was extracted from the company's annual financial statements. These are self-explanatory but to avoid confusion, definitions were provided in each case. These definitions proved reliable but minor amendments and elaborations were introduced during the course of the project to cope with issues such as variations in accounting practice. The next six items described as 'other data', represent additional background data which, *a priori*, were believed to be useful in the context of the present project, such as the number of breaches of environmental regulations and the position of the company's most senior environmental officer. The results of the study in relation to these items are discussed in Chapter 10. Lastly, the research instrument included a memorandum sheet used to record interesting and/or unusual items of information identified when content analysing the reports. Most of these items were manually recorded on the research instrument at the same time as performing the content analysis.

All company background data manually recoded on the research instrument were subsequently manually entered into a SPSS database *Working1*, separate columns being used to record each item of information. All monetary values were initially recorded in the reporting currency of the respective company, this being predominantly Belgian francs (BEF), Dutch guilders (NLG), German marks (DM) and Luxembourg francs (LUXF). Values other than those recorded in German marks were subsequently converted into German marks using the year-end exchange rate as at 31 December 1995. Converted data was subsequently entered into a second SPSS database *Content1* (see Section 8.8 above). The choice of the German mark was based on the fact that there are more German companies in the sample than Benelux companies and that the Benelux countries effectively tied their own national currencies to the German mark such that currency movements over time between the German mark and these other countries were minimal. The choice of 31 December 1995 for the exchange rate is somewhat arbitrary. Other dates could have been employed, including the year-end rate for each year of the study and/or an average rate for each year. However, movements in the Belgian franc, the Luxembourg franc (the exchange rate for the Luxembourg franc is the same as that for the Belgian franc) and the Dutch gilder, when pegged against the German mark, were not significant between 1989 and 1995 using either the average rate for the year or the year end rate.

8.15 Questionnaires to sample companies and ENGOs

As noted previously, variations in CED across firms have also been attributed to non-firm characteristics which relate to social and political influences on the business organization (see Figure 3.1, Chapter 3). Some of these socio-political influences were explored in detail in Chapters 6 and 7 towards the identification of measurable proxies for non-firm characteristics for the purpose of hypothesis testing. These variables were defined as follows:

(i) under managerial stakeholder theory (MST), (a) the relative importance of stakeholder groups to the business as a whole, and (b) the extent to which senior management was directly involved in formulating environmental policy; and,

(ii) under organizational legitimacy theory (OLT), (a) social pressures as measured by the extent of campaigns by environmental pressure groups (ENGOs) and (b) environmental performance as measured by the ENGOs' (eco-)ratings of companies.

In addition, under both economic agency theory (EAT) and OLT, industry sector environmental sensitivity was posited as being associated with variations in CED across firms. Whilst *a priori* assumptions were made for the classification of the eight industry sectors used in the present study as between environmentally-sensitive (ES) and less environmentally-sensitive (LES) (see Section 8.10 above), two alternative measurements of environmental sensitivity are proposed based on the perceptions of the management of the 90 sample companies themselves and ENGOs, respectively. To measure the variables identified in (i) and (ii) above as well as environmental sensitivity, a decision was taken to use two mailed questionnaires, one to be sent to companies and the other to be sent to ENGOs. (Copies of the questionnaires are not included in the thesis for reasons of space but are available from the author on request.) The use of these two questionnaires also provided an opportunity to obtain further background information on the views, attitudes, perceptions and activities of both management and ENGOS in relation to corporate environmental issues. The justification for using mailed questionnaires is addressed in the next paragraph.

A mailed questionnaire (i.e. one which is sent and returned by post) may be viewed as a form of a distance or far-removed interview. From this perspective, there is little in the way of difference between a formally-structured interview where the questions are structured and prepared in advance and the completion of a questionnaire. A semi-structured interview is obviously not the same as it allows more stories to be told. However, in view of the emphasis placed on obtaining large samples and taking into account time and resource constraints, the use of a questionnaire was judged to be the most effective and efficient approach in the circumstances. Mailed questionnaires are also one of the best means of eliciting information from a population that is widely dispersed and which may prefer a certain degree of anonymity (Wallace and Mellor, 1988). There are however, a number of disadvantages associated with remotely-completed questionnaires, notably the typically low response rates, that questions can be misunderstood, that answers have to be taken as given, that the researcher is unable to probe or follow-up interesting lines of enquiry, and that the answers provided represent the respondent's statements rather than a statement of what actually happened. The latter, known as vicarious information, implies the responses have to be taken on trust given that there is no alternative, independent way of verifying the accuracy of the responses. Details of the procedures followed in the preparation and circularisation of the two questionnaires and the response rates in each case are set out below. In both cases, all questionnaires were pre-numbered using a sequential numbering system prior to being sent out and all responses marked to indicate the date of receipt.

(i) Mailed questionnaire to sample companies

The structure and format of the questionnaire to companies was based largely on that used by Bebbington and Gray (1996), with adaptations to meet the specific objectives of the present study. The main part of the questionnaire comprised 19 questions structured into three sections. Questions were presented using either a simple rank-order five- or seven-part Likert scale or "yes/no" type format, as appropriate. The first section *Stakeholder groups* contained

general questions which were intended to provide an understanding of the relative importance of various stakeholder groups and the extent to which the company engages (that is, interacts and consults) with these groups. The second section, *Voluntary Environmental Policies and Performance* addressed the level of stakeholder involvement in the formulation of a company's environmental policy and each company's perception of the importance of its environmental performance to its various stakeholder groups. The third and final section, *Voluntary Communication of Environmental Information* attempted to gain an understanding of each company's policies and aims in relation to the voluntary communication of environmental information to its various internal and external stakeholders.

Copies of the questionnaire were sent to the 90 sample companies (as well as the 130 Nordic, Swiss and UK companies) together with a covering letter in Dutch, English, French or German, as appropriate (for reasons of time and resource constraints, the questionnaire was written in English only). Using information provided in *The Times 1000 1997* (Barrow, 1996), letters were addressed personally to the Chairman of the Executive Board of Directors. The first request was made in May 1998, except in the case of German companies, which were sent out in the month of July (Table 8.8).

Table 8.8
Responses to company questionnaire by country/region

Country/ Region	Total sample	Positive Responses	(%)	Negative Responses	Non - replies	1st request (1998)	1st reminder	2nd reminder
Benelux	40	16	40.0	4	20	27 May	3 July	23 July
Germany	50	16	32.0	10	25	2 July	3 August	8 Sept
Sub-totals	90	32	35.6	14	45			
Nordic	40	17	42.5	6	18	27 May	3 July	23 July
Switzerland	40	15	37.5	8	18	27 May	3 July	23 July
UK	50	23	46.0	14	14	27 May	3 July	23 July
Totals	220	87	39.5	42	95			

First reminder and second reminders were sent out between the months of July and September 1998, the first reminder being a letter only and the second including a copy of the questionnaire. Post-free, pre-addressed reply envelopes were provided with the first request and the second reminder. Details of the overall response rates are provided in Table 8.8 above. Those companies which responded positively are highlighted individually in bold in Appendix 4 (Benelux and German companies). Of the 90 Benelux and German companies, 35.6% responded positively; for the larger sample of 220 companies the overall response rate was 39.5 %.

Table 8.9
Responses to questionnaire to companies by industry sector and country/region

County/ Region	Total "yes"	Sector 1	Sector 2	Sector 3	Sector 4	Sector 5	Sector 6	Sector 7	Sector 8
Benelux	16	2	-	2	4	3	2	2	1
Germany	16	4	2	3	-	3	3	1	-
Sub-total	32	6	2	5	4	3	5	3	1
Nordic	17	4	4	3	1	1	1	1	2
Switzerland	15	1	2	1	3	5	2	1	-
UK	23	2	5	1	3	2	4	4	2
Sub-total	45	7	11	5	7	8	7	6	4
Totals	87	13	13	10	11	14	12	9	5

Notes: Sector 1 = chemicals; sector 2 = extractive; sector 3 = mech. eng. & metallurgy; 4 = energy utilities; 5 = banks & insurance; 6 = consumer goods; 7 = travel, tourism & transport services; and 8 = retail & leisure

Table 8.9 above summarises the response rates by industry sector. The number of responses in relation to individual industry sectors is never higher than five, limiting the degree to which the results can be relied upon to provide a valid representation of each industry sector. As a result, the discussion and analysis in Chapters 9 and 10 is restricted to results obtained at the aggregate level of the environmentally-sensitive (ES) sectors (sectors 1 to 4) and the less-environmentally sensitive (LES) sectors (sectors 5 to 8) only. More representative results are however possible at a country level. Positive questionnaire responses were provided by a variety of corporate personnel (Table 8.10 below).

Table 8.10
Responses to company questionnaire by position of responder

Country/Region	Total	MBD	GEC	EM	CCFO	ER	EEA	ND
Benelux	16	2	6	3	3	1	1	-
Germany	16	1	-	7	-	7	1	-
Sub-total	32	3	6	10	3	8	2	-
Percentages %	100	9.4	18.8	31.2	9.4	25.0	6.2	-
Nordic	17	11	2	-	-	3	-	1
Switzerland	15	2	3	-	3	7	-	-
UK	23	1	6	9	1	5	-	1
Totals	87	17	17	19	7	23	2	2
Percentages %	100	19.5	19.5	21.8	8.0	26.4	2.3	2.3

Notes: Where MBD = Main board director responsible for Environment/HSE; GEC = Group Environment/HS&E Officer Coordinator; EM = Environmental (or Social Affairs) Manager; CCFO = Chairman, CFO or Group Secretary General; ER = External Relations/Communications/Marketing Director/Dept.; EEA = External Environmental Adviser; ND = Not disclosed.

In the case of the 32 Benelux and German respondents, the highest percentage of positive replies were provided by main board directors, group environmental coordinators or managers with environmental expertise or responsibility (19 responses, i.e. 59.5%). Directors of or managers within the corporate external relations, communications or marketing departments, provided a further 25% of responses. Interestingly, in two cases, the responses were provided by an external environmental consultant, suggesting that the companies concerned were reliant on external rather internal expertise in relation to environmental matters[56].

(ii) Mailed questionnaire to environmental non-governmental organizations (ENGOs)

For the reasons set out above, a questionnaire was also developed to obtain information in relation to the views and activities of ENGOs. In Chapter 7, legitimacy theory (OLT) was used to explore the influence of ENGOs on the disclosure and reporting behaviour of companies. The basic premise underlying OLT in this context is that ENGOs, as one of the 'relevant publics' which reflect and act on behalf of the interests of society as a whole, represent a challenge to the social legitimacy of business organizations. The extent to which the actions and activities of the latter are out of step with the views, attitudes and norms of society, as reflected through ENGOs, represents a legitimacy gap. CED represents one of the tools available to management to reduce this gap through, *inter alia*, manipulating the perceptions of society. Thus, OLT posits that the perceptions of ENGOs (in relation to business' environmental sensitivity and environmental performance) and the activities of ENGOs (in relation to environmental campaigns) are associated with variations in CED across firms.

The format of the questionnaire to ENGOs was based on the questionnaire to companies used in the present study, aided by the work of prior CSR researchers in this particular area (notably, Deegan and Gordon, 1996; Tilt, 1994)[57]. The questionnaire to ENGOs was structured as follows. Part I solicited rudimentary background information including the position within the organization of the person completing the questionnaire, the year the ENGO was formed and current membership. The remaining questions were presented using either a simple rank-order five- or seven-part Likert scale or "yes/no"-type format, as appropriate. Part II sought to obtain the ENGO's perceptions of the environmental sensitivity of the eight industry sectors included in the study (see Appendix 5). These industry groups were presented in alphabetical order to avoid any pre-determined values[58]. An almost identical question was included in the questionnaire to companies, thus providing two alternative and independent measurements of industry environmental sensitivity. Part III asked the ENGO to indicate, using a rank-order Likert scale, the environmental reputation ("eco-rating") of the sample companies. For these purposes, a decision was taken to include only companies whose home country is the same as that of the ENGO. Thus, Belgian ENGOs were asked to comment only on Belgium companies. This approach was judged appropriate given that (i) national ENGOs might be expected to be more familiar with the actions and activities of companies headquartered in that country, and hence their responses would be more reliable and (ii) in order to rank a company's environmental reputation, the respondents must be in a position to have detailed information about the companies in the sample (Abbott and Monsen, 1979). Part IV solicited information on the extent to which an ENGO had conducted environmental campaigns to encourage, challenge or demonstrate against each

industry group's business activities. Part V asked each ENGO to indicate both the extent to which it sought to influence corporate environmental disclosure and reporting through the public policy arena and the extent to which it examined or reviewed such disclosure and reporting. Logically, if corporate disclosure and reporting is intended to influence or respond to the behaviour of other sections of society, such reporting must at least be known to those other sections of society. Reference to the overall results of these questions is made in Chapters 9 and 10.

Prior to being able to send the questionnaire, it was necessary to identify, as far as possible, the population of ENGOs in each country. Initial investigations, however, failed to identify a single, reliable and up-to-date source reference for European environmental organizations. A decision was therefore taken to establish a database of ENGOs (hereafter, "the ENGO database") on a country-by-country basis, this work being undertaken by the author over the period October to December 1999[59]. An international directory of environmental groups, *Environment Encyclopaedia and Directory 1998: A World Survey* (1998) (hereafter, "the Directory") was used as the main source for selecting the sample of ENGOs on the basis that, at the time, it was considered to be the most comprehensive reference for environmental organizations in Europe[60]. However, the Directory was found to be both out of date and incomplete and thus more detailed checks were carried out using other sources, including the Internet. Two other issues also became apparent during the course of setting up the ENGO database. Firstly, it is difficult to classify ENGOs as they are complex in nature and come in a variety of different forms (Van Heeren, 1996). Although prior CSR research is of help in defining the type of ENGO to be used in the study, considerable time was required to assess whether or not each ENGO met the conditions for inclusion in the study (see below). Secondly, the Internet has brought about a radical change in the way in which environmental movements, networks and alliances communicate both amongst themselves and with other sections of society[61]. Thus, the task of identifying and classifying an ENGO as being relevant/not relevant to the present study was far from easy. The first step in this process was to define an ENGO. Van Heeren (1996, pp.8-9), for example, classifies the wider population of environmental and development organizations into the following groups:

(i) the non-governmental organization (NGO) community, which includes: alliances and platforms; working groups; national campaigns; international co-operation; environmental organizations; development organizations; women's organizations; youth organizations; social justice organizations; alternative trade organizations; alternative media;
(ii) special interest groups, which includes: trade unions; consumer organizations; farmers' organizations;
(iii) research and education institutes;
(iv) consultancy agencies; and,
(v) private development agencies.

For the purposes of the present study, the term ENGO is restricted to those organizations which fall within item (i), the NGO community. This groups represents one of the 'relevant publics' referred to in Chapter 7 under OLT and, from this perspective, one which, to the extent it is funded and supported, reflects the values, norms, attitudes and beliefs of a society in relation to social justice and environmental protection issues (Campbell, 2001; Deegan and

Gordon, 1996; Gray *et al*., 1996; Guthrie and Parker, 1989; Patten, 1992). Within this community, Van Heeren (1996, p.27) defines NGOs as "… organizations that identify themselves with social movements… [Such] movements are complex by nature and hard to classify." In relation to Van Heeren's latter point, both Deegan and Gordon (1996) and Tilt (1994) provide useful practical guidance on the selection of ENGOs. Deegan and Gordon (1996) identified 41 'appropriate' Australian environmental organizations on the basis of various selection criteria, specifying that such organizations must: (i) deal with the natural environment as opposed to the built-up or non-natural environment; (ii) undertake activities of a lobbying nature that impose environmental pressures on companies and government regulators; and (iii) deal with national environmental issues and companies[62]. Tilt (1994), in her study of the influence of external pressure groups on corporate social disclosure, identified 146 organizations in public listings (her sources were not revealed) of social pressure groups in Australia. Tilt's list *excluded* highly specialised interest groups (including bird watchers, geologists, etc.) on the grounds that (i) the information contained in company annual reports is too generalised and imprecise to be of direct interest to such groups and (ii) such groups are unlikely to have or attempt to have very much influence over companies in general. Item (i) under Deegan and Gordon's criteria (see above), seems justified in the context of a study of environmental disclosures. Item (ii) is important given that, under OLT, ENGOs are one of the 'relevant publics' through which society imposes its values, norms and attitudes on business organizations. Thus, focusing on ENGOs which are involved in campaign activities directed at business organizations not only provides a more representative indication of society's values, norms and attitudes in the specific context of environmental issues but also of the social pressures which society, through ENGOs, brings to bear on business organizations in relation to those issues. A specific question was therefore included in the questionnaire to identify ENGOs which conducted environmental campaigns.

Item (iii) is also relevant given that the values, attitudes and norms of society vary from one country to another (Hofstede, 1980, 1991) and thus, accepting the argument set out under OLT (Chapter 7), both the environmental issues which are addressed by ENGOs and the behaviour of business organizations are likely to vary in the same way. International ENGOs which deal only with supra-national environmental issues outside of a national context were therefore excluded from the study[63]. Focusing on ENGOs which deal with national environmental issues is also relevant in the context of the social pressures argument, the real impact of the activities of NGOs taking place at the national rather than international level (Gray *et al*., 1996). Tilt's approach of eliminating highly specialised interest groups would also seem to be valid in the context of the present study[64].

Based on prior research (Deegan and Gordon, 1996; Tilt, 1994; Van Heeren, 1996), various types of ENGOs were therefore excluded from the study. Using the decision rules described above, an initial list of relevant (as defined) ENGOs was produced for each country from the Directory of ENGOs[65]. Although there is no guarantee that all relevant ENGOs have been included in the study, it seems reasonable to suggest that the main ones were identified through the procedures described[66]. The final list of 124 Benelux and German ENGOs, as well as 137 Nordic, Swiss and UK ENGOs, was completed in December 1999[67]. This list was used as the prime database ENGOs for the purposes of questionnaire circularisation. Copies of the questionnaires were sent to all 261 ENGOs in March 2000, together with a covering

letter in Dutch, English, French or German, as appropriate (for reasons of time and resource constraints, the questionnaire was written in English only). First reminders and second reminders were sent out during the months of July and November 2000, respectively. The overall response rates are summarised in Table 8.11.

Table 8.11
Responses to ENGO questionnaire by country

Country	Sample (No.)	Positive Responses	(%)	Negative responses	(%)	Non-replies	(%)
Belgium	47	10	21.2	3	6.5	34	72.3
Luxembourg	9	4	44.4	0	0.0	5	55.6
Netherlands	32	15	46.9	9	28.1	8	25.0
Germany	36	9	25.0	4	11.1	23	63.9
Sub-total A	124	38	30.7	16	12.9	70	56.4
Denmark	17	7	41.2	1	5.9	9	52.9
Finland	14	4	28.6	1	7.1	9	64.3
Norway	13	5	38.5	2	15.4	6	46.1
Sweden	20	6	30.0	2	10.0	12	60.0
Switzerland	26	10	38.5	4	15.4	12	46.1
UK	47	19	40.4	11	23.4	17	36.2
Sub-total B	137	51	37.2	21	15.3	65	47.5
Grand totals	261	89	34.1	37	14.2	135	51.7

In relation to the Benelux and German countries, the overall response rate was 30.7% (Table 8.11), with variations between countries ranging from a low of 21.2% in the case of Belgium to 46.9% in the case of the Netherlands. Overall, 89 useable responses were received (34.1%). These variations mirror differences in the number of ENGOs identified for each country, with the UK (47 ENGOs) and Belgium (46) having the highest absolute numbers.

Table 8.12
Responses to ENGO questionnaire by position of responder

Country/Region	Total	CPV	GS/MD	D	C/IC	S/E	Other	Not given
Benelux	29	5	5	3	10	2	4	-
Germany	9	1	3	3	1	-	1	-
Sub-total	38	6	8	6	11	2	5	-
Percentages	100.0	15.8	21.1	15.8	28.9	5.3	13.1	-
Nordic	22	1	4	7	6	-	3	1
Switzerland	10	-	1	4	2	-	3	-
UK	19	3	1	8	3	-	2	2
Totals	89	10	14	25	22	2	13	3
Percentages	100.0	11.2	15.7	28.1	24.7	2.3	14.6	3.4

Notes: Where CPV = Chairman/President or Vice-President; GS/MD = General Secretary/ Managing Director; D = Director (e.g. Conservation); C/IC = International Coordinator/Coordinator; S/E = Scientist/ Engineer.

The relatively high number of Belgian ENGOs may perhaps be explained by the fact that the seats of European political power, notably the European Parliament and the European Commission, are based in Brussels and, as with many other organizations and associations, close proximity to these power bases may be perceived as important in terms of their respective lobbying and campaign activities. In the case of the Benelux and German ENGOs, 20 of the 38 (52.7%) responses were provided by officers holding a senior management position (the first three columns on the left of Table 8.12 above). For the wider European sample, 55.0% of responses were provided by occupiers of a senior management position. Thus, it seems reasonable to suggest that the responses reflect the required degree of authority and authenticity in terms of the policies, views and activities of the organization as a whole.

8.16 Non-response bias

Non-response bias refers to the bias which is introduced into the inferences drawn from responses to mailed questionnaires due to the presence of a large proportion of those in the sample who fail to return the questionnaire (Wallace and Mellor, 1988). As such, questionnaire non-response bias is a phenomenon associated with the generally poor response to mailed questionnaires and, in severe cases, may render inferences worse than useless (Wallace and Mellor, 1988)[68]. However, Moser and Kalton (1975, p182) note that comparisons between respondents and non-respondents "… can never prove the absence of bias; at best, they can reassure the researcher that the final sample is not badly out of line." Accounting researchers generally contend themselves with response rates between 30% and 50% (Wallace and Mellor, 1988) although a response rate as low as 15.7% (Lee and Tweedie, 1977) has been reported. As indicated in Section 8.15 above, the response rates achieved in relation to the two questionnaires used in the present study lie towards the lower end of the 30% to 50% range and therefore some concern may be expressed over the degree to which confidence can be expressed in the results reported in the present study.

The presence of non-response bias implies that had the non-respondents completed the questionnaire, the inferences and subsequent conclusions drawn from the collected data would have been different. Thus, the issue is related to the extent to which a bias is reflected in the respondent sample rather than with the actual response rate (Babbie, 1989). Non-response bias checks, such as the surrogate method, can be performed to provide evidence of non-response bias (see, for example, Oppenheim, 1966; Wallace and Cooke, 1990; Wallace and Mellor, 1988; Wilmhurst and Frost, 2000)[69]. However, the literature is almost silent on how to choose between these different methods. The most popular method used in CSR research is the surrogate method which relies on the assumption that late respondents are a valid proxy for non-respondents. However, the truth of this assumption can never be established given that the non-respondents are just that. Therefore, the approach adopted in the present study has been to apply appropriate statistical tests of questionnaire data reliability (see Chapter 9). This approach was chosen in view of the fact that the principal data source is the Benelux and German companies themselves (see Section 8.10 above), rather than a large number of individuals, which were selected systematically. The only area where some concerns may be expressed over data reliability is in relation to the responses of the ENGOs due to the low response rates and missing values (these are discussed in Chapter

9)[70]. Where appropriate, therefore, statistical tests were performed to provide evidence of the variability of these responses both across and amongst ENGOs using the variance components procedure (see Chapter 9).

Notes

1. The pilot study (Hibbitt and Ursem, 1996) provided a valuable 'learning curve' in terms of the many idiosyncrasies associated with the use of content analysis methodology and other aspects of multi-period, cross-sectional studies. In particular, the study highlighted significant difficulties in obtaining company annual reports that were more than five years old. However, the pilot study 'failed' in one important respect, namely that the project's supervisors had a number of serious epistemological and methodological concerns. In particular, Gray *et al.*'s (1995b) use of 'soft' hypotheses from within the interpretive paradigm was not considered sufficiently robust, the supervisors preferring the use of 'hard' hypotheses using the hypothetico-deductive method of research that is common to the structural-functionalist tradition (see Chapter 4). As a result, the research method and approach had to be significantly revised for the purpose of the present study. Copies of the pilot study are available on request.
2. At the beginning of the twentieth century, for example, as newspapers in the United States shifted from a focus on religious, scientific and literary matters in favour of gossip, sports and scandals, researchers sought to reveal the influence of newsprint on society's values and norms (see, for example, Mathews, 1910; Speed, 1893; Wilcox, 1900). However, the technique became more scientific during the Second World War when, aided by the emergence of empirical methods of inquiry in the social sciences, the allied forces were able to predict military manoeuvres, notably the date of deployment of the German V-weapon against Great Britain (Krippendorff, 1980; Shoemaker, 1993).
3. Essentially, the method of content analysis used in this and other similar studies of CSR/CED is concerned with the *quantitative* rather than the *qualitative* aspects of those disclosures. However, following earlier studies (see, for example, Deegan and Gordon, 1996; Guthrie and Mathews, 1985; Gray *et al.*, 1995c; O'Dwyer and Gray, 1998), additional data fields have been included in the interrogation instrument (see Section 8.8) which permit other, non-quantitative aspects of CED to be explored, including whether an item of CED is descriptive, non-monetary quantitative or financial in form. Nevertheless, these additional fields do not permit an evaluation of the *quality* of environmental reporting where the latter is seen in terms of providing information with which to assess environmental performance. Hence, it is important to appreciate that the present study does not seek to comment on the quality of environmental reporting by Benelux and German companies, although some attempt is made to explore its characteristics. See, for example, Holsti (1969, Chapter 1) for a more detailed discussion of the quantity-quality issue in the context of content analysis.
4. A detailed consideration of content analysis methodology and methods is outside the scope of the present study. It has been adroitly addressed elsewhere, both in the context of the use of content analysis in conventional accounting research (see, for example, Lehman, 1992; Neimark, 1983; Parker, 1986) and in the specific context of CSR (see, for example, Gray *et al.*, 1995c; Hackston and Milne, 1996; Milne and Adler, 1999; Unerman, 2000). For a general overview of what content analysis is and what it is not and where it fits in among the many analytical tools available to social scientists see, for example, Holsti (1969, Chapter 1).
5. Krippendorff (1980, p.22) argues that meanings need *not* be shared and that consensus and inter-coder agreement as to what a message means exists either only regarding the most obvious or manifest aspects of communication or only for a few people that happen to share the same cultural and socio-political perspective. Gray *et al.*'s (1995c) just concern with shared meanings in the context of CSR is, however, key in terms of ensuring a reasonably high degree of replicability.
6. The selection of analytical categories to characterize the content of reported and disclosed messages involves a number of assumptions, notably "… that inferences about the relationship between intent and content (or between content and effect) can be validly made, that the study of manifest content itself is meaningful (i.e. meanings ascribed to content through categorization

correspond to meanings intended by the communicator), and that quantitative description of communication content is meaningful (e.g. through measurement of disclosure frequency) [Berelson, 1971]" (Guthrie and Parker 1990, p.172). According to Guthrie and Parker (1990), this form of content analysis assumes that the content categories identified in the written messages of corporate reports have manifest meanings (e.g. environment, employment practices) which can, therefore, be categorized. Unlike some research of semiotics in annual reports (see, for example, Lehman and Tinker, 1985; Lehman, 1985; Neimark, 1983), which attempt to explain the relationship between different societies, cultures, social practices, and the extant meanings in communications produced, this approach places greater emphasis on codifying expressed social information into the chosen descriptive categories. However, there is an obvious trade-off involved between the number of content categories and other refinements to the data which aid our understanding of CSR/CED, and inter-coder reliability (Milne and Adler, 1999).

7. This method of defining CED is tautological. That is, in social science parlance, it becomes true by definition and can never be refuted by evidence (Jensen, 1983). However, there would appear to be no way around this particular issue. As noted by Gray *et al*. (1995c, p.89), definitions of CSR are generally either too *exclusive* – the ultimate and complete effects of a company's activities on the environment, for example, are unknowable and thus cannot be communicated – or too *inclusive* – all the activities of a company can be said to have some environmental effects one way or another. Thus, there is a need for some form of closure which permits the researcher to define a boundary, despite its arbitrary nature, to separate what is CSR/CED from that which is not.
8. The classification of data into categories is more of an art than a science (Krippendorff, 1980), although once established within a research community such classifications take on the appearance of generally-accepted classification criteria. In the famous Ernst & Ernst (1972-78) surveys of CSR in the 1970s, seven types of social responsibility disclosure were identified: environment; energy; fair business practices; human resources; community involvement; products; other. The sub-category 'environment' was further sub-divided into four categories: pollution control; prevention or repair of environmental damage; conservation of natural resources; other. Using the Ernst & Ernst subcategories, but allowing for changes over time which made previously marginal categories too narrow and cumbersome, Gray *et al.* (1995c) initially developed 15 categories of CED although the final amended categories were narrowed down to just six: environmental policy; environmental audit; environmental – product and process-related; environmental financially-related data; sustainability; environmental other. These six categories are employed in the present study subject to two changes: (i) the reclassification of 'environmental audit' as 'environmental management, systems and audit' in the light of the increased emphasis being given to this aspect of corporate management, particularly following the introduction of the EMAS regulation (CEC, 1993b) in 1993; (ii) the introduction of a new subcategory for environmental disclosure, 'stakeholder relations' to reflect the increased emphasis by companies on stakeholder relations in the 1990s.
9. During the data capture phase of the study, additions and amendments were made to the list of items in Appendix 2 to clarify the definition of CED and thus improve the consistency and reliability of data capture.
10. As noted by Gray *et al*. (1995c, p.81), 'environment' was not a well-developed category of social disclosure in the CSR literature until the early 1990s when environmental disclosures rose significantly. In theory, any number of subcategories of environmental disclosure might be possible. The seven categories provided in the present study were therefore pre-tested on a small sample of *environment reports*. The results of these pre-tests revealed no significant problems or difficulties in terms of data capture and classification, although the number of decision rules was expanded for clarification purposes.
11. Prior CSR researchers (for example, Guthrie and Mathews, 1985) have sought to distinguish data in terms of its location within the annual report, e.g. whether data appears in the chairman's review, as part of a separate section of the annual report, as part of another section or in a separate booklet. Kirkham and Hope (1992) put forward various reasons as to why location of information may be important. These include the argument that users of annual reports, for example, are more

likely to read certain sections of the report than others. Knowing this, it is argued that management make conscious decisions as to where to locate certain information in order to achieve the greatest effect for the purposes of informing or managing the impressions of the users. Conversely, Gray *et al*. (1995c) argue that, though persuasive, the arguments of Kirkham and Hope (1992) fail to permit a single, unique choice as to why one location should be preferred. Gray *et al*. (1995c) posit a number of arguments for ignoring the issue of location, notably: (i) that the CSR literature has yet, in their view, provided any persuasive conclusions from the location of disclosures or to provide guidance on how data on a particular topic are to be interpreted where they appear in several sections of the same report or document; and (ii) that if 'location' is imposed on data some of its richness may be lost (see, for example, Guthrie and Mathews, 1985; Guthrie and Parker, 1989, 1990). There is even some evidence to suggest that location of CSR is *not* an important issue (e.g., Al Najjar, 1997). For the purposes of the present study, the issue of location within a document is ignored. However, the page location of each item of data is recorded on the interrogation instrument so that it would be possible at a later date, if necessary, to investigate the issue of location in more detail.

12. A good deal of information about a company's environmental performance can also reach the public domain via other routes. One of the principal sources is permits issued by central and local governmental authorities in relation to matters such as waste disposal, water discharges and effluents. In the Netherlands, for example, an extensive system of licences operates through which the relevant governmental authorities (i.e. Ministerie van Volksgezondheid, Ruimtelijke Ordening en Milieu, VROM), the Executives of the Provinces or the local Mayor and Alderman of the municipality) can impose obligations on a company to ensure that its activities do not lead to adverse environmental effects (Huizing and Dekker, 1992). There is also the potential impact of the World Wide Web (see, for example, Craven and Otsmani, 1999; SustainAbility/UNEP, 1999). However, in the present study, which covers the period to 1995, the impact of the World Wide Web is likely to be minimal.
13. A number of other arguments have been advanced in the literature for focusing solely on the annual report. These include the 'most readily available data source' argument (e.g. Brown and Deegan, 1998), the 'complete editorial control' argument (e.g. Guthrie and Parker, 1989), the 'permits comparison of results with other, previous studies' argument (e.g. Guthrie and Parker, 1989) and the 'institutionalized and regular basis' argument (e.g. Campbell, 2000; Macintosh, 1990; Roberts, C., 1992; Wolfe, 1991).
14. Unerman's (2000) content analysis of Shell Transport and Trading Co. Ltd. follows closely the decision rule adopted in the present study in relation to the choice of documents to content analyse. Unerman chose to examine all reports produced as part of Shell's annual corporate reporting cycle as well as any other publicly available documents mentioned in these regular reports as being available from the company on request. As a result, Unerman classifies his source documents into four categories: annual report and accounts; other documents produced as part of the annual reporting cycle apparently intended for widespread distribution; other documents produced as part of the annual reporting cycle apparently *not* intended for widespread distribution; one-off, *ad hoc* reports referred to in any of the regular corporate reports as being available from the company. However, Unerman does not provide further details of the type of reports which made up the latter three categories and thus the reader is left to presume that he included environmental and social reports. Moreover, Unerman makes no mention of whether the reports are company-wide, regional or local and thus it is unclear as to how he addressed this particular issue.
15. Zéghal and Ahmed (1990) looked at reports other than the annual report for a sample of 15 of the largest Canadian companies from the banking (6) and petroleum (9) sectors. In total they looked at 263 reports (30 annual reports, 109 advertisements, 124 brochures) relating to the years 1981 and 1982.
16. In 1997, at the time of developing the research method and approach, the author took this specific issue up with Professor Rob Gray and Professor David Owen. Whereas Rob Gray was of the opinion that annual reports are *the* key document, David Owen agreed that, with the increasing

number of corporate environment reports, it would seem rather odd to exclude the latter from the study.

17. This restriction effectively excludes interim reports. At the time of formally starting this project (1997), interim reports (whether issued on a quarterly or semi-annual basis) were included in the study. However, they were later excluded on practical grounds as it became evident that it would be impossible to obtain a complete set of interim reports for the companies included in the survey. The loss of this potential source of environmental disclosure would, however, appear to be a non-issue. Adams *et al.* (1998), for example, note in a footnote that interim reports are also normally sent to shareholders but such reports tend to contain little or no voluntary information and so were excluded from their study.
18. See, for example, O'Dwyer (2001) on the prevalence of such practices. As noted by Gray *et al*. (1996), organizations frequently prepare information for their own internal use, for use by regulatory authorities or contract with external consultants to provide them with information. Only rarely is such information released into the public domain, representing the tip of the social and environmental accounting iceberg (Gray *et al*., 1996).
19. The exclusion of site-based or regional environmental and social reports perhaps requires further explanation. It is not uncommon for companies to produce environment reports for a particular region (e.g. the home country) or for key operational sites. As was noted in Chapter 2, it is now mandatory in countries such as the Netherlands and Denmark for companies in environmentally-sensitive industries to produce site-based environment reports. The EMAS regulation (CEC, 2001a) also encourages companies to *voluntarily* produce environment reports as part of the EU's mission to improve the overall environmental performance of organizations. The Regulation was originally site-based but, following the introduction of a new EMAS regulation (CEC, 2001a) which replaced the original (CEC, 1993b), EMAS can be applied to all or parts of an organization. Local authorities too, in relation to planning applications and operating licences may also require companies to submit site-based environment reports. Hence, there are mechanisms in place which drive the production of regional or site-based environmental and social reports. However, unlike the group annual report and accounts, these reports do not cover a company's entire operations and as such are excluded from the study. Whilst it is certainly possible to present arguments for the inclusion of such reports in a study of this kind, a decision was taken to exclude them for the reasons set out in the main text.
20. Unitising the world of observations and messages gives rise to many epistemological questions that cannot be addressed here, other than perhaps to say that units are not absolute. Rather, they emerge in interaction between "reality" and the observer of that reality, being a function of empirical facts, research purposes and programmes, and demands made by available research tools and techniques (see, for example, Krippendorff, 1980).
21. On the related question of whether a distinction should be made between text and pictures, no distinction is made in the present study. Gray *et al*. (1995c) did make such a distinction for part of their sample (1979-87) but dropped it for the continuing (1980 *et seq*.) database as it was not clear what inferences might be drawn from making this distinction.
22. The inclusion of blank parts of a page introduces an element of subjectivity into the measurement process. The reasons justifying this approach have been addressed elsewhere (e.g. Unerman, 2000).
23. The evaluative dimensions of 'good' and 'bad' have their origins in psychology in relation to the concept of attitude and attitude theory development (Krippendorff, 1980). The addition of this qualitative characteristic of messages opened the door to terms such as 'pro-con' and 'favourable-unfavourable' in assessing the degree to which such messages contain evidence of direction or bias. See, for example, Abrahamson and Amir (1996) who used content analysis to measure the amount of negative words appearing in the president's letter to shareholders of firms listed on the New York or American Stock Exchanges. For their study, a word was coded 'negative' if it was used in the context of either a negative organizational outcome (e.g. … *disappointing* operating results) or of a negative effect on the environment on the organization (e.g. … had a *negative* effect on profits). There are obviously practical problems where a piece of text contains both

'good' and 'bad' news. In the case of the present study, where practicable, separate items of text were coded relating, respectively, to the good and bad news.

24. Guthrie and Parker (1990) treated environmental disclosures in the accounts which related to environmental damage and which were reported under US GAAP as 'bad news', such information normally appearing as contingent liabilities in the notes to the accounts which they concluded "… represented audited negative social disclosures" (p.170). However, such an approach seems presumptuous given that even 'bad' news can be presented as 'good' news. Thus, in the present study disclosures relating to environmental liabilities, provisions and contingent liabilities were treated as 'bad news' if the information was presented as such. That is, the mere presentation of such information in conformity with legal and accounting requirements was not of itself considered to be 'bad news'. Rather, the choice of words used to convey the information was seen as the primary factor in deciding whether the disclosure was 'good' or 'bad' news. It should also be borne in mind that a material disclosure of previously unforeseen losses or liabilities is, in the case of publicly-listed companies, likely to have been made public prior to the release of the financial statements concerned and as such will have already been discounted by the securities markets by the time the annual report is released.
25. The interrogation instrument is based on that used for the Gray *et al*. (1995b, c) study. However, as the latter was concerned only with annual reports, adaptations were made to cope with the present study's inclusion of social, environmental and other company reports. For example, the definition of accounting pages (AccPP) was adapted from that of Gray *et al*. (1995c) by including statutory and voluntary supervisory/management information because of difficulties experienced in separating 'pure' accounting information from management's discussion and analysis of the financial results. The interrogation instrument is not included in the thesis but a copy is available on request.
26. Those engaged in content analysis (i.e. the coders) for the present study worked through each report page by page, identifying (using a highlighting pen) each piece of data determined to be CED, assigning quantitative and qualitative characteristics either at the same time or at the end when all items of disclosure had been identified. When this process was complete for all pages, the coder would then enter each item of coded data onto the interrogation instrument, starting from the front of the report and working through page by page to the end. This was found to be the most efficient and effective method of coding and recording, particularly in the case of environment reports where many different items of coded data often appeared on the same page. This method also provides an audit trail in terms of being able to trace, using the page reference on the interrogation instrument, back to each item of CED. The total number of reports included for content analysis purposes was 1, 011 (Table 8.6). Thus, this is also the number of completed database interrogation instrument forms
27. The research approach of recording the data manually on the input forms first and then entering the summarised totals into the computer database has been found to be more reliable, more convenient and simpler than entering the data directly into a computer database from the source documents (Gray *et al*., 1995c). One risk noted by Gray *et al*. from adopting this approach is the possibility of data transference risk, i.e. the risk that the data in the computer database would not match the data as recorded on the input forms due to human error during the transfer process. Introducing a control check on the manual input forms to ensure the completeness of the data minimized this risk.
28. As a result of these checks, one error was found whereby an environment report had been incorrectly coded as an "other" report (OR). This error was corrected for the purposes of the descriptive analysis of results as provided in Chapter 10. This error did not affect the hypotheses tests described in Chapter 9, these being based on the total amount of CED per the "COY1" database.
29. The content analysis phase of the pilot study gave rise to a number of not unimportant questions and concerns. These were discussed in detail with Professor Rob Gray in an attempt to define more clearly and precisely the classification of the data to be captured for the purposes of transparency and comparability. Overall, two key issues emerged from this discussion in the context of the present study: firstly, content analysis is not an exact science and a degree of

subjectivity is unavoidable; and, secondly, the language used (in terms of style, choice of words, prose, etc.) in company reports has an intended impact upon the reader in terms of the underlying message which the company is trying to convey. The language being used should be seen as relevant to the process of classifying a particular disclosure item. In essence, a 'gut' feeling is as good as any.

30. As noted by Krippendorff (1980), this mutual adjustment process continues until some sort of homeostasis is reached between what the lead researcher wants, what the coders see and are capable of learning, what the instructions imply and how the source material can be interpreted without violating intuition.
31. In an ideal world, the individuals that take part in the development of suitable recording instructions should not be involved in the recording of data (Krippendorff, 1980). Furthermore, once the recording instructions have been developed, ideally they should be tested for reliability with a fresh set of independent coders. In practice, amongst CSR researchers it is common for the recording instructions to be developed by the researcher him/herself based on prior studies, but for the content analysis coding to be performed by multiple coders (normally the authors themselves and students or hired researchers) either independently of or in conjunction with the researcher (for example, Gray *et al*., 1995c; Guthrie, 1983; Hackston and Milne, 1999; Milne and Adler, 1999). Such an approach at least overcomes Krippendorff's (1980) most serious criticism of practice in content analysis whereby the researcher develops his/her own recoding instructions and applies them all by his/herself or with the aid of a few close colleagues thus preventing any form of independent reliability checks.
32. Other than the author, none of the coders had any prior experience of content analysis and little or no prior knowledge of CSR research. The author received training in content analysis through detailed discussions with an experienced researcher in the content analysis of corporate reports.
33. These documents included two papers published by Gray *et al*. (1995b, c), Krippendorff's (1980) *Content Analysis* and the (revised) research proposal document for the present study.
34. The overall findings of the Milne and Adler (1999) study suggest that the coded output from inexperienced coders with little or no prior training could be relied upon for aggregate total disclosure analysis, although they suggest that reliance on more detailed sub-category analysis required more training (at least 20 reports).
35. One of the weaknesses of content analysis, particularly in the context of longitudinal studies, is that the assessment of the type and amount of content must be consistent throughout the study and between companies. This need for consistency is hampered by the necessary element of subjectivity involved in determining what constitutes a particular type of disclosure (Zéghal and Ahmed, 1990). In other studies (see, for example, Deegan and Gordon, 1996; Deegan *et al*., 2002; Gibson and O'Donovan, 2000), this has been controlled for either through the use of spot checks on the content analysis between companies and over time or by the reports in question being content analysed by more than one researcher. With a large number of reports in a longitudinal study, there is the additional problem of minor variations in the measurement of items both by the same researcher and by different researchers. As noted by Gray *et al*. (1995c), omissions and differences are inevitable in this kind of research and can only be prevented by complete replication, which is, unfortunately, not an option because of the amount of work involved. Similarly, errors arising from the rounding of measurement appear unavoidable in view of the range of reporting styles and printing designs used by companies. The intuitive position, as opposed to any rational or quantifiable basis, adopted in the present study is that such errors will be contained within acceptable limits.
36. Other approaches include: (i) selecting large, medium and unlisted companies (see, for example, Gray *et al*., 1987; Kirkman and Hope, 1992; Maunders, 1981; 1982; Tonkin and Skerratt, 1991); (ii) selecting "interesting" or "best practice" examplers (see, for example, Harte and Owen, 1991, 1992); and (iii) haphazard samples (see, for example, Gray *et al*., 1995c - pilot sample 1979-87).
37. An initial sample of companies was selected from *The Times 1000 1996* (Barrow, 1995) reference book for the purposes of carrying out a pilot study (Hibbitt and Ursem, 2000). The initial sample was selected from *The Times 1000 1996* on the basis of two criteria: (i) industry sector; and (ii) country of origin (these two criteria are explained in more detail below). Using the industry

classification as set out in Gray *et al*. (1995c - Appendix 6), which classifies companies into 15 industry sectors based on the classification system used in *The Times 1000*, a total of six industry sectors were selected to provide a sample of environmentally-sensitive (ES) and less environmentally-sensitive (LES) companies for the pilot study. These six industry sectors were: mechanical and general engineering (ES); chemicals (ES); extractive (ES); food and drink (LES); electronics and electrical engineering (LES); and, retail and leisure (LES). Similarly, five European countries were chosen as the basis for the second criterion of selection: France; Germany; the Netherlands; Switzerland; and, the UK. On the basis of these two criteria, the total number of companies selected from *The Times 1000 1996* was 277 out of a total population of 1,000 European companies. Details of the initial sample by country and by industry sector are provided in the results of the pilot study (Hibbitt and Ursem, 1996) but are not presented here as they are not directly relevant to the present study. After identification of this initial sample, a standard letter was sent to the company secretary of all 277 companies with a request for copies of the English version (where available) of each company's annual report and accounts for the years ending in 1989 through to 1994 (six years). As at 26 April 1996, replies had been received from a total of 188 companies, of which only 75 (27% of the total sample) were satisfactory. The other 113 replies were considered unsatisfactory either because copies of the ARs were not received for all six years or because copies of the ARs for all six years were received but one or more AR was not in English. Following the pilot study, a revised proposal document was submitted for the present project in March 1997 which set out a significantly different research approach (see Section 8.1). As part of this revised approach, and taking into account the poor response rate experienced with the initial pilot study sample, a new, revised sample of 220 companies was selected from *The Times 1000 1997* reference book covering five geographical regions: Benelux (40 companies); Germany (50); Nordic (40); Switzerland (40); and, the UK (50). However, due to subsequent time and labour constraints and the considerable difficulties experienced in obtaining company reports (see Section 8.14), this sample was subsequently reduced to 90 companies (40 Benelux; 50 German). These companies were used as the principal source for statistical testing. However, given that some empirical research work had been performed in respect of all 220 companies, this work has been included in the study where appropriate. Thus, the research sample consists of two samples of companies, (i) a primary sample made up of 90 companies from two geographical regions (Benelux and Germany) which forms the main sample for the purposes of the hypotheses tests and (ii) a secondary sample comprising a further 110 companies from three geographical regions (Nordic (i.e. Denmark, Finland, Norway and Sweden), Switzerland and the UK).

38. ING Group was formed as a result of a *merger* of Nationale Nederlanden (NN) and NMB in 1991. The new group, retrospectively speaking, published two sets of annual reports in 1989 and 1990, one by NN and the other by NMB. Both sets of annual reports for 1989 and 1990 are included in the study. In the case of Akzo Nobel, this group was formed as a result of the *acquisition* by Akzo of Nobel Industries in 1993, effective for accounting purposes from 1 January 1994. The first annual report of the new group was the 1993 annual report. For the years 1989 to 1992, the annual reports used in the study are those of Akzo only given that the combined group was treated for accounting purposes as an aqcuisition not a merger.
39. Thus, in the case of the German company Henkel, this company is classified as "Health and Household" (sector 6) given that this is the group's predominant area of activity based on sales. Henkel describes itself as a specialist in applied chemistry, operating in three principal areas: brand-name products (e.g. detergents including *Persil*, which accounted for 40% of sales in 1994); chemical products (29%); and specialist chemicals (31%). Hence, the classification by *The Times 1000* as "Health and Household". An argument could be made for classifying Henkel as a chemicals company (sector 1) on the basis that chemical products and specialist chemicals combined account for 60% of sales. Nevertheless, a decision was made to follow *The Times 1000* classification. Similarly, Hornbach Holdings is classified as "building materials" in *The Times 1000* although the company is a DIY chain deriving 98% of its sales for 1994/95 from superstores and garden centres. For the purposes of the study Hornbach was classified under "Extractive" (sector 2) although an argument could be made for including it under "Retail and Leisure" (sector

8) depending on the extent to which the company sources its materials for resale from outside the company (i.e. through purchases). However, based on discussions with the respective research assistant, for two other companies, Nederlandse GasUnie (Netherlands) and VEBA (Germany), it was considered necessary to revise the classification given in *The Times 1000* to reflect more fairly the primary activities of the companies in question. In both cases the change was from Extractive (Oil and Gas) to Energy Utilities (sector 4), both classified as ES sectors.

40. In this context, it is important to remember that public data on the environmental effects of man-made substances, notably chemicals and fossil fuels, is both scarce and incomplete, such that much of the debate about these effects is *political*, with scientists on both sides of the divide producing evidence to support their own particular version of events. A case in point is the very political way in which public debates have been held over the association between fossil fuels and climate change which continues to be about *assumptions* and how to address the possible implications of those assumptions, *not* about scientific fact (see, for example, Soon *et al*., 2001).
41. One industry which Dierkes and Preston (1977) had problems with in terms of its proper treatment and analysis was the automobile industry. They noted that on the one hand this industry could be classified as environmentally-sensitive in view of the enormous, pervasive, and multi-dimensional impact which its products (motor vehicles) have on the environment. Conversely, they also recognised that it is the *use* of the industry's products, and not the production activity itself which leads to significant and pervasive environmental impact. From this latter perspective, automobile manufacturing may be considered no different from other types of industrial activity. Dierkes and Preston (1977) adopted the latter view, citing as their reasons the fact that, in their view, the ultimate scope of managerial authority and responsibility for the automobile industry was not the same as that for the 'environmental firm', being limited to the same issues of corporate social and environmental stewardship as that of the 'general case'. Thus, Dierkes and Preston (1977) state (p.9): "… it seems to us that General Motors is *not* responsible for urban smog and congestion in the same sense that Exxon or Shell *are* responsible for oil spills from their tankers." However, a more holistic approach is adopted in the present study with motor vehicle manufacturing being seen as contributing to environmental impacts through the use of the product itself. This approach is argued to be more in keeping with social attitudes of the present day, as evidenced by the emphasis (in Europe at least) on fuel efficiency.
42. The selection of industry sectors which, *prima facie*, have different degrees of environmental impact was made primarily to maximise the variance of the firm characteristic of industry affiliation for the purposes of statistical analysis. However, the classification of the eight industry sectors into environmentally-sensitive (ES) and less environmentally sensitive (LES) is arbirtrary, there being no generally-accepted basis, scientific or otherwise, for distinguishing between the two. Thus, strictly speaking, the allocation of industry sectors to ES or LES is hypothetical for which no formal justification is provided in the thesis.
43. There is some debate in the literature over whether to include or exclude financial institutions. Financial institutions could (justifiably) be excluded on the grounds that they are very different in nature from industrial companies (for example, it is not appropriate to measure the size of a bank or insurance company by reference to turnover). However, there are valid arguments for including financial institutions. For example, banks can report on what they are doing to ensure that their lending policies are 'environmentally-friendly' (UNEP IE, 1994) and ethical investment funds are growing in many European countries. There would seem to be no "right" or "wrong" answer to this issue and thus the decision to include financial institutions in the present study is an arbitrary one.
44. For the purposes of the study, the country of a company is defined as that country in which the company has its principal headquarters (hereafter, 'home country'). This is consistent with the definition used by *The Times 1000* reference book.
45. Initial investigations into the make-up of *The Times 1000* (Barrow, 1996) list of the top 1,000 European companies at the industry and country level revealed that for the smaller countries, such as Belgium, Luxembourg and the Netherlands, difficulties would have arisen in seeking to obtain a sufficient number of companies from within a particular industrial sector and across a number of sectors to achieve statistically significant results.

46. A consideration of extent to which these country-specific factors can and do explain variations in CED across European countries is outside the scope of the present study. However, many of the companies included in the present study are of huge economic size with global operations in most parts of the developed and developing world. Hence, it should not be assumed that national culture and differences in social and political contexts are the *dominant* influence on corporate social and environmental disclosure practices (Adams *et al*., 1998). Rather, the position taken here is that they are likely to be of *some* influence.
47. Time overruns in obtaining company reports meant that this was subsequently extended to include both 1996 and 1997 to make the study more current. Considerable time was spent in obtaining the annual, social, environmental and other relevant reports for a sample of 220 companies for the years 1996 and 1997. However, because of time and labour constraints, these two years (as well as the sample of 130 Nordic, Swiss and UK companies) were later excluded from the study. Storage constraints and other factors, notably that no research institute or university in the Netherlands is currently willing to finance a similar project, has meant that all reports obtained in the process of carrying out the present study (approximately 3,000) have had to be discarded for recycling. Such is the desperate state of academic and professional interest in CSR in the Netherlands at the present time.
48. As noted by UNEP IE (1994) reports other than the annual report are sometimes produced only in the company's home country and therefore the need for some flexibility was foreseen by being able to content analyse reports in four languages.
49. At the time this study was being devised (1996), there was no central or other reliable agency responsible for collating environment reports published by European companies. Hence, various alternative sources were used to identify the population of such reports, including company internet web sites, the *Environmental Accounting and Auditing Reporter* (EAAR) newsletter, which listed environment reports received by the editor, the ACCA Environmental Reporting Awards Scheme in Denmark, the Netherlands, and the UK and other *ad hoc* sources known to the author.
50. A different tactic was therefore used which involved contacting each company direct by telephone The main problem seemed to be that most companies do not keep copies of annual reports beyond five years. In many cases, companies initially supplied only three years out of seven, with a high percentage replying that they no longer had copies of the 1989 annual report. Even allowing for this, a high number of companies either failed to send what had been confirmed as existing or sent duplicate copies of previously-supplied reports. This part of the project significantly exceeded the original time budget. As a result, the project's goals had to be scaled-down drastically.
51. Purists might argue that these 'non-replies' should form part of the study. However, as indicated previously, the intention here is not to arrive at a sample which is representative of the population of companies as a whole, but to follow prior research in arriving at a complete sample of large companies.
52. Mannesmann also produced a social report in each of the seven years but only six of the seven were included in the study, the social report for 1994 being one of reports unintentionally excluded from the study (see Section 8.13).
53. DSM, for example, produced environment reports for its Dutch sites in 1989 and its first *Responsible Care Progress Report* under the chemical industry's *Responsible Care Programme* in 1993 but this was not a group-wide report. Similarly, Bayer's first comprehensive environment report was presented at a press conference on environmental protection in 1993 but this report was not group-wide (Bayer Annual Report 1993, p.17).
54. In Germany, for example, it is common practice for annual reports *in German* to contain, inter alia, consolidated financial statements and the financial statements of the mother (holding) company (AG). These two sets of financial statements are prepared in accordance with German law and German GAAP, respectively, and have separate auditor's reports. (Unlike under UK law, for example, there is no legal exemption from preparing the profit and loss account of the parent company.) It seems that in the case of the *English version* of the full German annual report, many German companies *exclude* either in full or in part the financial statements of the mother/parent company. In such cases, the English version is *not* a complete version of the full *German* annual

report. Thus, it was necessary, in the case of those companies which produce both a German and English version of their annual report, to confirm whether or not the English version is an abbreviated version of the (original) German version. If so, the German version was classified as the annual report for the purposes of the study, not the English version.

55. One company, BASF, produced its first group environment report before 1989 and is thus not included in Table 8.7. BASF is the only company in the sample which produced its first group environment report prior to 1989. The other companies listed in Table 8.7 produced a company environment report regularly following the first year of publication but not necessarily every year.
56. For the larger sample of 220 companies the picture is broadly similar with the highest percentage of positive replies also being provided by main board directors, group environmental coordinators or managers with environmental expertise or responsibility (53 responses, i.e. 60.8%). However, it is noticeable that a director of or manager in the external corporate external relations, communications or marketing departments, provided one quarter of positive responses.
57. The ENGO questionnaire was adapted on a country-by-country basis to include questions which relate to the environmental reputation of companies included in the study. Thus, for questionnaires sent to ENGOs in the Netherlands, two questions, Q4 and Q5, listed the Dutch companies included at Appendix 3. Likewise, for questionnaires sent to ENGOs in Belgium, questions 4 and 5 listed the Belgian companies included at Appendix 3. In all other respects, the questionnaire sent to all ENGOs was exactly the same.
58. Deegan and Gordon (1996) in their questionnaire to Australian ENGOs provided a list of over 50 industry sectors plus space for respondents to enter any industries of concern to ENGOs in order to avoid confining respondents to dealing only with the industries provided. The eight industry sectors included in the present study are groupings of more specific industry classifications given in *The Times 1000* reference book. It is possible that (a) ENGOs would have arrived at different groupings of industry sectors and (b) both more and less environmentally-sensitive industries have been excluded from the study, thus limiting the external validity of any assertion as to the relationship between environmental sensitivity and the volume of environmental reporting. However, it is argued that this does not detract from the value of the present study's attempts at exploring the influence of industry sector in the context of environmental sensitivity on environmental reporting and disclosure.
59. The ENGO database is not included in the study for reasons of space. Copies are available on request. Each record in the database contains the following details of each ENGO: (i) mail, web site and e-mail addresses (where applicable) and telephone and fax numbers; (ii) name of the contact person; (iii) current membership; (iv) year formed; (v) an internal reference number; (vi) the date on which the questionnaire was first sent and the dates of the first and second reminders; and (vii) the response date and comments (where applicable). Originally the work of setting up the database was expected to take between one and two weeks. However, the actual time taken was six weeks. In retrospect, assumptions about the amount of time required to produce a database of ENGOs were based on incomplete information in relation to both the number and variety of ENGOs operating within and across Europe. The extra time taken to prepare the database of ENGOs was justified on the grounds that ENGOs represent a key element of the research investigation.
60. The Directory lists both "Governmental" and "Non-governmental" environmental organizations by country as well as those classified as "International Organizations" (pp.149-169). Although some environmental organizations have international/European co-ordination centres, it is the activities of the national ENGOs which are of interest to this research investigation. The only other major reference source available was *A Directory of European Environmental Organizations* (Deziron and Bailey, 1991) but this was no longer in print and was very likely already out-of-date. Two other sources, *Green and Grey below Sea Level - An access Guide to Environmental and Development Organizations in the Netherlands* (Van Heeren, 1996) and *Yearbook of International Co-operation on Environment and Development 1998/99* (Bergesen *et al*., 1998), were also used.
61. One of the most distinguishing and empowering features of the Internet is the on-line and real-time access it provides to the web sites of other organizations. Some ENGOs (for example,

WWF) provide a links page which provides a direct link to a large number of web sites of similar organizations within their own country and internationally. To provide a further cross-check on the completeness of the list of ENGOs for the study, the links page of the web sites of three ENGOs (WWF, Friends of the Earth and Greenpeace) at a country and international level were reviewed. This involved a considerable amount of time and effort. One of the most comprehensive is the *WWF Green Web Directory* http://www.panda.org/greenweb/indx.htm which listed environmental internet sites by subject (general, forests, species, water and climate). At the time of the search (December 1999), this site providing a link to several hundred internet sites. Another is the *EarthAction* website http://www.oneworld.org/earthaction/en which listed member organizations of the *EarthAction Network*, of which there were 1,763 in 152 countries. The links site of *Greenpeace Berlin* "Ökolinks" http://www.greenpeace-berlin.de/links/li_links18.html provided internet links to over 2,000 web sites. Another site, *Environmental Contacts On-line* http://www.eco.uk.com, listed 680 environmental groups in the UK and over 2,300 environmental groups worldwide in more than 160 countries.

62. Deegan and Gordon (1996) provided a fourth criterion, namely that ENGOs should have a membership of greater than 400. This figure is noted by the authors as being arbitrary, justified on the basis that small groups would not be expected to have much power or influence over other members of society (see, for example, Peltzman, 1976; Stigler, 1971). Although Deegan and Gordon's argument may have been valid for their study of Australian companies at the time of their investigation, the meteoric rise in the use and availability of the Internet during the second half of the 1990s has radically changed the way in which pressure groups operate. In particular, the Internet has empowered small groups of individuals, even those acting alone from personal computers, to set up contact and action networks or alliances which may influence society at local, regional or national levels. Thus, it seems fair to at least question, in light of the huge number of alliances and networks which now exist, the assumption made by Deegan and Gordon (1996) that small groups would not be expected to have much power or influence over other members of society. This is an area that requires further research but is outside the scope of the present study.
63. Many ENGOs co-operate internationally through their national offices (e.g. Greenpeace and Friends of the Earth). These national offices of international ENGOs were included in the study, including those of: EarthAction; FoE, Fondation de Bellerive, Green Cross International, Greenpeace, International Youth Federation; WWF, World Society for the Protection of Animals (WSPA); and Youth and Environment Europe (YEE).
64. However, care needs to be exercised in determining the scope of an ENGO's activities. Whilst on the face of it, an ENGO may appear to be very specialised in its mission, in practice it can be participating in a broad range of activities that may indeed have an influence on one particular industrial sector or society in general. Wherever possible, therefore, a web site search was undertaken to establish the scope of an ENGO's operations and activities. In some cases, specialised ENGOs were included if the web site information indicated the organization was active in relation to general environmental issues.
65. The internet web site of the European Environment Bureau (EEB), the representative body for ENGOs in Europe, which provides a full list of its members by country, was then used to cross-check, and update this list as necessary. Further directories were discovered during the course of using the internet. These were used to provide a completeness check on the list of ENGOs given in the Directory, and any ENGOs which met the selection criteria were added to the list. For example, *The Directory of Organizations and Institutes Active in Environmental Monitoring* available from the UNEP web page *The Information Highway To The Global Environment: Directory of Organizations and Institutes Active in Environmental Monitoring* (http://www.gsf.de/UNEP/contents.html) provided a list of environmental organizations classified into various categories, by country.
66. The number and variety of organizations involved in environmental, ecological, animal rights, human rights and other social justice issues is overwhelming. This and the growth in the number of ENGOs, and the popularity and importance of the Internet during the 1990s, have made it virtually impossible for anyone to produce and maintain a comprehensive and up-to-date list of

ENGOs. Deegan and Gordon (1996) argue that it is not necessary to include all ENGOs, only those which have a membership of such size as to be able to influence other members of society. However, the assumption that membership may be a valid proxy for influence on or representation of social values and norms is culturally-dependent given that in some countries such as the Netherlands there are many ENGOs which are non-membership organizations (see, for example, Van Heeren, 1996).

67. The total number of ENGOs initially included in the Directory of ENGOs, including Nordic, Swiss and UK ENGOs, was 388. This number was subsequently revised downwards to 261 in the light of further detailed consideration of the activities of the ENGO (based mainly on information available on their respective internet web site) and responses received from ENGOs to the questionnaire. In relation to the latter, many organizations responded that they were neither an environmental organization nor involved in environmental campaigns concerning companies. One possible explanation for this is that NGOs over-play the scope of their activities (particularly in terms of the claims which appear on their web sites) in order to raise their public profile or increase funding opportunities. It is also possible that the responses were used as an excuse to avoid having to complete the questionnaire. In the absence of further investigation (which, for time and labour reasons, is impracticable), the replies were taken at their face value and the organizations in question excluded from the study.
68. No attempt is made to address those types of bias which are inherent in any response set. Such biases are part and parcel of questionnaire surveys and are due to the tendency amongst respondents to introduce bias into their responses by agreeing or disagreeing with questions in order to complete the questionnaire in the shortest possible time, and the bias inherent in the way questions are worded and sequenced (Wallace and Mellor, 1988).
69. The surrogate method involves comparing mean responses on one or more variables of interest given by *p* respondents of the last *m* days with those of a random sample of *p* respondents drawn from the responses received in the early days, the objective being to identify whether or not any statistically significant differences exist between the two sets (Wallace and Cooke, 1990; Wallace and Mellor, 1988), i.e.: *u*er = *u*lr, where er = early responders and lr = late responders. Procedures for determining the values of *p* and *m* vary, (see, for example, Buzby, 1974; Firth, 1978; Faircloth and Ricchuite, 1981).
70. Non-response bias could also be an issue when looking at the companies which responded to the questionnaire as between those which were disclosers and those which were non-disclosers of CED. In 1995, the only year for which the company questionnaire responses were employed in statistical tests under MST, the number of non-disclosers was six out of 90 companies (the number of disclosers of CED therefore being 73). None of these six non-disclosers completed the questionnaire. In other words, company questionnaire data for 1995 is based on responses from companies which disclosed CED, suggesting a possible non-response bias. However, it is difficult to assess how this might have affected the responses to the questions on stakeholder importance given that these questions were presented in the context of the business of the firm as a whole. Moreover, as indicated in the main text above, non-response bias is problematic because there is no fool-proof method of knowing the extent to which a bias is reflected in the respondent sample. The possible existence of a non-response bias in relation to the company questionnaire could weaken the reliability of the respective results reported in Chapter 9.

Chapter 9

Associations between firm characteristics, external socio-economic and socio-political influences and CED

9.1 Introduction

As discussed in Chapter 3, much of the research interest in social and environmental disclosure has focused on seeking to establish putative (i.e. anticipated) relationships between corporate social reporting (CSR), on the one hand, and observable (i.e. measurable) corporate characteristics and external influences, on the other. Typically, such relationships involve the researcher seeking to identify and model a recognisable relationship between two or more of these variables by employing hypothetico-deductive research (see, for example, Al Najjar, 1997; Belkaoui and Karpik, 1989; Gray *et al*., 2001; Hackston and Milne, 1996; Roberts, R., 1992). In exploring these putative relationships, CSR researchers have made recourse to an array of different theoretical frameworks each of which offers different insights into the underlying nature and causes of CSR. Whilst the motives suggested by these different perspectives vary according to the theoretical foundation of the research (Gray *et al*., 2001), the range of observable corporate characteristics and/or external influences employed in CSR research has been rather narrow (see Chapter 3). In the case of corporate characteristics, for example, researchers have been pre-occupied with the association between three observable corporate characteristics – size, profit and industry affiliation – and the volume of CSR, the putative association being that, *ceteris paribus*, larger, more profitable firms operating in the more 'socially-' and 'environmentally-sensitive' industries disclose more information about their social and environmental activities. However, as described in Chapter 3, such corporate characteristics have been only partially successful in terms of explaining variability in CSR (see, for example, Gray *et al*., 1995b; Mathews, 1987b; Ullmann, 1985 for reviews of this literature). Gray *et al*. (2001), for example, when testing for association between CSR and two corporate characteristics – i.e. size and profitability – for large UK companies, report that these characteristics explained only a relatively small amount of the variation in social disclosures. Ostensibly, this would suggest that there are other factors at work in influencing CSR.

Traditional (to accounting) theoretical frameworks, such as economic agency theory (EAT), have been employed to explain the nature and causes of voluntary corporate disclosure in this context. There is also a growing body of CSR literature, much of it coming from the insights provided by the counter-hegemony, counter-intuitive and non-conventional (to accounting) theoretical frameworks, which suggests that external social and political pressures from elements within the wider society may provide valuable clues towards greater understanding of the nature and causes of CSR. Two of these theories, managerial stakeholder theory (MST) and organizational legitimacy theory (OLT), were explored in detail at Chapters 6 and 7, respectively. This chapter is concerned with the various putative relationships hypothesised under three accounting theories – viz., EAT, MST and OLT – as set out in Chapters 5, 6 and

7, respectively. References below to individual hypotheses relate to the various hypotheses as described in these preceding chapters. For purposes of presentation, these putative relationships are categorised into two distinct groups: firstly, those which relate to associations between firm characteristics and CED; and, secondly, those which relate to associations between external (socio-economic and socio-political) pressures and CED. In each case, these various associations are examined for each year of the study. This chapter is thus focused on single period analysis, treating each year of the study as separate and distinct from other years. A time-series analysis which looks at trends over the period of the study is presented in Chapter 10.

The rest of this chapter is structured as follows. Section 9.2 analyses the raw data in relation to both selected firm characteristics and CED, including a discussion of skewness and kurtosis and the transformation of the raw data into a form suitable for hypothesis testing using parametric statistics. Section 9.3 provides detailed descriptive statistics for the various firm characteristics and the normalised data for CED. Section 9.4 introduces the various sets of testable hypotheses which are examined in subsequent sections under EAT, MST and OLT, respectively. The first of these is presented in Section 9.5 which explores three hypotheses under EAT, viz.: political visibility (H_1); industry environmental sensitivity (H_2); and, contracting and monitoring costs (H_3). Section 9.6 explores the second set of hypotheses under MST: stakeholder importance (H_4 and H_5) and management involvement in environmental policy formulation (H_6). The third set of hypothesis, those provided under OLT, is explored in Section 9.7, viz.: political visibility (H_{7a}); industry environmental sensitivity (H_{7b}); social pressures from ENGOs (H_{8a}); negative environmental performance (H_{9a}); and, that CED will be predominantly in the form of 'positive' (i.e. good) news (H_{7d}, H_{8b}, H_{9b}). Section 9.7 also includes a review of the nature of environmental campaigns by ENGOs and the ways and means by which these groups seek to influence CED.

9.2 Data examination, transformation and analysis

As noted previously in Chapter 8 (Section 8.14), data relating to selected firm characteristics (i.e. total assets, capital employed, total debt, profits, dividends, etc.) were extracted from the respective company's annual report and accounts and recorded in the SPSS database *COY1*, together with the content analysis measurement for the quantity and nature of environmental disclosures. *COY1* forms the primary database and is comprised of one record for each of the 90 sample companies for each year of the study, i.e. a total of 630 records. Each record in *COY1* includes the aggregate content analysis data relating to all reports content analysed for a particular company in each year. Subsequent fields were added to permit data analysis in relation to the various hypotheses tests as described in the remainder of this chapter.

Following Cooke (1998), the data for both the independent and dependent variables were screened to assess the impact of distribution problems of skewness and kurtosis as well as problems of outliers and non-linearity. An initial analysis of the environmental disclosure variable ('Total CED') revealed the absence of a normal distribution around the mean. Tests using the normal probability plot (*P-Plots*) function[1] within SPSS (Norusis and SPSS, 1988), in which the observed values are matched with expected values from the normal distribution (Cooke, 1998), showed that the raw data did not cluster around a straight line. Further tests using the *histogram* function[2] (Hair *et al.*, 1998) also revealed an asymmetrical distribution

curve with a significant positive skewness, a feature not uncommon to CSR studies which draw their samples based on the largest companies in a given population[3]. As shown in Table 9.1 below, a high percentage of the sample population provide relatively small quantities of environmental disclosure, typically less than one page. In addition, a few companies provide relatively much larger quantities of environmental disclosure, notably post-1991, these outliers providing in excess of 50 pages. In such circumstances, use of the raw values of Total CED as the dependent variable in statistical regression would result in excessive influence being attributed to the information pertaining to the small number of high disclosing companies.

Table 9.1
Distribution of total CED by pages amongst sample companies (%)

Band/Year	1989	1990	1991	1992	1993	1994	1995
	%	%	%	%	%	%	%
Percentage of companies providing:							
0.00 page (non-disclosers)	19	10	8	6	7	4	7
0.01 to 0.50 page	23	25	27	29	25	22	13
0.51 to 1.00 page	12	11	7	7	10	15	8
Sub-total (0.00 to 1.00 pages)	54	46	42	42	42	41	28
1.01 to 5.00 pages	30	33	38	38	34	38	33
5.01 to 10.00 pages	7	17	9	12	10	7	8
10.01 to 20.00 pages	7	2	4	3	6	4	4
20.01 to 50.00 pages	2	2	7	3	6	6	12
50.01 to 100.00 pages				2	2	4	12
More than 100.00 pages	-	-	-	-	-	-	3
Total (%)	100	100	100	100	100	100	100

Notes: This table shows the percentage of companies which provided environmental disclosure, analysed by bands of total amount disclosed.

To approximate to a normal distribution, the raw data for Total CED was therefore normalised using the Blom proportion estimation formula based on normal scores, whereby the rank of each observation is used rather than its actual value (Norusis and SPSS, 1988). Transformation results showed the transformed data to be much closer to a normal distribution. The transformed data for Total CED was thus considered suitable for hypothesis testing using parametric statistics which assume a normal distribution. An initial analysis of the corporate characteristics variables also revealed the presence of an asymmetrical distribution curve with a significant positive skewness. This reflects the presence of both a few companies in the sample with very high values in relation to total assets, capital employed, etc. and a large number of companies with relatively very low company characteristic variables, resulting in a clustering of these values towards zero, not around the mean. Taking the year 1992, for example, the mean value of total assets (in German marks) was DM45,843,751, with minimum and maximum values of DM460,574 and

DM495,577,539, respectively. Similarly, the minimum and maximum values for employees in 1992 was 428 and 382,633, respectively, with a mean of 44,459. This reflects the heterogeneous make-up of the sample of companies, with some, especially banks, having a comparatively much larger asset base. As a result, the ratio of the maximum to minimum values is particularly large, often exceeding 1,000. In these circumstances, use of the raw values of company characteristics as proxies for independent variables in statistical regression would likely result in significant influence being attributed to the information pertaining to a small number of very large companies (Gray *et al.*, 2001). Statistical hypotheses tests were therefore performed using transformed values ($\log_e$ transformation) of corporate characteristics[4]. Detailed descriptive statistics in relation to the independent and dependent variables are provided in Section 9.3 below.

The data collected for the purposes of the present study were subjected to various analyses using a number of different statistical techniques and procedures, as appropriate in the context of each test. In the majority of cases, relationships were tested using univariate analysis of variance (UNIANOVA) tests using the SPSS statistical package (Norusis & SPSS, 1988). The UNIANOVA procedure provides regression analysis and analysis of variance for one dependent variable by one or more factors and/or variables. For regression analysis, the independent variables are specified as co-variates. Generally, tests were run against each year and, in some cases, as a longitudinal set for the seven-year period as a whole. Treating each year of the study as providing a separate data set with which to perform statistical analysis assumes that each year's data set is independent of that of other years. It might be argued, particularly in the case of the dependent variable (CED), that this assumption may not be completely valid. That is, what companies disclose in relation to environmental, health and safety and energy issues in one year may have an influence on what is disclosed in the following years. Similarly, the size (e.g. total assets) of a company in year n will clearly have an influence on its size in year $n+1$. As such, even though the study looks at seven different periods they may not necessarily reinforce each other. To the extent that such dependencies exist, this represents a limitation to the approach adopted in the present study.

9.3 Descriptive results

Table 9.2 below provides detailed descriptive statistics in relation to the volume of corporate environmental disclosure (Total CED), the dependent variable, and the various corporate characteristics for political visibility and contacting and monitoring costs, respectively. Shown in these tables are the minimum and maximum values, median, mean, standard deviation and measures of skewness and kurtosis[5]. Based on median values, the typical firm in this study provides 1.43 pages of environmental disclosure in its annual, social, and environment reports, has total assets of DM8,489.7 million, is financed by shareholders equity and long-term funds (i.e. total capital employed) totalling DM3,828.9 million, has long term borrowings (i.e. total debt) of DM991.1 million, earns a profit (before interest and tax) of DM533.1 million, pays an annual dividend to its shareholders of DM81 million and employs 20,471 full-time staff. The median value for CED, being significantly less than the mean value of the mean, suggests the latter has been influenced quite significantly by the small number of companies which provide relatively very high amounts of environmental disclosure (see Table 9.1). Median values represent the 50th percentile (i.e. the value above

and below which half the cases fall) and thus provide a measure of central tendency that is not disturbed by outlying values, unlike the mean, which can be affected by a few extremely high or low values. As shown by the minimum and maximum figures for Total CED in Table 9.2, there is considerable variability in the quantity of environmental disclosure. The gap between the minimum and maximum values of Total CED was found to increase significantly over the period of the study. This reflects the influence of non-disclosers (i.e. companies for whom the quantity of environmental disclosure is nil) and the small number of 'very high' disclosers. The maximum amount of environmental disclosure amongst the sample companies was 43.66 pages in 1989, rising to 176.62 pages in 1995. The minimum was 0.00 in all years (i.e. the non-disclosers).

Table 9.2
Descriptive statistics (all years)

	Min.	Max.	Median	Mean	SD	Skewness	Kurtosis
Dependent variable:							
Total CED	0.00	176.62	1.43	6.82	16.21	4.53	28.25
Independent variables:							
Political visibility:							
Total Assets	238,971	721,665,000	8,489,655	47,117,846	97,626,323	3.10	10.51
Capital Employed	174,153	194,502,339	3,828,930	8,633,027	17,461,157	6.96	60.40
Profit (PBIT)	-3,511,000	11,614,434	533,143	1,135,207	1,620,735	2.98	12.47
Number of employees	213	382,633	20,471	43,148	62,349	2.96	10.05
Contracting & monitoring costs:							
LTD: Equity	0.00	6.02	0.422	0.666	0.94	3.85	16.56
LTD: Total Assets	0.00	0.81	0.119	0.149	0.133	1.76	5.07
Div.: Retained Earnings	-0.96	6.39	0.107	0.187	0.426	9.60	119.45

Notes: Descriptive statistics shown above relate to the raw (i.e. untransformed) data based on all years from 1989 to 1995 treated as a longitudinal set. Monetary items are shown in DM000s. 'Min' and 'Max' denote the minimum and maximum, respectively, Median is the 50th percentile and SD is the standard deviation. 'Skewness' and 'Kurtosis' denote the coefficients of skewness and kurtosis, respectively. 'LTD' is the long-term debt; 'Retained earnings' is accumulated unrestricted distributable retained earnings (negative values indicate negative reserves, i.e. losses); 'Equity' is total of shareholders' funds (i.e. equity share capital and distributable and non-distributable reserves including retained earnings). Zero values arise due to some companies in the sample having no long-term debt and thus the debt to equity and debt to total assets ratios are zero. Negative values in the case of profit refer to losses.

The skewness and kurtosis values shown in Table 9.2 reveal a strongly positive skewness to the data that does not exhibit a normal distribution. As indicated above, the dependent variable (Total CED) data was therefore normalised using the Blom proportion estimation formula (Norusis and SPSS, 1988)[6]. In the case of the independent variables, skewness and kurtosis values are significant, reflecting a distribution that is strongly positively skewed. However, for the purposes of a standard regression, the normality of the independent variables is not part of the standard regression assumptions. Rather, what matters is whether the residuals (i.e. the differences between the observed values of the dependent variable and the values predicted by the regression model) are normally distributed. Having normalised the data for the dependent variable, there is reasonable assurance that the distribution of the

residuals are themselves normalised and thus, when using parametric tests, reliance can be placed on the measures for significance (*F*-scores) and coefficients (the *t*-statistic).

9.4 Testable hypotheses

Previous chapters on EAT, MST and OLT identified a number of corporate characteristics and external influences which are hypothesised, under these three theories, respectively, as being associated with variations in CED across firms. Notwithstanding that much of CSR research in the 1970s and 1980s focused on corporate characteristics, such as size and profitability, a considerable amount of literature appeared in the 1990s which promoted the general argument that social and environmental disclosures provided by corporations to society in their annual reports are related to external variables such as socio-political pressure from campaign groups which offered new insights into the form and causes of CSR. Whilst corporate characteristics such as size and profitability are, by their definition, relatively easy to measure, the same does not hold true for external social and political influences. A major problem with attempting to model the impact of these external influences on firms is that no 'pure' measure of these influences exists and the researcher is therefore forced to rely on proxy variables that are, at best, imprecise indicators of the influences companies face (Patten, 1991). Indeed, doubts have been raised within the CSR literature as to whether it is even possible to successfully capture these influences for statistical modelling purposes (Gray *et al*., 2001). Such doubts notwithstanding, the present study seeks to capture various measures of both corporate characteristics and external influences which the three different theories suggest as offering possible explanations for variations in corporate environmental disclosure. In the following sections, hypotheses are presented under each theory, beginning with EAT. In each case, hypothesis numbers correspond to the hypotheses presented in the respective theory chapter presented earlier.

9.5 Economic Agency theory (EAT)

Three hypotheses are to be explored under economic agency theory, expressed formally (in alternative form) as follows:

H_1: There is a positive association between political visibility and the volume of CED.
H_2: There is a positive association between industry environmental sensitivity and the volume of CED.
H_3: There is a positive association between contracting and monitoring costs and the volume of CED.

Where:

(i) political visibility is based on size, as measured by four surrogates, i.e. (a) Total Assets, (b) Number of Employees, (c) Capital Employed, and (d) Profit in each of the years 1989 to 1995;
(ii) industry environmental sensitivity is related to the sensitivity of an industry's activities to the natural environment;
(iii) contracting and monitoring costs are measured by two 'key market variables', i.e. (a) financial leverage, using two surrogate ratios, Long-Term Debt to Total Assets and

Long-Term Debt to Equity; and (b) dividend cover, the ratio of dividends to unrestricted retained earnings, in each of the years 1989 to 1995.

These three hypotheses provide a testable model under which Total CED is asserted to be positively associated with political visibility, industry environmental sensitivity and contracting and monitoring costs. The model is formally specified in equation (1) below, where: CED_{cy} denotes the transformed value of the volume of corporate environmental disclosure made by company *c* in year *y*, α_{0y} is the intercept, $POLVIS_{cy}$ denotes the value of the corporate characteristic for political visibility of type *p* made by company *c* in year *y*, IES_{cy} denotes the industry environmental sensitivity of industry sector *i* for company *c* in year *y*, $CONMON_{cy}$ denotes the value of the corporate characteristic for contracting and monitoring costs of type *m* for company *c* in year *y* and e is the random error term[7]:

$$CED_{cy} = \alpha_{0y} + \alpha_{py}POLVIS_{cy} + \alpha_{iy}IES_{cy} + \alpha_{my}CONMON_{cy} + e_{cy} \quad (1)$$

9.5.1 Political visibility

The political visibility argument under both economic agency theory (EAT) and organizational legitimacy theory (OLT) posits that there is a positive association between political visibility and the volume of corporate environmental disclosure (CED). Thus, hypotheses H_1 under EAT and H_{7a} under OLT (see below) both predict that the more politically-visible companies will provide greater levels of environmental disclosure. As indicated previously, four surrogates for political visibility were chosen, viz. total assets, capital employed, profits (PBIT) and number of employees. The phenomenon of political visibility is seen as a function of these various factors, both individually and collectively. Given that their combined effect is likely to be more significant in a political sense than that of each factor individually, the extent to which each of these four characteristics are correlated with one other (i.e. the correlation coefficients) is clearly relevant. As shown in Table 9.3 below, the correlation between the four characteristics for political visibility is highly positive and significant in all cases, with absolute values (indicating the strength of the relationship) ranging from 0.515 for Total Assets and Number of Employees to 0.878 for Profit and Total Assets[8].

Table 9.3
Coefficients of correlation between corporate characteristics for political visibility

Corporate characteristic	Total Assets	Capital Employed	Profit (PBIT)
Capital Employed	+0.878*	-	-
Profit (PBIT)	+0.783*	+0.845*	-
Number of Employees	+0.515*	+0.576*	+0.649*

Notes: Measures of the linear association for the transformed variables (natural log, $\log_e$) were calculated using Pearson's correlation coefficient statistic. Profit (PBIT) excludes losses. The sign of the coefficient indicates the direction of the relationship, and the absolute value indicates the strength, with larger absolute values indicating stronger relationships. Starred values indicate that the correlation is significant at the 0.01 level (two-tailed).

To test the hypothesis that political visibility is positively associated with the volume of environmental disclosure, the disclosure variable ("Total CED") was regressed on each of the

four corporate characteristics which serve as proxies for political visibility. This regression was performed by running a univariate analysis of variance (UNIANOVA) test for the full sample of 90 Benelux and German firms for each of the seven years of the study, controlling for both the effect of country and industry sector. For the purposes of the regression, industry sector was represented by seven dummy variables (each taking the value 1 or 0). The results of each set of regressions are summarised in Table 9.4[9].

Table 9.4
Association between each individual characteristic for political visibility and total CED, by year

Characteristic (x-variable)	1989	1990	1991	1992	1993	1994	1995
Total Assets							
Regression coefficient	+	+	+	+	+	+	+
p-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.002**	**0.002**	**0.000**
Industry *p*-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.001**
Country *p*-value	**0.012**	**0.000**	0.095	0.099	**0.042**	0.074	**0.017**
Adjusted *R*-squared	0.412	0.522	0.497	0.451	0.354	0.356	0.277
Capital employed							
Regression coefficient	+	+	+	+	+	+	+
p-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.005**	**0.000**	**0.000**
Industry *p*-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.007**
Country *p*-value	**0.001**	**0.000**	**0.011**	**0.019**	**0.009**	**0.011**	**0.002**
Adjusted *R*-squared	0.419	0.542	0.512	0.457	0.341	0.377	0.280
Profit (PBIT)							
p-value	**0.001**	**0.000**	**0.001**	**0.007**	0.059	**0.025**	**0.003**
Regression coefficient	+	+	+	+	+	+	+
Industry *p*-value	**0.000**	**0.000**	**0.001**	**0.000**	**0.000**	**0.000**	**0.018**
Country *p*-value	**0.007**	**0.000**	0.073	0.078	0.062	**0.045**	**0.020**
Adjusted *R*-squared	0.355	0.480	0.433	0.410	0.303	0.316	0.229
Employees							
p-value	**0.009**	**0.006**	**0.017**	**0.020**	0.080	**0.043**	**0.008**
Regression coefficient	+	+	+	+	+	+	+
Industry *p*-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.009**
Country *p*-value	**0.048**	**0.000**	0.185	0.185	0.070	0.112	**0.035**
Adjusted *R*-squared	0.314	0.438	0.390	0.393	0.296	0.307	0.212

Notes: This table shows the *p*-value for the regression coefficient of environmental disclosure ("Total CED") on each corporate characteristic run against all companies in each year using univariate analysis of variances (UNIANOVA), controlling for both industry sector and country. All *p*-values are one-tailed probabilities. All tests were run against transformed values for the dependent and independent variables. Significant (at 5%)*p*-values are highlighted in bold. Regression coefficients (+/-) indicate the direction of the relationship, where + indicates a positive association. 'Adjusted *R*-squared' values provide an indication of the proportion of the variance of the dependent variable about the mean which is explained by the respective co-variate and fixed factors in the model.

The results in Table 9.4 provide strong support for hypotheses H_1 EAT and H_{7a} OLT and thus for rejecting the null hypothesis. The four surrogates for political visibility provide a significant regression coefficient (at the 5 per cent level) in 26 out of the 28 cases presented (see *p*-values[10]) and have a positive sign in all 28 cases as predicted. These findings support H_1 EAT and H_{7a} OLT, suggesting that there is a positive correlation between political visibility and the amount of environmental disclosure. Looking at the individual

characteristics for political visibility, the strongest results were found in the case of total assets and capital employed, with statistically significant regression coefficients for both characteristics for all seven years. In the case of the other two characteristics, the results were less significant but nonetheless provided statistically significant regression coefficients in six out of the seven years.

These results compare favourably with previous studies, notably that of Gray *et al.* 2001, who report a significant positive association between four measures of political visibility and environmental disclosure by large UK companies in 16 out of 32 cases over an eight year period from 1988 to 1995. The latters' study also reported lower *p*-values in the case of capital employed compared to that of either the number of employees or profit. However, in contrast to the Gray *et al*. study, which reported a greater variation in the relationship between social and environmental disclosure and political visibility characteristics over time, the results of the present study seem to suggest the presence of much more stable relationship with total assets achieving the lowest *p*-value of the four surrogated for political visibility in six out of seven years. The two variables which were controlled for, namely country and industry sector, also appear to be significantly associated with the dependent variable. In the case of industry sector, significant *p*-values were found in all 28 cases, many of these having probability values of less than 0.0005. The influence of country was also significant (at the 5 per cent level) in 18 out of 28 cases, although the association with the dependent variable appears less significant for country than for industry sector.

The amount of variability in disclosure (as measured by the coefficient of determination, adjusted *R*-squared), when controlling for both country and industry effects, varies both over time and according to the corporate characteristic for political visibility being used. For example, in the case of capital employed, the adjusted *R*-squared varies from 0.28 to 0.54. The highest adjusted *R*-squared value was 0.54 (capital employed 1990), the lowest was 0.21 (employees 1995). The adjusted *R*-squared value provides an indication of the explanatory power of the regression equation (Hair *et al*., 1998). In essence, the greater the value of *R*-squared, the greater the explanatory power of the model and, thus, the better the prediction of the dependent variable. However, the adjusted *R*-squared values shown in Table 9.4 indicate the proportion of the variance of the dependent variable about the mean which is explained by the model as a whole. When looking at the proportion of the total variability in the dependent variable that is accounted for by the variation in each independent variable, known as the estimate of effect size (or *Eta*-squared, i.e. the proportion of the total variability in the dependent variable that is accounted for by variation in the independent variable), the effect of industry sector was clearly dominant. For example, when running the regression using total assets as the independent variable, controlling for both country and industry sector, the *Eta*-squared values for industry sector were as follows: 1989, 0.42; 1990, 0.51; 1991, 0.54; 1992, 0.49; 1993, 0.39; 1994, 0.43; 1995, 0.26[11]. In the case of country sector, the *Eta*-squared values when running the same regression were more modest: 1989, 0.07; 1990, 0.23; 1991, 0.02; 1992, 0.02; 1993, 0.04; 1994, 0.03; 1995, 0.06. These findings suggest that, in a European context at least, industry sector and, to a lesser extent, country, are significant in terms of explaining variations in the volume of corporate environmental reporting. Comparing the *Eta*-squared values for industry sector as shown above with the adjusted *R*-squared percentages reported in Table 9.4 for the model as a whole, clearly indicates that a significant proportion of the variability in disclosure is explained by industry sector. In other

words, the amount of variability that is explained by the surrogates for political visibility and country are modest in comparison to the amount of variability explained by industry sector. These findings may help to explain those of Gray *et al*. (2001) who report average adjusted *R*-squared values of only 0.03 in the case of size and profit measures, the authors suggesting that other explanatory factors, such as industry sector, which were not included in their initial analysis, may have important explanatory power. The influence of industry sector is explored in more detail below.

9.5.2 Industry environmental sensitivity

As described in Chapter 5, the political costs argument under economic agency theory has been augmented by further studies which posit that firms operating in socially- and environmentally-sensitive industries are vulnerable to regulation and political intervention. Thus, the political visibility of an organization is seen as being determined not just by its size but also by the type of industry in which it operates. Drawing on the 'relevant information to shareholders' hypothesis, the management of companies operating in industries whose economic activities modify or impact on the environment are posited as providing a greater volume of environment-related disclosures (CED) in their corporate reports than companies in other less environmentally-sensitive industries. Thus, under hypothesis H_2, it is posited there is a positive association between industry environmental sensitivity and the volume of environmental disclosure, i.e. the more sensitive the industry, the greater the volume of CED. To test hypothesis H_2, the 90 Benelux and German companies were categorised as falling into one of two industry classifications for environmental sensitivity: environmentally-sensitive (ES) industries; and, less environmentally-sensitive (LES) industries. Categorisation of each company was performed at industry level, with each of the eight industry sectors included in the study being classified, based on prior anecdotal evidence, as either ES or LES (see Chapter 8 for details). On this basis, the four environmentally-sensitive sectors are: Chemicals; Extractive; Mechanical Engineering and Metallurgy; and, Energy Utilities; the four less environmentally-sensitive sectors are: Banking and Insurance; Consumer Goods; Travel, Tourism and Transport Services; and, Retail and Leisure (see Appendix 5 for details). As the 90 sample companies had been selected so as to provide an equal sample of companies classified as either ES or LES, the sample population divided equally into two groups of 45 companies (although the number of companies falling within each of the eight industry sectors varies, see Table 8.2, Chapter 8). Hence, the hypothesis to be tested under H_2 is that the 45 companies classified as ES provide a greater volume of environmental disclosure than the 45 companies classified as LES in each of the years 1989 to 1995.

To test the hypothesis that industry environmental sensitivity is positively associated with the volume of environmental disclosure, the disclosure variable ("Total CED") was regressed on the variable which distinguishes companies as between those which operate in environmentally-sensitive industries and those which operate in less environmentally-sensitive industries. The results are summarised in Table 9.5[12]. The regression results reported in Table 9.5 were performed by running a multivariate analysis of variance (MANOVA) test for the full sample of 90 Benelux and German firms for each of the seven years of the study, controlling for both country and size. Complete nesting of companies within the two categories of industry environmental sensitivity was achieved by running a bespoke MANOVA command syntax (Norusis and SPSS, 1988)[13]. For these purposes, a

simple nominal scale was employed to distinguish between the Benelux and German companies. Total assets and capital employed were used as alternative proxies for size.

Table 9.5
Association between industry environmental sensitivity and total CED, by year

	1989	1990	1991	1992	1993	1994	1995
Industry environmental sensitivity:							
Regression coefficient	+	+	+	+	+	+	+
p-value	**0.018**	**0.031**	**0.019**	**0.010**	**0.017**	**0.018**	**0.043**
Size - total assets *p*-value	**<0.0005**	**<0.0005**	**<0.0005**	**0.003**	**0.015**	**0.003**	**<0.0005**
Country *p*-value	**0.007**	**<0.0005**	**0.039**	**0.034**	**0.010**	0.081	**0.012**
Regression coefficient	+	+	+	+	+	+	+
p-value	**0.026**	0.052	**0.029**	**0.029**	**0.020**	**0.031**	0.061
Size - capital employed *p*-value	**<0.0005**	**<0.0005**	**<0.0005**	**0.001**	**0.002**	**<0.0005**	**<0.0005**
Country *p*-value	**<0.0005**	**<0.0005**	**0.003**	**0.006**	**0.001**	**0.013**	**0.001**

Notes: This table shows the *p*-value for the regression coefficient of environmental disclosure ("Total CED") on industry environmental sensitivity run against all companies in each year using multivariate analysis of variances (MANOVA), controlling for both size and country. The two separate regressions shown were performed using alternative proxies for size, i.e. (i) total assets and (ii) capital employed. All *p*-values are one-tailed probabilities. All tests were run against transformed values. Significant (at 5%)*p*-values are highlighted in bold. Regression coefficients (+/-) indicate the direction of the relationship, where + indicates a positive association.

The results shown in Table 9.5 provide support for the hypothesis (H_2) that companies operating in environmentally-sensitive industries disclose more environmental information than companies operating in less environmentally-sensitive industries, significant *p*-values being reported for all seven years. In other words, the extent to which a company's operations and products impact on the natural environment appears to be positively associated with the amount of environmental disclosure appearing in the corporate annual, social and environment reports of large European companies[14]. These results also indicate that both size and country are statistically significant in terms of explaining the amount of variability in disclosure[15]. The results in relation to size are consistent with the results provided in Table 9.4 above, where various proxies for size were used to test the political visibility argument. In relation to country, the results shown in Table 9.5 suggest that the reporting behaviour of German and Benelux companies was not homogeneous. Rather, the home country of the reporting company was also a significant factor in explaining variability in the volume of environmental disclosure in each of the seven years.

9.5.3 Contracting and monitoring costs (key market variables)

In Chapter 5, reference was made to the contracting and monitoring costs hypothesis under economic agency theory which can be expressed in terms of the association between certain key market variables and environmental disclosure. In the context of the present study, the basic hypothesis is that there is a positive association between these key market variables and the volume of environmental disclosure (H_3). Two proxies were chosen for testing the

contracting and monitoring costs argument, viz.: (i) *financial leverage*, as represented by the ratios long term debt to equity capital and long term debt to total assets; and (ii) *dividend cover*, as represented by the ratio of dividends to unrestricted retained earnings. To test hypothesis H_3, the disclosure variable ("Total CED") was regressed on each of these three key market variables for the full sample of 90 firms for each of the seven years of the study. This regression was performed by running a UNIANOVA test, controlling for size (total assets), country and industry sector[16]. The results of each set of regressions is summarised in Table 9.6 below.

Table 9.6
Coefficients of correlation between 'key market' variables and volume of environmental disclosure

Key market variable (x-variable)	1989	1990	1991	1992	1993	1994	1995
Financial leverage:							
LTD to Total Assets ratio							
Regression coefficient	+	+	+	–	–	+	–
p-value	0.401	0.158	0.180	N/s	n/s	0.394	n/s
Industry *p*-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.001**
Country *p*-value	**0.020**	**0.000**	0.056	0.282	0.175	0.086	**0.047**
Size (total assets) *p*-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.002**	**0.002**	**0.000**
Adjusted *R*-squared	0.404	0.523	0.496	0.453	0.357	0.347	0.270
LTD to Equity ratio							
Regression coefficient	+	+	+	–	–	+	–
p-value	0.326	0.176	0.147	n/s	n/s	0.462	n/s
Industry *p*-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.002**
Country *p*-value	**0.020**	**0.000**	0.053	0.227	0.088	0.086	**0.030**
Size (total assets) *p*-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.002**	**0.003**	**0.000**
Adjusted *R*-squared	0.398	0.519	0.498	0.455	0.352	0.347	0.270
Dividend cover:							
Dividends to Retained Earnings ratio							
Regression coefficient (+/-)	+	+	+	+	+	–	–
p-value	0.129	0.100	0.212	0.387	0.468	n/s	n/s
Industry *p*-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.004**
Country *p*-value	**0.032**	**0.000**	**0.100**	**0.151**	**0.007**	**0.070**	**0.021**
Size (total assets) *p*-value	**0.000**	**0.000**	**0.000**	**0.000**	**0.001**	**0.001**	**0.001**
Adjusted *R*-squared	0.410	0.525	0.480	0.448	0.346	0.319	0.263

Notes: This table shows the *p*-values for the regression coefficient of environmental disclosure ("Total CED") on each key market variable run against all companies in each year using UNIANOVA, controlling for size (total assets), industry sector and country. All *p*-values are one-tailed probabilities. Regression coefficients (+/-) indicate the direction of the relationship, where + indicates a positive association and – a negative association. All tests were run against transformed values. 'LTD' denotes Long-Term Debt; 'n/s' denotes not significant as the direction of association was not as predicted. Significant (at 5%) *p*-values are shown in bold.

Based on these results, the null hypothesis under H_3 cannot be rejected. The direction of association was as predicted for only 13 out of the 21 regressions and none provided a significant regression coefficient. Moreover, for the other 8 regressions the direction of

association was opposite to that predicted. In other words, the association between variability in environmental disclosure was *negatively* associated with the key market variables in these 8 cases. However, looking at the *p*-values for both the controlled variables, i.e. industry sector, country and size, these results are consistent with those under H_1 and H_2 as described previously, namely that the amount of variability in environmental disclosure does seem to be highly influenced by these three variables with those for industry sector representing by far the largest proportion of the adjusted *R*-squared values shown in Table 9.6. The other point worth noting here is that the adjusted *R*-squared values shown in Table 9.6 are of the same magnitude in each year, irrespective of which key market variable is used as the covariate. This suggests that variations in environmental disclosure from company to company are not associated with variations in the key market variables. This is evidenced by the size of the *Eta*-squared values for the market variable, all of which were very small (less than 0.01 in most cases), indicating they offer little explanatory power.

A further set of UNIANOVA tests was also run by regressing the disclosure variable ("Total CED") on the three key market variables simultaneously for the full sample of 90 firms for all seven years, again controlling for size (total assets), country and industry sector. The results were very similar to those presented in Table 9.6.

9.5.4 Political visibility, industry sector and country

The empirical evidence provided in Tables 9.4 to 9.6 above suggests that the political visibility, industry sector and country characteristics may have considerable value in terms of explaining the variability in environmental disclosure amongst large European companies, whilst other characteristics associated with contracting and monitoring costs do not. To assess the combined explanatory power of political visibility, industry sector and country, a further series of statistical tests was performed by regressing the disclosure variable ("Total CED") on each of the four characteristics for political visibility for the full sample of 90 firms for each of the seven years of the study, controlling for both country and industry sector. The results of each set of regressions are summarised in Table 9.7[17].

As indicated previously in relation to Table 9.3 above, the correlation between the four characteristics for political visibility is highly positive. The extent to which, individually and collectively, these four variables 'capture' the political visibility characteristic of corporations is difficult to assess in the absence of more detailed empirical investigations. However, it seems reasonable to argue that the political visibility of a corporation is a function of several different corporate characteristics, the relative importance of each varying underthe relative influence of an array of different internal and external events. From this perspective, political visibility may be construed as a complex, multifaceted phenomenon, dependent upon a variety of factors, such as size and profitability. Examining the correlation coefficients of each of the four proxies for political visibility (i.e. total assets, capital employed, profits (PBIT) and number of employees) when run in the same regression provides an indication of the specific explanatory power of each (in the sense that the resulting *Eta*-squared value indicates the proportion of the total variability in the dependent variable that is accounted for by the variation in each proxy, respectively, other proxies for political visibility being held constant statistically). The modelled relationship between variations in environmental disclosure and these various corporate characteristics, when controlling for industry and country, is shown to be statistically significant in all years, with *p*-values in all but one year being <0.0005. The amount of variability in disclosure explained by

these characteristics is also large, with adjusted *R*-squared values ranging from 0.27 in 1995 to 0.55 in 1990.

Table 9.7
Association between political visibility and total CED, by year

	1989	1990	1991	1992	1993	1994	1995
Model values:							
p-value	**<0.0005**	**<0.0005**	**<0.0005**	**<0.0005**	**<0.0005**	**<0.0005**	**0.001**
Adjusted *R*-Squared	0.463	0.546	0.540	0.448	0.366	0.362	0.274
Co-variates:							
Total Assets *p*-value	**0.017**	0.118	**0.023**	0.125	**0.012**	0.451	0.245
Regression coefficient	+	+	+	+	+	+	+
Eta-squared	0.062	0.02	0.056	0.019	0.07	0.00	0.007
Cap. Employed *p*-value	0.064	0.059	0.219	0.269	0.192	0.064	0.253
Regression coefficient	+	+	+	+	–	+	+
Eta-squared	0.033	0.035	0.009	0.005	0.011	0.033	0.006
Profits (PBIT) *p*-value	**0.029**	0.135	0.362	0.481	0.248	0.194	0.091
Regression coefficient	–	–	+	+	+	–	–
Eta-squared	0.051	0.017	0.002	0.000	0.007	0.011	0.025
Employees *p*-value	**0.054**	0.094	**0.004**	0.105	**0.023**	0.375	0.351
Regression coefficient	–	–	–	–	–	–	+
Eta-squared	0.036	0.025	0.093	0.022	0.056	0.001	0.002
Fixed factors:							
Industry *p*-value	**<0.0005**	**<0.0005**	**<0.0005**	**<0.0005**	**<0.0005**	**<0.0005**	**0.008**
Eta-squared	0.353	0.350	0.451	0.407	0.373	0.326	0.210
Country *p*-value	**0.001**	**0.000**	**0.011**	**0.039**	0.100	**0.017**	**0.015**
Eta-squared	0.117	0.289	0.073	0.043	0.023	0.06.3	0.066

Notes: This table shows the *p*-values for the regression coefficient of environmental disclosure for the model and for each corporate characteristic of political visibility run against all companies in each year using univariate analysis of variances (UNIANOVA), controlling for both industry sector and country. All *p*-values are one-tailed probabilities. Significant (at 5%) *p*-values are shown in bold. Where: Regression coefficients (+/-) indicate the direction of the relationship, a "+" indicating a positive association; *Eta*-squared values indicate the proportion of the total variability in the dependent variable that is accounted for by variation in the independent variable, respectively.

In terms of the relative importance of the individual company characteristics includedin the modelled relationship, it is evident from Table 9.7 that industry sector and, to a lesser extent, country are more significant than the proxies for political visibility. Industry sector, for example, has the highest (or equal highest) *p*-value in all seven years, having a value of <0.0005 in all but 1995. The proportion of the total variability in environmental disclosure that is accounted for by industry sector variation, i.e. the *Eta*-squared value, is also quite high ranging from 0.21 to 0.45. However, the direction of association for the various proxies for political visibility is not as previously predicted nor is it the same as when these proxies were looked at in isolation (Table 9.4). This is particularly noticeable in the case of the number ofemployees which is negatively associated with variations in CED for all years other than 1995. These results highlight the fact that different approaches can be taken to exploring putative relationships. One approach is to

explore relationships between independent and dependent variables in isolation (as shown in Tables 9.4 to 9.6). Another approach is to consider these variables simultaneously in a more sophisticated model of the relationship being explored. Whilst neither approach is more "correct" than the other, the use of more than one approach highlights different aspects of the same phenomenon, each providing an alternative insight into interrelatedness of the variables in question[18]. Although further exploration of these issues is outside the scope of the present study, the results presented in Table 9.7 suggest that future research in this area should seek to provide a more detailed understanding of the relative influence of the various proxies for political visibility, both individually and collectively, particularly in terms of their interaction with each other (i.e. multicolineality) in more complex models.

9.6 Managerial Stakeholder Theory (MST)

The managerial model of stakeholder theory argues that management seeks to manage conflicting relationships with its various stakeholder groups using a variety of strategic devices and tactics, one of which is the use of *information* to influence the perceptions and impressions of stakeholder groups whilst maintaining course in terms of the long-term strategic goals of the business. Social and environmental disclosure is posited as being one such tactic. However, to date, there has been very little empirical or field research which explores the managerial model of stakeholder theory in relation to variations in environmental disclosure across companies. This reflects the fact that this model is still relatively under-developed within the corporate social and environmental reporting literature. In seeking to add new knowledge to this area, the hypotheses tests and results which follow should be seen as an attempt to explore the potential descriptive value of stakeholder theory in the context of CED. The approach taken combines empirical and field research (i) to examine the perceptions of management in relation to their stakeholders and (ii) to explore possible associations between these perceptions and variations in environmental disclosure. The general line of argument employed here is that managerial behaviour towards stakeholder groups in this context is influenced by the degree to which these groups are perceived by management to be important in relation to the business as a whole. Field data on stakeholder importance was obtained by means of a mail questionnaire to companies. In addition, stakeholder importance is assumed to be both a function of management's attitude to individual stakeholder groups and to stakeholders as a whole. That is, it may be expected that within a firm some stakeholder groups are perceived as more important than others (intra-firm stakeholder importance) and that some firms perceive stakeholders *as a whole* to be more important in comparison to other firms (inter-firm stakeholder importance). To obtain data on intra-firm stakeholder importance companies were asked to rank the relative importance of individual stakeholder groups in relation to the business of the firm as a whole. This data was used for the purposes of exploring the association between both intra-firm and inter-firm stakeholder importance and CED. Three hypotheses were identified in Chapter 6 to be explored under managerial stakeholder theory (MST) as follows (in alternative form):

H_4: The relative importance of stakeholder groups to the firm's business as a whole varies both within firms and across firms.

H_5: There is a positive association between perceived stakeholder importance and the volume of CED.

H_6: There is a positive association between the extent to which senior management is directly involved in formulating environmental policy and the volume of CED.

Hypothesis H_4, although not a test of association, is relevant in the context of the model of stakeholder theory being explored here (see Figure 6.2, Chapter 6) because it explores intra-firm stakeholder importance. In this context, stakeholder pressure on business organizations may be perceived as occurring on three different levels: (i) in aggregate, i.e. from stakeholder groups as a whole; (ii) individually, i.e. from individual stakeholder groups; and (iii) at a sub-aggregate level from several different stakeholder groups in combination, i.e. 'clusters' of stakeholder groups. In all three cases, it is posited that there is a positive association between stakeholder importance and CED. Hypothesis H_4 examines the extent of intra-stakeholder importance for the sample of 90 Benelux and German companies. Hypotheses H_5 and H_6 explore the association between stakeholder importance and CED on the three different levels previously described. The model is formally specified in equation (2) below, where: CED_{cy7} denotes the transformed value of the volume of CED made by company *c* in 1995 (year 7 = $_{y7}$), α_{0y7} is the intercept, $STIMP_{cy7}$ denotes the relative importance of stakeholder group *s* for company *c* in 1995, and e is the random error term[19]:

$$CED_{cy7} = \alpha_{0y7} + \alpha_{sy7}STIMP_{cy7} + e_{cy7} \qquad (2)$$

9.6.1 Stakeholder importance

Hypothesis H_4 seeks to assess intra-firm stakeholder importance, i.e. whether the relative importance of stakeholder groups differs from one group to another within the firm. Conversely, the null hypothesis is that stakeholder groups are perceived by management to be homogeneous, i.e. that equal weightings are given to the different stakeholder groups. Respondents to the questionnaire were asked to score, *inter alia*, (i) stakeholder importance and (ii) their extent of direct engagement with stakeholder groups, using a rank-order Likert scale consisting of five points ranging from not very important to very important and very little engagement to significant engagement, respectively[20]. Details of the questionnaire, including the response rate, were provided in Chapter 8 (Section 8.15) above. Of the 90 companies included in the study, 32 completed the questionnaire, all of which disclosed some environmental information in 1995. These 32 companies are highlighted in the list of sample companies at Appendix 4. The primary variable for testing the managerial model of stakeholder theory in this study is management's perception of stakeholder importance in relation to the firm's business as a whole. However, the variable 'extent of direct engagement' is used here as an alternative, support proxy for stakeholder importance to reinforce the validity of the model. In other words, the extent to which the sample companies are directly engaging with their different stakeholder groups is seen as a physical manifestation of underlying perceptions of stakeholder importance in a general business context. For these purposes, direct engagement is defined as face-to-face contact through such channels as discussion groups, open days, public meetings, consultations and partnerships. Table 9.8 below provides a summary comparison of the mean scores and rankings of both relative importance and extent of direct engagement in relation to the 32 Benelux and German companies which completed the questionnaire[21].

Table 9.8
Relative importance and extent of direct engagement with stakeholder groups

Stakeholder group	Relative importance			Extent of engagement		
	Mean	Std Dev	Ranking	Mean	Std Dev	Ranking
Shareholders	4.52	0.561	1	4.32	0.653	2
Employees	4.44	0.658	2	4.34	0.745	1
Customers and Consumers	4.29	1.006	3	4.00	1.061	3
Public authorities	4.22	0.832	4	3.88	1.023	4
The Media	3.75	0.968	5	3.81	1.120	5
Trade Creditors and Suppliers	3.41	1.043	6	3.69	1.310	6
Neighbours and local communities	3.26	1.095	7	3.22	1.184	7
Industry and Trade Associations	3.13	0.718	8	3.16	1.020	8
Science and education	3.06	1.294	9	3.09	1.174	9
Environmental organizations	2.72	1.068	10	2.84	1.003	10
Non-participatory owners & lenders	2.69	1.117	11	2.79	1.063	11
Other pressure groups and NGOs	2.41	1.160	12	2.31	0.931	12

Notes: This table shows the means scores and resultant rankings for (a) stakeholder importance and (b) extent of direct engagement for organizational stakeholders. Where: mean = mean score based on responses to a mailed questionnaire in which respondents were asked to score their responses on the basis of a rank-order five-point Likert scale; Std Dev = Standard deviation. Rankings represent a simple integral ordering of stakeholder groups according to their mean scores in each case, the highest mean score being accorded a ranking of one, the second highest mean score a ranking of two, and so on.

A number of key observations may be made on the basis of the information presented in Table 9.8. Firstly, management do not perceive all stakeholders groups as homogeneous, the mean scores for each stakeholder group showing a wide variation from a highest score of 4.52 for shareholders to a lowest score of 2.41 for pressure groups and other NGOs other than environmental groups[22]. Secondly, these different groups would appear to fall into clusters, the first cluster being what might be termed "primary" stakeholders, comprising shareholders, employees, customers and consumers and public authorities including government. The second cluster of "secondary" stakeholders includes the media, suppliers, neighbours and local communities, industry associations and science and education. The third cluster, comprising what appear to be the "least important" stakeholder groups, comprises environmental organizations, other NGOs and pressure groups, and lenders and bondholders. These findings are perhaps not surprising given that large, publicly-listed business organizations not only have a legal and fiduciary duty to their shareholders in the first instance, but also depend heavily on customers and consumers as well as their employees to sell their products and services in the market place. The primacy of shareholders as reported in Table 9.8 is also consistent with Wilmhurst and Frost's (2000) study which reported shareholder and investor rights to information as being the most significant influence on the decision to disclose environmental information and that of Ullmann (1985) who reports shareholders as being the primary user of the corporate annual report as a means of reducing uncertainty. Similarly, the relative importance of public authorities including government could be explained by the latter's ability to impact significantly on a firm financially through such mechanisms as legal requirements and regulations, including taxation, and licensing

requirements and restrictions (e.g. in relation to environmental issues). Conversely, the relatively low scores given to non-governmental organizations (NGOs) and pressure groups suggests that large companies do not perceive these stakeholders as important in the context of their businesses as a whole. The relatively low ranking of non-participatory owners and creditors, such as bondholders, is particularly interesting in the context of EAT as explored in Section 9.5 above. One possible interpretation is that non-participatory owners and creditors are perceived as having a narrow set of economic concerns, their wants and needs being satisfied through the ability of the firm to meet its financial and other covenanted obligations under the terms of any lending agreement[23]. Such a perspective would be consistent with the results reported under EAT above where no association could be established between 'key market' variables under the monitoring and contracting costs hypothesis and CED. It is also consistent with the findings of Wilmhurst and Frost (2000) who report a low ranking of importance attached to financial institutions in the decision to disclose environmental information, the authors suggesting that the information needs of this stakeholder group may not be the primary objective of annual report preparers.

Thirdly, it may be suggested that the relative importance of the various stakeholders groups provides some insights into the degree to which these groups are perceived as able to exert economic and socio-political influences on the business organization. In an *economic* context, consumers, customers and employees are clearly able to affect *directly* the organization's profitability and cash flow, as are shareholders in relation to the performance of its quoted ordinary shares. In a *social-political* context, it would appear the public authorities, the media and neighbours and local communities are perceived as being relatively more important than environmental pressure groups and other NGOs[24]. These findings are consistent with those of Wilmhurst and Frost (2000) who found the concerns of environmental lobby groups to be of relatively little importance to management in terms of the factors influencing their decision to disclose environmental information. Both the findings of the present study and that of Wilmhurst and Frost (2000) are particularly interesting when contrasted with those of Tilt (1994) whose study of environmental pressure groups in Australia found that these groups do in fact utilise the contents of corporate annual reports. This point is returned to in Section 9.7 below when looking at the results of the present study's investigation into the activities and perceptions of European environmental pressure groups. Fourthly, the results presented in Table 9.8 also suggest that, despite the 'coming of the greens' and an upsurge in the popularity of green politics and pressure groups more generally in the 1990s, environmental groups, non-governmental organizations (NGOs) and other pressure groups are not perceived by the management of large Benelux and German companies as being important, in a general business context, relative to that of other stakeholder groups.

Lastly, looking at the extent to which large Benelux and German companies engage directly with their various stakeholder groups, Table 9.8 suggests that the extent to which corporate management directs efforts towards engaging with stakeholder groups may be linked to the relative importance of a particular stakeholder group. The fact that direct engagement was defined in socio-political terms (i.e. face-to-face contact) rather than on a legal or 'nexus of contracts' basis, may be significant in this context. As shown by the respective rankings of relative importance and extent of engagement (Table 9.8), those stakeholder groups which were ranked as being the most important to the business as a whole were also ranked as being the most engaged with directly. To test statistically the strength of the correlation between

these two variables, a two-tailed bivariate correlation was performed by running the Pearson's standard product moment (parametric) and Spearman's rho rank correlation (non-parametric) tests with the mean scores of relative importance and extent of engagement, respectively, for the 12 stakeholder groups as variables[25]. The results of this test are presented in Table 9.9. To improve the external validity of the results, this test was also performed using mean values based on the responses of a larger sample of 220 companies which also included companies from the Nordic countries (Denmark, Finland, Norway and Sweden), Switzerland and the UK (details of these companies can be found in Chapter 8). For both samples, the correlation coefficients were close to one and the *p*-values below 0.0005, providing evidence of a strong correlation between stakeholder importance and extent of direct stakeholder engagement.

Table 9.9
Comparison of relative importance and extent of direct engagement with stakeholder groups (n = 12)

	Benelux & German companies		European companies	
	t-statistic	*Significance*	*t-statistic*	*Significance*
Pearson's product moment correlation	0.975	$p <$ **0.0005**	0.858	$p <$ **0.0005**
Spearman's rho rank correlation	0.993	$p <$ **0.0005**	0.799	$p <$ **0.0005**

Notes: This table shows the correlation coefficients and *p*-values for a two-tailed bivariate correlation using Pearson's standard product moment (parametric) and Spearman's rho rank correlation (non-parametric) tests, respectively, when run against the overall mean scores for relative importance and extent of engagement, respectively, of 12 stakeholder groups. Scores in each case were based on the responses to a questionnaire sent to a sample of European companies, including the Benelux and German companies which form the main sample for the study.

To test hypothesis H_4, differences between and across companies in the two variables 'stakeholder importance' and 'extent of direct engagement' were measured by running a special MANOVA test using the General Linear Model (GLM) Repeated Measures procedure within SPSS (Norusis and SPSS, 1988)[26]. To perform this test requires a full complement of responses, ignoring all the responses of any company for which at least one of the 12 within-subject factors (i.e. stakeholder groups) was missing. This reduced the number of useable responses to 29 (i.e. 32 per cent of the sample) as three of the companies which provided positive responses did not complete all parts of the respective question in the questionnaire. Consequently, the resulting mean and standard deviation values for each stakeholder group are slightly different from those given in Table 9.8 above. To improve the external validity of the results, this test was also performed for the wider European sample. The results are summarised in Table 9.10. These results provide strong support for the alternative hypothesis under H_4 and thus the null hypothesis can be rejected. In all cases, multivariate tests using Pillai's Trace and Wilks' Lambda statistics yielded both a high *F*-statistic and a *p*-value below 0.0005, supporting the alternative hypothesis (Norusis and SPSS, 1988)[27]. Thus, there is a statistically significant difference between both (i) the relative, perceived importance of the 12 stakeholder groups and (ii) of the extent to which management directly engages with these different groups. Based on this evidence, it may be

Table 9.10
Test of differences in stakeholder importance and extent of engagement with stakeholders using MANO

Stakeholder Group:	Shareholders	Non-participatory owners and lenders	Employees	Trade Creditors and suppliers	Customers & consumers	Industry & Trade Assoc.	Public authorities	Neighbours & Local Comm.	T
Panel A: Benelux and German companies (n= 29)									
Stakeholder importance									
F-statistic 17.194									
p-value **< 0.0005**									
Mean	4.500	2.750	4.500	3.500	4.393	3.143	4.250	3.464	
Std. Error	0.109	0.210	0.109	0.182	0.173	0.133	0.160	0.174	
Stakeholder engagement									
F-statistic 8.071									
p-value **< 0.0005**									
Mean	4.310	2.793	4.414	3.724	4.069	3.207	3.966	3.379	
Std. Error	0.123	0.201	0.127	0.237	0.178	0.182	0.175	0.201	
Panel B: Extended sample of European companies (n = 79)									
Stakeholder importance									
F-statistic 38.194									
p-value **< 0.0005**									
Mean	4.408	3.132	4.395	3.395	4.421	3.000	4.158	3.632	
Std. Error	0.098	0.125	0.088	0.104	0.110	0.094	0.094	0.124	
p-value **< 0.0005**									
Stakeholder engagement									
F-statistic 31.294									
p-value **< 0.0005**									
Mean	4.266	2.949	4.380	3.570	4.165	3.291	3.924	3.481	
Std. Error	0.101	0.130	0.087	0.127	0.107	0.097	0.106	0.114	

Notes: This table shows the results of the General Linear Model (GLM) Repeated Measures MANOVA test when run ag
importance' and 'extent of direct engagement', respectively, for each of the 12 stakeholder groups listed in questions 1 and quest
samples of (i) Benelux and German companies (n = 29) and (ii) a wider sample of European companies (n= 79). Where: mean = r
point Likert scale from 1 to 5; Std Error = Standard error; *F*-statistic = scores for multivariate test using Pillai's Trace and Wilk
values are shown in bold. All statistics are based on untransformed (i.e. raw) data.

suggested that the management of large European companies do not perceive the different stakeholders as a homogeneous bunch. Whether these intra-firm differences in perception also lead to differences in disclosure behaviour across firms in relation to CED is the subject of the next section.

9.6.2 Stakeholder importance and environmental disclosure

The putative association between stakeholder importance and CED, as explored here, is that companies which perceive stakeholder groups to be more important (either collectively or individually) provide *greater* volumes of environmental disclosure in comparison to other companies (hypothesis H_5 above). This association is still very much under-researched within the CSR literature. The method adopted in the present study is to explore this association using a number of different approaches, seeking out both associations and non-associations towards greater understanding of the influence of stakeholder groups on CED. The first approach involves an investigation of the association between variations in the levels of importance attached to stakeholders as a whole (i.e. collectively, not distinguishing between the different groups) across companies and variations in the volume of CED. The second approach investigates the same association but this time by looking at individual stakeholder groups. The third approach explores this association in relation to various 'clusters' of stakeholder groups. In each case, data relating to stakeholder importance is based on replies to the questionnaire to companies which were received during the course of 1998. These responses were interpreted as relating to the period closest to that of the study (i.e. 1995). Thus, all of the hypotheses explored below have been applied using 1995 CED data only, unless otherwise stated[28].

(i) Stakeholder groups as a whole

The alternative hypothesis under this test is that there is a positive association between stakeholder importance for stakeholders *collectively* and the volume of environmental disclosure. This test was carried out using the univariate analysis of variance (ANOVA) test for the 32 companies that completed the questionnaire, running the overall mean value of stakeholder importance for each company against 1995 CED data only. Stakeholder importance was measured using a rank-order five-point Likert-scale, where 1 = very little and 5 = significant. The results are presented in Table 9.11.

Table 9.11
Association between stakeholder importance (mean values) and total CED (1995 only, n = 32)

Stakeholder group	Regression Coefficient (Standardized = Beta)	t-statistic	*p*-value	Adjusted *R*-squared
All stakeholders collectively	+ 0.448	2.746	**0.005**	0.174

Notes: This table shows the value for the regression coefficient, *t*-statistic, *p*-value (one-tailed probabilities) and adjusted *R*-squared for environmental disclosure ("Total CED") for 1995 only when run against mean values for the importance rating of stakeholder groups as a whole for the 32 companies which completed the questionnaire, using ANOVA. The regression coefficient indicates the direction of the relationship, where "+" indicates a positive association. All tests were run against transformed values for CED.

These results support the alternative hypothesis with a probability statistic (*p*-value) of 0.005 and thus the null hypothesis can be rejected. Moreover, the size of the regression coefficient and the *t*-statistic, both being significantly different from zero, suggest that these two variables (environmental disclosure and stakeholder importance) are highly correlated with one another. Moreover, the adjusted *R*-squared value of 0.174 suggests that a not insignificant proportion of the variability in disclosure across firms can be explained by variability in stakeholder importance across firms[29]. Thus, these results suggest the existence of a general association between stakeholder importance and CED across firms, with those companies which perceive stakeholders to be more important disclosing more CED, compared to other companies[30].

(ii) Individual stakeholder groups

The results presented above, however, do not explore the influence of *individual* stakeholder groups on CED. Recent evidence provided by Wilmhurst and Frost (2000), for example, offers some support for the contention that management takes into account the perceived, relative importance of different stakeholder groups when considering what environmental disclosure to provide in the annual report. The specific influence of stakeholder groups on CED was therefore explored by testing the association between differences in the relative importance attached to individual stakeholder groups and variations in volume of CED across firms. For these purposes, a series of separate regressions was run using the univariate analysis of variance (UNIANOVA) test to regress the disclosure variable "Total CED" on the importance ratings of each stakeholder group for the 32 companies which provided useable responses. The results of each regression are summarised in Table 9.12 below[31].

As shown in Table 9.12, all of the regression coefficients are greater than zero, indicating a positive association between stakeholder importance and environmental disclosure in the case of each of the 12 stakeholder groups. However, only some of the regression coefficients are significant, that in the case of shareholders being of such size as to suggest almost no correlation. In the case of seven stakeholder groups this association was shown to be statistically significant (at 5 per cent). The results presented in Table 9.12 indicate a possible *specific* influence of stakeholder importance on CED, i.e. an influence attributable to specific individual stakeholder groups, some groups being more influential than others. However, this specific effect may be overshadowed by a *general* effect, as evidenced by the results presented in Table 9.11 above. In other words, whilst some individual stakeholder groups may influence the volume of CED, there may be a general 'stakeholder importance' effect based on the perceptions of management in relation to stakeholders as a whole. The latter implies that if company A perceives stakeholder group 1 to be more important compared to the perceptions of company B, then company A is also more likely to perceive stakeholder group 2 to be more important compared to company B. The data presented in Tables 9.11 and 9.12 do not permit an evaluation of the extent to which the reported associations with CED are attributable to these specific and general influences, respectively. A reliability test was therefore performed, based on the responses of the 32 companies to question 1 of the questionnaire for all stakeholder groups, to measure the extent of inter-item correlation[32]. The resulting reliability coefficient (Alpha) of 0.82 indicates a high degree of inter-item correlation amongst the 32 companies. This suggests that the general stakeholder importance effect is stronger than the specific stakeholder importance effect, although it is evident from looking at the betas that there are differences (Table 9.12).

Table 9.12
Association between stakeholder importance (individual groups) and total CED (1995 only, n = 32, separate regressions)

Stakeholder group	Regression Coefficient (Beta)	*t*-statistic	*p*-value
Shareholders	+ 0.001	0.007	0.497
Non-participatory owners & lenders	+ 0.217	1.154	0.130
Employees	+ 0.326	1.189	**0.034**
Trade Creditors & Suppliers	+ 0.002	0.010	0.497
Customers and Consumers	+ 0.016	0.084	0.467
Industry & trade associations	+ 0.240	1.329	**0.049**
Public authorities	+ 0.451	2.765	**0.005**
Neighbours and local communities	+ 0.548	3.527	**<0.0005**
The Media	+ 0.366	2.152	**0.020**
Environmental organizations	+ 0.381	2.258	**0.015**
Other pressure groups and NGOs	+ 0.370	2.184	**0.019**
Science and education	+ 0.275	1.568	0.064

Notes: This table shows, for each regression, the value for the regression coefficient, *t*-statistic and *p*-value of environmental disclosure ("Total CED") for year 1995 only when run against values of the importance rating of *each* stakeholder group for the 32 companies which completed the questionnaire, using UNIANOVA. All *p*-values are one-tailed probabilities. The regression coefficient (+/-) indicates the direction of the relationship, where "+" indicates a positive association. All tests were run against transformed values for CED. Significant (at 5%) *p*-values are shown in bold.

The results presented in Table 9.12, when compared to the rankings of stakeholder groups as provided in Table 9.8 above appear, *prima facie*, contradictory. The more important stakeholder groups in relation to the firm's business as a whole, (i.e. shareholders) appear to have little or no association with variations in the level of environmental disclosure. Conversely, those stakeholder groups which are ranked lower down in order of importance (e.g. environmental groups) appear much more strongly associated with variations of environmental disclosure across firms[33]. One possible interpretation is that whilst the perceived importance of different stakeholder groups varies within firms, these differences do not significantly influence CED. In other words, CED is influenced more strongly by a general perception of stakeholder importance compared to the relative importance of individual stakeholder groups. Further analysis of the possible influence of stakeholder groups on CED is provided in Tables 9.13 and 9.14 below.

Table 9.13 summarises the results of an ANOVA test run against the volume of environmental disclosure for 1995 only, using the responses of the 32 companies in relation to 'stakeholder importance' and 'extent of direct engagement', respectively. For this test, the actual values given by each respondent in relation to all 12 stakeholder groups were entered as separate covariates. Panel A of Table 9.13 provides summary statistics for the model as a whole while Panel B provides details of the regression coefficients and probabilities for each stakeholder group. For the model as a whole, the values reported in Panel A provide further support for the alternative hypothesis under H_5 (see above), the *F*-values indicating a positive association and the *p*-values being statistically significant (at 5 per cent) in both cases. The adjusted *R*-squared values of 0.55 for 'stakeholder importance' and 0.41 for 'extent of direct

stakeholder engagement', respectively, suggest that this variable may account for a significant proportion of the variability in environmental disclosure across Benelux and German companies[34]. The regression coefficients (Panel B of Table 9.13) in relation to each stakeholder group vary in size and direction, supporting the viewpoint that these stakeholder groups are not perceived by management as homogeneous[35].

Table 9.13
Association between levels of stakeholder importance/stakeholder engagement and total CED (1995 only, n = 32)

Stakeholder group	Stakeholder importance			Stakeholder engagement		
Panel A - Model Summary	F-statistic	*p*-value	Adjusted *R*-squared	F-statistic	*p*-value	Adjusted *R*-squared
	3.706	**0.005**	0.546	2.614	**0.018**	0.409
Panel B – Coefficients	Regression Coefficient (Beta)	*t*-statistic	*p*-value	Regression Coefficient (Beta)	*t*-statistic	*p*-value
Shareholders	- 0.582	- 3.123	**0.003**	+ 0.032	0.162	0.437
Non-participatory owners & lenders	+ 0.080	0.393	0.350	- 0.409	- 1.961	**0.034**
Employees	+ 0.582	2.311	**0.017**	+ 0.039	- 0.202	0.421
Trade Creditors & Suppliers	+ 0.154	0.788	0.221	- 0.370	- 1.418	0.088
Customers and Consumers	- 0.583	- 2.485	**0.012**	- 0.119	- 0.582	0.285
Industry & trade associations	- 0.195	- 1.166	0.131	- 0.258	- 1.267	0.112
Public authorities	- 0.021	- 0.097	0.462	+ 0.155	0.578	0.286
Neighbours and local communities	+ 0.720	3.466	**0.001**	+ 0.583	2.451	**0.013**
The Media	+ 0.393	2.063	**0.029**	+ 0.078	0.466	0.324
Environmental organizations	- 0.293	- 1.108	0.142	+ 0.095	0.413	0.343
Other pressure groups and NGOs	- 0.023	- 0.094	0.466	+ 0.442	1.703	0.054
Science and education	+ 0.114	0.478	0.340	+ 0.045	0.222	0.414

Notes: This table shows the *F*- and *t*-statistics and *p*-values for the regression coefficient of environmental disclosure ("Total CED") year 1995 only for the model and for each stakeholder group run when run against the 32 respondents' ratings for 'importance' and 'extent of engagement', respectively,using analysis of variances (ANOVA). Regression coefficients (+/-) indicate the direction of the relationship, where "+" indicates a positive association and "-" a negative association. All *p*-values are one-tailed probabilities. Significant (at 5%) *p*-values are shown in bold. All tests were run against transformed values for CED.

Table 9.14 below summarises the responses for the sample of Benelux and German companies and the wider sample of European companies, respectively, to question 15 of the questionnaire to companies. This question asked respondents to indicate the extent to which their firm's *voluntary* communication of environmental information is aimed at meeting the needs and/or interests of the 13 different stakeholder groups listed therein, using a rank-order five-point Likert-scale, where 1 = very little and 5 = significant. These 13 stakeholder groups mirror those referred to previously except for the inclusion on this occasion of management as a specific stakeholder group[36]. Rankings are presented to provide an indication of the relative priority of stakeholders in this context. The figures relating to the wider sample of European companies, which includes the Benelux and German companies, serve to indicate how the sample of Benelux and German companies compares to a more representative sample of European companies[37].

Table 9.14
Extent to which the firm's voluntary communication of environmental information is aimed at stakeholders

Stakeholder group	Benelux and German companies (n = 32)			European companies (n = 87)		
	Mean	Std Dev	Ranking	Mean	Std Dev	Ranking
Employees	4.13	0.671	1	4.30	0.655	1
Public authorities	4.10	0.790	2	3.85	1.035	4
Management	4.06	0.629	3	4.19	0.630	2
Customers & Consumers	3.90	1.044	4	3.89	1.030	3
The Media	3.77	1.175	5	3.67	1.072	6
ENGOs	3.65	1.226	6	3.53	1.197	7
Neighbours & local commun.	3.50	1.137	7	3.51	1.203	8
Shareholders	3.48	1.184	8	3.73	1.118	5
Industry & Trade Associations	3.07	0.907	9	2.93	1.022	13
Science and education	3.00	1.050	10	2.96	1.138	11
Trade Creditors and Suppliers	2.94	1.237	11=	3.01	1.153	9
Other pressure groups & NGOs	2.94	1.365	11=	2.96	1.217	10
Non-part. owners and lenders	2.83	1.037	13	2.96	1.125	12

Notes: This table shows the means scores and resultant rankings for extent to which the firms' voluntary communication of environmental information is aimed at different stakeholder groups. Where: mean = mean score based on responses to a mailed questionnaire in which respondents were asked to score their responses on the basis of a rank-order five-point Likert scale; Std Dev = Standard deviation. Rankings represent a simple integral ordering of stakeholder groups according to their mean scores in each case, the highest mean score being accorded a ranking of one, the second highest mean score a ranking of two, and so on.

Table 9.14 is particularly instructive in terms of what it reveals about the targeted stakeholder groups. Based on these results, environmental disclosure would appear to be targeted at employees, public authorities and the management itself. Conversely, such disclosures would not appear to be targeted at trade creditors and suppliers, pressure groups and NGOS, and non-participatory owners and lenders. These findings are broadly consistent with those of Spencer-Cooke (1994) who found employees, shareholders and public authorities to be the

most important target audiences for environmental information provided by firms, whilst financial analysts were not viewed as a priority audience[38]. To assess whether differences in the extent of voluntary communication of environmental information between the different stakeholder groups are statistically significant, a MANOVA test under the General Linear Model (GLM) Repeated Measures procedure (Norusis and SPSS, 1988) was run for the sample Benelux and German companies[39]. This regression had a *F*-statistic of 6.723 and a *p*-value of <0.0005 under both the Pillai's Trace and Wilks' Lambda multivariate tests (Norusis and SPSS, 1988), indicating that variations in management's voluntary communication of environmental information to stakeholder groups is statistically significant (at 5 per cent). A further test was performed to test the strength of the association between the overall mean values of the 32 companies' responses on communication of environmental information and environmental disclosure, the hypothesis being that there would be a positive association between the two. The results of the linear regression are shown in Table 9.15, with a *t*-value of +0.512 and a *p*-value of 0.0015, providing evidence of a strong positive correlation between these two variables. The latter results appear to reinforce the general stakeholder importance hypothesis, i.e. even though there are significant *intra-firm* differences in the extent to which a firm's environmental disclosure was directed at the different stakeholder groups, CED is more strongly influenced by management's concern at meeting the information needs of stakeholder groups as a whole.

Table 9.15
Association between the extent to which communication of environmental information is intended to meet stakeholders' needs and/or interests and total CED (1995 only, n = 32)

Stakeholder group	Regression Coefficient (Standardized = Beta)	*t*-statistic	*p*-value	Adjusted *R*-squared
All stakeholders collectively	+ 0.512	3.209	**0.0015**	0.237

Notes: This table shows the value for the regression coefficient, *t*-statistic, *p*-value (one-tailed probabilities) and adjusted *R*-squared for environmental disclosure ("Total CED") for 1995 only when run against mean values for the extent to which communication of environmental information is intended to meet stakeholders' needs and/or interests as a whole for the 32 companies which completed the questionnaire, using linear regression (ANOVA). The regression coefficient indicates the direction of the relationship, where "+" indicates a positive association. All tests were run against transformed values for CED

(iii) Clusters of stakeholder groups

The third and final approach to investigating the association between variations in importance attached to stakeholders and variations in the volume of CED involves looking at "clusters" of stakeholder groups rather than such groups individually or as a whole. "Clusters" in this context refers to the grouping together of several different stakeholder groups and treating them as one for the purposes of empirical analysis. Although the identification of such "clusters" is still very much under-researched within the stakeholder theory literature, one possible approach is to use the data provided in Table 9.8 above where stakeholder groups were ranked by respondent companies in relation to their importance to the goals of the organization as a whole. This approach permits an investigation of the disclosure/stakeholder importance relationship amongst stakeholder groups that are perceived as being of more equal importance in relation to the firm's business as a whole. Based on the respective scores

under the rank-order Likert scale, consisting of five points ranging from not very important to very important (see Table 9.8 above), the 12 stakeholder groups were combined into three clusters as follows:

- 'Most important' stakeholder groups (having a mean score between 4.00 and 4.99) = shareholders; employees; customers and consumers; public authorities;
- 'Important' stakeholder groups (mean score between 3.00 and 3.99) = the media; trade creditors and suppliers; neighbours and local communities; industry and trade associations; science and education; and,
- 'Least important' stakeholder groups (mean score less than 3.00) = environmental organizations; non-participatory owners and lenders; other pressure groups and NGOs.

In addition, a further cluster of stakeholder groups was formed to explore the association between those stakeholder groups generally perceived to be most concerned about environmental issues and the extent of environmental disclosure. These 'key environmental stakeholders' comprised four stakeholder groups, viz.: employees, neighbours and local communities, environmental pressure groups and other NGOs[40]. An analysis of variance (ANOVA) test was performed by regressing the disclosure variable "Total CED" for 1995 only on the mean importance rating for each cluster in the case of the 32 companies that provided useable responses. The results of each set of regressions are summarised in Table 9.16 below. In this case, the mean importance rating represents the mean value of responses of each of the 32 companies for each stakeholder cluster, which was regressed against CED. The results for all four stakeholder clusters support the hypothesis that variability in environmental disclosure is positively associated with stakeholder importance as the regression coefficients are all positive and large, the *t*-statistics are all large and the corresponding *p*-values are significant (at 5 per cent). The last of the four stakeholder 'clusters', that of 'key environmental stakeholders', provides the strongest support for the alternative hypothesis with a *p*-value of 0.002 and an adjusted *R*-squared of 0.23.

Table 9.16
Association between stakeholder importance and total CED for stakeholder 'clusters' (1995 only, n = 32)

Stakeholder 'cluster'	Regression Coefficient (Beta)	*t*-statistic	*p*-value	Adjusted *R*-squared
'Most important' stakeholders	+0.381	1.828	**0.034**	0.070
'Important' stakeholders	+0.400	2.393	**0.012**	0.132
'Least important' stakeholders	+0.379	2.243	**0.016**	0.115
'Key environmental' stakeholders	+0.508	3.226	**0.002**	0.233

Notes: This table shows, for each regression, the value for the regression coefficient, *t*-statistic, *p*-value and adjusted *R*-squared for environmental disclosure ("Total CED") for 1995 only when run against mean values for the importance rating of stakeholder 'clusters' for the 32 companies which completed the questionnaire,using ANOVA. All *p*-values are one-tailed probabilities. The regression coefficient indicates the direction of the relationship, where "+" indicates a positive association. All tests were run against transformed values for CED. Significant (at 5%) *p*-values are shown in bold.

At first glance, these latter statistics appear to contradict the alternative hypothesis under H_5 given that the four 'key environmental stakeholders' (i.e. employees, neighbours and local communities, environmental organizations, and other pressure groups and NGOs) had quite different mean scores and rankings for stakeholder importance, with some of these stakeholder groups coming quite low down in the rankings (Table 9.8). One possible interpretation is that the disclosure/stakeholder importance relationship is sensitive to *socio-political influences*. To explore the disclosure/stakeholder importance relationship further, an analysis of variance (ANOVA) test was performed by regressing the disclosure variable "Total CED" for 1995 only on the mean importance rating (in relation to the business as a whole) for a cluster of five stakeholder groups which may be classed as *socio-political*, i.e., public authorities, including governments and local authorities; neighbours and local communities; the media; environmental organizations; other pressure groups and NGOs[41]. The results of this regression are summarised in Table 9.17 below. These results suggest that the disclosure/stakeholder importance relationship may indeed be sensitive to socio-political influences, as the regression coefficient is positive, the *t*-statistic is large and the corresponding *p*-value significant (at 5 per cent).

Table 9.17
Association between stakeholder importance and total CED for socio-political stakeholders (1995 only, n = 32)

Regression Coefficient (Beta)	*t*-statistic	*p*-value	Adjusted *R*-squared
+0.561	3.708	**<0.0005**	0.291

Notes: This table shows the value for the regression coefficient, *t*-statistic, *p*-value (one-tailed probabilities) and adjusted *R*-squared for environmental disclosure ("Total CED") for 1995 only when run against mean values for the importance rating of five stakeholder groups (i.e. public authorities, neighbours and local communities, the media, environmental organizations, other pressure groups and NGOs) collectively, for the 32 companies which completed the questionnaire, using ANOVA. The regression coefficient indicates the direction of the relationship, where "+" indicates a positive association. All tests were run against transformed values for CED.

9.6.3 Influence of top management

Under the managerial model of stakeholder theory, it is argued that management, as one stakeholder group, are likely to have a key impact upon the company's environmental policies, programmes, and communications to society. The influence of top management in the context of social and environmental disclosure is well known. Freedman and Stagliano (1992), for example, argue that although it is probable that no one single motivation underlies management's decision for making social disclosure, such disclosure is, for the most part, a function of the attitude of top management towards its stakeholders. Any exploration of stakeholder theory would therefore be deficient without at least considering the possible association between the influence of top management and variations in environmental disclosure. Measuring this influence obviously creates some problems given that no one variable is likely to capture the numerous ways in which top management influences a company's environmental disclosure. For example, there may be cultural influences whereby top management seeks to create a culture within which employees and managers are encouraged to be pro-active on environmental issues, or management may become more directly involved in decisions on what environmental information to include in the company's

reports to shareholders and the wider society (see, for example, Brophy, 1998; Crane, 1997; Shelton and Shopley, 1997; Welford, 1998).

Nevertheless, one possible way of exploring the influence of top management on environmental disclosure is to look at the extent to which top management is involved in the formulation of a company's environmental policy given the latter's adoption is often the first stage in an organization's systematic and structured approach to environmental, health and safety issues (Hibbitt and Kamp-Roelands, 2001). As Gray *et al.* (1993) have stated:

> *The primary prerequisite for an organization intending to take environmental matters seriously is the development of an environmental policy. This will ... be the principal signal to the internal and external stakeholders of the seriousness (or otherwise) of the organization's intentions with respect to the environment* (p.58).

Using this as a proxy for management's influence on a firm's environmental disclosure strategy, the hypothesis employed here is that there is a positive association between the extent to which top management was directly involved in formulating the firm's environmental policy and environmental disclosure (H_6). Question 8 of the questionnaire to companies asked respondents to indicate whether the company had an environmental policy at group, company or site level. Twenty-nine respondents (out of 32) indicated that the firm had an environmental policy at either group or company level; one company indicated that it had an environmental policy for the main part of its business operations and two others, both German banks, indicated their signatories to UNEP's *Statement by Banks on the Environment and Sustainable Development* launched in 1992. A further question (question 9) asked respondents to indicate the extent to which various internal parties and departments, including top management, had been involved in formulating the firm's environmental policy, using a five-point Likert scale where 1 = very little involvement and 5 = significant involvement. Based on the replies, an ANOVA test was performed by regressing the disclosure variable "Total CED" for 1995 only on the mean values for three stakeholder groups, viz.: (i) the Chief Executive Officer (CEO); (ii) Top Executive Directors, being the President/Chairperson, the CEO and the main executive board of directors; and (iii) Top Executive and Non-Executive Directors. The results of each set of regressions are summarised in Table 9.18 below.

Table 9.18
Association between involvement of top management in the formulation of the company's environmental policy and total CED (n = 32)

Stakeholder group(s)	Regression Coefficient (unstandardized)	*t*-statistic	*p*-value	Adjusted *R*-squared
Chief Executive Officer (CEO)	+0.265	1.454	0.078	0.037
Top Executives Directors	+0.176	0.978	0.168	0.000
Top Executive and Non-executive Directors	+0.204	1.139	0.132	0.009

Notes: This table shows, for each regression, the value for the regression coefficient, *t*-statistic, *p*-value and adjusted *R*-squared for environmental disclosure ("Total CED") for 1995 only when run against mean values for the involvement of each stakeholder group shown in the formulation of the company's environmental policy, using ANOVA. All *p*-values are one-tailed probabilities. The regression coefficient indicates the direction of the relationship, where "+" indicates a positive association. All tests were run against transformed values for CED.

As shown in the table, although the regression coefficients were positive in each case, none of results was statistically significant. Thus, the null hypothesis under hypothesis H_6 cannot be rejected. Whilst top management is likely to be involved in formulating a firm's environmental policy, these results suggest that such involvement does not necessarily influence an organization's environmental disclosure strategy. Further research is needed to gain a better understand the influence of senior management on a firm's CSR/CED disclosure strategy in this context (see, for example, Campbell, 2000)[42].

9.7 Organizational Legitimacy Theory (OLT)

As set out in Chapter 7, OLT places the study of CED predominantly within a *socio-political* context, distinguishing it from that offered by the *economic* lens of economic agency theory (EAT) and the *socio-economic* lens of managerial stakeholder theory (MST). Put simply, OLT posits that the survival of the firm depends on there being a perception amongst the wider society that the values adopted by the firm match society's own values (Gray *et al.*, 1996). To the extent that the firm's *perceived* social values are out of step with those of the societies in which it operates, the firm's legitimacy is said to be under threat (Lindblom, 1994). In response to this 'legitimacy gap', organizations are argued to employ various strategies of legitimation, the aim of which is to close the 'legitimacy gap'. CED is seen as one of the means by which a business organization seeks to maintain, reclaim and reinforce its legitimacy in the face of conflicts and dissention within a society. In this context, CED is depicted as a *reaction* on the part of the organization to a perceived threat to its legitimacy. Thus, whereas MST highlights how stakeholder groups may be important to a business organization from the perspective of the *organization*, legitimacy theory asserts that there are other, equally important tensions in the organization-society relationship within society as a whole. Based on this theoretical framework, the following hypotheses (in alternative form) were identified in Chapter 7 to be explored using OLT:

H_{7a}: There is a positive association between political visibility and the volume of CED.

H_{7b}: There is a positive association between industry environmental sensitivity and the volume of CED.

H_{7c}: The political visibility-disclosure association is stronger in the case of companies operating in environmentally-sensitive industries compared to those operating in less-environmentally sensitive industries.

H_{8a}: There is a positive association between social pressure from environmental groups and the volume of CED.

H_{9a}: There is a negative association between environmental performance and the volume of CED.

$H_{7d, 8b, 9b}$: CED will form part of a corporation's public relations machinery aimed at influencing society's perceptions by biasing disclosures away from information which presents the firm as acting irresponsibly in relation to environment issues.

Where:

(i) political visibility is assumed to be a function of size, as measured by (a) Total Assets, (b) Number of Employees, (c) Capital Employed, and (d) Profit);

(ii) industry environmental sensitivity is related to the sensitivity of an industry's activities to the natural environment;
(iii) social pressure from environmental groups is measured according to the extent of environmental campaigns by these groups; and
(iv) environmental performance is measured using the surrogate of environmental performance ratings by ENGOs.

The putative association between political visibility and environmental disclosure is derived under both EAT (H_1) and OLT (H_{7a}), although the underlying explanation differs in each case according to the respective theoretical framework. As with economic agency theory, alternative, independent measures for industry environmental sensitivity (H_{7b}) were measured based on the perceptions of the companies themselves and of environmental pressure groups using their respective responses to a mailed questionnaire. Hypothesis H_{7c} is tested by comparing the strength of association between political visibility and environmental disclosure for each industry sector, the assertion being that this association is stronger for those companies which operate in the more environmentally-sensitive sectors. Proxies for social pressures from environmental groups (H_{8a}) and environmental performance (H_{9a}), respectively, were obtained using the positive responses received to mailed-questionnaires sent to ENGOs. Outcomes in relation to the two independent measurements of industry environmental sensitivity, the extent of social pressure from environmental groups and environmental performance ratings are provided in the results section below. Details of the research method are set out in Chapter 8. Classification of environmental disclosure according to news type (i.e. 'good' news and 'bad' news) ($H_{7d,\ 8b,\ 9b}$) was made according to protocol rules developed for content analysis, details of which are provided in Chapter 8.

The above set of hypotheses provide a third testable model whereby environmental disclosure is asserted to be positively associated with political visibility and social pressure from environmental groups, and negatively associated with environmental performance. The model is formally specified in equation (3) below, where: CED_{cy} denotes the transformed value of the volume of CED made by company c in year y, α_{0y} is the intercept, $POLVIS_{cy}$ denotes political visibility of type p for company c in year y, $SOPREN_{cy}$ denotes the level of social pressure from ENGOs on companies operating in industry sector i for company c in year y, $ENVPERF_{cy}$ denotes the environmental performance of company c in year y and e_{cy} is the random error term:

$$CED_{cy} = \alpha_{0y} + \alpha_{py}POLVIS_{cy} + \alpha_{iy}SOPREN_{cy} - \alpha_{ey}ENVPERF_{cy} + e_{cy} \qquad (3)$$

Previous discussions under the economic agency and managerial stakeholder theories models of managerial behaviour have focused on, respectively, an economic and a socio-economic analysis of managerial behaviour. In this section, the lens of analysis is drawn back even further to provide a *socio-political* analysis of that behaviour. A detailed exploration of the socio-political perspective was provided previously in Chapters 4 and 7 and thus will not be repeated here. However, it is worth recalling the essential attributes of a socio-political analysis of managerial behaviour in the specific context of environmental disclosure. In short, a recognition of the influences on business organizations of changes within society as a whole gives rise to the notion that there may be an association between manifestations of those changes, such as, for example, the rise in the environmental movement and green politics in the late 1980s and early 1990s, and changes in management behaviour in response to those

changes. Organizational legitimacy theory is seen as a useful heuristic for exploring this putative association because of its focus on the socio-political aspects of society, such as the activities of social activists and lobby groups who seek to question, challenge, and confront the legitimacy of some of the activities or behaviour of particular sections of society. In the context of corporate social and environmental responsibility, for example, as was described above in Chapter 3, there has been a long and, as yet, unresolved debate about the role of business organizations in society, starting with the social and environmental activist movement in the United States in the late 1950s and early 1960s and continuing with the environmental movement within Europe from the late 1980s. The approach adopted in the present study has been to combine empirical and field research, the latter in the form of a postal questionnaire, to explore the association between the perceptions, attitudes and behaviour of environmental groups, as a legitimised section of society (legitimised because of its voluntary funding by, and membership through, society generally) and the disclosure behaviour of the firm's management in relation to environmental issues.

9.7.1 Political visibility

As described in Chapter 7, the political visibility argument under organizational legitimacy theory (OLT) is different from under economic agency theory (EAT), although both theories explore the same putative association. Under EAT, firms of abnormal size or earning excessive profits are seen as vulnerable to political interference, especially from governments and administrations keen to be seen as acting in the 'public interest'. Such firms are said to use various strategies to reduce their political exposure, including spending programmes on social (and environmental) responsibility activities. Social (and environmental) disclosures are assumed to follow from such programmes. Thus, researchers have tested for a relationship between social responsibility disclosures and political visibility (see, for example, Belkaoui and Karpik, 1989; Ness and Mirza, 1991; Trotman and Bradley, 1981). The political visibility argument under OLT is somewhat different. Larger firms, because of their sheer presence in the 'high street' are seen as exposed to pressure from social activist and campaign groups that seek socially responsible behaviour. Politically visible firms are seen as responding to such criticism by employing various legitimation strategies (Dowling and Pfeffer, 1975; Guthrie and Parker, 1990; Lindblom, 1994; O'Donovan, 1999b, 2002; Oliver, 1991 Sethi, 1978, 1990). One such strategy involves the use of social and environmental disclosure to project an image of being socially responsible to reduce or deflect further criticism (the fourth legitimising strategy identified in Chapter 7). This has led researchers to explore the association between larger firms and/or firms operating in socially and environmentally sensitive industries (Campbell, 2001; Deegan and Gordon, 1996; Patten, 1991). Two hypotheses were presented in Chapter 7 that test this association:

H_{7a}: There is a positive association between political visibility and the volume of environmental disclosure (CED) in each of the years 1989 to 1995, inclusive.

H_{7b}: There is a positive association between industry environmental sensitivity and the volume of environmental disclosure in each of the years 1989 to 1995, inclusive.

The first of these hypotheses has already been explored in the section on economic agency theory above where empirical evidence was presented which enabled the null hypothesis to

be rejected. This evidence will therefore not be repeated here[43]. The industry environmental sensitivity-disclosure relationship was investigated using an *a priori* division of industry sectors into 'environmentally sensitive' (ES) and 'less environmentally sensitive' (LES). This approach, whilst arguably defensible, lacks any recourse to the perceptions of those sections of society, viz., the social activists and campaign groups, which may influence the behaviour of political visible organizations in a socio-political context. The perspective being explored here is not one which views these groups as 'stakeholders' within the firm but more in terms of such groups being 'stakeholders' within society as a whole. Hence, the analysis presented here draws back from the firm to consider the relationship between different sections of society, with the business organization as one element within that broader society. Furthermore, the terrain in which these relationships are played out is not seen as settled under some form of legal or contractual arrangement but contested, disputed ground where different factions engage in socio-political struggles exacerbated by institutionalised power inequalities and asymmetries. Thus, even though the responses of business organizations suggest that social activists groups are not very important in relation to the firm's business as a whole (Table 9.8), its direct engagement activities (Table 9.8), or its voluntary communication of environmental information (Table 9.14), there may nevertheless be *indirect* socio-political influences at work which do impact on managerial behaviour in relation to variations in environmental disclosure across firms.

To investigate further the industry-disclosure relationship under hypothesis H_{7b}, field research was undertaken to solicit the views of non-governmental environmental groups (ENGOs) in relation to industry environmental sensitivity. Specifically, these groups were asked to indicate the relative impact which they believe each of the eight industry sectors used in the study has on the natural environment, environmental impact being used as a measure of environmental sensitivity. For these purposes *environmental impact* was defined as including "both direct and indirect and impacts resulting from the extraction, modification, and/or use of natural raw materials, as well as impacts that occur in the manufacture, processing, performance, delivery, end-use and/or ultimate disposal of the industry's products and/or services". Respondents were asked to score their responses on the basis of a rank-order five-point Likert scale where 1 = very little impact and 5 = significant impact. Table 9.19 below provides descriptive statistics of the responses of the ENGOs of the Benelux and German countries, as well as for a wider sample of ENGOs which also included the Nordic, Swiss and UK countries[44], as provided by a MANOVA test under the General Linear Model (GLM) Repeated Measures procedure (Norusis and SPSS, 1988). The latter test was used to evaluate whether the resultant mean values for each industry sector are significantly different overall[45].

The multivariate and univariate tests results reported in Panel A of Table 9.19 below indicate that the mean values of perceived environmental impacts for each sector are significantly different from one another at an overall level, with high F-statistics and significant (at 5 per cent) p-values in all cases[46]. Table 9.19 also summarises the mean values of the responses for each sector, together with the standard error, and rankings based on a simple integral ordering of mean scores, the highest mean score being accorded a ranking of one, the second highest mean score a ranking of two, and so on. Looking specifically at the mean scores and resultant rankings (Panel B of Table 9.19), there are a number of observations worth noting at this juncture. Firstly, the results for the wider sample of European ENGOs mirror closely those of

the Benelux and German ENGOs suggesting that the perceptions of ENGOs from the Benelux and German countries are representative of the views of ENGOs across Europe. Secondly, no sector is perceived as having very little impact on the environment, the lowest mean score of 3.162 and 3.294, respectively, being given to the banking and insurance sector.

Table 9.19
Descriptive statistics and test of differences in relation to ENGOs' perceptions of the environmental impact of industry sectors

	Benelux & German environmental organizations (n = 37)			European environmental organizations (n = 85)		
Panel A – Test results	*F-statistic*	*p-value*		*F-statistic*	*p-value*	
Multivariate test using Pillai's Trace and Wilks' Lambda statistics	13.819	**< 0.0005**		25.055	**< 0.0005**	
Univariate test using Mauchly's test of sphericity in combination with the Huynh-Feldt epsilon	20.506	**< 0.0005**		47.360	**< 0.0005**	
Panel B – Descriptive statistics	*Mean*	*Std. Error*	*Ranking*	*Mean*	*Std. Error*	*Ranking*
Chemicals	4.649	0.097	1	4.776	0.051	1
Extractive	4.568	0.091	2	4.647	0.064	3
Energy Utilities	4.514	0.126	3	4.718	0.066	2
Travel, Tourism & Transport Services	4.216	0.123	4	4.259	0.082	4
Consumer Goods	4.189	0.108	5	4.059	0.083	6
Mechanical Engineering & Metallurgy	4.081	0.119	6	4.106	0.090	5
Retail & Leisure	3.432	0.148	7	3.600	0.099	7
Banks & Insurance	3.162	0.203	8	3.294	0.149	8

Notes: This table provides the results of the General Linear Model (GLM) Repeated Measures MANOVA test when run against the mean values of environmental organizations' views on the extent to which each of the eight industry sectors impacts on the natural environment, "environmental impact" being defined as including both direct and indirect and impacts. Where: Std Error = Standard error; mean = mean score on the basis of a rank-order five-point Likert scale from 1 (very little impact) to 5 significant impact); rankings represent a simple integral ordering of mean scores. Significant (at 5 per cent) *p*-values are shown in bold.

Thirdly, the three sectors judged to have the most impact on the environment are chemicals, extractive and energy utilities, respectively. In prior tests, these three sectors have been assumed to be environmentally-sensitive in comparison to the other sectors. However, both the Benelux/German ENGOs and the European environmental groups perceive the travel, tourism and transport services sector as having greater environmental impact than the mechanical engineering and metallurgy sector, contradicting the earlier assumption (i.e. that the latter sector is "environmentally-sensitive" compared to other sectors) when exploring the industry-size-disclosure relationship. Further, the mechanical engineering and metallurgy sector is itself perceived as less environmentally-sensitive than the consumer goods sector in the case of the Benelux/German ENGOs. Clues as to why these perceptions are held by ENGOs can be found in the annotated notes provided voluntarily by some respondents. In particular, it is apparent that the definition of environmental impacts (see above), which included both direct and indirect impacts, influenced their assessment, especially in the case

of the banking and insurance sector whose investment and funding policies were seen as having a significant indirect impact on the environment[47]. As one respondent stated:

> *Even with better knowledge on these issues, it seems to me very difficult to make useful differentiations! All of them have a tremendous influence on environmental impacts (e.g. CO_2, transportation of persons and goods, treatment of disposals, kinds of investments etc.).*

Similarly, another respondent stated (original emphasis):

> *You have to distinguish direct and indirect, because banks and financial institutions by themselves pollute very little, but they finance mostly very wrong things.*

Notwithstanding this important issue, the responses of ENGOs overall suggest that sectors are perceived as having significantly (in statistical terms) different levels of environmental impact and thus, arguably, provide a useful basis for exploring the industry sensitivity-disclosure relationship in a socio-political context. Thus, to test the association between industry environmental sensitivity and variations in disclosure, i.e. hypothesis H_{7b}, mean values for the disclosure variable ("Total CED") were computed for each industry sector using normalised values. These values were then used in one-tailed bivariate correlation procedures to test for a positive association between mean CED and mean environmental sensitivity based on the perceptions of ENGOs (see Table 9.19 above) at industry group level for each of the seven years of the study and for the data set as a whole[48].

Table 9.20
Coefficients of correlation between industry environmental sensitivity based on perceptions of environmental organizations and total CED

	1989	1990	1991	1992	1993	1994	1995	All years
Benelux/German ENGOs								
Pearson's correlation coefficient	0.788	0.844	0.768	0.731	0.779	0.848	0.465	0.695
p-value	**0.010**	**0.004**	**0.013**	**0.020**	**0.011**	**0.004**	0.123	**<0.0005**
Spearman's rho coefficient	0.714	0.786	0.738	0.714	0.762	0.905	0.405	0.678
p-value	**0.023**	**0.010**	**0.018**	**0.023**	**0.014**	**0.001**	0.160	**<0.0005**
European ENGOs								
Pearson's correlation coefficient	0.834	0.883	0.831	0.775	0.820	0.913	0.526	0.742
p-value	**0.005**	**0.002**	**0.005**	**0.012**	**0.006**	**0.001**	0.090	**<0.0005**
Spearman's rho coefficient	0.833	0.881	0.857	0.810	0.810	0.976	0.524	0.771
p-value	**0.005**	**0.002**	**0.003**	**0.007**	**0.007**	**<0.0005**	0.091	**<0.0005**

Notes: This table shows the correlation coefficients and *p*-values for a one-tailed bivariate correlation using Pearson's standard product moment (parametric) and Spearman's rho rank correlation (non-parametric) tests between the overall mean scores for environmental disclosure ("Total CED") and perceived environmental impacts, respectively, of the eight industry sectors (see Appendix 5 for details). All tests were run against transformed values for CED. Significant *p*-values (at 5 per cent) are shown in bold.

As shown in Table 9.20 above, all of the correlations were positive, with 14 out of 16 having high coefficients and significant (at 5 per cent) *p*-values. These results provide evidence of a positive association between industry environmental sensitivity, when based on the perceptions of environmental groups, and the volume of environmental disclosure and thus the null hypothesis can be rejected. The results for 1995, however, although showing a positive correlation, were not significant. *A priori,* it might be expected that the strongest results would be found for 1995 given that this is the most recent period of the study and thus the one in which any influence of socio-political pressures from ENGOs would be most apparent[49]. However, the more critical issue here concerns the assumptions which underlie environmental sensitivity as explored previously under both EAT and OLT where the eight industry sectors were classified binomially as between environmentally and less environmentally sectors on the basis of general perceptions within the literature.

The results presented in both Tables 9.19 and 9.20 suggest that such *a priori* classifications may not tell the full story, the test results for hypothesis H_{7b} providing evidence which suggests that the relationship between industry sector and variations in environmental disclosure across firms and over time may be subject to socio-political influences emanating from sections of society which, in turn, influence managerial behaviour. In other words, a better understanding of the industry sector-disclosure relationship may be possible through exploring the perceptions of groups in society. This suggests that, in future research at least, more careful consideration may need to be given to the classification of industries in relation to environmental sensitivity.

9.7.2 Environmental sensitivity and size

A second aspect of the industry-size-disclosure relationship that has recently been explored using organizational legitimacy theory is the assertion that this relationship is much more sensitive in the case of environmentally-sensitive sectors than it is for less environmentally-sensitive sectors (see, for example, Deegan and Gordon, 1996; Hackston and Milne, 1996). As size is seen as a proxy for political visibility, this assertion implies that the association between political visibility and variations in environmental disclosure is stronger in the case of companies operating in environmentally-sensitive (ES) industries than for companies operating in less environmentally-sensitive (LES) industries. In other words, size or profit may be a much more important moderator of environmental disclosure for environmentally-sensitive companies than their less environmentally-sensitive counterparts, stated formally at hypothesis H_{7c} (see above).

Essentially, this hypothesis is concerned with the slope or angle of the linear relationship between CED and political visibility. For the association to be stronger in the case of ES companies than for LES companies implies that the slope of the regression line is steeper for ES companies than for LES companies when using political visibility as the coefficient. By definition, the null hypothesis is that the slopes of the two regression lines are parallel to one another, i.e. the difference in the two slopes is close to zero[50]. To test hypothesis H_{7c}, a specific MANOVA command syntax was written which effectively instructs the SPSS programme to provide net values for the difference in slopes of the two linear relationships between political visibility and CED for ES and LES companies, respectively (Norusis and SPSS, 1988). Using this command syntax, a UNIANOVA test was performed by regressing the disclosure variable "Total CED" on each of the four corporate characteristics which serve

as proxies for political visibility for the full sample of 90 Benelux and German firms for each of the seven years of the study. The results of each set of regressions are summarised in Table 9.21 below.

Table 9.21
Comparison of the strength of the relationship between political visibility and total CED for environmentally-sensitive and less environmentally-sensitive companies

Characteristic (x-variable)	1989	1990	1991	1992	1993	1994	1995
Total Assets							
Difference in slopes	-0.054	0.003	0.013	0.032	-0.037	-0.022	-0.049
F-value	0.22	0.00	0.02	0.09	0.09	0.00	0.12
p-value	0.327	0.486	0.441	0.390	0.390	0.492	0.372
Capital Employed							
Difference in slopes	-0.131	-0.098	-0.078	-0.103	-0.147	-0.115	-0.083
F-value	1.05	0.94	0.96	1.79	3.22	2.08	0.43
p-value	0.172	0.185	0.183	0.115	0.062	0.100	0.268
Profits (PBIT)							
Difference in slopes	-0.104	-0.058	-0.059	-0.028	0.124	-0.141	0.019
F-value	0.67	0.61	0.05	0.09	2.48	2.42	0.02
p-value	0.222	0.232	0.245	0.390	0.083	0.085	0.450
Number of employees							
Difference in slopes	0.036	0.059	0.094	0.088	0.091	0.032	0.083
F-value	0.13	0.39	0.60	0.61	0.39	0.08	0.32
p-value	0.364	0.277	0.234	0.232	0.278	0.391	0.296

Notes: This table shows the *F*- and *p*-values, for each regression, when comparing the linear relationship between political visibility and Total CED for environmentally-sensitive less environmentally-sensitive companies, respectively, for each variable for political visibility run against all 90 companies in each year 'Difference in slopes' indicates the net slope of the two regression lines when one is subtracted from the other, a + *ve* indicating that the slope of the regression line for environmentally-sensitive companies is steeper than that for less environmentally-sensitive companies and a –*ve* vice versa. All tests were run against transformed values.

These results do not support the alternative hypothesis and thus the null hypothesis that the slopes of the two regression lines are not different from one another cannot be rejected. Of the 28 values for the 'difference in slopes', 16 are negative indicating that the slope of the regression line for the less environmentally-sensitive companies is *steeper* than that for environmentally-sensitive companies. However, none of these values is significantly different from zero, the *F*-values are relatively small and none of the *p*-values is significant (at 5 per cent), all of which indicates that the two slopes are almost parallel to one another. The present study's findings therefore do not support the hypothesis that the association between political visibility and environmental disclosure is stronger in the case of environmentally-sensitive companies compared to less environmentally-sensitive companies, thus providing a rebuttal to legitimacy theory in this particular context. Given that these results contradict those of previous studies (Deegan and Gordon, 1996; Gray *et al*., 2001; Hackston and Milne, 1996), further research in this area is needed to examine in more detail the influence of other factors, such as culture, for example, on the industry-size-disclosure relationship. For now, extant empirical evidence in support of hypothesis H_{7c} remains no more than equivocal.

9.7.3 Social pressures (environmental campaigns) from ENGOs

Societal pressures or constraints may take different forms – laws and regulations, internal demands from within the organization (values), expectations of investors, employees, customers and consumers, and other stakeholders including non-governmental organizations. Given that social pressure is in part a function and result of the views and activities of various sections of society, the campaigning and lobbying activities of non-governmental organizations (NGOs) arguably represent a powerful source of such pressure in modern Western democracies. Thus, if we accept that campaigning organizations such as environmental pressure groups are one of the sources of social pressures on companies and that such pressures have an impact on companies activities, including their communications to society, then by obtaining a measure of the extent to which ENGOs have conducted campaigns against the companies in the study, it is possible to test the existence of a relationship between *actual* social pressures and CED.

Whilst concern for environmental issues and corporate environmental performance is not necessarily limited to one particular faction within society, the rise in the prominence of environmental pressure groups since the late 1980s as a powerful political lobby group concerned with making corporate entities much more responsible for, and responsive to, environmental issues is well documented (see, for example, Bebbington *et al*., 1994; Elkington 1994, 1997; Tilt, 1994). In the specific context of the environment, it is argued that one of the primary factors influencing a company's response on environmental issues is the growth in awareness and concern for environmental issues in the general community (Deegan and Gordon, 1996; Hines, A., 1991). Moreover, this argument is extended by the claim that if the members of the wider community are becoming more interested in corporate environmental impacts, management is more likely to feel called upon to provide an account to that society of those impacts (Wilmhurst and Frost, 2000).

Deegan and Gordon's (1996) study is important in this context because they report a positive association between increases in environmental disclosure and changes in the membership of environmental pressure groups over time. This positive association is seen as supporting their argument that management uses environmental disclosure as part of a legitimising strategy in response to a perceived change in the norms and values of society as a whole. Wilmhurst and Frost (2000) employ the same argument, suggesting that membership of environmental lobby organizations is a reflection of community concerns and that companies respond to community concerns rather than directly to the concerns of environmental groups. In other words, the values and norms of society as a whole are reflected through their voluntary membership and support for the activities of environmental pressure groups and that business organizations, recognising this connection, respond by increasing their focus on environmental issues to defend, protect and support their legitimacy status. Moreover, while the membership of environmental organizations may be a useful heuristic for exploring community concerns, corporate management is seen as more concerned with appearing to be deferential to community concerns in general rather than to the specific agendas of environmental organizations (Wilmhurst and Frost, 2000).

The latter suggestion could explain the apparent contradiction between, on the one hand, positive correlations between corporate environmental disclosure and the membership of environmental lobby organizations (Deegan and Gordon, 1996), and, on the other, the

relatively low importance afforded by senior management to environmental pressure groups, both in relation to the level of direct engagement (Table 9.8) and the voluntary communication of environmental information (Table 9.14).

The degree to which the membership of environmental lobby groups adequately captures the norms and values of a society has received little detailed analysis in the CSR literature. Rather, it has been assumed to provide a valid proxy for those norms and values. However, field work carried out as part of the present study revealed a large number of environmental groups within certain countries, notably the Netherlands, to be non-membership organizations, such as "Stichting" (i.e. foundations) which are financed by grants from central and local government and other sources of funding. Hence, research based on membership alone in a European context would, by definition, exclude these particular types of organization. Moreover, recent developments in communication technology, notably the Internet and portable telephones, and in the way in which environmental organizations operate, such as through permanent affiliations and *ad hoc* action networks (see, for example, Van Heeren (1996) for a more complete picture), have brought about much more sophisticated and complex forms of lobbying by environmental groups which, arguably, cannot be adequately reflected in a simple measure based on membership. Whilst these issues may not completely invalidate the use of membership of ENGOs as a proxy for the values and norms of a society, they do suggest that other research approaches may be more appropriate in certain contexts[51]. An alternative approach, the one adopted here, is to consider the possible *direct* influence of environmental pressure groups on corporate environmental disclosure. This not only avoids the problem of membership referred to above but also has the advantage of focusing on the specific activities of ENGOs, activities which, arguably, are supported by the society in which they are carried out. Whether management do in fact react in a disclosure capacity to pressure from environmental lobby groups is still unclear and there has been relatively little research to date which explores the influence of these groups on management behaviour (Tilt, 1994 being a notable exception).

Table 9.22
Aspects of socio-political interaction between ENGOs and large European businesses

Aspect and response (%)	Benelux & German ENGOs (n = 38)			European ENGOs (n = 89)		
	Yes	No	Other	Yes	No	Other
Does your organization conduct environmental campaigns? (Q6)	66	34	0	68	31	1
Does you organization attempt to influence environmental reporting by companies? (Q9)	55	42	3	46	48	6
Does your organization examine or review environmental information disclosed by companies? (Q10)	66	32	2	63	33	4

Note: This table summarises the responses of the sample of Benelux/German and the wider European sample of ENGOs, respectively, to questions in a mailed questionnaire where respondents were asked to indicate their response using a "yes/no" type format.

One way of exploring such influence is, following Deegan and Gordon (1996) and Tilt (1994), to conduct research into the campaign activities of environmental groups, the presumption being that there is a positive association between the extent of such activities and the amount of corporate environmental disclosure (H_{8a}). Although the campaign activities of environmental pressure groups represents the focus of the present study, the opportunity has been taken to explore other activities related to ENGOs' campaigns to provide a broader socio-political picture of the interaction between environmental groups and large business organizations. The questionnaire to ENGOs therefore included three specific questions on this aspect of their activities (Table 9.22 above). As shown in Table 9.22, two thirds of the ENGOs sampled conduct environmental campaigns (defined as: "campaigns which encourage, challenge or demonstrate against the activities of business organizations and/or industries, including publicity campaigns through the media and the internet, direct action against individual companies or whole industries, working with companies and/or their industry trade bodies to improve environmental performance and political lobbying of the European Commission, the European Parliament, Government ministries and regulatory authorities").

ENGOs involved in environmental campaigns were also asked to indicate the nature of these campaigns in relation to each of the eight industry sectors included the study. Their responses are summarised in Table 9.23, which distinguishes between 'negative' and 'positive' campaigns. A number of issues are apparent from the empirical data presented in Table 9.23. Firstly, environmental campaigns by ENGOs appear to be conducted on a broad front covering all areas of economic activity rather being confined to the (presumed) more environmentally-sensitive industries sectors. Secondly, these campaigns take on a variety of different forms, with some being negative in nature (e.g. those against the chemicals, consumer goods and energy utilities sectors) whilst others are of a more positive nature involving cooperation between ENGOs and individual companies. Indeed, it is evident from the replies that some environmental organizations are actively working with business in what are known as 'green alliances'[52] (Arts, 2001), for example, towards minimizing environmental impacts and to encourage firms to develop their own strategic bio-diversity action plans to meet bio-diversity targets. More intriguing perhaps is the fact that a number of ENGOs are actively hiring themselves out as consultants to business on environmental issues, mainly in relation to public relations campaigns, (these were, perhaps not surprisingly, unwilling to comment on the environmental performance of their "clients" - see below).

Table 9.23
Nature of ENGOs' environmental campaigns, by industry sector

Industry sector	Negative campaigns	Positive campaigns
Banking & Insurance	Financing of destructive extraction projects (e.g. ABN-AMRO of mining in Papua New Guinea)	'Green'/ethical investments; environmental education & research into impact of banking on the environment; incorporation of environmental priorities in lending policies; EIAs; investment policies & official standards

Table 9.23 (continued)

Industry sector	Negative campaigns	Positive campaigns
Chemicals	Agro-chemicals; dioxins; PVC and plastics; phosphates; pesticides; paints and solvents; dyes; chlorine chemicals; general environmental performance e.g. controlling emissions; anti-licences	Eco-friendly (eco-labelled) detergents; research into risk and uncertainty issues; compliance with international codes and conventions
Consumer Goods	Packaging; building materials; pesticide use; batteries; genetically-modified organisms; non Forestry Stewardship Council (FSC)-certified timber products; supply chain initiatives; fishing; cosmetics; solvents; battery farming; animal testing; plastic bags; 'buy nothing' days	Energy efficiency; organic farming; use of regional goods; FSC-certified timber products; vegetarianism; consumer information; eco-labelling; responsible consumption
Energy Utilities	Anti-nuclear campaigns; change of energy policy; general environmental performance; liberalisation of energy market; off-shore installations	Eco-taxes; energy conservation; renewable/green energy; efficient household appliances; housing insulation; spatial planning; eco-labelling for energy produced with renewables (e.g. solar, wind, wave)
Extractive	Mining of oil, clay, sand and gravel; Brent Spar; Shell in Nigeria	Stakeholder forums with mining companies; 'cradle to grave' for aluminium production
Mechanical Engineering & Metallurgy	Automotive sector; fuel consumption; solvents; releasing of mercury	Product take-back; recycling; fuel consumption
Retail & Leisure	Travel by car and aeroplane; one-way beverage containers; out-of-town shopping centres; use of tin for drinks; supply chain initiatives; pesticides in food; 'buy nothing' days	Product take-back; eco-products; energy efficiency; "fair trade" in coffee and bananas (e.g. Max Havelaar)
Travel, Tourism & Transport Services	Highways; airports (e.g. Schiphol); plans for new airport runways; road and airport use and construction; traffic congestion; transportation of nuclear waste	Local and 'sustainable'/eco-tourism; education of tourists; taxes on aviation fuel; public transport; "sustainable" transportation; cycling; clean air

Almost half of the ENGOs included in the study attempt to influence environmental reporting by companies (Table 9.22). Table 9.24 summarises the variety of ways in which they seek to do this. Again, it is evident that these extend over broad range of issues, some of which involve working with companies and others which are more adversarial in nature, such as those involving litigation.

Table 9.24
Ways and means by which ENGOs attempt to influence corporate environmental reporting

Chosen means of influence
► Lobbying for standardized environmental reporting to permit intra- and inter-sector comparability
► Laws to enforce further disclosure e.g. disclosure of information on chemicals in order to improve hazard and risk assessment of these chemicals
► Lobbying of governments and regulatory bodies for greater disclosure of environmental information through campaigns for freedom of access to environmental, health and safety information
► Comments on published reports and presentations on what is expected; generating negative publicity in the media in response to poor environment reports
► Legal action against holding back of information on energy reduction by businesses and regulatory bodies
► Publication of reports on environmental reporting, co-operation in a national scale reports test
► Monitoring of compliance with codes of conduct, investigating and reporting on pesticide problems and campaigns for stronger regulations
► Seminars and conferences
► Stakeholder dialogue and openness, accountability and consumer choice
► Better product labelling and indication of the contents of the product
► Consultees on reporting structures for companies and encouraging companies to develop and report against targets

The third and final aspect of socio-political interaction between companies and ENGOs concerns the review and examination by the latter of corporate environmental information that is released by companies into the public domain in one form or another. As shown in Table 9.22 above, this is a popular activity amongst ENGOs with almost two thirds doing so. The most popular sources of information in this context were corporate annual reports, environment reports, site environment reports, press releases, advertisements, newsletters, and policy documents. However, it is evident that respondents use information from whatever other sources are available, including leaked documents, performance information from government departments and agencies, research papers from universities, reports by industrial bodies, government statistics, industry journals, environmental and permit compliance reports by regulatory bodies, third party reports such as accreditation organizations and other NGOs, as well as their own research.

The above analysis suggests that ENGOs are active rather than passive in relation to the environmental disclosure and performance activities of large business organizations. To explore the influence of ENGOs in this context, these groups were asked to indicate the extent to which they have conducted environmental campaigns in relation to the business activities of the eight industry sectors included the study over the last few years[53]. Measurement in this case is based on a rank-order five-point Likert scale where 5 =

constantly, 4 = frequently, 3 = occasionally, 2 = very few, and 1 = never conducted environmental campaigns. Table 9.25 below provides descriptive statistics of the responses of the ENGOs of the Benelux and German countries, as well as for a the wider sample of European ENGOs, as provided by a MANOVA test under the GLM Repeated Measures procedure to evaluate whether the resultant mean values for each industry sector are significantly different from each another (Norusis and SPSS, 1988)[54].

Table 9.25
Descriptive statistics and test of differences in relation to environmental campaigns by ENGOs by industry sector

	Benelux & German ENGOs (n = 22)			European ENGOs (n = 50)		
Panel A – Test results	*F*-statistic		*p*-value	*F*-statistic		*p*-value
Multivariate test using Pillai's Trace and Wilks' Lambda statistics	4.581		**0.006**	10.138		**< 0.0005**
Univariate test using Mauchly's test of sphericity in combination with the Huynh-Feldt epsilon	5.614		**< 0.0005**	9.560		**< 0.0005**
Panel B – Descriptive statistics	Mean	Std. Error	Ranking	Mean	Std. Error	Ranking
Chemicals	3.273	0.288	1	3.280	0.202	3
Consumer Goods	3.136	0.296	2 =	3.020	0.209	4
Energy Utilities	3.136	0.324	2 =	3.300	0.210	2
Travel, Tourism & Transport Ser.	3.136	0.311	2 =	3.360	0.197	1
Retail & Leisure	2.455	0.235	5	2.720	0.181	5
Extractive	2.409	0.234	6	2.560	0.186	6
Mechanical Engineering & Metal.	1.864	0.211	7	1.960	0.159	8
Banks & Insurance	1.818	0.243	8	2.200	0.190	7

Notes: This table provides the results of the General Linear Model (GLM) Repeated Measures MANOVA test when run against environmental organizations' responses for extent of campaigns directed at eight industry sectors. Where: Std Error = Standard error; Mean = mean score based on a rank-order five-point Likert scale where 5 = constantly, 1 = never; rankings represent a simple integral ordering of mean scores. Significant (at 5 per cent) *p*-values are shown in bold.

The multivariate and univariate tests results reported in Panel A of Table 9.25 indicate that the mean values of environmental campaigns directed at the eight industry sectors are significantly different from one another, with high *F*-statistics and significant (at 5 per cent) *p*-values in all cases. Looking at the mean scores and resultant rankings as shown in Panel B, the chemicals, consumer goods, energy utilities and travel, tourism and transport services sectors were targeted to a greater extent than the banking and insurance and mechanical engineering and metallurgy sectors. This was the case in relation to the Benelux and German ENGOs as well as the wider sample of European ENGOs.

To test the association between social pressure from environmental groups and CED (hypothesis H_{8a}) a one-tailed, bivariate correlation was performed between the mean values of the disclosure variable ("Total CED") and the mean values for environmental campaigns by ENGOs at industry group level for each of the seven years of the study and for the data set

as a whole. Correlations were performed based, firstly, on the responses of the Benelux/German ENGOs only and, secondly, on the responses of the wider sample of European ENGOs. In relation to the Benelux and German ENGOs only, two correlations were performed. The first involved calculating the mean values for the responses of Benelux and German ENGOs, respectively, and running these in a single bivariate correlation against the mean values of CED by Benelux and German companies, respectively, by sector for each year and for the period as a whole[55]. This provided 16 matched items in each correlation, i.e. one Benelux and one German, each across the eight industry sectors. The second used the mean values for the combined responses of Benelux and German ENGOs. This provided a further eight matched items. The results of the three sets of correlations are presented in Table 9.26. These results suggest that there is no positive correlation between the extent of environmental campaigning by environmental organizations and corporate environmental disclosure. Although the direction of association was as predicted in all but one case, it was statistically significant (at five per cent) in only two cases. Based on this evidence, the null hypothesis under hypothesis H_{8a} cannot be rejected.

Table 9.26
Coefficients of correlation between extent of environmental campaigns by environmental organizations and total CED

	1989	1990	1991	1992	1993	1994	1995	All years
A. Benelux & German ENGOs separated								
Pearson's correlation coefficient	0.266	0.514	0.316	0.241	0.269	0.482	0.193	0.358
p-value	0.159	**0.021**	0.116	0.185	0.156	**0.029**	0.237	0.087
Spearman's rho coefficient	0.205	0.544	0.323	0.279	0.220	0.500	0.133	0.349
p-value	0.223	**0.015**	0.111	0.148	0.207	**0.024**	0.312	0.092
B. Benelux & German ENGOs aggregated								
Pearson's correlation coefficient	0.426	0.561	0.469	0.385	0.463	0.551	0.217	0.459
p-value	0.146	0.074	0.120	0.173	0.124	0.079	0.303	0.126
Spearman's rho coefficient	0.415	0.537	0.488	0.488	0.366	0.561	0.146	0.537
p-value	0.153	0.085	0.110	0.110	0.186	0.074	0.365	0.085
C. European ENGOs								
Pearson's correlation coefficient	0.331	0.464	0.396	0.269	0.362	0.489	0.157	0.368
p-value	0.211	0.123	0.166	0.259	0.189	0.110	0.356	0.185
Spearman's rho coefficient	0.214	0.238	0.262	0.143	0.095	0.357	-0.024	0.238
p-value	0.305	0.285	0.265	0.368	0.411	0.193	N/A	0.285

Notes: This table shows the correlation coefficients and *p*-values for a one-tailed bivariate correlation using Pearson's standard product moment (parametric) and Spearman's rho rank correlation (non-parametric) tests between the overall mean scores for environmental disclosure ("Total CED") and environmental campaigns, respectively, of the eight industry sectors. All tests were run against transformed values for CED. Significant *p*-values (at 5 per cent) are shown in bold. Where N/A means not applicable, negative correlation.

To explore further their influence on corporate disclosure in this context, ENGOs were asked to indicate, for each of the eight industry sectors, the extent to which their environmental campaigns had increased or decreased over the last few years. This question was structured in the form of a rank-order seven-point Likert scale, where 1 indicated that such campaigns had strongly decreased over the last few years, 7 that they had strongly increased and 4 that there had been no change. Table 9.27 below provides descriptive statistics of the responses of the ENGOs using a MANOVA test under the GLM Repeated Measures procedure to evaluate whether the resultant mean values for each sector are significantly different from one another.

Table 9.27
Descriptive statistics and test of differences in relation to the change in extent of environmental campaigns by ENGOs, by industry sector

	Benelux & German E NGOs (n = 22)			European ENGOs (n = 50)		
Panel A – Test results	F-statistic	*p*-value		F-statistic	*p*-value	
Multivariate test using Pillai's Trace & Wilks' Lambda statistics	2.639	0.05100		5.065	**< 0.0005**	
Univariate test using Mauchly's test of sphericity in combination with the Huynh-Feldt epsilon	4.273	**< 0.0005**		5.477	**< 0.0005**	
Panel B – Descriptive statistics	Mean	Std. Error	Ranking	Mean	Std. Error	Ranking
Travel, Tourism & Trans. Serv.	5.000	0.227	1	5.000	0.167	1
Consumer Goods	4.870	0.211	2 =	4.700	0.141	2
Energy Utilities	4.870	0.229	2 =	4.680	0.168	3
Retail & Leisure	4.348	0.119	4	4.640	0.133	4
Banks & Insurance	4.261	0.113	5	4.300	0.125	5 =
Mech. Engineering & Metallurgy	4.192	0.193	5	4.140	0.103	8
Chemicals	4.130	0.211	7 =	4.300	0.170	5 =
Extractive	4.130	0.221	7 =	4.200	0.125	7

Notes: This table provides the results of the General Linear Model (GLM) Repeated Measures MANOVAtest when run against mean scores for the extent to which environmental organizations' campaigns directed at eight industry sectors have changed over the last few years. Rankings represent a simple integral ordering of mean scores. Significant (at 5 per cent) p-values are shown in bold.

The multivariate and univariate tests results reported in Panel A of Table 9.27 indicate that the mean values for each of the eight industry sectors are significantly different from one another. Looking at the mean scores as shown in Panel B, all are slightly above 4.00, indicating that there had been some increase in the level of campaigns in the case of each industry sector but that this increase was marginal. Moreover, looking at the rankings, ENGOs appear to have shifted the focus of their campaign activities in the 1990s towards the travel, tourism and transport and consumer goods sectors in preference to the chemical and extractive industries. Such a shift in policy could be due to a perception amongst environmental groups that increased regulations of the activities of the chemical and extractive industries since the late 1980s and the adoption of industry codes of best practice, such as the chemical industry's *Responsible Care Programme*, were 'signals' of successful

campaigning which allowed them to re-direct their activities towards more current issues associated with increased travel and consumption patterns (see Table 9.23 above).

The data presented in Table 9.27 were used to test for an association between changes in social pressure from environmental groups and increases in disclosure under hypothesis H_{8a}. In this specific context, the alternative hypothesis is that there is a positive association between *changes* in the extent of environmental campaigning by environmental pressure groups and *changes* in environmental disclosure over time. For these purposes, changes in environmental disclosure over time were measured by simply taking the amount disclosed in three separate years (i.e. 1989, 1992 and 1995), computing the change (i) between 1989 and 1995 and (ii) between 1992 and 1995, respectively, for each of the 90 companies in the sample and then computing mean values for each industry group. This test was performed by running a bivariate correlation between the mean values for changes in disclosure between 1989 and 1992 and between 1989 and 1995, respectively, and mean values for environmental campaigns (see Table 9.27 above) in the case of each industry group. Two sets of correlations were performed in each case, one based on the responses of the Benelux/German ENGOs only and one based on the responses of the wider sample of European ENGOs. Again, two sets of correlations were run for the responses of the Benelux and German ENGOs, the first based on the their separate responses ('separated') and the second using the mean values for their combined responses ('aggregated'). The results are presented in Table 9.28.

Table 9.28
Coefficients of correlation between changes in environmental campaigns by ENGOs and changes in total CED

Test statistic	*Change in CED between 1989 and 1995*			*Change in CED between 1992 and 1995*		
	Benelux & German ENGOs separated	Benelux & German ENGOs aggregated	European ENGOs	Benelux & German ENGOs separated	Benelux & German ENGOs aggregated	European ENGOs
Pearson's correlation coefficient	-0.269	-0.455	-0.346	-0.077	-0.229	-0.185
p-value	N/A	N/A	N/A	N/A	N/A	N/A
Spearman's rho coefficient	-0.0127	-0.337	-0.108	-0.130	-0.181	0.252
p-value	N/A	N/A	N/A	N/A	N/A	0.274

Notes: This table shows the correlation coefficients and *p*-values for one-tailed bivariate correlations using Pearson's standard product moment (parametric) and Spearman's rho rank correlation (non-parametric) tests between the overall mean scores for changes in the amount of environmental disclosure and changes in the extent of environmental campaigns, respectively, of the eight industry sectors. All tests were run against transformed values for CED. Significant p-values (at 5 per cent) are shown in bold. Where N/A not applicable, negative correlation.

The results presented in Tables 9.26 and 9.28 are instructive because they suggest that managerial behaviour in relation to CED is *not* influenced by the campaign activities of environmental groups[57]. This is significant in the context of OLT given that ENGOs are posited as being one of the relevant publics which reflect the values, norms and attitudes of society, and thus, to the extent to which firms do not reflect these values, there is said to be a

problem of social legitimacy. The results are, however, consistent with the results presented in Table 9.8 above where ENGOs were seen as relatively unimportant to management. One possible interpretation is the presence of a time lag between the campaign activities of environmental groups and the response by companies. That is, management may be cautious in its response, adopting a 'wait and see' approach while assessing the degree to which the activities of ENGOs have the support of society generally. In the short term, it is possible that management does not feel threatened by the campaign activities of ENGOs in the normal course of events and that it takes something extraordinary, such as in the case of the *Exxon Valdez* disaster or the *Brent Spar* debâcle, for public pressure through the media and consumer boycotts, to bring about immediate changes in managerial behaviour towards environmental disclosure. The *Exxon Valdez* oil spill off the coast of Alaska, U.S., in March 1989, for example, has been seen as 'the straw that broke the camel's back' in terms of a growing, general concern for the environment reaching critical mass, a state which corporations as a whole could no longer ignore (see, for example, Benoit, 1989; Grover, 1989; Post, 1991). ENGOs may bring about change over the longer term, for example, in the form of legislation and regulation, through the lobbying of governments and other regulatory bodies (see Table 9.24)[58].

9.7.4 Negative environmental performance

As described in Chapter 7, under legitimacy theory it is argued that poor environmental performers are likely to use environmental disclosures as part of a concerted exercise in legitimation in the face of a perceived threat to their legitimacy. Thus, it is hypothesised that there is a negative association between environmental performance and the amount of environmental information disclosed (H_{9a}). To obtain a proxy for society's perception of the environmental performance, ENGOs were asked to provide an indication of each company's environmental reputation ("eco-rating") based on their knowledge of the company and its activities, on a country-by-country basis. Thus, German ENGOs were asked to eco-rate the 50 German companies in the sample and Belgian ENGOs were asked to do the same for the 17 Belgian companies, and so on. For these purposes, environmental reputation was evaluated using a rank-order five-point Likert scale, where 5 = outstanding, 4 = good, 3 = fair, 2 = poor, and, 1 = very poor. Similarly, ENGOs were also asked to indicate the extent to which each company's eco-rating had changed over the last few years using a rank-order seven-point Likert scale, where 1 = strongly worsened, 4 = no change and 7 = strongly improved.

Mean values for each of the 90 sample companies in relation to both their environmental performance rating (or "eco-rating") and changes in that rating over the last few years could thus be computed using the responses of the 38 Benelux and German ENGOs to questions 4 and 5 of the questionnaire. However, the number of responses received in relation to each company varied considerably, not only because of the fact that the number of responses varied between the Benelux and German countries but also because not all ENGOs provided complete responses to both questions. (These missing values were mainly due to the fact that some ENGOs did not recognise the company by name and thus were not in a position to respond in that particular case.) In order to establish the reliability of the responses of ENGOs to questions 4 and 5, a variance components procedure was performed using the analysis of variance (ANOVA) components (Type I sum of squares) method (Norusis and SPSS, 1988).

This procedure provides an estimate of the degree of variability amongst ENGOs in their eco-rating of companies, where the eco-ratings are entered as the dependent variable and the 90 companies as the random factor. In effect, this analysis estimates how much variance in the ENGOs' scores of each company is attributable to (i) perceived differences in the eco-rating of one company from another, i.e. the true (i.e. systematic) variance, and (ii) perceived differences in the views of the ENGOs themselves, i.e. the unwanted variance or error. The results of this test are thus presented in the form of two variability (i.e. variance) estimates:

(a) the variance component estimate, which measures the degree of systematic variance of ENGO responses *between* companies (VAR(company)); and,

(b) the variance error estimate which measures the degree of inconsistency of ENGO responses *within* companies (VAR(error)).

The results of the ANOVA variance component method for the responses of the Benelux and German are summarised below in Table 9.29. Based on these values, an estimate of the reliability of one observer (i.e. of one ENGO) can be computed using the formula:

$$\text{Estimate of reliability for one observer, } r_1 = \frac{\text{est.}\sigma_c^2}{\text{est.}\sigma_c^2 + \text{est.}\sigma_E^2}$$

where σ^2= estimated variance, c = company, and E = error. Using the values shown in Table 9.29, the estimate of reliability for one observer, r_1, is computed as 0.191/(0.191 + 0.679), i.e. 0.2195 for the responses to question 4 and 0.142/(0.142 + 0.679), i.e. 0.1730 for the responses to question 5. As a rule of thumb, reliability values of 0.50 or higher are considered acceptable. Thus, mean values of sample companies based on the responses of one ENGO would not be considered reliable.

Table 9.29
Variance estimates for environmental reputation ("eco-rating") responses of ENGOs

	Estimated Between-Variance Component	Estimated Error Component
Current environmental reputation (Q4)	0.191	0.679
Change in environmental reputation over the last few years (Q5)	0.142	0.679

Notes: This table provides the results of the analysis of variance (ANOVA) Type I sum of squares components procedure when run against the Benelux and German environmental organizations' rating of the environmental reputation ("eco-rating") of the 90 sample companies.

Two possible approaches are available for making use of this information. The first is to look at the mean number of responses for all sample companies, which is computed simply by dividing the total number of responses by all ENGOs for all sample companies by the number of companies for which responses were given. For questions 4 and 5, this mean value is computed as 679/88 (i.e. 88, not 90 as two German companies (AVA and Hornbach) were not eco-rated by German ENGOs) = 7.7159 and 756/90 = 8.4, respectively. Using this value, the estimate of reliability for the averaged rating for the responses to question 4 is computed using the following formula:

$$\text{Estimate of reliability for observers } r_n = \frac{n(r_1)}{1 + (n - 1)\, r_1}$$

$$= \frac{7.7159 * 0.2195}{1 + (7.7159 - 1) * 0.2195}$$

$$= 0.68$$

Using the same procedure, the estimate of reliability for the averaged rating for the responses to question 4 is 0.6373. An alternative procedure is to insist on some minimum value for observer reliability, then to compute the minimum number of observers (i.e. ENGOs) required for a particular company, removing from any subsequent correlations all companies for which the number of observers (i.e. responses from ENGOs) is below this minimum. Rearranging the above formula and then filling in the desired reliability (r_n) of 0.50 and r_1 = 0.22, the minimum number N is:

$$N = \frac{r_n - r_1 \cdot r_n}{r_1 - r_1 \cdot r_n}$$

$$N = \frac{0.50 - 0.22 * 050}{0.22 - 0.22 * 0.50}$$

$$N = 2.27$$

Thus, for a minimum reliability of 0.50, the minimum number of responses required from ENGOs to question 4 for each sample company is 2.27. Using the same formula, the minimum number of responses required from ENGOs to question 5 is 4.78. Applying these values to the responses of ENGOs to questions 4 and 5, respectively, requires the elimination of all eco-ratings of the sample companies for which the number of ENGO respondents is less than three and five, respectively. Based on the ENGOs' responses to the questionnaire, this results in the exclusion of eight sample companies (seven German and one Benelux) from the correlation procedures when using the responses to question 4 and five sample companies (two German and three Benelux) when using the responses to question 5. Based on these results, the approach adopted was to run two sets of correlations, the first using all the ENGO responses, irrespective of the number of observers, and the second using only those companies for which the number of observations was not less than the required minimum (82 companies in the case of question 4 and 85 in the case of question 5). The hypothesis that environmental reputation, as a proxy for environmental performance, is negatively associated with environmental disclosure was tested by running a partial correlation on the mean responses of ENGOs to question 4 of the questionnaire and the amount of environmental disclosure by each company in each of the years 1989 to 1995, controlling for size (total assets) and country effects. The results for both sets of partial correlations are shown in Table 9.30. Similar results to those presented in Table 9.30 were achieved when using the number of employees and profits (PBIT), respectively, as the proxy for size[59]. The results presented in Table 9.30 offer support for the alternative hypothesis under H_{9a}. The direction of the association is as predicted under the hypothesis for all years and the *p*-values are significant for all years other than 1995, suggesting that the correlation is

not due to chance. The strength of the correlation, as indicated by the size of the partial correlation coefficient, varies from -0.14 (1995) to -0.43 (1989), which suggests a medium-sized strength of correlation[60], i.e. not small and not large, with more than half of the variation seemingly due to their mutual association with other variables.

Table 9.30
Partial coefficients of correlation between environmental reputation and total CED

	1989	1990	1991	1992	1993	1994	1995
All companies (= 90)							
Partial correlation coefficient	-0.4257	-0.3765	-0.3230	-0.3493	-0.2579	-0.3166	-0.1414
p-value	**< 0.0005**	**< 0.0005**	**0.001**	**< 0.0005**	**0.008**	**0.001**	0.097
Companies with at least 3 observers (= 82)							
Partial correlation coefficient	-0.4075	-0.3707	-0.3101	-0.3524	-0.2364	-0.3254	-0.1097
p-value	**< 0.0005**	**< 0.0005**	**0.003**	**0.001**	**0.017**	**0.002**	0.166

Notes: This table shows the correlation coefficients and *p*-values for one-tailed partial correlations between environmental disclosure ("Total CED") and mean values for ENGOs scoring of each company's environmental reputation according to a rank-order five point Likert scale where 1 = very poor and 5 = outstanding, controlling for the effects of size (total assets) and country. All tests were run against transformed values for CED and size. Significant *p*-values (at 5 per cent) are shown in bold.

However, the extent to which these results support the alternative hypothesis is limited by the fact that the proxy for environmental performance is based on the responses received from ENGOs in 2000 and, strictly speaking, would be applied against the measure of environmental disclosure for the period closest to the date of the responses, which in this case would be 1995. As shown in Table 9.30, although the direction of association was as predicted in 1995, the *p*-values are not significant (at five per cent) and the correlation coefficients are small.

Why the strongest results should be found for the earlier years of the study is unclear. One plausible explanation is that the ENGO's based their responses on their knowledge of the industry rather than on specific knowledge of the company itself, i.e. the industry in which a company operates casts a long shadow over its environmental reputation. Several different items of empirical evidence appear to support this contention. Firstly, many of the 38 Benelux and German ENGOs did not provide complete responses to question 4 of the questionnaire, the main reason given being that they did not know the company by name (although it is possible ENGOs are more familiar with the company's branded products). Secondly, ENGOs were asked, as part of question 4, to indicate which factors were most significant in determining their eco-rating. Although not all ENGOs provided responses, those that did referred predominantly to issues associated with the industry in which the firm operated rather than issues affecting the firm alone, such as PVC, general pollution, dioxins, nuclear power, air travel, etc.

Only a few ENGOs gave detailed descriptions of the specific activities of individual companies in relation to environmental issues. If few ENGOs have detailed knowledge at the company level, this would be consistent with their reluctance to eco-rate companies, a high

number of "don't know" replies and their reference to industry-wide issues (Table 9.23 above). Thirdly, the mean values of the responses of ENGOs to question 4, when grouped at industry level produce a rank order that is consistent with the *a priori* classification of industry sectors as between environmentally-sensitive and less environmentally-sensitive (Table 9.31).

Table 9.31
Mean scores by ENGOs of environmental reputation of sample companies, by industry group

Sector	Means scores by Industry group	Ranking	*A priori* classification
Retail & Leisure	2.96	1	LES
Consumer Goods	2.69	2	LES
Banks & Insurance	2.65	3	LES
Travel, Tourism & Transport Services	2.39	4	LES
Mechanical Engineering & Metallurgy	2.22	5	ES
Energy Utilities	2.18	6	ES
Extractive	2.15	7	ES
Chemicals	1.98	8	ES

Notes: This table shows the means scores and resultant rankings at industry group-level based on responses to the mailed questionnaire in which ENGOs were asked to score the environmental reputation of the sample companies on the basis of a rank-order five-point Likert scale, where 1 = very poor and 5 = outstanding. Rankings represent a simple integral ordering according to the mean score in each case, the highest mean score being accorded a ranking of one, the second highest mean score a ranking of two, and so on. Where ES = environmentally-sensitive and LES = less environmentally-sensitive.

As shown in Table 9.31, it is the environmentally-sensitive sectors, particularly chemicals, which receive the lower scores for environmental reputation, with the less environmentally-sensitive sectors, notably retail and leisure, receiving higher scores. However, Table 9.31 highlights the generally poor ratings awarded across the board, with no sector having an average score above 3.00 which was defined as "fair" in the text of the question, scores of 2 and 1 being defined as "poor" and "very poor", respectively. In other words, Benelux and German ENGOs, perhaps not surprisingly, have a low opinion of the corporate sector as a whole in relation to environmental issues. More research is obviously needed to substantiate the view that ENGOs' assessment of corporate environmental reputation is significantly influenced by sector-level issues, but it may go some way towards explaining the results shown in Table 9.30 where the negative correlation would be entirely predictable given the tests of association between environmental disclosure and industry environmental sensitivity referred to previously (Table 9.20). That is, the partial correlation tests reported in Table 9.30 above in relation to eco-ratings and CED mirror the earlier tests of association between industry environmental sensitivity and CED except that the ranking of relative values for the independent variable is reversed with the environmentally-sensitive sectors being ranked lowest (eco-rating) rather than highest (environmental impact)[61].

Empirical evidence was provided above (Table 9.22) which demonstrated that ENGOs not only examine environmental disclosures by companies but that they also try to influence such

disclosures. It is possible that those firms which were aware of ENGOs perceptions and campaign activities in relation to their (poor) environmental performance used CED to influence these perceptions as part of a legitimation strategy (see Chapter 7). To explore the influence of the CED strategies on ENGOs' perceptions of Benelux and German companies, ENGOs were asked to indicate the extent to which the environmental reputation of these companies had changed over the last few years. Using a rank-order seven point Likert-scale, respondents were asked to score their responses from 1 to 7, where 1 = strongly worsened, 4 = no change and 7 = strongly improved. The variable estimate and variable error components of these scores were reported in Table 9.29 above. A partial correlation test was performed on the mean scores and the change in CED between two time periods (i.e. between 1989 and 1995, and between 1992 and 1995), controlling for size (total assets) and country effects. The results for both sets of partial correlations are shown in Table 9.32. Similar results to those presented in Table 9.32 were achieved when using the number of employees, profits (PBIT) and capital employed as alternative proxies for size[62].

Table 9.32
Partial coefficients of correlation between change in environmental reputation and change in total CED

	Change in environmental disclosure between 1989 and 1992	Change in environmental disclosure between 1989 and 1995
All companies (= 90)		
Partial correlation coefficient	0.1964	0.3073
p-value	**0.033**	**0.002**
Companies with at least 5 observers (= 85)		
Partial correlation coefficient	0.1942	0.3093
p-value	**0.039**	**0.002**

Notes: This table shows the correlation coefficients and *p*-values for one-tailed partial correlations between changes in environmental disclosure ("Total CED") between two points in time and mean values for ENGOs scoring of the change in each company's environmental reputation according to a rank-order seven point Likert scale where 1 = strongly worsened, 4 = no change and 7 = strongly improved, controlling for the effects of size (total assets) and country. All tests were run against transformed values for CED and size. Significant *p*-values (at 5 per cent) are shown in bold.

The results reported in Table 9.32 offer some support for the hypothesis that companies in negotiating their legitimacy status with ENGOs have used CED successfully. In the case of both time periods, the correlation coefficient was positive and the *p*-value significant (at five per cent). However, the strength of the correlation is not strong, indicating the presence of other variables. Whilst a detailed exploration of this issue lies outside the scope of the present study, evidence presented in Table 9.33 below, which aggregates ENGOs responses at industry group level, suggests that the influence of increased levels of CED on ENGOs' perceptions has been very marginal. Indeed, in the case of the chemicals sector, for example, increases in environmental disclosure by chemical companies over the period do not seem to have improved their environmental reputation. This suggests that other factors may play a role in influencing ENGOs' perceptions of corporate environmental performance.

Table 9.33
Mean scores by ENGOs of change in environmental reputation of sample companies over the last few years, summarised by industry group

Sector	Means scores by industry group	Ranking	*A priori* classification
Energy Utilities	4.138	1	ES
Mechanical Engineering & Metallurgy	4.054	2	ES
Banks & Insurance	4.011	3	LES
Extractive	3.981	4	ES
Consumer Goods	3.962	5	LES
Chemicals	3.948	6	ES
Travel, Tourism & Transport Services	3.931	7	LES
Retail & Leisure	3.863	8	LES

Notes: This table shows the means scores and resultant rankings at industry group-level based on responses to a mailed questionnaire in which ENGOs were asked to score the change in environmental reputation of the sample companies over the last few years on the basis of a rank-order seven-point Likert scale where 1 = significantly worsened, 4 = no change and 7 = significantly improved. Rankings represent a simple integral ordering of according the mean score in each case, the highest mean score being accorded a ranking of one, the second highest mean score a ranking of two, and so on. Where ES = environmentally-sensitive and LES = less environmentally-sensitive.

9.7.5 News type – good or bad?

The final hypothesis under OLT asserts that environmental disclosure will be in the form of 'positive' i.e. ('good news') environmental information as part of a corporation's public relations exercise aimed at changing society's perceptions of the corporation by presenting itself as acting responsibly in relation to environment issues (H_{7d}, H_{8b}, H_{9b}). Table 9.34 provides some descriptive statistics about the distribution of the total, 'good/neutral' and 'bad' amounts, respectively, of environmental disclosures for all 90 Benelux and German companies for all years[63].

As can be seen from the table, disclosure of bad news is minuscule in comparison to good/neutral news. In 1995, for example, the mean number of pages of bad news was 0.144 pages, compared to 18.820 pages of good/neutral news, a ratio of 1:131. For the seven year period as a whole, the mean number of pages of bad news was 0.07 pages compared to an average of 6.75 pages of good/neutral news, a ratio of 1:96. Moreover, in many cases large Benelux and German companies failed to disclose any 'bad' news. As shown in Table 9.34, the percentage of companies not disclosing any bad news varies between 66% and 80%, whereas the percentage of companies not disclosing any good/neutral news ranges from 4% to 20%. Although there is no 'objective' or scientific way of knowing the total amount of bad news which large Benelux and German companies could disclose (simply because we just don't know how human activities will impact on the planet's eco-systems over the long-term), the statistics presented in Table 9.34 suggest that Benelux and German companies were clearly focusing on disclosing environmental information which avoided creating an unfavourably perception of the organization.

Table 9.34
Descriptive statistics for 'news value' of total CED, by year (n = 90)

	1989	1990	1991	1992	1993	1994	1995
Total disclosures							
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	43.66	45.99	46.61	53.48	68.37	81.25	176.62
Mean	3.084	3.440	4.523	5.032	5.742	7.099	18.820
Median	0.770	1.165	1.450	1.660	1.290	1.440	2.770
Standard deviation	6.187	7.081	9.005	10.674	12.237	15.179	31.827
Bad news							
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	0.60	0.54	1.96	1.39	1.40	0.68	4.18
Mean	0.039	0.027	0.093	0.073	0.055	0.038	0.144
Median	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Standard deviation	0.109	0.077	0.269	0.211	0.188	0.113	0.561
Good/neutral news							
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	43.60	45.59	46.51	53.18	68.33	81.09	175.60
Mean	3.045	3.413	4.430	4.959	5.687	7.061	18.676
Median	0.820	1.165	1.400	1.445	1.270	1.430	2.770
Standard deviation	6.299	7.079	8.874	10.647	12.187	15.150	31.576
Non-disclosers (%)							
Bad news	0.80	0.80	0.66	0.67	0.68	0.72	0.76
Good/neutral news	0.20	0.10	0.09	0.06	0.07	0.04	0.07
Any news	0.19	0.10	0.08	0.06	0.07	0.04	0.07

Notes: This table shows descriptive statistics in relation to Total CED by year for the 90 Benelux and German companies, where disclosure is classified as between 'bad' and 'good/neutral news' (as defined in Chapter 8). The percentages in relation to non-disclosers refer to the percentage of sample companies (out of 90) which disclosed no bad and good/neutral news, respectively, in each year of the study, where 'Any news' indicates the percentage of companies which made no environmental disclosure.

To determine whether there was a statistically significant difference between the amounts disclosed in relation to 'bad' CED and 'good/neutral' CED, a paired samples *t*-test and a Wilcoxon matched-pairs signed-ranks tests were performed, the results of which are set out in Table 9.35 below. As shown in the table, a significant difference was found between these two types of disclosure for each year of the study. These results are consistent with those of prior studies (see, for example, Deegan and Gordon, 1996; Deegan and Rankin, 1996) which provide strong evidence to support the hypothesis that large companies seem reluctant to provide information within their external annual, social and environment reports about any negative environmental effects of their business operations. Such observations, when viewed through the lens of OLT, are seen as evidence of a perceived need of the part of senior management to legitimise their business activities in the face of a perceived threat to their legitimacy status. Such evidence lends weight to the view that annual, social and environment reports not only fail to provide an accurate, balanced or fair portrayal of corporate environmental performance, but that such reports are used teleologically (see Chapter 1)in an ideological end-game the main purpose of which is to deflect social criticism away from the firm. This perspective is entirely consistent with Elkington's (1997) argument that most

companies engaging in social and environmental reporting view their reports as public relations vehicles and as such are designed to offer reassurance and assist with 'feel-good' image building rather than providing any meaningful representation of environmental performance. It is also consistent with Hooghiemstra's (2000) analysis of Royal Dutch Shell's attempts at influencing public perceptions in relation to the company's image and reputation following the *Brent Spar* debâcle.

Table 9.35
Comparison of amount of good/neutral and bad environmental disclosures (n = 90)

	1989	1990	1991	1992	1993	1994	1995
Paired-samples t-test							
t-value	4.635	4.537	4.699	4.378	4.403	4.405	5.610
Significance (*p*-value)	**< 0.0005**	**< 0.0005**	**< 0.0005**	**< 0.0005**	**< 0.0005**	**< 0.0005**	**< 0.0005**
Wilcoxon matched-pairs							
Z-score	-7.265	-7.713	-7.870	-8.008	-7.961	-8.055	-7.921
Significance (*p*-value)	**< 0.0005**	**< 0.0005**	**< 0.0005**	**< 0.0005**	**< 0.0005**	**< 0.0005**	**< 0.0005**

Notes: This table shows the results of a paired samples t-test and a Wilcoxon matched-pairs signed-ranks test when run against the amounts of 'bad' and 'good/neutral' environmental disclosure for the 90 sample companies. All tests were run against raw (i.e. untransformed) data. Significant (at 5%)*p*-values are shown in bold.

Notes

1. *P-P Plots* are used to plot a variable's observed cumulative proportions (i.e. the cumulative proportion that is less than a specified value) against expected cumulative proportions using Blom's proportional estimation formula (Norusis and SPSS, 1988). If the selected variable matches the expected distribution, the points cluster around a straight line.
2. *Histograms* provide a graphical display of the distribution of a single variable (Hair *et al*., 1998). This enables a visual comparison to be made of a variable's distribution with the *normal distribution*. In a normal distribution, 68 per cent of values fall within one standard deviation (SD - a measure of dispersion of data around the mean) of the mean and 95 per cent of cases fall within 2 SD, resulting in a clustering of the variable around the mean in a symmetrical, unimodal pattern known as the bell-shaped, or normal, curve. Thus, for example, if the mean value of a variable were 45, with a standard deviation of 10, 95 per cent of values would be between 25 and 65 in a normal distribution. A normal distribution is symmetric, and has a skewness value of zero. Skewness values that fall outside the range of –1 to +1 normally indicate a substantially skewed distribution. A positively skewed distribution has relatively few large values and tails off to the right.
3. For example, Deegan and Gordon (1996) report high figures for both skewness and kurtosis when looking at the association between environmental sensitivity (concern by environmental pressure groups) and environmental disclosure. Gray *et al.* (2001), in examining the association between corporate characteristics and social disclosure, report that all four measures for size and profitability (turnover, capital employed, number of employees and profit) were not normally distributed, those in relation to size exhibiting extremely large positive skewness. As a result, Gray *et al*. performed logarithmic transformations to normalise their raw data. In the case of the dependent variable, Total CSR, the skewness and kurtosis figures were low and as such no transformation was required, although individual elements within this, notably the category environment, were positively skewed (Gray *et al.*, 2001). Hackston and Milne (1996) transformed three dependent measures of size (sales, total assets, and market capitalization) by their natural log due to non-normality but the values for Total CSR were not transformed.

4. The fact that the independent variables are not normally distributed does not in itself invalidate the use of parametric tests in regression. Rather, given that it is assumed in regression analysis that the error term is normally distributed (Cooke, 1998), what matters is whether the residuals in the regression are themselves normally distributed. By normalising the distribution of the dependent variable, the residuals are automatically normalised.
5. Kurtosis provides a measure of the extent to which observations cluster around a central point (Norusis and SPSS, 1988). For a normal distribution, the value of the kurtosis statistic is 0. Positive kurtosis indicates that the observations cluster more and have longer tails than those in the normal distribution whereas negative kurtosis indicates the observations cluster less and have shorter tails.
6. Descriptive statistics for the normalised data of Total CED were as follows: mean = 0.00897; standard deviation = 0.975; skewness = 0.103; kurtosis = -0.291.
7. The model specified in equation (1) is not a complete specification of the economic agency model but only of chosen variables which the theory suggests may hold explanatory power when seeking to explain variations in CED across firms in the context of the principal-agent relationship. Similar models are provided below in relation to MST and OLT. Such models are constructed to view chosen aspects of reality, which may be complex or simple depending on the subject matter, to explore associations with CED. Such models focus on factors which the chosen theories suggest as being of relevance to the present study and which can be explored using the chosen research instruments.
8. The values shown in Table 9.3 are derived from the data set for the period of the study as a whole. Pearson correlation coefficients were also calculated for each year of the study, with similar results.
9. Whilst Table 9.3 reveals the four characteristics for political visibility to be highly correlated with one another, such that the regressions presented in Table 9.4 are also similar, these regressions nonetheless have value given that they are not completely alike.
10. The *p*-value is the probability that a statistical result as extreme as the one observed would occur if the null hypothesis were true. If the observed significance level is small enough, usually less than 0.05, the null hypothesis is rejected. It should be readily apparent from the *p*-values given in Table 9.5 that the statistical probability of 26 out of the 28 combinations occurring if the null hypothesis were true is extremely low. Hence, the null hypothesis in this case can be rejected.
11. In some cases, the *Eta*-squared values for industry sector given here are greater than the adjusted *R*-squared values for the model as a whole. However, such a comparison is misleading given that the adjusted *R*-squared values are for the population rather than the sample, whereas the *Eta*-squared values are for the sample (Norusis and SPSS, 1988). (Sample *R*-squared values tend to optimistically estimate how well the models fit the population. The model usually does not fit the population as well as it fits the sample from which it is derived. Adjusted *R*-squared attempts to correct *R*-squared to more closely reflect the goodness of fit of the model in the population. As a result, adjusted *R*-squared values are normally lower.)
12. Previous tests of association between proxies for political visibility and CED (Table 9.4) showed industry sector to be significant. Thus, the results presented in Table 9.5 could be seen as confirming something already known. However, for the regressions reported in Table 9.4 industry sector was merely controlled for, whereas in Table 9.5 the emphasis in on exploring the specific influence of industry sector.
13. Complete nesting in this context refers to the process of ensuring that all companies within a specific industry sector, such as chemicals, are included within the same category of industry environmental sensitivity. Thus, it was not possible for one (e.g.) chemical company to be classified as environmentally-sensitive and another chemical company as less environmentally-sensitive.
14. This statement is conditional upon the classification of companies as between environmentally-sensitive and less environmentally-sensitive, this classification being assumed to be a valid proxy for environmental impact. A further set of regressions, not reproduced here, was also run based on the responses received to the company questionnaire. These responses provided independent, previously unavailable data which was used to classify the 90 Benelux and German companies as between environmentally-sensitive and less environmentally-sensitive. The results of the second

set of regressions using these independent measures of perceived environmental sensitivity were almost identical to those reported in Table 9.5, thus increasing the validity of the results.

15. The same set of regressions was also run using both profit (PBIT) and number of employees as alternative proxies for size. The results were very similar to those reported in Table 9.5.
16. Total assets were used to control for size given that, in this case, the market variables do not represent a measure of size. Similar results to those presented in Table 9.6 were achieved when using the number of employees as a proxy for size.
17. Table 9.7 provides an indication of both the individual and combined explanatory powers of the four variables for political visibility. Notwithstanding the problem associated with multicolineality, i.e. a situation where the correlations among the independent variables are strong (see Table 9.3), the information presented in Table 9.7 highlights both the combined and unique contribution of each of these four variables in relation to their association with variations of CED across firms.
18. Previous regressions (see Table 9.4) have demonstrated a statistically significant, positive relationship between each of the four proxies for political visibility and CED. These four proxies have also been shown to have a high intercorrelation (Table 9.3). The regression results as presented in Table 9.7 indicate only the *direct* effects of each co-variate when run against CED, with the *indirect* effects being effectively hidden from view. That is, when including each of the four proxies for political visibility in a more complex model of the relationship between political visibility and CED, as shown in Table 9.7, the results of the regression reflect only the direct relationship between each variable and CED and not the indirect relationship which exists by virtue of each proxy's relationship with each of the other proxies. The interrelationship between the proxies for political visibility (technically known as multicolineality) may have an effect on the direct, specific relationship between each proxy and CED when all four proxies are included as co-variates in the same regression. It is this indirect relationship which may explain the negative regression coefficients in the case of some proxies for some years (see Table 9.7). The reader should be aware of the influence of both the direct and indirect effects between each of the four proxies and CED when interpreting the results presented in Table 9.7. Overall, the strength of the modelled association between these four proxies for political visibility is shown by the high adjusted R-squared values.
19. Whilst there is a general presumption that stakeholder importance is positively associated with environmental disclosure, the MST hypotheses seek to explore the relative importance of different sets of stakeholder groups. As such, the model as presented here is a general one, with variations of that model being explored by looking at associations between different groups of stakeholders and CED.
20. The use of a five-point (or seven-point) Likert scale to obtain an indication of preferences is common to many areas of the social sciences (Cooke, 1998). In accounting, there have been a number of studies that have asked users of financial accounts to express an opinion on the usefulness of accounting information (see, for example, Epstein and Pava, 1993; Hines, 1982; Lee and Tweedie, 1975). Likert scales have also been used in CSR research (see, for example, Deegan and Gordon, 1996; Tilt 1994; Wilmhurst and Frost, 2000). The Likert scale was considered appropriate in this case given that the objective of the research instrument was to obtain a level of importance attached to different aspects of managerial perceptions and behaviour. However, the Likert scale is not an interval scale and thus no conclusions can be drawn about the interval between each position along the scale (Moser and Kalton, 1975).
21. The fact that tests of stakeholder theory are restricted to 32 companies compared to the 90 companies available for testing economic agency theory weakens the external validity of the former tests and the conclusions drawn therefrom. In addition, the 32 companies which completed the questionnaire may be biased in the sense that they are more responsive to stakeholder demands that the remaining 58 companies which did not. Evidence of this is the fact that researchers are a stakeholder group (science and education) and the author's request for information was in itself part of the interaction that takes place between organizations and the societies in which they operate. From that perspective, there may be some truth in the suggestion that the companies that completed the questionnaire are indeed more responsive to stakeholders' demands than those companies that did not.

22. Very similar results were found when the sample of companies was broadened to include companies from the following other European countries: the Nordic countries (Denmark, Finland, Norway and Sweden), Switzerland and the UK. Details of the wider sample are provided in Chapter 8. Although not directly relevant to the present study, the results from the wider sample provide additional empirical evidence to support the results for the sample of Benelux and German companies as presented in this thesis.
23. This explanation is speculative and more research is needed to establish why non-participatory owners and creditors rank so low compared to other stakeholder groups. The economic agency model (Chapter 5) would suggest, for example, that the importance of lenders of finance vis-à-vis shareholders depends, *inter alia*, on the number of transactions which management has with each group under the 'nexus of contracts' arrangements. The stakeholder model as employed here makes no assumptions as to whether management deals with shareholders and bondholders more or less frequently. What it does is show that, in terms of the business as a whole, shareholders are perceived as more important than bondholders.
24. Why this might be so is difficult to assess in the absence of further research. However, it may be contended that companies perceive it as more important to manage their relationship with public authorities, the media and neighbours and local communities because these groups are able to hurt the company, in terms of its primary goals, to a greater extent than is the case with environmental pressure groups and other NGOs. This, however, is not to say that ENGOs are not influential some of the time. Royal Nedlloyd, for example, a large Dutch logistics company, stated in its 1991 annual report (p.33): "In view of increasing pressure from environmentalists concerning the use of packaging, Faxion [a group company] expects there to be an accelerated shift from packed to hanging garments."
25. Correlations measure how variables or rank orders are related, Pearson's correlation coefficient being a measure of linear association (Hair *et al*., 1998). Given that Pearson's correlation coefficient is an appropriate statistic for measuring association only if the relationship is linear (Norusis and SPSS, 1988), evidence of a linear relationship was confirmed beforehand by running a simple scatter plot graph.
26. The General Linear Model (GLM) Repeated Measures procedure within SPSS (Norusis and SPSS, 1988) is used in situations where the same type of measurement is taken of each subject or case, as in this case here for the measures of stakeholder importance and engagement, respectively, for each stakeholder group by different companies, and the researcher wishes to investigate whether differences exist across these measures (see, for example, Hair *et al*., 1998). The term 'repeated measures' refers to the fact that the repeated analysis of variances is performed on the measures attributed to each stakeholder group. For these purposes, the stakeholder groups represent the 'within-subjects factor' and each stakeholder group is considered a separate level within that factor.
27. A repeated measures analysis can be approached in two ways, univariate and multivariate. The results reported in Table 9.10 are based on the multivariate approach. The univariate approach (also known as the split-plot or mixed-model approach – see Norusis and SPSS, 1988) yielded very similar results. Using Mauchly's test of sphericity in combination with the Huynh-Feldt epsilon to correct the Greenhouse-Geisser epsilon, which tends to be overly conservative especially for small sample sizes, the F-statistic was 22.553 and the p-value <0.0005 for the sample of Benelux and German companies and 15.342 and <0.0005, respectively, for the wider European sample.
28. The replies to the questionnaire were received in 1998 and therefore there is a mismatch between the last year for which CED data was obtained (1995) and the variable which measures stakeholder importance. As indicated in Chapter 8 although the study was originally intended to include the years 1996 and 1997 resource constraints and time overruns meant that this was not possible. Further analysis to lend support to the results reported in Table 9.12 was performed by running data the relating to stakeholder importance against CED data for all other years (i.e. 1989 to 1994). The direction of association was positive for all years, although none was statistically significant at the five per cent level. These results offer some corroboration for the results reported in relation to 1995 CED data given that they suggest the existence of the same

underlying relationship over time, although in the case of 1995 variances across firms are more pronounced.

29. The same test as reported in Table 9.11 was run again but this time controlling for size (log of assets) and country. For the model, the *F*-statistic was 3.601, with a significant (at 5 per cent) *p*-value of 0.013 and an adjusted *R*-squared value of 0.21. Of the covariates, only that for shareholders had a significant *p*-value (0.030), with an *Eta*-squared value of 0.121. Similarly, when controlling for size (log of assets) and industry sector, the model *F*-statistic was 2.384, with a significant (at 5 per cent) *p*-value of 0.033 and an adjusted *R*-squared value of 0.183. Of the covariates, only that for shareholders had a significant *p*-value (0.005), with an *Eta*-squared value of 0.228.
30. A similar UNIANOVA test to that described above was performed using the mean value of responses to question 2 of the questionnaire to companies which asked respondents to indicate the extent to which the relative importance of the 12 stakeholder groups had changed over the last few years. Question 2 was structured in the form of a seven-point Likert scale, where 1 represents a significant decrease in stakeholder importance, 4 represents no change, and 7 represents a significant increase. The dependent variable in this case was the change in CED for the 32 companies between 1992 and 1995, this change in CED computed as the mathematical difference between the amount of environmental disclosure in 1995 and that for 1992 of the 32 companies, respectively. This variant of hypothesis H_5 asserts that there is a positive association between *changes* in stakeholder importance over time and *changes* in CED over time. The results of this test were mixed. Although the direction of association was as predicted under the alternative hypothesis, the results were not significant.
31. The results presented in Table 9.12 have been influenced by the standard deviation value (i.e. the dispersion of values around the mean) for each stakeholder group. As shown in Table 9.8 these values vary between 0.561 in the case of shareholders and 1.294 in the case of science and education.
32. The reliability analysis procedure is used for evaluating multiple-item-additive scales, providing a large number of reliability coefficients (Norusis and SPSS, 1988). The reliability analysis procedure determines the extent to which items are related to one other (inter-item correlation). An Alpha reliability coefficient of 0.00 indicates no inter-item correlation, whereas a reliability coefficient of 1.00 indicates that items are perfectly correlated with each other. In the specific situation being described here, the reliability analysis procedure was used to identify the general (i.e. non-specific) influence of stakeholder groups.
33. Care is needed in interpreting the results as reported in Table 9.12 due to the presence of what is known as a 'ceiling effect'. This arises because of the method used to measure perceived differences in stakeholder importance from one stakeholder group to another. The ceiling effect is a concern where a respondent indicates that all stakeholder groups are very important (a score of 5) given that this restricts the level of distinction that can be made between 'very important' stakeholder groups. This is an acknowledged weakness of the research approach but one which is difficult to overcome in the absence of a more detailed investigation into alternative measures of stakeholder importance.
34. It is assumed here that both variables serve as valid proxies for 'stakeholder importance'. The lower figure in the case of the surrogate 'extent of direct engagement' suggests that this proxy does not fully capture 'stakeholder importance' although it arguably represents a useful heuristic for exploring the model of stakeholder theory as employed here.
35. Care needs to be exercised when interpreting the results as reported in Table 9.13 given that, as a rule of thumb, the ratio of observations to the number of variables in a regression is 10:1. In the case of Table 9.13, the number of variables is 12, whereas the number of observations is only 32 (the number of companies). What are important perhaps are the regression coefficients because these provide an indication of the effects of each variable in the regression. The downside to the approach used here is that it masks the shared contribution of stakeholder groups collectively. Conversely, the approach does provide an indication of the specific contribution of each stakeholder group. To that extent Table 9.13 provides some useful information although it is not possible to place any emphasis on these findings.

36. For these purposes, 'management' was treated as one stakeholder group with no distinction being made between top, middle and lower management. Respondents were not asked to give their responses in relation to any particular report, such as the annual report and accounts, but for voluntary communication of environmental information in general. However, it seems reasonable to assume that firms' reporting strategies in relation to specific reports, such as the annual report and the environment report, reflect, as least in part, the preferences revealed in Table 9.14.
37. The larger sample of 220 companies included the Benelux and German companies as well as companies from the Nordic countries (Denmark, Finland, Norway and Sweden), Switzerland and the UK, based on a total of useable 87 responses to the questionnaire (see Chapter 8, Table 8.10).
38. These results are also consistent with a general recognition within the European environmental movement that corporate report makers do not regard environmental campaigners as their primary audience, coming after employees, local communities and shareholders (Van Dieren and Van Swigchem, 1995).
39. To perform this test requires a full complement of responses for each company, ignoring the responses of any company for which at least one of the 13 within-subject factors (i.e. stakeholder groups) was missing (Norusis and SPSS, 1988). This reduced the number of useable responses to 29 (i.e. 32 per cent of the sample) as three of the companies which provided positive responses did not complete all parts of the respective question in the questionnaire.
40. These four groups were identified as being those most likely to be particularly concerned with environmental issues *per se* based on prior (anecdotal) evidence (DTTI, IISD and SustainAbility Ltd., 1993; KPMG Peat Marwick, 1993; SustainAbility/UNEP; 1996a; UNEP IE, 1994).
41. It may be argued that two stakeholder groups 'consumers and customers' and 'employees' could be included as 'socio-political' stakeholders. However, they have been excluded here because of their obvious *economic* attachment to the firm or its products and/or services, which more correctly classifies them as socio-economic rather than socio-political. A further ANOVA test was performed to examine the affect of *socio-economic* influences on the environmental disclosure/stakeholder importance relationship for a stakeholder cluster comprised of shareholders, non-participatory owners and lenders, employees, trade creditors and suppliers, industry and trade associations, and customers and consumers. This test was performed by regressing the disclosure variable "Total CED" for 1995 only on the mean stakeholder importance rating for this cluster for the 32 companies which provided useable responses. Although the regression coefficient was positive (0.435), the results were not significant (p-value = 0.136) and the adjusted R-squared was a mere 0.8%.
42. During the early stages of this project a separate questionnaire was developed to be used in exploring more fully the attitudes and beliefs of CEOs in relation to environmental issues. However, sending two questionnaires to each sample company was judged to be too demanding.
43. Whilst such evidence supports the political visibility argument under both EAT and OLT, it remains a matter of subjective belief as to which of the two underlying theoretical explanations is the more acceptable. There is in fact no 'scientific' way of deciding which of these two theories' explanation is the more believable. Whether one prefers the explanation provided by EAT or by OLT is, ultimately, a matter of personal belief influenced by socio-political ideology. However, this need not necessarily be an 'either/or' choice. It is perfectly reasonable, for example, to argue that both perspectives are 'correct', or that one perspective is more relevant than the other in a particular context or situation. This debate, though important, is not explored here.
44. The figures in Table 9.19 relating to the wider sample of European ENGOs provide an indication of how the sample for the Benelux and German countries compares to a more representative sample of Europe as a whole. The larger sample includes the Benelux and German ENGOs as well as ENGOs from the Nordic countries (Denmark, Finland, Norway and Sweden), Switzerland and the UK, based on a total of useable 89 responses to the questionnaire. Details of the ENGOs are not included in the thesis for reasons of space but a complete listing is available from the author on request.
45. To perform this test requires a full complement of responses from each ENGO, ignoring all the responses of any ENGO for which at least one of the eight within-subject factors (i.e. industry sectors) was missing (Norusis and SPSS, 1988). This reduced the number of useable responses to

37 in the case of the Benelux and German ENGOs and 85 in the case of the European sample of ENGOs as a whole.

46. The tests performed here indicate only that there are significant differences overall (i.e. between the high and low mean values). It is evident from Table 9.19 that there are differences between the mean values but that these differences are not equal. For example, the mean values for the top three listed sectors (chemicals, extractive and energy utilities) clearly differ from that of the bottom two listed sectors (retail & leisure and banks & insurance) but the mean values for the first three sectors are not very different from each other. Once differences have been determined to exist among means, post-hoc range tests and pairwise multiple comparisons tests can be performed to determine which means are significantly different (range tests identify homogeneous subsets of means that are not different from each other; pairwise multiple comparisons test the difference between each pair of means, and yield a matrix where significantly different group means are highlighted). However, such tests were not considered necessary in the context of the present study given that the main concern here is merely to establish that differences exist between the means.
47. The inclusion of both direct and indirect impacts in the definition of environmental impacts was intentional though it was a debating issue in the construction of the question. Whether a different set of responses would have been solicited had the definition been restricted to direct impacts alone is not known but seems probable.
48. Due to small samples sizes (see Chapter 8, Table 8.2) it was not possible to perform this test for the Benelux and German companies separately. It is possible that tests at the country level would produce different results to those shown in Table 9.20 although further research is required to explore this in more detail.
49. Although the responses of ENGOs were received in 2000, the approach adopted here is to argue that such responses represent valuable data on the perceptions of ENGOs that has built up over a period of time. Many of these groups have been around for many years and as such it seems reasonable to test for an association between these perceptions on environmental sensitivity and the levels of disclosure over the seven years from 1989 and 1995 as well as for the period as a whole.
50. The null hypothesis in this case does not focus on the position of the two regression lines for environmentally-sensitive (ES) and less environmentally-sensitive (LES) companies, respectively, when run against the proxies for political visibility. As has been shown in previous tests, generally speaking ES companies disclose higher amounts of environmental information than LES companies, indicating that the slope of the regression line for ES companies lies above that of LES companies. Rather, the null hypothesis being explored here posits that the slopes of the two lines are the same when using political visibility as the covariate, implying that any difference in the slopes of the two regression lines is not explained by variations in political visibility.
51. It is possible, for example, that increases in environmental disclosure by business over time and increases in the membership of environmental organizations are *both* the result of changes in the values and norms of society. Hence, whilst they may be positively correlated with one another, this may not be a cause and effect relationship but simply the effect of a common underlying phenomenon. This alternative notion does not appear to have received sufficient discussion in the CSR literature to date.
52. 'Green alliances', defined as collaborative partnerships between ENGOs and business that pursue mutually beneficial ecological goals (Stafford *et al*., 2000), stand in marked contrast to the more traditional, antagonistic postures adopted by ENGOs (see, for example, Eden, 1996; *The Economist*, 1993a). Since the late-1980s and early 1990s, green alliances between NGOs and business have become much more popular, partly because both parties have become frustrated with government policy-making (Arts, 2001) and partly because there has been a discernable consolidating and professionalising trend among the largest NGOs (Smillie, 2000). Greenpeace, for example, recently started to co-operate with business partners to design and produce eco-products, some of its more well-known examples including the *smile* car, a car designed by the Swiss firm Wenko AG which has half the fuel consumption of a normal car, and the *Greenfreeze*, a CFC-safe refrigerator produced by the German company Foron (Arts, 2001). Thus it should not

come as a surprise to find some of the ENGOs included in the present study working with business through these sort of alliances.

53. This question was focused at industry rather than company level given that prior investigations indicated that campaigns by ENGOs were directed mainly at industries rather than specific companies.
54. This test requires a full complement of responses from each ENGO, ignoring all the responses of any ENGO for which at least one of the eight within-subject factors (i.e. industry sectors) was missing. This reduced the number of useable responses to 22 in the case of the Benelux and German ENGOs and 50 in the case of the European sample of ENGOs as a whole.
55. The mean values for the separate responses of Benelux and German ENGOs, respectively, in relation to environmental campaigns against each industry sector were computed in the same way as those shown in Table 9.25 (the latter being based on aggregate responses) but were different in each case. The General Linear Model (GLM) Repeated Measures MANOVA test when run against Benelux and German ENGOs' responses, respectively, for the extent of campaigns directed at the eight industry sectors showed the mean scores for each sector to be significantly (at 5 per cent) different from each other.
56. The test was performed against each year's data for environmental disclosure as evidence provided below (Table 9.28) indicates that the extent of ENGOs' environmental campaigning activities had not changed significantly over the last few years. However, there is clearly a limitation to this test given that the responses from ENGOs were received in 2000.
57. This assertion should, however, be tempered by the fact that the number of environmental groups in the present study was limited (38 in the case of Benelux and German countries) and did not include in all cases some of the more prominent environmental campaign groups such as Friends of the Earth, Greenpeace and WWF. More substantial research is needed to explore the influence of European environmental groups in this particular context, for example, in terms of the activities of these groups as a whole and in tracking the actions of particular groups in relation to specific companies. One of the key problems encountered in the present study was the time and effort required to persuade ENGOs to assist in the research project. Many, particularly the larger, international groups and their umbrella organizations such as the European Environment Bureau (EEB), were unwilling to participate due to limited human and financial resources.
58. It is also possible that the campaign activities of ENGOs are influential in ways other than those explored here. The present study looks at environmental disclosure not *performance*, and it is possible (although unlikely) that ENGO's campaign activities have changed the environmental performance of companies without this necessarily leading to increased disclosure. As discussed in Chapter 7, under OLT actual changes in corporate behaviour were identified as the first legitimation strategy, where a change in the organization's mission is seen as necessary in response to shifts in the society's values, norms, customs and attitudes, the objective being to educate and inform the relevant publics about the changed performance (Lindblom, 1994). Whilst it is theoretically correct to suggest that changes in performance do not necessarily lead to changes in reporting, OLT suggests that if the former is due to the perception on the part of management of a legitimacy gap, there will be an emphasis on communicating this change to society, which, arguably, would lead to increased levels of reporting.
59. Similar results to those presented in Table 9.30 were achieved when also controlling for industry sector, although significant *p*-values (at the 5 per cent level) were found for the years 1989 and 1990 only. One possible explanation for these results when compared to those presented in Table 9.31 is that both CED and environmental reputation are correlated with industry sector. In other words, there is an industry sector affect on both CED and environmental reputation. Previous tests have shown that CED is sensitive to industry sector (Table 9.5). It is possible that eco-ratings of companies by ENGOS were based on their perceptions of the company as well as the industry in which it operates. By controlling for industry sector, the industry sector level influence is effectively removed, leaving only the company level influence. The hypothesis tested here makes no distinction between sector level and company level influences on eco-ratings.
60. Judgement as to what represents a significant correlation coefficient varies. However, a general rule of thumb would suggest that the correlation between two variables that remains after removing the correlation that is due to their mutual association with the other variables may be

considered large if it is greater than 0.50, medium if between 0.30 and 0.50 and small if between 0.1 and 0.3.

61. Further evidence of the 'industry effect' on environmental reputation was found when running the same partial correlation as reported in Table 9.30 but this time controlling for industry as well. The results were not significant in any year, which is consistent with what might be expected given that controlling for industry would effectively neutralise the variation in environmental reputation.
62. A further series of partial regressions was also performed controlling for industry sector. The results were similar to those reported in Table 9.32.
63. A simple dichotomy is employed which classifies disclosure as between 'good' and 'bad' news, where good is taken to include neutral disclosures. This approach reflects the way in which the data was collated. The inclusion of 'neutral' disclosures within the 'good' news category is justified on the grounds that, under OLT, in attempting to manage public impressions in relation to environmental issues, OLT suggests that management of a company will deliberately bias the reporting of information away from 'bad' news by focusing on news which has a positive (or neutral impact) on the organization. In this context, it is the avoidance of bad news which is particularly significant in terms of socially constructing society's perception of the business organization given that much of the environmental debate since the late 1980s has been about the negative environmental impacts of modern industrial capitalism.

Chapter 10

Interpreting longitudinal trends in corporate environmental disclosure

10.1 Introduction

The previous chapter focused on single-period, putative associations between corporate environmental disclosure (CED) and other variables using the hypothetico-deductive method of research. In contrast, this chapter employs interpretive research in offering a descriptive interpretation of the underlying causes of trends in CED over time. Interpretive research provides an alternative approach to exploring social phenomena that may offer different, but not necessarily conflicting, accounts or 'stories' of those phenomena. The interpretive paradigm (see Chapter 4, Section 4.6) has value because, even though (we think) we know how accounting and reporting is used in a narrow, functionalist sense, we still have relatively little understanding of the varieties of roles, constructions and meanings which accounting and reporting actually play in a wider socio-political context (Burchell *et al.*, 1980; Cooper *et al.*, 1981; Dey *et al.*, 1995; Hayes, 1983; Tomkins and Groves, 1983). Essentially, an interpretive approach involves interplay between the data and the theory, looking for trends and then trying to interpret those trends based on a perception of the changes that are taking place within society over time (see, for example, Gray *et al.*, 1995b). The researcher begins with an *a priori* understanding about relationships between organizations and society through an explicit recognition of the existence of certain structures and relationships that exist within society. These *a priori* assumptions are used to formulate general understandings about the changes that are taking place within society over a specific time period and the main determinants of those changes.

The rest of this chapter is structured as follows. Section 10.2 provides an overview of the origins of the interpretive approach and of its application in the study of accounting in general and CSR/CED in particular in the context of the business-society relationship. Sections 10.3 through to 10.6 provide a descriptive account of trends in CED over the period of the study and an interpretation of those trends. The descriptive analysis is presented along three fronts: firstly, by reference to the popularity (i.e. frequency) of CED (Section 10.3); secondly, in relation to the volume (i.e. quantities) of CED (Section 10.4); and thirdly, by reference to the form (i.e. qualitative characteristics) of CED (Section 10.5). Section 10.6 forms the 'meat' of the present chapter, drawing on four theoretical frameworks (i.e. EAT, MST, OLT and PEAT) in seeking to offer an interpretation as to the underlying causes of trends in CED by large Benelux and German companies over the period of the study. Section 10.7 provides a summary of, and some conclusions on, the different perspectives offered by these four theoretical frameworks.

10.2 An interpretive approach to accounting and reporting

The interpretive approach to research in the social sciences is derived from the Germanic philosophical tradition that emphasises the roles of language, interpretation and understanding in the social sciences (Chua, 1986). This tradition, influenced particularly by the work of Schutz (1971, 1972)[1] and Berger and Luckmann (1967), places emphasis on the meanings which human beings give to their everyday realities. From this perspective, 'social reality' acquires meaning through a process of self-reflection, an individual's lived experiences having in themselves no meaning or identity until retrospectively endowed with meaning by the individual. Such experiences, rather than taking place within a vacuum, are perceived as taking place within a continuous process of social intercourse which, through intersubjective interaction, generates a comprehensive set of social norms and meanings that become 'real' (Chua, 1986). Interpretive research is thus concerned primarily with *understanding*[2] these social norms and everyday meanings, rather than with prediction and explanation, by looking at the deeply-embedded rules which structure the social world, how such rules are sustained and modified, and the typical motives which explain the actions of society as a whole. Thus, in essence, "… the interpretive scientist seeks to make sense of human actions by fitting them into a purposeful set of individual aims and a social structure of meanings" (Chua 1986, p.614). To understand such meanings requires what is called 'subjective interpretation', whereby the scientist seeks to ascribe meaning to an individual's action. Hence, interpretive knowledge is intended to reveal to people what they are doing when they act and behave as they do within the respective social and historical contexts (Fay, 1975).

The importance of the interpretive approach in an accounting context is the recognition that, in practice, accounting information may be ascribed various social meanings, rather than simply being seen from within the mainstream accounting tradition as a means of regulating or controlling the behaviour of 'inputs', or as a mechanism for efficient contracting[3]. Such a variety of meanings are seen as intrinsic to an emergent and emerging social and accounting reality that is continually being redefined (Chua, 1986). In addition, these meanings:

> *… do not necessarily conform to a priori rational definitions such as "being useful for efficient decision-making". Accounting numbers are inadequate representations of things and events as experienced by human beings. Because of this actors will seek to transcend the formality of the numbers and manipulate their symbolic meaning to suit their particular intentions* (Chua 1986, p.617).

Hayes (1983), for example, suggests that, with the ever-expanding demand and use of accounting information, it is the intrinsic ambiguity of such information which permits complex trade-offs between interest groups within society as a whole. Moreover, not only is accounting, and thus disclosure, viewed as a means of giving visibility to particular definitions of what is 'efficient' or 'effective' or that which is 'desirable' and 'feasible', it may also be used to actively mobilize bias, to define the parameters of organizational debates and to legitimise particular sectional interests (Chua, 1986). As such, the focus of interpretive research moves accounting into the real-life world of actors (Chua, 1986), in which, instead (as under EAT) of constructing rigorous but artificial constructs which presume rational, consensual human action, the 'black box' of the firm is opened up to explore the *processes* by

which the various factions both within and outside the firm deal with situations involving goal-conflict.

The explicit recognition and acceptance of conflict amongst the members of a society evolved out of a number of developments in political theory, notably empirical democratic theory, i.e. 'pluralism' and, later, neo-pluralism (see Chapter 6). In the specific context of the natural environment, conflict between various groups in society may be said to revolve around the way in which those different groups perceive the environment. For example, business organisations have traditionally seen the environment as a commodity, i.e. as a factor of production, to be utilised in the production and distribution of goods and services. In sharp contrast to this utilitarian viewpoint, the deep ecology movement perceives all living organisms as having an inherent right to existence and sees humans as not more or less important than any other species. Between these two extremes lie a number of different, alternative perspectives which recognise, to varying degrees, the need to protect, nurture and restore the natural environment within or outside the social framework of a liberal economic democracy.

The extent to which a society is able to arrive at some kind of consensus on the extent to which the environment should be protected is influenced by a variety of factors, including our knowledge as to the implications which current human lifestyles have for the future health and diversity of life on Earth. New scientific knowledge, such as, for example, that relating to the effect of chlorofluorocarbons (CFCs) on the ozone layer, can profoundly change a society's values, attitudes, perceptions and concerns in relation to the natural environment. Since the 1970s through to the present day there have been a number of social, political and scientific events and developments which have raised the profile of these values and concerns, bringing them to the attention of mass audiences (see, for example Elkington 1997, pp.45-66). The Club of Rome's report *The Limits to Growth* on the predicament of mankind (Meadows *et al*., 1972), the United Nations World Commission on Environment and Development's report *Our Common Future* (UNWCED, 1987) and the United Nations Conference on Environment and Development in Rio de Janeiro, Brazil, in 1992 (known as the Rio Summit) were all cogent signals of a growing re-assessment of the business-society relationship in the context of social and environmental issues. The Rio Summit, for example, was a significant landmark in the raising of international consciousness on environmental and social issues in the Third-World and resulted in a number of key international programmes towards sustainable development, including *Agenda 21*, *The Rio Declaration on Environment and Development* and *The Convention on Biological Diversity* (Gilpin, 1996).

Notwithstanding the significance of individual events, such as, for example, the *Exxon Valdez* incident (see, for example, Patten, 1992; Walden and Schwartz, 1997), each may be seen as offering only a partial insight towards a more holistic, inclusive understanding of human, social and environmental responsibility. Rather than employ positivist methodology to analyse this greater whole, assuming of course that such an analysis is at all possible[4], the 'story' presented in this chapter uses an interpretive approach to explore alternative accounts or 'stories' of trends in CED over the period 1989 to 1995. This account recognises the socio-political importance of historical facts but sees these facts as merely elementary and partial aspects of a much bigger issue. Simply put, that bigger issue is the relationship of humankind to the natural world and the associated responsibilities that go with humankind's role as the

self-appointed, sole trustee of the planet for present and future generations of *all* life-forms[5]. This relationship and its responsibilities have been partially captured by 'green' economists, accountants and gurus within the more common constructions of 'sustainability' and 'sustainable development' (see, for example, Bebbington and Thomson, 1996; Elkington, 1994, 1997, 2001; Ekins, 1992; Gray, 1990a; 1992; Hawken, 1993; Hawken *et al*., 1999; Pearce *et al*., 1989). However, given that human understanding of 'reality' is severely limited, such concepts are more appropriately seen as social constructions of phenomena that rely on a set of human values and beliefs which create a certain view of how the world might be or should be rather than describe what that world actually is. It is from within this perspective and context that all social constructions and accounts of the relationship between business and society are explored when addressing corporate environmental (as well as social and ethical) responsibilities, irrespective of whether or not the researcher is able or willing to countenance an holistic approach to relationships, responsibility, uncertainty and truth.

Each of the three theoretical frameworks used to predict and explain CED in the proceeding chapters (i.e. EAT, MST and OLT) may thus be seen as an account or 'story' constructed from within different research traditions. Whilst these different research traditions place emphasis on particular methods of research (such as 'positive economics' in the case of EAT), the respective theories associated with these different traditions lend themselves to alternative research approaches[6]. The approach adopted in this chapter is to employ each of these three theories in interpreting trends in CED over time. In addition, the use of an interpretive approach opens the door to the inclusion of other theoretical perspectives which would otherwise have been excluded from the study because of the phenomenon known as theory closure (see Chapter 4). Thus, a fourth perspective, that of classical (i.e. Marxian) political economy of accounting theory (PEAT), is employed for the purposes of providing an alternative lens through which to interpret these trends from a radical structuralist perspective (see Chapter 4). A descriptive account is provided below of the trends in CED as a precursor to theoretical interpretation.

10.3 Popularity of environmental disclosure

Results in relation to the popularity of environmental disclosure across various testable dimensions adopted in the present study (see Chapter 8, Section 8.3) are summarised in Table 10.1 below. This table points to an overall pattern of increasing frequency of disclosure amongst Benelux and German companies over the period of the study. These results are consistent with earlier, similar Western European longitudinal CSR studies (see, for example, Gray *et al*., 1995b; Van Nuffel *et al.*, 1994, 1995; O'Dwyer and Gray, 1998). The number of Benelux and German companies providing at least one item of CED over the period was high, rising from a base point of 81 per cent of companies in 1989 to a maximum of 96 per cent in 1994, declining slightly in 1995 to 93 per cent of companies. Sample companies which made no CED in a particular year (the non-disclosers) were split fairly evenly between the Benelux and German companies. Only one company, AEGON, a Dutch-based international insurance and financial services group, made no environmental disclosure over the period of the study[7]. The percentage of non-disclosers as reported here is more or less in line with other European studies. Adams *et al*. (1995), for example, who studied the 1992

Table 10.1
Popularity of environmental disclosure amongst Benelux and German companies, 1989 to 1995

	1989		1990		1991		1992		1993	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Perce
Disclosure										
Companies making disclosures	73	81	81	90	83	92	85	94	84	93
Companies making no disclos.	17	19	9	10	7	8	5	6	6	7
Totals	90	100	90	100	90	100	90	100	90	100
Location										
Annual Reports (AR)	83	78	80	72	83	70	85	71	84	71
Social Reports (SR)	8	7	10	9	9	7	9	8	8	7
Environment Reports (ER)	2	2	2	2	3	3	5	4	6	5
Reviews of the Year (RY)	9	8	13	12	15	13	11	9	10	8
Other reports/documents (OR)	5	5	6	5	9	7	9	8	11	9
Totals	107	100	111	100	119	100	119	100	119	100
Theme										
Environment	71	47	79	48	80	48	84	49	83	50
Energy	28	19	32	19	29	18	34	20	29	18
Health and Safety	51	34	54	33	56	34	54	31	53	32
Totals	150	100	165	100	165	100	172	100	165	100
Evidence										
Monetary & Non-Monetary*	27	37	30	37	27	32	32	37	34	40
Monetary Quantification only*	8	11	5	6	9	11	3	4	4	5
Non-monetary quantities only*	13	18	8	10	13	16	18	21	20	24
Declarative only	25	34	38	47	34	41	32	38	26	31
Totals	73	100	81	100	83	100	85	100	84	100
'News' value										
Good/neutral	72	80	81	82	82	73	85	74	84	74
Bad	18	20	18	18	31	27	30	26	29	26
Totals	90	100	99	100	113	100	115	100	113	100

Notes: * Including declarative disclosures

English language versions of annual reports of the largest 25 companies across six European countries (the Netherlands, France, Germany, Sweden, Switzerland and the UK) report that 23% of companies provided no environmental disclosure.

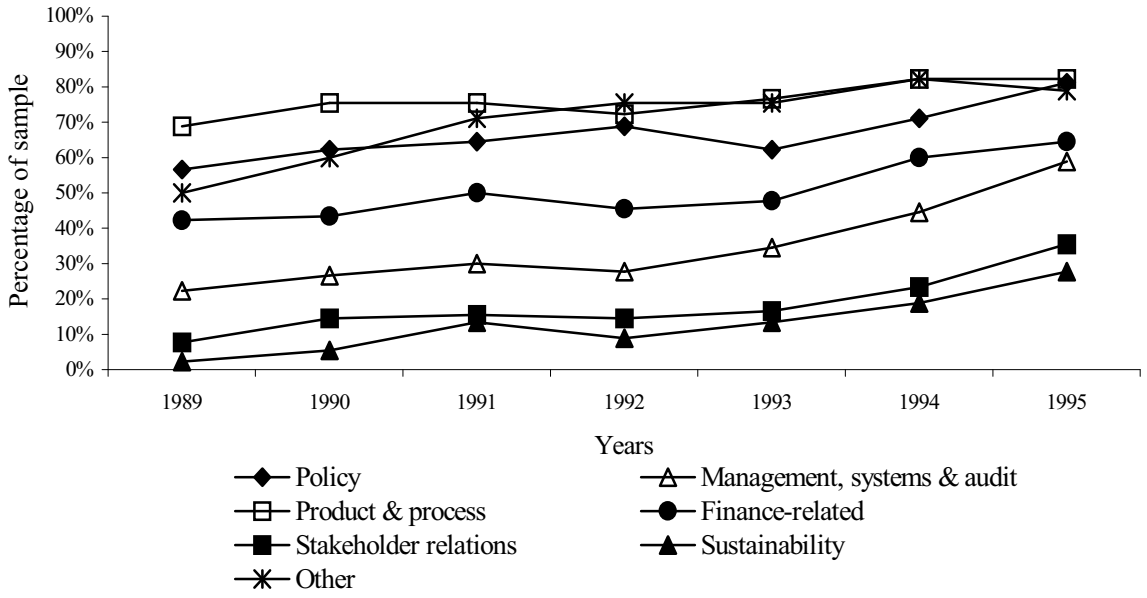
In relation to the location of CED within the various reports included in the study (see Chapter 8, Section 8.5), the majority of companies chose to disclose environmental information in the annual report (Table 10.1). However, whilst annual reports remained the primary location, other source documents, particularly company-wide, stand-alone environment reports and other reports and documents became increasingly more popular. Indeed, by 1995 the popularity of environment reports appeared to account for the declining popularity of annual reports in the context of environmental disclosure. The popularity of social reports and reviews of the year remained relatively stable throughout the period. Most Benelux and German companies made environmental disclosure in more than one area. Whilst the number of disclosures in each of these areas increased steadily throughout the period, their relative proportions remained more or less constant.

Of the three principal categories of disclosure (i.e. environment, energy and health and safety - see Appendix 2), environment was noticeably the most popular item reported by Benelux and German companies in all seven years from 1989 to 1995. For much of this period, health and safety disclosure was relatively stable suggesting that the increase in environmental reporting (see Section 10.4 below) did not act as a significant spur to greater reporting of related health and safety issues. Energy disclosure was the least popular of the three, although reporting on energy issues rose significantly in 1995[8]. The trends and relative proportions of these three categories of disclosure are more or less in line with those reported by Gray *et al.* (1995b) in the case of UK companies over the period 1987 to 1991. The latter's study showed a significant increase in environmental disclosure between 1987 and 1991, with health and safety disclosure, although less popular, also rising steadily over this period, whilst energy disclosure was the least popular, failing to rise above 20% of the sample companies.

Looking at the form (i.e. the qualitative characteristics) of these disclosures, the majority of the sample companies offered some form of monetary or non-monetary quantification in addition to simple descriptive CED (Table 10.1 above). The number of companies offering only descriptive information rose between 1989 and 1990, but declined steadily thereafter such that over the entire period it decreased from 34% of companies in 1989 to 21% in 1995. In comparison, the number of companies providing both monetary and non-monetary quantifications increased from 37% of companies in 1989 to 56% of companies in 1995 with much of this increase taking place between 1993 and 1995. These trends would seem to suggest that Benelux and German companies are moving away from merely discursive forms of environmental reporting towards the provision of more quantified forms of disclosure. A small minority of disclosures reported 'bad' news, with the majority reflecting favourably or neutrally on the company ('good/neutral' news). The number of disclosures representing 'bad' news increased between 1989 and 1991 but declined thereafter.

Figure 10.1 below provides a longitudinal analysis of the popularity (*not* volume) of environmental disclosure for the taxonomy of CED used in the present study (see Chapter 8, Section 8.4).

Figure 10.1 Environmental disclosure by category



The most popular categories of CED over the period of the study were those relating to: (i) environment product- and process-related, (ii) environment policy, (iii) environmental financially-related and (iv) environmental management systems and audit, respectively. The least popular categories were sustainability and stakeholder relations, respectively. However, the popularity of some categories of CED increased more significantly than others, notably disclosures relating to (i) management systems and audit, (ii) stakeholder relations and (iii), sustainability, these categories starting from a relatively low base, with the popularity of the more common categories of disclosure such as environment product- and process-related remaining fairly stable over the period.

The rising trend of CED throughout the period of the study is consistent with prior longitudinal studies which have explored trends in CSR/CED amongst large Western European and Australian companies in the 1990s (Table 10.2 below), although Irish companies appear to buck this trend (O'Dwyer and Gray, 1998). The Gray *et al.* (1995b) study reports environmental disclosure being dominated by disclosures relating to products and processes, environmental other and, to a lesser extent, environmental policy. O'Dwyer and Gray (1998), in their study of the largest stock exchange-listed companies in the Republic of Ireland over the five-year period from 1991 to 1995, report that companies disclosing information relating to the environment concentrated mainly on general environmental policy with disclosures relating to products and waste recycling being the second most common category of environmental disclosure.

A similar pattern was reported by Van Nuffel *et al.* (1995) in their longitudinal analysis of environmental reporting by large Belgium companies over the five-year period from 1987 to 1991, with disclosures in relation to environmental policies, environmental improvements and emission levels being the most popular areas of reporting. The present study's findings suggest that the management of Benelux and German companies focused initially on eco-efficiency issues, notably matters closely associated with their products and processes (e.g.

Table: 10.2
Longitudinal studies of corporate social and environmental disclosure

Author(s)	Period of study	Sample companies	Variable studied	Main findings
Gray *et al*. (1995b)	13 years 1979 to 1991	Two samples, the first (relating to 1979-87) being a haphazard sample and the second (relating to 1988-91) being the largest 100 UK companies ranked by turnover	Corporate social disclosure (CSR) in annual reports	General rise in the disclosing mandat notably environm volume of mandat voluntary disclosu largely to employ disclosure and the disclosure from th
Gibson and O'Donovan (1994)	10 years 1983 to 1992	41 Australian publicly-listed companies from eight industry groups	CED in annual reports (AR)	Proportion of AR period. Upward tr descriptive, non-f environmental inf
O'Dwyer and Gray (1998)	5 years 1991 to 1995	50 largest companies listed on Irish stock exchange as at 31 December 1995, based on market capitalisation	CSR in annual reports (AR)	Highest incidence of AR devoted to environmental dis little quantitative Almost all disclos evidence of any 'b
Niskala and Pretes (1995)	6 years from 1987 to 1992	75 Finnish firms drawn from the largest firms in the most environmentally-sensitive industries	CED in annual reports	Increase in the pro environmental inf 1992
Van Nuffel *et al*. (1995)	5 years from 1987 to 1991	39 companies from five largest industrial sectors in Belgium (chemicals, textiles, processing, food, and motor)	CED in annual reports covering seven specific areas	Increasing numbe time (except for 1 information provi only 'positive' ne

'environmentally-friendly' production methods and 'environmentally-friendly' products) as well as the costs associated with such activities and associated financial investments, and the formulation of an environmental policy. Later on however, particularly post-1992, there was an apparent shift in reporting strategy with a greater focus on eco-justice issues, notably, stakeholder relations and sustainability[9].

Another interesting feature of this pattern is the relative changes in the popularity of the different categories of environmental disclosure throughout the period. Disclosure in relation to environmental product and process, for example, was widely adopted by the sample companies in each year, increasing from 69 per cent of companies in 1989 to 82 per cent in 1995. In comparison, disclosure in relation to stakeholder relations was made by only 8 per cent of companies in 1989, but rose dramatically throughout the period to 36 per cent of companies in 1995. Similarly, the popularity of sustainability issues, disclosure items in relation to which were provided by only 2 per cent of companies in 1989, rose rapidly over the period to 28 per cent of companies by 1995.

10.4 Volume of environmental disclosure

The above analysis of CED serves a useful purpose in terms of providing a broad overview of the frequency of corporate environmental disclosure over the period of the study. However, a significant feature of the present study is the amounts of CED contained within company reports as revealed through content analysis. Table 10.3 below provides summary values for the total amount of CED (in A4 pages or part thereof) by Benelux and German companies in each year of the study and for the period as a whole.

Table 10.3
Volume of environmental disclosure 1989 to 1995

Year	N	Total CED (pages of A4)	Mean CED	Median	Maximum	Minimum
1989	90	277.56	3.08	0.77	43.66	0.00
1990	90	309.60	3.44	1.17	45.59	0.00
1991	90	407.08	4.52	1.45	46.61	0.00
1992	90	452.84	5.03	1.66	53.48	0.00
1993	90	516.82	5.74	1.29	68.37	0.00
1994	90	638.90	7.10	1.44	81.25	0.00
1995	90	1,693.80	18.82	2.77	176.62	0.00
All years	630	4,296.60	6.82	1.43	176.62	0.00

Notes: Where: N represents the total sample of companies; maximum and minimum are the highest and lowest volumes, respectively, of CED amongst the sample companies.

The overall statistics presented in Table 10.3 reveal a rising trend of environmental disclosure by Benelux and German companies over the period, the mean number of pages increasing from only 3.08 pages in 1989 to 18.82 pages in 1995. The rise between 1994 and 1995 is particularly noticeable in this context. The median (i.e. typical) values over the period reveal

a different trend, CED rising steadily over the years 1989 and 1992, declining in 1993 and rising again, albeit from a lower base, between the years 1993 and 1995. The trend in median values, being based on the typical firm in the sample, suggests that mean values have been influenced quite significantly by the small number of companies which provide relatively very high amounts of environmental disclosure (see Chapter 9, Table 9.1)[10]. Moreover, there are considerable fluctuations in disclosure over the period within each company, much of which has to do with the significant influence of corporate environment reports. Thus, whilst at a macro-economic level these results suggest increasing environmental disclosure by Benelux and German companies, there can be considerable fluctuations from one year to another within individual firms.

The statistics presented in Table 10.3, whilst illustrating changes in the level of CED over time, provide no means of comparing environmental disclosure to what companies were reporting to society as a whole. To place environmental disclosure in a wider social reporting context, Figure 10.2 below compares the mean number of pages of CED to both the total number of pages published and the amount of space given over to 'Management and Accounting Information ('AccPP') whether statutory or voluntary[11].

Figure 10.2 Relative proportions of disclosure by source

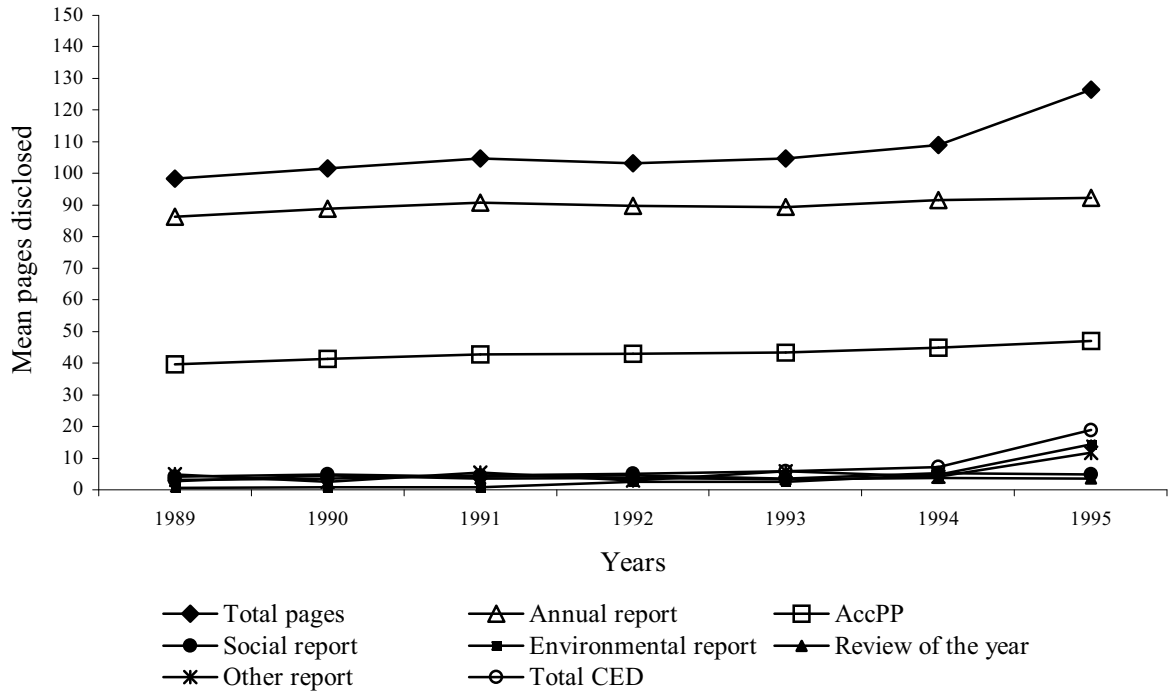


Figure 10.2 aids understanding in terms of the relative amounts of space, and thus, arguably, by implication, the relative importance given to environmental issues in terms of the variety of economic, environmental and social issues which companies may choose to report upon. Looking at the total volume of economic and socio-political information placed in the public domain by Benelux and German companies over the period, the vast majority of this information is to be found in the annual report and accounts[12]. In 1989, for example, the total volume expressed in terms of the mean number of pages per company was 98.4 pages, of

which 86.4 pages (87.8 per cent) were contained in the annual report. In the final year of the study, 1995, the mean volume of total information included in company reports (as defined) had risen to 126.6 pages per company, of which 92.3 pages (73.0 per cent) were contained in the annual report. Thus, although its share of the total volume of published information declined over the period, the annual report remained by far the most significant source of economic, social and political information by volume for companies as a whole.

None of the other types of report included in the study challenged the dominant position of the annual report. This would suggest, *prima facie*, that annual reports continued to serve an important role in terms of the economic and socio-political messages which Benelux and German companies wished to communicate to society. The second obvious feature of Figure 10.2 is the relative importance which accounting and related financial and supervisory /management information played in this context. In 1989, accounting and management information ('AccPP') represented 40.3 per cent of total average information by volume compared to 37.2 per cent in 1995. By contrast, CED represented only 3.1 per cent by volume in 1989, rising to 14.87 per cent in 1995. Thus, despite a small decline over the period, accounting and financial and supervisory/management information constituted a much more significant element by volume, relative to that of other disclosures, including CED, throughout the period. However, looking more closely at the trends revealed by Figure 10.2, there are some interesting developments. Importantly, there does appear to be a shift in the relative proportions of other types of reports and other categories of disclosure in the later part of the study. Whilst the total volume of information increased by 28.6 per cent between 1989 and 1995, the volume of information as contained in annual reports was relatively stable, rising by only 6.8 per cent. This implies that the relative significance of other types of reports, in the context of the total volume of reported information, was increasing. The evidence as presented in Figure 10.2 would suggest that this is due, in part at least, to the increased popularity of corporate environment reports and other one-off reports as opposed to increased reporting through social reports or reviews of the year.

To illustrate this point, between 1994 and 1995 the average number of pages represented by corporate environment reports increased from 4.62 pages per company to 14.30 pages per company, an increase of 210 per cent. Looking at the amount of total pages devoted to accounting and related financial and supervisory/management information, this remained fairly constant over the period, increasing from an average of 39.66 pages in 1989 to 47.04 pages in 1995, i.e. a rise of 18.6 per cent. In contrast, the amount of pages devoted to environmental issues increased from an average of 3.08 pages in 1989 to an average of 18.82 pages in 1995, an increase of over 510 per cent[13]. As indicated in the previous paragraph, much of the significant increase in the CED between 1994 and 1995 was due to a significant increase in the reporting of environmental information via corporate environment reports. Projecting beyond 1995, this would seem to suggest that both corporate environment reports and corporate environmental disclosure might come to play a more significant role vis-à-vis the annual report in the context of the organization-society dialogue. The specific role of annual reports in this context is depicted in Table 10.4. The data presented in Table 10.4 indicate that the annual reports of Benelux and German companies provided little by way of environmental disclosure relative to the total volume of information contained in these reports. In the case of Benelux companies, the proportion of annual reports devoted to CED increased over the period from 1.20 per cent in 1989 to 1.80 per cent in 1995, shadowing the

rise in the average number of pages devoted to annual reports which increased from an average of 87.73 pages in 1989 to 96.35 pages in 1995. For German companies, however, the mean amount of environmental information in annual reports fell from 2.65 per cent in 1989 to 2.44 per cent in 1995, despite the fact that the average number of pages in annual reports rose from 85.26 pages in 1989 to 89.1 pages in 1995.

Table 10.4
Mean pages of annual reports devoted to environmental issues

Region	Year	n	Number of pages in Annual Report (mean)	Total CED in Annual Report (mean)	%
Benelux	1989	40	87.73	1.05	1.20
	1990	40	90.43	1.07	1.18
	1991	40	95.20	1.75	1.84
	1992	40	93.08	1.84	1.98
	1993	40	92.53	1.34	1.44
	1994	40	94.13	1.63	1.73
	1995	40	96.35	1.73	1.80
Germany	1989	50	85.26	2.26	2.65
	1990	50	87.42	2.64	3.02
	1991	50	87.14	2.30	2.63
	1992	50	87.08	2.27	2.60
	1993	50	86.86	2.71	3.12
	1994	50	89.54	2.28	2.55
	1995	50	89.10	2.17	2.44

This difference in trends between German and Benelux companies might be explained by the fact that a much higher percentage of German companies produced first-time corporate environment reports during the period (Chapter 8, Table 8.7), perhaps preferring to use these reports as a vehicle for more detailed environmental disclosure. A more detailed analysis of environmental disclosure by Benelux and German companies over the period is provided in Figures 10.3 to 10.7 below. Figure 10.3 shows the relative proportions of the three principal categories of environmental disclosure in comparison to the total amount (Total CED). The rise in average volumes of Total CED by Benelux and German companies over the period is obviously influenced by the rise in the proportion of companies disclosing environmental information (see Table 10.1 above).

Figure 10.3 (see below) is striking on two counts. Firstly, although Total CED rises steadily between the years 1989 and 1994, the change between 1994 and 1995 is much more dramatic[14]. As indicated above, the source of this step-change is the increase in the number of companies publishing company-wide, stand-alone environment reports. Secondly, this change is almost entirely due to the increase in environmental disclosure, with the amount of health and safety and energy disclosure remaining relatively constant throughout the period. The relatively low incidence of energy disclosure throughout the period is consistent with the results reported by Gray *et al*. (1995b) in the case of UK companies over the period 1979 to 1991. However, Gray *et al*. reported a significant increase in health and safety disclosures over the period of their study, whereas this was not the case with Benelux and German companies over the period 1989 and 1995. One possible explanation for this dissimilarity is

that health and safety matters were much less of a social issue for Benelux and German companies compared to their UK counterparts due to higher health and safety standards resulting from the influence of Workers' Councils and the European Union's Social Chapter. UK companies were not subject to these socio-political influences and as such may have been using health and safety disclosure to demonstrate increasing concern for the protection and training of the workforce as part of a legitimation strategy to change perceptions (Gray *et al.*, 1995b).

Figure 10.3 Volume of CED by principal categories

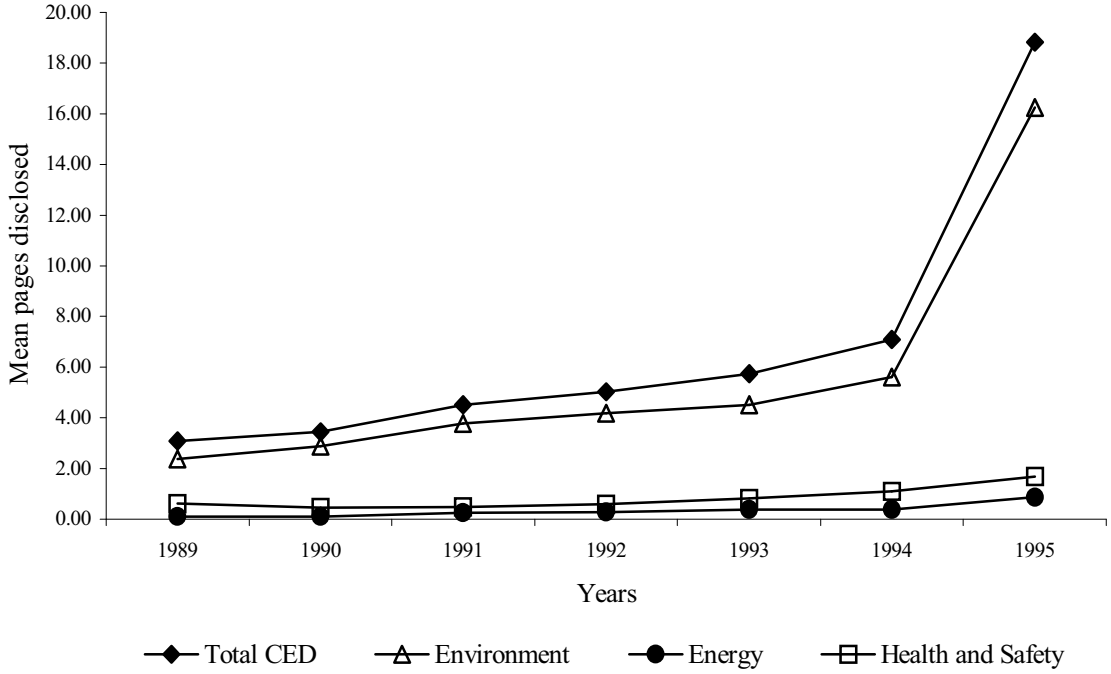


Figure 10.4 below provides an analysis of the volume of environmental disclosure only (i.e. excluding energy and health & safety) according to the seven different categories used for classifying these disclosures (see Appendix 2). In contrast to Figure 10.1 above, which describes the frequency of disclosure amongst the sample companies, Figure 10.4 highlights the relative mean number of pages devoted by Benelux and German companies to each of the seven categories of environmental disclosure. However, the pattern is a similar one, with environmental product and process-related disclosure being the most common by volume, particularly from 1993 onwards. By 1995, the average amount of pages devoted to environmental product- and process-related was 8.02 pages, roughly half of all total environmental disclosures by volume. This compares to only 1.53 pages by volume in 1989, an increase of 425 per cent over the period.

Figure 10.4 Analysis of environmental disclosure by type

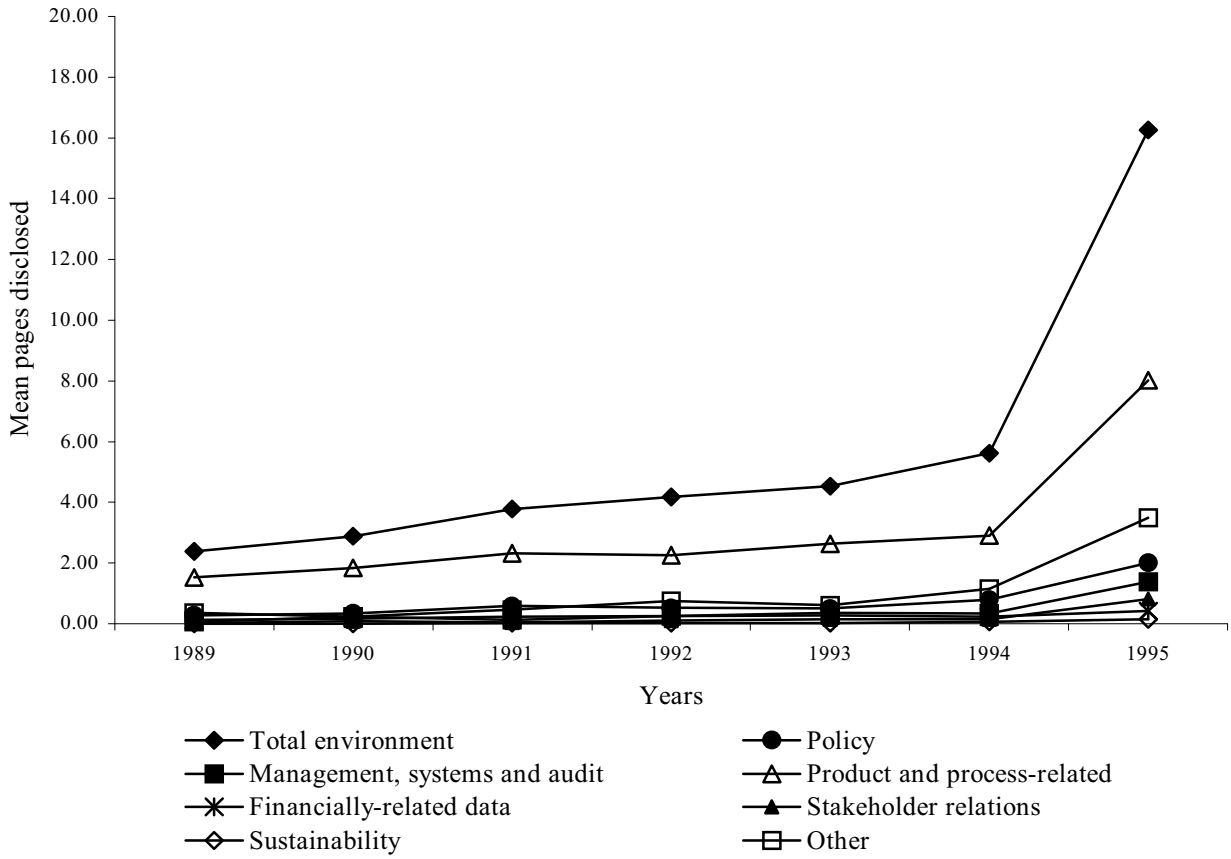


Table 10.5 below indicates the three main areas of emphasis of environmental disclosure by Benelux and German over the period of the study (where 'environment' refers to the seven categories of 'environment' shown in Appendix 2 excluding the categories 'health and safety' and 'energy').

Table 10.5
Area of emphasis for top three areas of environmental disclosure

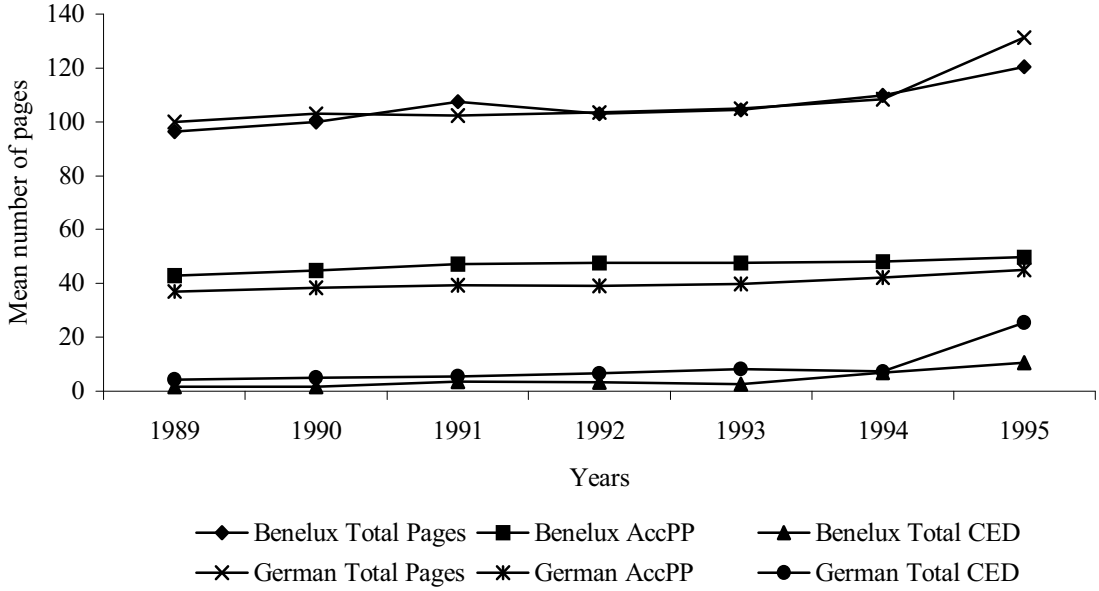
Year	Mean no. of pages	Primary focus (% of total)	Secondary focus (% of total)	Third focus (% of total)
1989	2.37	Product & Process (64.4%)	Policy (11.9%)	Finance-related (5.2%)
1990	2.87	Product & Process (63.9)	Policy (11.5)	EMS & Audit (8.2)
1991	3.79	Product & Process (61.3)	Policy (15.6)	Finance-related (5.9)
1992	4.18	Product & Process (54.1)	Policy (12.3)	EMS & Audit (6.2)
1993	4.52	Product & Process (58.2)	Policy (11.0)	EMS & Audit (7.7)
1994	5.62	Product & Process (52.6)	Policy (14.4)	EMS & Audit (6.0)
1995	16.25	Product & Process (49.3)	Policy (12.3)	EMS & Audit (8.5)

Notes: 'Environment' excludes the categories 'environment other' and 'energy' and 'health& safety'. EMS & Audit = 'Environmental management systems and audit'. Figures in parentheses are percentages.

As shown in Table 10.5, the primary focus of environmental disclosure by volume was product- and process-related, with policy and EMS and audit/financially-related issues coming some way behind[15]. By contrast, the least popular disclosure category by volume was 'sustainability' which although showing an increase over the period represented an average of only 0.15 pages in 1995. A pattern may be discerned from the data presented in Figure 10.4 and Table 10.5 which suggests that Benelux and German companies were preoccupied with reporting environmental information concerning their products and processes, and, to a lesser extent, their environmental policies. However, relatively little reporting space was devoted to reporting on stakeholder aspects or the financial and economic aspects of environmental issues, and even less in relation to sustainable development. These findings mirror those of O'Dwyer and Gray (1998) who, in a review of recent surveys on the level of environmental disclosure among the larger companies in the world, concluded that, in general, the most popular types of environmental disclosure relate to environmental policies and environmental impacts of products and processes. The focus by companies on environment product- and process-related issues could be interpreted as being consistent with a technological (i.e. eco-efficiency) approach to environmental issues rather than with addressing the wider socio-political issues. In doing so, management may well be involved in "… the sense-making and shared meaning…" (Buhr 1998, p.174) undertaken by management who are largely technicians (engineering, managerial, accounting) by training and see technology as the answer to economic as well as social and environmental issues. Buhr argues that as companies become more technologically-advanced in addressing societies concerns over social and environmental impacts (eco-efficiency), they may become more open, having "… achieved sufficient technological success to look outward …" (p.183) through higher levels of reporting which are designed more to influence relations with the relevant publics than with avoiding further government interference. (A more detailed discussion of possible interpretations in this context is provided in Section 10.6 below).

Figures 10.5 to 10.7 explore the influence of the home country of the reporting company and industry sector, respectively, on the results described above. Figure 10.5 portrays the corporate reporting strategies of the 40 Benelux and 50 German companies, respectively, in relation to the mean volume of pages. What is particularly noteworthy about Figure 10.5 is the similarity of reporting strategies of companies from these separate political regions in relation to the total volume of published information (Total Pages) and management and accounting information (AccPP). For the period from 1989 to 1994, both sets of companies would seem to be disclosing broadly similar volumes of information overall. In 1994 for example, Benelux companies provided a mean of 104.48 pages, with German companies producing, on average, an almost identical 104.77 pages. This is all the more intriguing given that the total volume here is based not only on the annual report and accounts, but also includes social reports and environment reports. Similarly, throughout the period Benelux and German companies adopted quite similar reporting strategies in relation to management and accounting information (AccPP). Whilst Benelux companies disclosed more management and accounting information than their German counterparts, this pattern was consistent over the period of the study. The generally stable feature of management and accounting reporting suggests that this form of disclosure may have reached a certain level of maturity amongst both Benelux and German companies.

Figure 10.5 European CED by political region



A noteworthy feature of Figure 10.5 is the relative proportions of pages devoted to management and accounting information (AccPP) and environmental issues (Total CED). Whilst Benelux companies disclose, on average, more management and accounting information than German companies, the reverse is true in the case of environmental issues with German companies providing slightly higher volumes of environmental disclosure. In 1989, for example, Benelux companies provided an average of 42.9 pages of management and accounting information, compared to 1.6 pages devoted to environmental issues. By contrast, in 1989 German companies provided 37.0 pages of management and accounting information and 4.27 of pages on environmental issues. By the end of the period (i.e. 1995), this had increased to 49.7 and 10.6 pages, respectively, in the case of Benelux companies and 44.9 and 25.4 pages, respectively, in the case of German companies. However, in 1995 the environmental reporting strategies of German companies appear to deviate from those of their Benelux counterparts, with German companies disclosing much higher levels of environmental disclosure by volume. This increase is due largely to a relatively greater proportion of German companies publishing corporate environment reports for the first time in 1995 (see Chapter 8, Table 8.7). This could represent either a systemic divergence of environmental reporting strategies between the two regions or simply a time lag with Benelux companies taking longer to implement environmental reporting practices at corporate level. The latter is perhaps the more probable although further investigation would be necessary to establish this empirically.

It is also interesting to note how the reporting strategies of both Benelux and German companies appear to react consistently in relation to increased reporting of environmental issues. As indicated in Figure 10.5, the pattern of CED over the period 1989 to 1994 is of a steady increase in the volume of these disclosures, but with German companies disclosing more than Benelux companies. However, in 1995, there is a significant increase in the year-on-year change, with German companies increasing their average volume of Total CED from

7.2 pages in 1994 to 25.4 pages in 1995 (an increase of 253 per cent), whilst for Benelux companies the rise was also significant but less dramatic, CED increasing from an average of 6.9 pages in 1994 to 10.6 pages in 1995 (an increase of some 54 per cent). However, this increase did not result in a reduction of other published information. Rather, both Benelux and German companies chose to increase the total number of pages devoted to external reporting. This could be interpreted as suggesting that (i) management and accounting reporting by Benelux and German companies is relatively immune to changes in other forms of CSR, perhaps reflecting an established routine, and/or (ii) that the various messages which management seeks to convey through additional environmental disclosure are perceived as sufficiently important to justify the extra costs of preparing, printing and distributing more voluminous reports.

Figure 10.6 European CED in context: Industry sensitivity

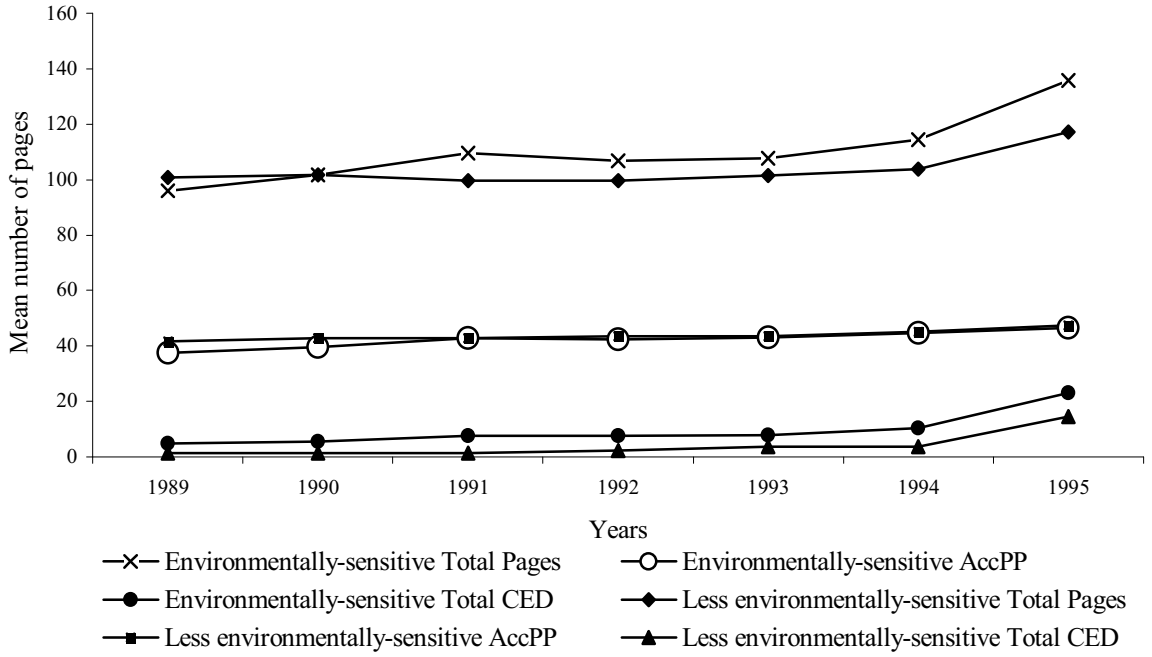


Figure 10.6 above presents the same basic data as reported in Figure 10.5 but this time analysed according to industry environmental sensitivity. For these purposes, the 90 sample companies are categorised as operating in either environmentally-sensitive (ES) or less environmentally-sensitive (LES) industry sectors, with 45 companies in each category (see Chapter 8, Table 8.2). Figure 10.6 provides evidence which suggests that, post-1990, ES companies consistently published more pages than LES companies. Figure 10.6 also indicates that management and accounting disclosure is not influenced by the environmental sensitivity of the industry in which a company operates, both groups disclosing almost identical volumes of management and accounting information. More significant perhaps is the relative volumes of Total CED, with ES companies consistently disclosing more environmental information than LES companies. This pattern is consistent with the industry sensitivity hypothesis under both EAT and OLT as explored in Chapter 9 where a significant positive association was found between industry environmental sensitivity and the volume of CED in each of the years 1989 to 1995. In 1989, ES companies devoted 4.8 pages to environmental issues; by contrast,

LES companies provided only 1.3 pages on environmental issues. By the end of the period (i.e. 1995), this had increased to 23.1 pages in the case of ES companies and 14.5 pages in the case of LES companies. These results are consistent with prior studies, notably that of Adams *et al*. (1998). The latter study found large differences in the average amounts of environmental disclosure across industry sectors in the 1992/3 annual reports of large European companies, the oil/chemicals/metal/power sectors having the highest mean amount of disclosure at 1.31 pages compared to only 0.21 pages in the case of the service/retail/food sectors. A further interesting feature of Figure 10.6 is the change in volume between 1994 and 1995. This step-change in the year-on-year increase in disclosures by volume reflects a significant increase in the incidence of corporate environment reports (see Chapter 8, Table 8.7). Moreover, this step-change appears to be systemic, all eight sectors showing a significant increase in Total CED between 1994 and 1995 (from 10.6 pages to 23.1 pages in the case of ES companies, i.e. 118 per cent, and 3.7 pages to 14.5 pages, i.e. 292 per cent in the case of LES companies). The implications of this apparent systemic increase in environmental disclosure are important, not least in terms of any attempts to explain the nature and causes of these changes. If indeed such changes were occurring at a macro-economic level across economies as a whole, then it would suggest that theories which explore the organization-society relationship at a structural level, such as PEAT (see Chapter 7), may be important[16].

Figure 10.7 European CED in context: Industry sector influence

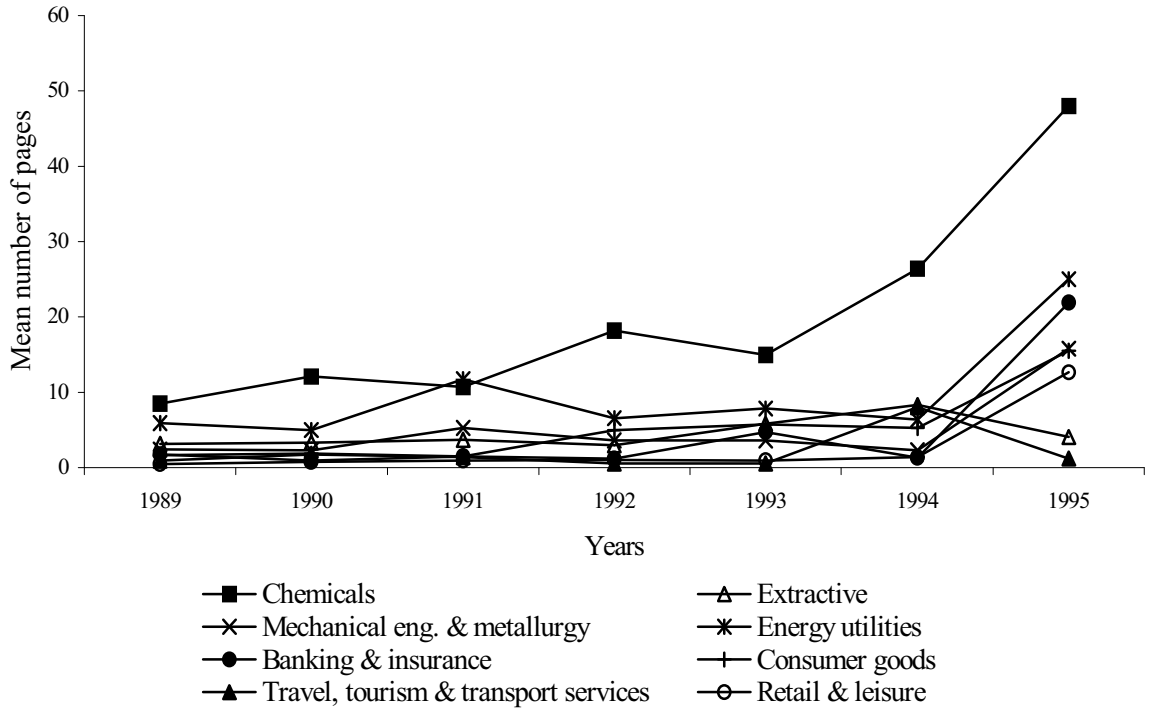


Figure 10.7 above presents an analysis of the mean number of pages of environmental disclosure (Total CED) by industry sector over the period of the study. The most obvious feature of Figure 10.7 is the pattern of environmental disclosure by the chemicals industry which, apart from 1991, provided the highest amounts of environmental disclosure relative to that of other sectors throughout the period of the study. The dominance of the chemicals

sector is particularly noticeable between the years 1993 and 1995, when the average amount of pages disclosed by chemicals companies increase from 14.97 pages to 47.99 pages. The primary influence on this trend is the publication of company-wide, stand alone environment reports by companies in the chemicals industry. The dominance of the chemicals sector is consistent with prior European studies (see, for example, Pföhler (1996) in the case of German companies and Van Nuffel *et al*. (1995) in the case of Belgium companies).

Figure 10.7 also reveals a general increase in the levels of CED across all eight industry sectors, suggesting that this phenomenon persists at a macro-economic level. Moreover, apart from the chemicals sector, it is not immediately obvious that sectors traditionally perceived of as environmentally sensitive provided significantly higher levels of environmental disclosure over the period of the study compared to those sectors traditionally seen as less environmentally sensitive. For example, environmental disclosure by the banking and insurance sector increased from an average of 1.71 pages in 1989 to 21.90 pages in 1995. By comparison, environmental disclosure by the extractive sector increased from 3.17 pages in 1989 to 4.03 pages in 1995. The lowest average volumes of disclosure were those of the travel, tourism and transport services sector which rose from 0.93 pages in 1989 to 1.18 pages in 1995. However, the relatively small sample sizes at industry sector level (these vary from a minimum of 7 to a maximum of 16 per sector - see Appendix 3) require that care is exercised when interpreting these results.

10.5 Form of environmental disclosure

The longitudinal results discussed above provide new and valuable insights into trends in environmental disclosure by Benelux and German companies over the period 1989 to 1995. Further insights can also be gained by looking at the form of these disclosures. As described in Chapter 8, items of disclosure were captured using content analysis which attributed seven testable dimensions to each item of CED (Chapter 8, Table 8.1). Four of these testable dimensions have been discussed in sections 10.3 and 10.4 above, i.e. location, theme, amount and evidence. The remaining three testable dimensions, which relate to the form of each item of disclosure itself, are:

(i) *Auditability* – 'auditable' or 'non-auditable', where auditable data is defined as data which can, in principle, be verified by an independent third party, with 'unauditable' data being an assertion which is not capable of independent verification;

(ii) *'News' type* – 'good', 'bad' or 'neutral' news according to whether the information reflects well, badly or neutrally, respectively, on the reporting organization; and,

(iii) *Compliance* – 'voluntary' or 'required', where voluntary CED is defined as disclosure that is not required under any disclosure law or regulation and required CED being legally-binding disclosure including those relating to the annual report, accounting rules and reporting regulations, and other requirements relating to specific industries.

Table 10.6 below summarises the overall form of environmental disclosure by Benelux and German companies according to these different dimensions for each year of the study.

Table 10.6
Cross-tabulations of the frequencies of co-occurrences of mean values of CED and other measurable dimensions

Mean pages/Year	1989	1990	1991	1992	1993	1994	1995
Total mean CED	3.08	3.44	4.52	5.03	5.74	7.10	18.82
Auditability							
Auditable	2.81	3.23	4.31	4.68	5.37	6.63	18.29
%age of Total	91.23%	93.90%	95.35%	93.04%	93.55%	93.38%	97.18%
Not auditable	0.27	0.21	0.21	0.35	0.37	0.47	0.53
%age of Total	8.77%	6.10%	4.65%	6.96%	6.45%	6.62%	2.82%
Compliance							
Voluntary disclosures	3.06	3.41	4.49	4.98	5.70	7.06	18.77
%age of Total	99.09%	99.10%	99.20%	99.04%	99.29%	99.43%	99.75%
Required disclosures	0.02	0.03	0.03	0.05	0.04	0.04	0.05
%age of Total	0.91%	0.90%	0.80%	0.96%	0.71%	0.57%	0.25%
News type							
Good news/neutral	3.04	3.41	4.43	4.96	5.68	7.06	18.68
%age of Total	98.74%	99.22%	97.93%	98.56%	99.03%	99.47%	99.24%
Bad news	0.04	0.03	0.09	0.07	0.06	0.04	0.14
%age of Total	1.26%	0.78%	2.07%	1.44%	00.97%	00.53%	0.76%

Notes: This table analyses the total mean CED by year according to the three testable dimensions of 'auditability', 'news type' and 'compliance' based on relative quantities. Percentages are based on the mean amount of CED in each case as a proportion of total mean CED by year.

As revealed by Table 10.6, the vast majority of CED by Benelux and German companies is auditable, reflects favourable (or neutrally) on the reporting organization, and is voluntary. In relation to auditability, the proportion of data which, potentially at least, may be subjected to independent verification increases from 91.2 per cent in 1989 to 97.2 per cent in 1995, suggesting that companies were moving away from statements and/or assertions that are not capable of independent verification. The amount of disclosure identified as 'required', i.e. disclosure that is made in compliance with laws and/or regulations, remained at less than one per cent of total CED over the period of the study. In absolute terms, however, the amount of pages devoted to required disclosures remains fairly stable over the period fluctuating between an average of 0.02 and 0.05 pages, a trend that is consistent with the amount of space devoted to management and accounting information (AccPP) (see Figure 10.2 above). The relatively small amount of required CED is perhaps not surprising, reflecting as it does the lack of specific, detailed environmental reporting requirements in the countries included in the study (see Chapter 2 and Appendix 1). More importantly, perhaps, these findings suggest that, when looking at environmental disclosure in a European context, there is little to be gained from distinguishing between required (i.e. mandatory) and voluntary disclosures. Other studies which have focused on *social* (including environmental) disclosure have stressed the importance of such a distinction, particularly in the context of UK companies (see, for example, Gray *et al*., 1995b, 2001) where there clearly does appear to be a significant amount of social disclosure that is mandatory. Hence, Gray *et al*.'s (2001)

argument that such a distinction is necessary would seem to be valid only in certain specific contexts where reporting requirements indicate that such a distinction might be necessary. In the case of the present study, all of the disclosure identified as 'required' rather than 'voluntary' relates to environmental disclosure in the financial statements section of the annual report, being disclosure required in compliance with accounting rules governing the presentation of balance sheet, profit and loss account items, and the notes thereto, judged to be material in terms of providing a true and fair view of the financial result and state of affairs of the company. Specific examples of this kind of required disclosure include:

- *Akzo Nobel's* disclosure in its 1995 group accounts of provisions for environmental costs together with a detailed note under commitments and contingent liabilities in which management describes the company's position vis-à-vis future costs arising out of its obligations to eliminate or limit the effects on the environment of the disposal or release of certain waste or substances at various sites;
- *Petrofina's* disclosure of extraordinary costs charged against profits in the 1994 group accounts relating to provisions for environmental costs and restoration of sites;
- *Royal Dutch/Shell's* detailed note to the 1993 group accounts on the company's accounting policy in relation to environmental expenditures and liabilities for environmental remediation resulting from past operations;
- *Dykerhoff's* note to the company's 1991 group accounts concerning provisions set aside to meet future costs associated with the recultivation of depleted quarries;
- *Heidelberg Zement's* disclosure in the parent company's 1994 financial statements of reserves set aside to meet environmentally-responsible maintenance of asset values and the note to the group accounts on the company's policy of making provision for environmental precautions to cover all expected environmental risks;
- *Südzucker's* note to the 1993/94 group accounts on amounts included under other accruals to cover expenses relating to draining and recultivating mud ponds and excavation work at waste tips; and,
- *VEBA's* disclosure in its 1995 group accounts of provisions relating to nuclear waste disposal and damages caused by mining operations in connection with hard coal and lignite mining.

The relatively small amounts of such mandatory disclosure are consistent with general trends within Europe in the 1990s. According to Gray and Bebbington (2001), for example, even though the percentage of companies reporting on environmental issues increased during this period, the proportion disclosing environmental financial information in the annual report remained relatively low. Excluding the USA, when taking into account medium as well as large companies, very few companies report on environmental issues in their financial statements with the majority being companies in the more environmentally sensitive sectors such as chemicals, forestry and the extractive industries (e.g. oil and gas) (Gray and Bebbington, 2001). KPMG (1997a), in their survey of international environmental reporting, found less that 20 per cent of the world's largest companies included environmental costs in the financial statements or the notes to the accounts. The majority of these were companies based in the USA, where SEC regulations require the measurement and disclosure of environmental liabilities, provisions and contingent liabilities (see, for example, AICPA, 1996; Newell *at al*., 1990; Roussey, 1992; Rubenstein, 1992; UN, 1990). Similarly, Pföhler

(1996) notes a dearth of environmental cost data in the annual reports of German companies but that such information, when provided, was used to argue against the German government's environmental policy, the latter allegedly generating excessive costs for industry with little in the way of improvements in environmental performance.

The 'news' type of CED when characterised as either 'bad' or 'good/neutral' news, as shown in Table 10.6, is overwhelmingly weighted towards good/neutral news. In 1989, the average amount of 'bad' news was 0.04 pages, or 1.26 per cent of total CED in that year. In the following years, this percentage fluctuates reaching a maximum of around 2 per cent of total CED in 1991, before declining in later years. In 1995, 'bad' news represented less than 1 per cent of total CED. Thus, whilst the overall mean volume of environmental disclosure increased over the period of the study (see Table 10.6 above), the amount of space devoted by Benelux and German companies to reporting 'bad' news as a proportion of total pages actually *decreased* over the period. These results are consistent with prior studies (see, for example, Brockhoff, 1979; Brown and Deegan, 1998; Deegan and Gordon, 1996; FEE, 1993, 1994; Guthrie and Parker, 1989, 1990; Hines, A., 1991; Macve and Carey, 1992; O'Dwyer and Gray, 1998; Roberts, C., 1991; Van Nuffel *et al*., 1995) which have found a tendency amongst corporate management towards the selective use of favourable rather than unfavourable CSR in annual reports and other corporate documents. Van Nuffel *et al*. (1995), for example, report that Belgium company annual reports over the period 1987 to 1991 contained only positive (i.e. good) information, the general trend being a lack of objective information on the negative environmental performance of the company. Similarly, both Brown and Deegan (1998) and Deegan and Gordon (1996) report environmental information contained in annual reports as being overwhelmingly 'good news' in terms of content. The tendency for companies to disclose the positive aspects of social and environmental issues is not new. The AICPA (1977), for example, in its comprehensive review of the state of the art of social performance reporting in the US in the late 1970s, noted that stand-alone social reports could be faulted for emphasizing favourable facts, omitting or glossing over the unfavourable and for using oblique language (Heard and Bolce, 1981).

Empirical evidence on the prevalence of 'bad' news suggests that only a minority of large companies report on the negative aspects of their environmental performance. KPMG (1996), in their survey of the FTSE top 100 UK companies for 1995, report that only 15 (15 per cent) of companies included information on bad environmental performance (breaches of regulations, fines and prosecutions) in the annual report and accounts or a stand-alone environment report, compared to 20 companies (20 percent) in the previous year (1994). Deegan and Gordon (1996), as part of their study of environmental disclosures of the 1991 annual reports of a sample of 197 large Australian companies, focused on the 'bad news' element of such disclosures. Their study drew on the earlier Guthrie and Parker (1990) study in which the absence of bad news about the activities of Australian companies in relation to environmental disclosure was construed as part of a legitimisation strategy (see Chapter 7). Based on the use of content analysis to count the number of words in the 1991 annual reports, Deegan and Gordon found that the average amount of positive news (181 words) was significantly different from the average amount of negative news (6 words), providing support for their contention that firms will disclose positive news but will suppress negative news as part of a legitimisation strategy. A similar focus on positive news was also found for a further study of 25 Australian companies in relation to their annual reports for the years

1980, 1985, 1998, 1991, suggesting that this practice is not an isolated phenomenon (Deegan and Gordon, 1996). This view is reinforced by the findings of Woodward *et al*. (2001) who, in interviewing senior executives of UK companies identified as being amongst the highest disclosers of social information in their respective sectors, found that, in relation to environmental reporting, the companies' messages tended to be of a 'good news' nature. International studies also suggest that this aspect of CSR is not restricted to particular countries. The KPMG 1996 survey of international environmental reporting (KPMG, 1997a), for example, reports that of the 220 environment reports examined, only 26 (35%) disclosed information on poor performance (e.g. breaches of regulatory requirements, prosecutions and accidents). Bad news was most common in the chemical, oil and gas, utilities and forestry, pulp and paper sectors. However, the KPMG 1996 survey included site-level and business unit level environment reports and thus the extent to which 'bad news' was reported at corporate level is unclear.

10.6 Interpreting trends in CED by Benelux and German companies

The data presented above provides much 'food for thought' when seeking to offer interpretations as to the possible causes of trends in corporate reporting by large Benelux and German companies over the period of the study. Looking at the total amount of pages appearing in the various annual, social, environmental and other reports included in the study, i.e. not just total CED but the entire extent of external reporting, these companies increased their volume of reporting between 1989 and 1995 by some 30 per cent. In other words, there was a significant increase in the amount of external reporting over the period of the study. Whilst accounting and management information ('AccPP') constituted a significant element throughout the period (see Figure 10.2 above), there was little noticeable increase in the *relative* amounts of space devoted to these issues. Rather, much of the upward trend in external reporting was in fact due to a significant increase in environmental disclosure, suggesting a change in management's overall disclosure strategy towards greater emphasis on reporting on environmental issues. This upward trend in the quantity of environmental disclosure is consistent with other longitudinal studies (see, for example, Campbell 2001; Deegan and Gordon, 1996; Gibson and O'Donovan, 2000; Gray *et al*., 1995b; KPMG 1997c)[17]. However, the noteworthy characteristic of the present study in this context is the role played by company-wide, stand-alone corporate environment reports. As indicated above (Figure 10.2), much of the increase in CED over the period of the study is attributable to a growing popularity of these reports, particularly between 1994 and 1995 when there appears to have been a systemic (i.e. economy-wide) increase. This change is almost entirely due to an increase in environmental disclosures, with the amount of health and safety and energy disclosure remaining relatively stable throughout the period.

In seeking to discover plausible explanations for the trend in CED revealed by the present study, one potential source of information is obviously the environment reports themselves, particularly those relating to the 27 companies which published these reports for the first time during the period of the study (see Chapter 8, Table 8.7). Such reports represent potentially important statements in the context of the organization-society relationship given that the company's senior management has complete editorial control over their content and thus a free hand in terms of constructing a social imagery of the company under their stewardship. Very little empirical research has been conducted to date into the processes which companies

go through in preparing and releasing these reports voluntarily (although see, for example, Rovira, 2002). However, Ljungdahl (1999a, b) suggests that there may be some diffusion process taking place similar to that in the case of innovation diffusion theory (see, for example, Rogers, 1983). Ljungdahl argues that first time adopters of environmental reporting, i.e. companies reporting on environmental issues for the first time, adopt this practice at different stages depending on various factors including internal organization, strategic factors and external institutional factors. In the particular context of stand-alone environment reports, Ljungdahl argues, based on interviews with 20 first-time reporters in Sweden, that these are often the result of mimicking the reporting practices of competitors, i.e. when one company starts it triggers off a pattern which others follow. Ljungdahl also suggests, based on this diffusion concept, that the spread of environmental reporting to companies operating in less environmentally-sensitive industries may be due to this mimicking pattern spreading to other stock market-listed companies.

The decision by a company to be the first, or one of the first, in its industry to *voluntarily* publish a corporate environment report is arguably not one that is taken lightly. KPMG (1994), for example, state that once companies start down this path there is no way back, the company having effectively locked itself into a reporting process that is expected to lead to more comprehensive reporting in the future. Empirical evidence of this 'locked-in' effect is provided by O'Dwyer (2003) who reports senior managements' concerns over the fact that reporting in one year made it difficult to avoid reporting in future years, creating a certain reticence towards CSR. Hence, it may be suggested that the executive management of any large business organization would think twice before committing itself to the on-going task of collecting, organising, verifying and publishing company-wide environmental information. Equally, given the potential significance of such an important change in reporting strategy, management may seek to explain to the outside world its reasons for doing so.

In the case of the present study, the vast majority of the 27 'first-time' environment reports contain a preface or foreword, frequently in the name of a senior executive officer (such as the chairman of the board of management as in the case of Akzo's *Environmental Annual Report 1993*, Daimler-Benz's *Environmental Report 1995* and Otto Versand's *Environmental Report 1995*). An examination of the prefaces to these 27 first-timers' corporate environment reports reveals a variety of different explanations (Table 10.7)[18]. In some cases, management is transparent in terms of its stated reasons for publishing a corporate environment report; in other cases, the reasons are less clear, being enmeshed in public relations-type statements. By far the most common explanation provided is that such reports serve as a means of demonstrating or reporting on a company's environmental action plans and targets, its improvements and past achievements and future priorities and problems yet to be solved. Sixteen of the 27 'first-timers' (i.e. 59 per cent) gave this explanation in the foreword to their first corporate environment report (Table 10.7, item (i)). This explanation would seem to accord with the findings referred to above where environmental policy disclosures were shown to be the second most popular category of disclosure after disclosures relating to products and processes (ignoring the category 'other').

The second most popular explanation, item (ii) of Table 10.7, is concerned with stakeholder relations. This explanation could be interpreted as suggesting that management's environmental reporting strategy is influenced by their perceptions of stakeholders'

expectations in relation to the content of corporate environment reports. Looking at the underlying substance of the reasons provided, all companies which provided an explanation appear to be concerned with demonstrating, in one form or another, a commitment to addressing the 'environmental challenge'. This concern is expressed in a number of different ways, for example, in the context of a commitment to improvements in environmental performance (item (i) of Table 10.7), stakeholder accountability (item (ii)), sustainable development/sustainability (items (ii), (iii) and (v)) or social responsibility (item (iv)).

Table 10.7
Explanations for 'first-time' corporate environment reports

Explanation	Companies providing this explanation
(i) As a means of demonstrating or reporting on a company's environmental action plans and targets, its improvements and past achievements and future priorities and problems yet to be solved	16 = Akzo Nobel; Bayerische Landesbank; Bayerische Vereinsbank; Daimler-Benz; Electrabel; Goldschmidt; Heineken; Henkel; ING; Lufthansa; Otto Versand; Schering; Solvay; Thyssen; Unilever; Wacker-Chemie
(ii) To provide information to society and stakeholders or as part of an open dialogue with stakeholders in relation to environmental issues and sustainability	7 = Hypotheke-und Wechsel-Bank; Herlitz; Lufthansa; Petrofina; Thyssen; Volkswagen; Wacker-Chemie;
(iii) To demonstrate the compatibility of economic and ecological aspects of sustainability in the context of the International Chamber of Commerce's *Business Charter for Sustainable Development*	2 = Allianz; Henkel
(iv) To demonstrate that the organization is living up to its social responsibility vis-à-vis the environment	2 = Daimler-Benz; Goldschmidt
(v) To demonstrate that the organization's approach is a responsible basis for a free-market solution towards sustainability	1 = Allianz
(vi) As part of the company's structured approach to the strategic management of environmental issues	1 = Petrofina
(vii) To gain public understanding and support for the company's efforts	1 = Solvay
(viii) To demonstrate that environmental issues are important to the organization and its long-term survival	1 = Unilever

However, whilst the various reasons given by companies for publishing their first corporate environment report are clearly relevant, by themselves these explanations provide only a partial insight into understanding the trends in CED revealed by the present study. Put simply, in the context of the business-society relationship, the explanations provided by

management do not in themselves make known the economic, social and political motivations underlying their behaviour. For example, even though the executive management of Solvay state that the reason for publishing their first environment report was to gain public understanding and support for the company's efforts (see Table 10.7), this statement *per se* leaves unanswered the very important question as to why Solvay's management perceived it as necessary to gain such understanding and support in the first place. Whilst motivation is difficult to assess for those not directly involved in the decision-making processes, it can be explored by recourse to theoretical frameworks which offer accounts or 'stories' through which to interpret behaviour. Towards this objective, four accounting theories (i.e. EAT, MST and OLT and classical (i.e. Marxian) political economy of accounting theory (PEAT)) are employed below to interpret managerial behaviour in relation to the increase in CED over time.

10.6.1 Economic agency theory (EAT)

EAT posits that managerial behaviour is motivated solely by self-interest. If left unchecked, this implies that management would not necessarily act in the best interests of shareholders (see Chapter 5). However, under Jensen and Meckling's (1976) theory of agency costs, shareholders and bondholders are said to overcome the 'agency problem' of managerial opportunism and 'acting with guile' by putting into place various contractual arrangements and positions (the 'nexus of contracts') which effectively transfers all the costs of agency to the management. Other market-based limitations on managerial discretion (arising from, *inter alia*: the market for goods and services; the market for finance and for corporate control; and, the market for managerial services) are seen as ensuring that "… corporate managers have little discretion to act other than in the interests of shareholders" (Benston 1982, p.92). Within this theoretical framework, information, including accounting and reporting, is seen as an economic good with managers trading that information for self-interest purposes. Thus, managers are assumed to supply information *voluntarily* only if (i) the information is relevant to determining a company's stock market value and (ii) the manager can maintain exclusive access to that information until it is published (Watts, 1977). Similarly, all decisions concerning the costs of publishing voluntary information are said to be made on the basis of a cost-benefit analysis from the perspective of shareholders, such that information the supply of which imposes costs on shareholders in excess of the associated benefits would not (and should not) be included in public reports (Benston, 1982).

Although Jensen and Meckling (1976) present a single period model, the underlying theory of agency costs can be extended to an investigation of managerial behaviour in a multi-period context. Hence, whilst the arrangements under the nexus of contracts are depicted by Jensen and Meckling as *ex-ante*, economic agency theory can be used to explain and predict managerial behaviour in a dynamic, multi-period context where individuals and institutions continuously enter and exit the various securities markets. In particular, the assumption of efficient markets under the efficient market hypothesis (see Chapter 5) implies that investors and bondholders are able to correctly discount information, economic or otherwise, as it relates to the future earnings capacity of companies. Disclosure in this context can have economic benefits resulting from a lower cost of equity and debt capital, increasing the earnings potential and stock market value of the company and thus benefiting both management (whose compensation package is normally linked to share price and earnings

performance) and shareholders. Under the assumption that the objective of the firm is to maximise its long term cash flow, it can be argued that an entity benefits when disclosure leads to a lower cost of capital, the assumption being that the greater the informativeness of disclosures, the lower the cost of capital (Elliot and Jacobsen, 1994). Thus, *ceteris paribus*, companies which are more transparent in terms of their disclosure strategy are argued to have better access to the capital markets (Eccles and Khan, 1998) and a lower cost of capital (see for example, Botosan, 1997; Conover and Wallace, 1994; Dhaliwal, 1978; Sengupta, 1998). Sweeney (1994), for example, argues that many companies realize that institutional investors prefer to put money into companies that provide lots of information and that good investor relations can help their share price. Hence, it could be argued that managers who disclose more environmental information, such as that contained in an environment report, do so on the basis that such disclosures provides a more favourable impression of the company to the securities markets and financial analysts, such good impression being reflected in a higher share price through a lower cost of capital. This line of argument is consistent with that of the European Federation of Financial Analysts' Societies (EFFAS, 1994) who view environmental issues as a management issue, arguing that, in the 1990s, environmental matters became one of Europe's most important management issues because of the potential financial effects on a company's net worth of society's concern about the state of the environment:

> *The widespread concern over the current state of the environment and the limited success of existing policies affect every link in the financial chain, from investor to producer. This situation causes confusion among banks, insurers and corporate executives who realize that through the clean-up of industrial activities net worth might be eroded* (EFFAS 1994, p.2).

Similarly, Spencer-Cooke (1994) reports that what matters for companies, as far as financial analysts are concerned, is to be seen to be reporting, CED representing a concrete symbol of management's commitment to environmental issues[19]. A concern with assuaging financial analysts' concerns about the potential impact of future environmental costs and liabilities on the net worth of a business could be seen as a possible motivation for companies increasing their reporting of environmental information through stand-alone corporate environment reports. The growing awareness amongst institutional investors during the 1990s of the possible financial implications of society's increased concern for the state of the environment may be argued to have created conditions, in a dynamic context, under which management had *economic* incentives for increasing their reporting of environmental issues. Such a perspective would be entirely consistent not only with increased reporting of environmental issues by companies in the early 1990s but also with a focus of such reporting on a company's strategy in relation to environmental issues (i.e. environmental policy) and of the environmental aspects of a company's products and processes, the latter in particular being important in terms of mitigating exposure to environmental risk (Blacconiere and Paton, 1994). Disclosures which depict companies as adopting environmental policies and strategies and 'environmentally-friendly' products and processes may arguably provide a positive signal to investors and the securities markets generally that management is responding responsibly to society's concern for the state of the environment and thus reducing the likelihood of state or regulatory interference and thus any consequential wealth transfers. As shown in Table 10.7 above, both Daimler-Benz and Goldschmidt stated that their reason for

publishing their first corporate environment report was to demonstrate that the respective organization was living up to its social responsibility vis-à-vis the environment. Although the disclosure of a firm's strategy to reduce environmental risk could be useful to other firms in the same industry, proprietary costs (i.e. costs associated with disclosures that provide a competitive advantage to rival firms) related to environmental disclosure could be outweighed by the increase in firm value which results from providing positive signals to the market. From this perspective, a trend of increasing levels of 'good' news concerning a firm's environmental efforts may be interpreted as part of management's strategy to signal to shareholders and bondholders a lower level of exposure to environmental risk and future regulatory costs (Blacconiere and Paton, 1994).

However, what is not so evident from the preceding analysis is why so little emphasis was placed by Benelux and German companies on reporting on the financial aspects related to issues such as future environmental costs and future and past environmental obligations and contingent obligations (Figure 10.4). Under EAT, a policy of greater openness would, ostensibly, lead to increased emphasis on financial aspects in terms of assuring investors of management's concern with and competence to manage such issues. As described in Chapter 5 (Section 5.8), markets-based research under the adverse selection argument (Grossman, 1981; Milgrom, 1981) for full disclosure of valuation-relevant information asserts that if potential investors are aware that a certain information is being withheld by a firm, then, in the absence of full disclosure, investors will rationally mark down the value of the firm by assuming the worst case (Fekrat *et al*., 1996). It could be argued that such issues were considered by management to have been sufficiently addressed within the traditional financial reporting framework and thus needed no further explanation. However, as illustrated by the experience of the SEC in the US in relation to the obligations or possible obligations of US-listed companies under the Superfund (see Chapter 2, Section 2.4), outside investors and creditors cannot rely on the financial reporting framework to accurately reflect the costs and risks related to compliance with environmental laws (ENDS, 2001). Similarly, developments in 2002 surrounding ABB, Europe's largest engineering firm at that time, in relation to asbestos-related claims in the US, despite the parent company's management's attempts to 'ring-fence' these liabilities within the subsidiary concerned, provided a salient reminder of the huge potential, but as yet un-booked, liabilities which exist and which can have dramatic implications for investor confidence. A much more (seemingly) plausible argument is that management were not giving priority to reporting on the cost implications of a more stringent application within the European Union of the 'polluter pays' principle (see, for example, CEC, 2000), aided perhaps by a perception amongst investors that management does not have such information (which seems likely based on present knowledge - see, for example, Bebbington *et al*., 2001; Hibbitt and Kamp-Roelands, 2001, 2002a). Hence, in terms of the dividing line which separates investor valuation-relevant information from non-valuation relevant information, more detailed environmental costing data, such as that provided by experiments into forms of full cost pricing may fall into the latter category on the assumption that, even under the worst case scenario (Fekrat *et al*., 1996), investors do not expect governments to force companies to bear the full environmental (and social) costs of their activities[20]. From the latter perspective, information on the full environmental costs of a firm's activities has no value whatsoever to the outside shareholders or bondholders and thus

managers would not be expected to supply it or be rewarded for doing so (Benston, 1982; Watts, 1977).

10.6.2 Managerial stakeholder theory (MST)

MST may also offer insights into the motives underlying increased trends in environmental disclosures over time. In a dynamic context, the bourgeois model of stakeholder theory as outlined in Chapter 6 would suggest that corporate disclosure is used by management in negotiating emerging social issues with the various stakeholder groups within society. Thus, it has been argued that CED is used by management in attempting to negotiate the concept of 'environment' and to secure a strong, controlling influence over companies' relationship with society in general and environmental pressure groups in particular (Gray *et al*., 1995a, 1995b). When applied in a dynamic, social context, such a perspective is consistent with a supple reporting strategy under which management gives increasing or decreasing levels of emphasis to specific areas of CSR according to the degree to which these areas are perceived as being important to its key stakeholders. As shown in Table 10.7 above (item (ii)), seven companies in the present study indicated that the reason for providing their first corporate environment report was to provide information to society and stakeholders in relation to environmental issues. Under the theoretical framework provided by MST (see Chapter 6), such a reporting strategy is seen as being influenced by the degree to which management considers there is a need to be seen as responding to changing stakeholder concerns and priorities, such need being determined in large part by the degree to which the organization is dependent on the support of various stakeholder groups. Thus, the greater the importance of a particular stakeholder group to the overall long-term strategic objectives of the organization, economic or otherwise, the more emphasis management is said to place on negotiating its relationship with that stakeholder group (Freeman, 1983, 1984, 1994).

In the context of CSR, stakeholder theory has been used to explain variations in certain areas of social disclosure over time as new issues arise and older issues decline (see, for example, Gray *et al*., 1995b) and across a relatively narrow front of dominant issues (see, for example, Roberts, R., 1992). Gray *et al*. (1995b), for example, suggest that the decline in disclosures concerning redundancy and industrial relations and value added, on the one hand, and the rise in data on industrial training and equal opportunities and health and safety, respectively, on the other, by UK companies over the period 1979 to 1991 may be explained by management operating a system of 'compensation' in which new and emerging issues are strategically managed whilst attention to older, previously-negotiated (and thus, settled) issues declines. Applying this perspective to the present study, a re-examination of Figures 10.3 and 10.4 above through the lens of a managerialist model of stakeholder theory offers an alternative, plausible explanation for the trends in environmental, health and safety and energy disclosures by Benelux and German companies over the period 1989 to 1995 along two fronts. Firstly, it may be conjectured that health and safety and energy issues had been largely satisfactorily negotiated (and thus settled) in the Benelux and German societies, respectively, through various regulatory and voluntary agreements with the key stakeholder groups concerned, notably employees and their representatives. Consequently these aspects required little in the way of additional 'compensation' through CSR/CED. Conversely, growing public concern about the state of the natural environment in the 1990s and of the associated responsibilities of business could be construed as giving rise to new stakeholder concerns on

an emerging, dominant issue which required (re-)negotiation in terms of its possible impact on the long term strategic goals of the organization. Secondly, and linked to the foregoing, the compensation required in the form of increased levels of CED (Figure 10.3) is structured along a narrow economic front which emphasises management's focus on the company's products and processes and strategic (i.e. policy) issues (Figure 10.4), such issues being perceived to be of concern to the organization's most important stakeholders, i.e. its shareholders, employees and customers (Chapter 9, Table 9.8). Much more limited compensations in the areas of stakeholder relations and sustainability (Figure 10.4) may be construed as reflecting a managerialist perspective which regards such areas of disclosure as relatively unimportant to the organization's key stakeholder groups (see Chapter 9, Section 9.6). Those stakeholder groups which may be assumed to have particular concern for issues of stakeholder democracy and sustainability, i.e. ENGOs, other pressure groups and NGOs, were found to be relatively unimportant to the firm in comparison to other stakeholder groups (Chapter 9, Table 9.8). Hence, a communications strategy which ignored the needs and wishes of these stakeholder groups would be entirely consistent with the stakeholder importance argument under MST as set out in Chapter 6. In effect, management does not feel the need to (re-)negotiate the concept of corporate environmental responsibility with its most important stakeholder groups since these groups are perceived to place a higher priority on other corporate responsibilities, such as profitability, security of employment and product development and reliability.

10.6.3 Organizational legitimacy theory (OLT)

The bourgeois, management-centred model of legitimacy theory as described in Chapter 7 differs from the perspectives offered by either EAT or MST in that, whereas the latter two theories depict voluntary disclosure as a predominantly *active* function on the part of management, legitimacy theory suggests that such activity is largely a *reaction* to perceived threats to a business organization's social legitimacy[21]. The existence of such threats is rooted in the notion that business organizations have a social contract with the societies in which they operate, the terms of this contract being determined by the values, norms, customs and attitudes of those societies as a whole. A society's values, norms, customs and attitudes are not seen as static but dynamic, changing over time and thus the social contact is itself dynamic. Where legitimacy becomes problematic, CSR is seen as a tactic available to corporations who seek to maintain, reclaim or improve their status of legitimacy by employing various legitimising strategies which involve (i) actual change on the part of the organization, (ii) attempts to manipulate and/or influence the expectations and/or perceptions of society, or (iii) attempts to deliberately avoid an issue through its non-reporting (Deegan, 2002; Dowling and Pfeffer, 1975; Guthrie and Parker, 1990; O'Donovan, 1999b, 2002; Oliver, 1991 Lindblom, 1994; Sethi, 1978, 1990). Against a background of increasing societal expectations on companies to demonstrate their commitment to improved levels of environmental performance, CSR is argued to be one of the mechanisms by which business organizations satisfy (or manipulate) those expectations (Gray *et al*., 1995b).

In this context, legitimacy theory can also be used to explain the relatively low incidence of both health and safety and energy disclosures relative to environmental disclosures (see Figure 10.3 above). Whereas the latter may be seen as part of a perceived need to demonstrate CSResp in the context of changing social expectations, data provided by the

present study would seem to suggest that health and safety and energy were not legitimacy issues throughout the period. In relation to health and safety issues, it could be speculated that the competence or behaviour of Benelux and German companies in this area maintained a state of legitimacy, perhaps because of a long history of employee protection, consultation and disclosure through regulation, Workers' Councils and employee reports/reporting. The lack of concern with energy issues is somewhat different given that there was considerable discussion in the late 1980s and early 1990s concerning the need for and economic advisability of energy efficiency (Gray *et al*., 1995b). Using the legitimacy framework, it could be speculated either that Benelux and German companies maintained a state of legitimacy in this area or that energy efficiency was simply not an issue which exercised the minds of the 'relevant publics' (i.e. those controlling the degree of consensus granted to business organizations to operate within society (Preston and Post, 1975)) during this period. The latter conjecture seems more plausible given that there was no energy crisis during this period on anything like the scale experienced in the 1970s following the 1973 oil crisis, and that concerns over energy pollution (such as acid rain, global warming and nuclear power) tended to be discussed within the general context of environmental issues.

Conversely, the significant increase in environmental disclosure throughout the period of the study may be interpreted as consistent with one or all of the different legitimation strategies under OLT as identified in Chapter 7, Section 7.5. Which particular strategy is being employed and by how many companies is more difficult to interpret, not least because individual companies may be employing more than one legitimation strategy at any one time (Lindblom, 1994). There is, for example, clear evidence of internal changes taking place which are consistent with Dowling and Pfeiffer's (1975) legitimation strategy involving adaptations to the organization's output, goals and methods of operation (see Table 10.7 above, item (i)). Further evidence of such changes can be found in the environmental policy statements provided by Benelux and German companies, a substantial minority of which disclosed quantified targets in relation to the organization's goals and objectives. To the extent that such policy statements reflect a real change in corporate environmental performance, the reporting of these changes may be said to accord with a legitimation strategy involving (i) an actual change in corporate performance and (ii) the use of CED by the companies concerned to educate and inform their relevant publics about the changed performance (Lindblom, 1994). However, there is also evidence which suggests that management is involved in seeking to influence the perceptions and/or expectations of society through the selective use of CED. In the continued absence of strict, detailed and comprehensive laws governing the disclosure of environmental issues at corporate level[22], senior executives of large corporations have almost complete editorial control over the design, selection and presentation of environmental information in corporate reports. This power and information asymmetry places senior executives in a significant position to shape the way in which the readers of such reports socially construct their knowledge of and attitudes towards a particular corporation. Whilst it is certainly true that there is much 'good' news available for companies to report on, and which they do report, such as improvements in energy efficiency, pollution controls and product recycling, a 'complete, fair and balanced' presentation of environmental issues arguably requires the inclusion of disclosures which seriously address many of the environmental problems linked to the commercial exploitation of and trade in the Earth's natural resources[23]. These include issues such as the thinning of

the ozone layer, poverty in the Third World caused by lack of access to land, global warming, deforestation, species extinction, waste disposal, habitat destruction, energy usage, acid rain, desertification, soil erosion, air pollution, water depletion, water pollution, toxic chemicals, land pollution, nuclear waste and resource scarcity.

The fact that such an overwhelming proportion of environmental disclosures avoided discussion of these serious ecological issues and focused instead on the 'good' news (Table 10.6) may be perceived as evidence of Benelux and German companies using CED as part of legitimising strategies aimed at (i) influencing external expectations and/or perceptions and (ii) distracting attention away from other issues, such as sustainability and stakeholder relations (Figure 10.4). The latter strategy is consistent with the analysis provided by Stone (1995) in terms of the way in which the focus of environmental disclosure is directed towards eco-efficiency issues, such as recycling, waste management, 'closing the loop' and other product- and process-related aspects, and away from issues of eco-justice and the associated environmental problems created by a global trading system which treats the environment as an economic good for commercial exploitation. By focusing on eco-efficiency issues, companies are effectively disowning responsibility for eco-justice issues and emphasising their responsibility for eco-efficiency issues, a strategy which not only opens the door to the disclosure of 'good' news but which also has the potential to distract attention away from some of the more disturbing patterns of environmental degradation which have been apparent for some time (see, for example, Carson, 1965; Friday and Laskey, 1989; Silver, 1990; Ward and Dubos, 1972). The fact that the chemicals industry, for example, provided relatively much higher volumes of positive (i.e. good news) CED throughout the period, particularly post-1993, may be interpreted as evidence of attempts by the chemicals industry to change perceptions of that industry's environmental performance. Such an interpretation would be consistent with prior studies (for example, Patten, 1992) which linked such disclosure with a concern with legitimation.

10.6.4 Classical political economy of accounting theory (PEAT)

Classical 'political economy' in the context being used here refers to the broad "…social, political and economic framework within which human life takes place" (Gray *et al*., 1996, p.47). In contrast to traditional neo-classical economics (see Chapter 5), which has sought to remove politics from economics, classical political economy places the politics of class relations, institutions, power and conflict at the heart of economic analysis[24]. Power in this context is seen as a weapon which is wielded by the dominant institutional structures within society to maintain economic, social and political inequalities (Puxty, 1986). From this perspective, society is depicted as persistently ravaged by deep-seated and endemic conflicts born out of repression, with social order structured through suppression, manipulation and exploitation based on existing power asymmetries (see Chapter 4, Section 4.7). An analysis of corporate behaviour, when viewed through the lens of classical (i.e. Marxian) political economy of accounting theory (PEAT), seeks to place such behaviour within a wider social, political and economic setting than that offered by the frameworks of EAT, MST or OLT as set out above. Rather than focus on relations between economically-contracted parties (as under EAT), between management and its key stakeholders (MST) or between management and its 'relevant publics' (OLT) in the context of 'the firm', classical political economy is primarily concerned with unfolding class relations between two 'factors of production', i.e.

capital (as represented by the share-owning and managerial classes) and labour in the context of the social system as a whole (i.e. capitalism)[25].

Although classical political economy is far from new, its adoption by accounting scholars is relatively recent (see, for example, Cooper, 1980, 1983, 1988; Cooper and Shearer, 1984; Tinker, 1980). Accounting researchers have employed the theoretical construction provided by PEAT to focus on the broad socio-political role played by accounting and accountants and the more complex institutional roles of business organizations, in society. In this context, PEAT is primarily concerned with the effects of accounting information and corporate reporting on the distribution of income, wealth and power within society as a whole (see Chapter 4, Table 4.3 and Chapter 7, Section 7.3). Viewed through the lens of PEAT, corporate accounting and reporting are not seen as neutral but as a partial, interested language by which conflict between the different social classes is exploited, manipulated, mediated and mystified (Neimark, 1986, 1992; Puxty, 1986; Tinker and Neimark, 1987; Tinker *et al.,* 1982, 1991). Hence, corporate reports take on the perceived role of ideological weapons aimed at influencing the distribution of wealth, income and power in order to ensure that capital remains free to continue its pursuit of making money for its owners. Such reports are thus perceived of as a source of anti-democracy, representing and reinforcing "… the neo-pluralist view of an unbalanced distribution of power" (Gray *et al*., 1996, p.41). Research informed by this perspective is thus concerned with exposing and highlighting the ways in which accounting and reporting, through the selection of and emphasis given to specific topics, concerns and policies, is used to modify, ameliorate, suppress, mystify and transform social conflict between capital and labour. Tinker *et al*. (1991), for example, see corporate reports as ideological, strategic documents used to influence decisions by projecting selective impressions about a firm's prospects, problems and needs, re-presenting reality from a particular point of view:

> *… like other ideological materials (party political statements, advertising, public relations 'fluff', religious dogma), it is the repetition of the mundane and particularly the censoring of other points of view that makes these reports most effective* (p.39).

An understanding of accounting and reporting from this perspective places emphasis on the specific historical context and institutional features of society (Cooper and Sherer, 1984). Puxty (1986), for example, states:

> *The nature of any system of accounting can be understood only in the context of the social system in which it operates. As an artefact within that system it is affected by the ruling ideas of the system and reproduces the nature of the system by its existence* (p.97).

Whilst traditionally concerned with the struggle between labour and capital, arguments for a political economy of accounting rest on the normative assertion that accounting, as a social practice, should be valuable to society as a whole rather than individual, privileged constituents such as shareholders and investors (Cooper and Sherer, 1984). Hence, it is possible to extend the theoretical framework provided by classical PEAT to include other aspects of the social world which form an integral part of the complex processes involved in the creation, appropriation and distribution of money wealth. By doing so, accounting researchers are able to bring into focus these other aspects of society which may be depicted

as representing elements of a new, broad, social and environmental challenge to the existing business-society hegemony (Gray *et al*., 1995b). These other aspects include, for example, race, ethics, feminism, social justice and the natural environment. In relation to the latter, unlike the three other theories discussed previously (i.e. EAT, MST and OLT), classical political economy is not concerned with the detail of corporate social and environmental reporting (Gray *et al*., 1996), other than to see such voluntary reporting as a blunt, crude instrument in a broad social and historical context. The latter can be seen, for example, in Puxty's (1986) description of voluntary CSR as 'crumbs of legitimation' allowed to fall from the table of capitalism. From this perspective, CSR merely forms as part of corporate ideological machinery that is used to maintain the legitimacy of the capitalist system as a whole (see, for example, Cooper and Sherer, 1984; Macintosh, 1990). Puxty (1986) argued that social accounting, to the extent that it legitimates and reproduces class relations, is only a more effective way of doing so. From this perspective, Puxty viewed social accounting not as 'part of the give and take of pluralist conflict' (Parker, 1986) but one of the means by which firms seek to maintain their asymmetrical structural strengths in contrast to other sections of society. Hence, those who adopt the radical structuralist approach of PEAT are unsympathetic towards alternative forms of social and environmental accounting which leave as unchallenged existing institutional structures since such structures are seen as merely legitimising and thus reproducing existing inequalities and privileges.

Notwithstanding its lack of concern with the exact form and content of CED, the value of PEAT in the context of the present study is two fold. Firstly, PEAT encourages accounting researchers to see CSR in a broad social, political and historical context where the different elements and aspects of the social world are engaged in a constant power struggle and in which the role of the State is crucial (see, for example, Arnold, 1990). Secondly, PEAT encourages CSR researchers to interpret trends in CSR/CED in systemic political terms. Gray *et al.* (1996), for example, suggest that, using PEAT:

> *the growth in environmental disclosures by companies in the late 1980s and early 1990s can be interpreted as an attempt to act* ***as if*** *in response to environmental pressure groups while, actually, attempting to wrest the initiative and control of the environmental agenda away from these groups in order to permit capital to carry on doing what it does best – make money for capital* (p.48, original emphasis).

Such an analysis, when employed to examine corporate behaviour, sees such behaviour as the outcome of a predominantly political process which gives social, political, economic and historical context to what takes place at a particular point in time and over time. Thus, the consideration of a single issue, such as managerial disclosure behaviour in relation to environmental issues, when viewed through the lens of PEAT, is seen merely as a small cog in a much larger mechanism that is modern industrial capitalism. While a detailed discussion of these broad, socio-political and historical issues is beyond the scope of the present study, mention can be made of some of the key geo-political events that took place over the period of the present study. These are summarised chronologically in Table 10.8 below[26]. A brief overview of these key geo-political events, drawing on the corporate reports included in the study, provides the broad, political and historical backdrop against which to interpret trends in CED through the lens of PEAT. At the end of the 1980s, following what was described as

a 'turbulent decade' (Bayerische Hypotheken-und Wechsel-Bank *Annual Report 1989*, p.10), many of Europe's largest companies were optimistic about the economic prospects for the 1990s. Bayer's *Letter from the Chairman of the Board of Management* which appeared in *Reviews Fiscal 1989* (p.3), for example, refers to the coming decade as offering: "… completely new, highly promising perspectives for the world economy. The establishment of democracy and the introduction of the social market economy in many Eastern European countries open up the prospect of freedom and greater prosperity for the people there." Similarly, ABN AMRO, points to the shift away from a welfare society towards a market economy (ABN AMRO *Annual Report 1991*, p.45), the newly-signed international trade agreements creating the "… right [economic] conditions …" for future economic growth (ABN AMRO *Annual Report 1992*, p.22). Likewise, both Volkswagen (*Annual Report 1992*, p.13) and Wella (*Annual Report 1994*, p.11) highlighted their respective expansion into the Eastern European economies of the Czech Republic, Hungary, Poland, Romania and Slovakia as these economies shifted to market-economy structures following the break up of the former Soviet Union and the disintegration of the Warsaw Pact and Comecon organization.

Table 10.8
Key geo-political events, 1989 to 1995

Year	Event
1989	Fall of the Berlin Wall (November 9).
1990	Invasion of Kuwait by Iraqi troops (August 2); agreement by the European Council of the EU to embark from 1 January 1994 on the second phase of European Monetary Union (EMU) (October 28); political and economic reunification of Germany (October 30).
1991	Start of hostilities in the Persian Gulf (January 17); the (then) 12 Member States of the European Community (EC) and the 7 countries of the European Free Trade Association (EFTA - Austria, Finland, Iceland, Liechtenstein, Norway, Sweden and Switzerland) agree to form an internal market to be known as the European Economic Area (EEA).
1992	Signing of the Treaty on European Union in its definitive form by the EU heads of state and government in Maastricht (February 7); formal signing of the EEA Agreement in Porto, Portugal for the free movement of goods, services, capital and persons between the 12 EC and 7 EFTA states (May 2); UN Environment Conference on Environment and Development, Rio de Janeiro, Brazil (June 3 to 14); signing of The Rio Declaration on Environment and Development (July 16); broad agreement by the respective governments of the US, Canada and Mexico on establishing a free trade zone, referred to as the North America Free Trade Agreement (NAFTA) (August 12); Swiss citizens vote against membership of the European Economic Area (EEA) (December 6).
1993	Single European Market becomes a reality (January 1).
1994	Uruguay Round (8th round) of GATT concluded with the signing of the Final Act in Marrakech creating the World Trade Agreement (April 15); European Union prepared for enlargement in 1994; numerous Asian countries, along with Australia and the United States, agree at the Asia-Pacific Economic Cooperation (APEC) Conference in Bogor, Indonesia, to aim to create a large free-trade zone for countries on the Pacific rim (November 15).
1995	Establishment of the World Trade Organization (WTO) by the Final Act of the Uruguay Round of GATT negotiations (1 January); creation of Mercosur, an economic common market for the South American countries of Argentina, Brazil, Paraguay and Uruguay (1 January).

Some of the well-established market economies were also going through or entering a period of what economists refer to as 'structural adjustment' (see, for example, Poff, 1994), a term used to describe the privatisation, deregulation and liberalisation of national economies in an attempt to create a free market or 'level playing field' on a global scale, engendering the 'right' market conditions for the emergence of 'the global economy'. The latter was particularly important for the prolongation of the capitalist system, many of the world's largest companies seeking new markets to add to the already over-saturated 'home' markets for their products and services. Mannesmann's *Annual Report 1991*, for example, states (p.7, emphasis added): "The Soviet Union and Yugoslavia are dissolving into their constituent nations. New nation-states are being born. Such developments influence the flow of goods and shape business prospects. *The market economy is establishing itself as the economic system of the future*." The perceived emergence of the 'market economy' as the only credible and workable social system for the world's economies was a common theme in corporate reports in the late 1980s and early 1990s. The 'Management Report' section of Volkswagen's *Annual Report 1989*, for example, suggests that large companies were already gearing themselves up for this 'New World Order':

> *The growing international détente now in evidence is having increasingly stimulating effects on economic activity. The democratization and liberalization process now under way as the East European countries open their borders are in particular helping to create the basis for future-orientated developments which will be of lasting mutual benefit.* ***The market economy has emphatically demonstrated that it is superior to every conceivable alternative when it comes to offering the prerequisite for political, economic and social progress*** (p.17, emphasis added).

The geo-political changes in the late 1980s and early 1990s, particularly the break up of the former Soviet Union, the shift from welfare-based to market-based economies in many European states, and the new international trade agreements and trading blocks[27] (see Table 10.8), considerably reinforced the power base of capital. The active support of the nation State in these geo-political changes was significant, those national governments which were signatories to the new transnational 'free trade' agreements effectively transferring even more sovereignty to large corporations. By opening up the world's markets to global competition through the removal of barriers to 'free trade', many national governments were empowering 'global industrial capitalism' as the supreme and undisputed social system for the 21st century (see, for example, Korten, 1995, 1999). These geo-political developments are significant in any context. However, a parallel development was taking place at the same time which, if taken to its ultimate conclusion, seriously threatened not only the moral justification for the 'New World Order' but also its economic, social and political rational.

Although the concepts of 'sustainable development' and 'sustainability' (see Chapter 2) were not new, by the end of the 1980s, notably following the publication of *Our Common Future* by the United Nations World Commission on Environment and Development (UNWCED, 1987), debates about the social and environmental (in)justices of global industrial capitalism for present and future generations and the natural environment had entered the conventional social, economic and political frameworks within which human life takes place. In other words, it had become part of mainstream political economic analysis. A highpoint, perhaps

the pinnacle, of this debate, in global geo-political terms, was reached in 1992 with the Third-World UN *Conference on Environment and Development* (UNCED) held in Rio de Janeiro, Brazil in June 1992 (see Section 10.3 above). The purpose of this Third-World environment conference was to review progress since the earlier UN conferences in 1972 and 1982 in safeguarding the human environment and promoting human welfare.

Two key documents adopted at the Conference were *Agenda 21* and *The Rio Declaration on Environment and Development*. *Agenda 21* represents a programme for the 21st century for the alleviation of poverty, hunger, sickness, and illiteracy worldwide and simultaneously arresting the deterioration in the earth's ecosystems on which humankind depends to sustain life (Gilpin, 1996). *The Rio Declaration on Environment and Development*, signed on 16 July 1992, is a proclamation made by UNCED following the Conference containing 27 Principles for social and environmental justice. Principle 7 of the Declaration states that "States shall cooperate in a spirit of global partnership to conserve, protect and restore the health and integrity of the Earth's ecosystems" (Gilpin 1996, p.218). Although a detailed exploration of the various outcomes of UNCED is outside the scope of the present study, its overall importance lies in the concern expressed by the international community, particularly the developing countries which contain the most environmentally vulnerable, to protect the global natural environment. This concern, particularly in relation to the concept of sustainability (see, for example, Bebbington, 2001), and the rise in the 'green' movement during the late 1980s and early 1990s (see, for example, Elkington, 1997), may be seen as the manifestation of a new, potentially potent challenge to the existing business-society relationship and the business hegemony. Or, to put it another way, a 'crisis of capitalism' (see Chapter 1, Section 1.2) in the context of the new politics of sustainable development (Newell, 2000).

Business, aided by 'positive' economics and traditional forms of accounting, have traditionally viewed the natural environment from a utilitarian perspective, natural resources being a tradeable, sacrificial commodity to be exploited under licence from national governments as part of a remit from the state to create wealth, provide employment, maximise productivity and efficiency, etc. However, drawing on the definition of 'environment' as provided in Chapter 1, the natural environment in an ecological context can be construed as a separate and distinct aspect of reality, both in terms of the natural environment itself and of human experiences within that context (the latter would include, for example, the physical and aesthetic experiences derived from observing and discovering aspects of a pristine, natural world). Such a perspective allows alternative (admittedly) anthropocentric constructions of the environment to emerge, including those which recognise the environment as having certain rights and interests separate and distinct from those of humankind. To some, particularly the green activists and the deep ecology and spiritual ecology movements, these rights and interests are increasingly seen as subjugated by the rights and interests of capitalism as a whole and those of large, business organizations in particular[28].

This conflict of interest between capitalism and the environment, seen in its more extreme forms as 'the environmental crisis', may, when viewed through the lens of PEAT, be seen as the manifestation of a new challenge (or crisis) in the development of late twentieth century capitalism. Greater concern for the natural environment from the Third World, NGOs, the

general public and thus, in turn, the state, represents a potentially serious threat to this aspect of the business-society relationship for Western, capitalist societies. Put simply, such concerns may lead to the development of a counter-hegemony which seeks to empower natural capital at the expense of money capital through tougher environmental protection laws and legal limits on the exploitation, consumption and use of natural resources. Reisman (1997), for example, in his treatise on capitalism, concludes that environmentalism is the greatest current threat to capitalism, regarding it as the 'red movement in its demented old age'.

Similarly, Elkington and Dimmock (1991) quote the then president of ICC as stating that the 'withering away of the Marxist challenge' (presumably referring to the fall of communism in Eastern Europe) left the environmental challenge as the most fundamental challenge facing business in the foreseeable future. In this context, the construction given to the nature of the relationship between economy (i.e. business) and ecology (i.e. the natural environment) is fundamental to how society addresses, debates and resolves any perceived contradiction between the two[29]. In other words, the perceived magnitude of the environmental challenge or crisis, depending on how one sees it, in the context of the business-society relationship is essentially a function of the degree to which the goals of economic growth and ecological protection are constructed as compatible/incompatible with one another. More particularly, given the significant degree to which any 'strong' social construction of sustainability represents a challenge to liberal economic democracies operating under industrial capitalism (see, for example, Bebbington and Thomson, 1996), this challenge has the potential to develop into a crisis of such magnitude as to threaten not just the legitimacy of the business organization (as described under OLT), but the very legitimacy of the *social system* itself[30]. Hence, whatever construction is given to sustainability is crucial to the outcome of the sustainability debate.

By presenting the 'environmental crisis' (Arvill, 1976) as a (potentially) systemic threat to capitalism, the theoretical framework provided by PEAT can be employed to interpret how capital, through the large business organization, uses accounting and reporting as part of a strategy of suppressing, mystifying and transforming the sustainable development agenda. Thus, using PEAT, it may be hypothesised that capital, in systemic political terms, would have the following 'broad brush' aims in the context of a corporate environmental reporting strategy:

(i) *suppression* – capital will seek to suppress any significant development of the more radical forms of accounting *for* (un)sustainability since these would most likely provide a very different account of the benefits/costs of capitalism (see, for example, Bebbington *et al*., 2001; Gray 1992);
(ii) *transformation* – capital will seek to define, capture and control the sustainability debate, transforming the discourse into one which does not threaten the status quo; and,
(iii) *mystification* – the language and imagery of corporate reports will be presented in such a way as to create the impression that the pursuit of sustainable development is not incompatible with capitalism.

In essence, when viewed through the lens of PEAT, each of these activities has the same underlying rationale, namely to transform a 'crisis of capitalism' into a state of affairs which leaves the present social system and its inherent structural inequalities and privileges

unchallenged and unchanged[31]. Whilst none of these explanations can be used to interpret trends in CED *per se*, they do offer valuable insights when seeking to interpret the motivations underlying the environmental reporting strategies adopted by companies which lie behind these trends. However, seeking to interpret the 'story' which large European businesses were seeking to convey through their environmental disclosure strategies is problematic because it is evident that a number of different (and not entirely consistent) 'stories' were being told simultaneously. These 'stories' may, for simplicity's sake, be grouped into four categories:

(i) statements to the effect that that the primary goals of business are to increase market share, profitability and shareholder value based upon the free enterprise system[32];
(ii) statements to the effect that the natural environment is important and that business takes its responsibility in relation to the environment seriously[33];
(iii) statements to the effect that excessive regulatory measures to protect the environment are harming, or could harm, business[34]; and,
(iv) statements to the effect that it is possible to combine the primary goals of business with environmental protection through pursuing the 'sustainable development' agenda (see Table 10.9 below).

Statements falling into categories (i) and (iii), whilst clearly in keeping with the goals of the capitalist system as a whole, are not easily reconcilable to those falling under items (ii) and (iv) *unless* 'sustainable development' is constructed from within the traditional economic growth, free markets paradigm. In other words, even though sustainability was, by the late 1980s and early-1990s, no longer an issue that business or nation States could ignore or suppress (see, for example, Bendell, 2000; Elkington, 1997; SER, 2001), the door remained open for capital, through the business organization, to use corporate reports for manipulating, mystifying, managing and ultimately transforming the sustainability debate so as to remove the threat posed by a more radical interpretation.

That business began to take the environment more seriously in a reporting context is not in dispute here (see Table 10.7). However, there was a growing discernment in the late 1980s and early 1990s that business was attempting to influence the direction of the sustainability debate (see, for example, Beder, 1997; Greer and Bruno, 1996; Welford, 1997). Using the theoretical framework of PEAT, it may be hypothesized that large business corporations became engaged in transforming and mystifying the sustainability debate by creating the impression that the pursuit of sustainable development is *not* incompatible with the goals of the capitalist system. Empirical evidence which could be interpreted in the context of management's use of corporate reports as part of such a strategy, is provided in Table 10.9 below based on the content analysis of the reports included in the present study[35].

Several observations may be made based on the data presented in Table 10.9 and the wider review (not reported here) undertaken to extract this data[36]. Firstly, it is evident that sustainable development was an issue for large European business organizations during the period of the study. Thus, it seems reasonable to argue that capital, through the business organization, was engaged in the discourse surrounding the outcome of the sustainability debate. Secondly, the various statements made in this context seek to emphasise the compatibility of a free market economy with a responsible attitude to the environment. Whilst protecting the environment may have become a more important issue to business, this is not

seen as implying that the baby had to be thrown out with the bath water. Rather, growth, generating profits, environmental and social justice are seen as perfectly compatible with one another (sometimes referred to as the 'win-win-win' scenario of sustainable development).

Table 10.9
Manipulating, mystifying and transforming the sustainability debate

Company (source)	Extract
Akzo Nobel (ER 1993, p.3)	"Akzo Nobel seeks to make a significant contribution to sustainable growth in terms of the world economy, not only by serving our customers but also by observing high environmental standards."
Bayer (ER 1995, p.6)	"[S]ustainable development does not only demand a new impetus in the field of ecology. Economic and social goals also have to be sustainable. Only if the objectives in all three areas are pursued with equal vigour can sustainable development point the way to the future."
BASF (AR 1994, p.2)	"In our work we are guided by the concept of sustainable development. ... Development geared to the future requires innovative products which in turn assure a company's success. We need an environment which gives equal priority to economic, ecological and social objectives."
Henkel (1992 ER, p.2)	"We are convinced that growth, generating profits and environmental compatibility are not irreconcilable. Henkel is committed to the principles of the [ICC] Business Charter for Sustainable Development."
Hoechst (AR 1994, p.8)	"Hoechst fully acknowledges its economic, social and environmental responsibilities and is committed to sustainable development."
Hoogovens (AR 95, p.8)	"As a responsible participant in society, Hoogovens contributes towards sustainable development."
Nederland Spoorwegen (AR 1995, p.12)	"[O]ur objective is to conduct our activities on an ecologically sustainable basis while at the same time safeguarding the continuity of our business and our strong market position."
Royal Dutch/ Shell (AR 1993, p.2)	"Environmental considerations must be weighed alongside other pressing social and economic requirements, and objective judgements must be made about costs and benefits of environmental measures."
Unilever (ER 1995, p.43)	"Unilever wishes to be part of a sustainable future, in which economic growth combines with sound environmental management to meet the needs and aspirations of people throughout the world."
Volkswagen (AR 1994, p.60)	"Environmental protection is the challenge of our age. … Our basic approach is derived from the principles laid down in the International Chamber of Commerce (ICC), which places emphasis on sustainable development - in other words, economic activity that meets the needs of the present age without endangering the well-being of future generations."

Notes: Where: AR = Annual Report; ER = Environment report.

Thirdly, institutional support for this perspective is based on the definition of sustainable development as provided in the Brundtland Report *Our Common Future* (UNWCED, 1987) and the ICC's *Business Charter for Sustainable Development* (reproduced in Gray *et al.* 1996, pp.137-39). Since neither of these social constructions of sustainability represent a serious threat to capitalism[37], using the PEAT framework, it may be interpreted that these

sources are being used, both in a reporting context and in the general discourse with society, as ideological weapons to transform the sustainability debate into one which leaves the present social system essentially unchanged. Under this interpretation, the increase in CED over the period of the study is entirely consistent with business' attempt to manage the sustainable development debate. Increasing the amount of reporting space devoted to eco-efficiency issues (i.e. reducing waste and emissions, improving recycling, etc.) distracts society's attention away from the more radical elements of sustainability (i.e. those which challenge the moral legitimacy of capitalism itself), thus reinforcing attempts to control the debate over sustainability[38]. As such, corporate statements which present management's construction of sustainability in a way that is consistent with the primary goals of international capitalism (Table 10.9) may be interpreted as part of a strategy to mystify, mediate and transform a potential crisis between capital and the natural environment.

Whilst this interpretation provides an insight into the public relations strategies of large business organizations it is difficult to assess the degree to which they are influential in terms of the business-society relationship. At one level, there is clear confirmation of management's perceptions of its responsibility in relation to the environment. However, it is evident that other (non-reporting) strategies were adopted, such as the lobbying of national governments in signing up to international free trade treaties (e.g. the World Trade Organization (WTO)) and influencing the outcomes of international conferences and protocols such as those relating to sustainable development, third world poverty and climate change. It is worth noting, for example, the environmental movement's growing perception in the 1990s of the failure of international environmental agreements such as UNCED (see above) to regulate transnational companies (TNCs) responsible for ecological degradation. Chatterjee and Finger (1994), for example, report that the issue of TNC regulation was dropped from the UNCED agenda at the insistence of the US in particular. Instead of international binding commitments which would regulate corporate behaviour, the 1990s were witness to "… a growth in voluntary agreements, self-monitoring and the proliferation of sustainability audits of corporations by external consultants" (Newell 2000, p.34). At the same time as developing their own set of voluntary guidelines on the environment (most notably the ICC's *Business Charter for Sustainable Development*), big business, through organizations such as the ICC and the Business Council for Sustainable Development (BCSD), presented itself during the UNCED negotiations as part of the solution to environmental problems[39], arguing that only big business has the capital, technology and expertise needed to deliver on sustainable development (Chatterjee and Finger, 1994). More recently at the Earth Summit in Johannesburg in 2002, the sustainable development agenda has shifted markedly away from the social and ecological aspects of sustainability towards *economic development*, a strategy that is clearly evident in a recent publication from business leaders and the World Business Council for Sustainable Development (Holliday *et al*., 2002).

10.7 Summary and conclusions

The diverse theoretical perspectives outlined above may be seen as providing alternative accounts or stories of the same social phenomenon. Drawing conclusions from these diverse perspectives largely depends upon the view taken about the social responsibilities of companies in the context of the business-society relationship (Adams *et al*., 1995). The narrow economic perspective, as offered by EAT, assumes that managerial behaviour is

predicated on self-interest and that the latter's sole responsibility is to the company's shareholders to maximise their returns subject only to obeying all relevant laws and regulations. From this perspective, it could be argued that the trend in CED by Benelux and German companies over the period of the study simply reflects management's increased efforts to influence the cost of equity and debt capital. It would perhaps be a rather sweeping statement to suggest that the motive of self-interest is not present at all in relation to trends in CED over the period of the study. However, it would be equally sweeping to suggest that this is the *only* motive. While there are, at present, no clear definitions of what actions society considers desirable or even necessary, there is at least partial agreement that companies should behave in an ethically acceptable manner, restrict any adverse environmental impact on the environment to a minimum and behave in a responsible way to their employees. If it is generally agreed that these are desirable characteristics of a company, then a case can be made for the reporting of information about corporate activities in these areas (Adams *et al*., 1995b).

The perspectives offered by both MST and OLT reflect a wider socio-economic view of the world, one in which CED is seen as part of a process for managing or responding to socio-economic and socio-political issues such as social and environmental responsibility. MST suggests that these issues are managed from a strictly organization-centred perspective, where the emphasis is on appearing to appease key stakeholders whilst at the same time maintaining course in terms of the organization's primary (economic) objectives. In that context, environmental disclosure is seen as a mechanism by which the corporation manages its key stakeholders, trends in the quantity, orientation, tone and focus of such disclosure reflecting the relative importance of different stakeholder groups to the corporation. In contrast, OLT focuses on the legitimacy of corporations in the context of a social contract between business and society as a whole, the terms of which are seen as fluid, rather than immutable. From this perspective, the growing environmental agenda in the 1990s is viewed as a reflection of changes in social values, attitudes and norms, leading to changes in the terms of the social contract between business and society, and hence the possible emergence of a legitimacy gap. In a dynamic context, corporations are depicted as responding to these developments over time by adopting various legitimation strategies aimed at managing the legitimacy gap. From this perspective, CED is argued to be one of the mechanisms by which management educates its relevant publics about actual improvements in environmental performance, manipulates their perceptions and/or expectations as to the company's environmental performance, or distracts their attention away from more disturbing environmental issues. As such, trends in the quantity, orientation, tone and focus of CED are seen as determined by the particular mix of legitimation strategies being employed by management over time. The overwhelming absence of bad news, for example, may be seen as part of a legitimation strategy aimed at influencing society's perceptions, thus enabling management to construct an image of the corporation as a competent and concerned organization which takes in responsibilities in relation to environmental issues seriously (Gray *et al*., 1995b). Deegan and Gordon (1996), in considering the various theoretical arguments in support of companies disclosing bad as well as good news, argue that readers of annual reports are likely to have a general awareness of the potentially harmful activities that companies undertake. As such, these readers would be rather cynical of companies that deliberately chose to avoid any admission of the negative

aspects of their organization's environmental performance. This line of argument is consistent with the view expressed by KPMG (1993):

> *Disclosing the bad news as well as the good is very important if companies want to gain credibility for their reports. Otherwise, the reports can appear biased and akin to public relations tools. Even if there is considerable data, an otherwise 'good' report will invite suspicion on all its disclosures if companies are not 'up front' about the problems they are facing, including fines and prosecutions* (p.16).

However, the evidence provided by the present study suggests that the management of large Benelux and German companies *do* seek to bias their reporting of environmental issues. One possible reason for this could be that corporate management perceives the potential negative reactions to the disclosure of bad news to be greater than any perceived benefits of balanced, fair reporting (Deegan and Gordon, 1996). It could also be the case that environmental reporting is simply considered to be part of a public relations strategy, with no recognition of the need for 'coming clean' via a 'warts-and-all' approach as has been suggested by Deloitte Touche Tomatsu, IISD & SustainAbility (1993).

Of the four perspectives offered in the previous section, that of PEAT is the most disquieting in terms of its depiction of the business-society relationship in contemporary liberal economic democracies. PEAT's focus on the use of language, images and rhetoric by management for the purposes of immanent legitimation and social construction of society's perceptions to hide, mystify and mediate developing crises offers a disturbing and uncomfortable account of the motivations underlying CED. PEAT's central concern in this context is with the way in which capital, through it's appointed agents, uses corporate accounting and reporting to preserve existing inequalities and asymmetries that positively discriminate in favour of capitalism. From this perspective, corporate accounting and reporting are not seen as neutral, value-free activities but as part of the socially-constructed technology of capitalism, "… determined by capitalistic power and advocated by professional ideology" (Dillard 1991, p.10) to provide an interpretation of events, and the specification of what is considered to be an event, from a particular socio-political point of view. Extending this analysis to include the natural environment shines a light on the challenges posed by the concept of sustainability to the present business-society hegemony. Strong forms of sustainability are radical in the sense that they suggest no business corporation has *ever* made a profit and that no business can ever be sustainable no matter what improvements or changes are made to its products, processes or means of doing business under the present rules of the game (see, for example, Bebbington and Gray, 2001; Bebbington and Thomson, 1996; Gray 1992; Hibbitt, 1999). Whilst the management of large Benelux and German companies made some attempts to convince society of their concern for the natural environment (see Table 10.7 above), PEAT argues that such concerns need to be seen in the context of existing institutionalised structures and international agreements and protocols which reinforce a social system that is perceived of as being deeply unjust and morally indefensible. Gray *et al*. (1995b), for example, refer to the re-powerment of capital in Western economies during the late 1980s and early 1990s, with business taking over many of the responsibilities previously assumed by the state. In that context, CSR/CED may be seen as driven by matters which are important to capital and not by what is important to society or to the environment. That is, the capital and managerial

classes, can, through the firm, choose to focus on the areas of CSR/CED when it matters to them. This selective process therefore has an underlying agenda. In a wider context, it might be that society's acceptance of the 'business case' for sustainability is seen as essential for preserving the present hegemony in which the role of business in a capitalist-owning democracy is as custodians of wealth-creation, the market place and welfare functions, many of which were previously part of the role of the state but which are being increasingly transferred to the 'market'. In that context, environmental disclosure may well form part of the process by which this widening capitalist franchise (Gray *et al*., 1995b) is legitimised.

Notes

1. Alfred Schutz (1899-1959) had a major influence on the development in the English-speaking world of phenomenological sociology, a school of sociology derived from phenomenological philosophy which takes as its main aim the analysis and description of everyday life (Abercrombie *et al*., 1994). Essentially, phenomenologists argue that although people tend to take the everyday social world for granted, individuals socially construct the world around them. Thus, phenomenologists reject the notion that human beings are formed by the social world, but instead seek to understand the meaning of human action and the processes underlying that action.
2. Recognising that there is no neutral, objective world of facts, the scientist's task of acquiring interpretive understanding normally involves methods similar to those found in anthropology where there is an emphasis on observation, linguistics and a careful attention to detail (see, for example, Barley, 1986). Such research may involve a case-study approach in which the researcher is able to observe real-life actors in their day-to-day life (see, for example, in the context of social accounting systems, Dey, 2000, 2002; Dey *et al.*, 1995). Whilst this approach is generally considered to be fruitful in terms of being able to observe day-to-day human action, it does not remove the problem of having to interpret and thus give meaning, in a scientific sense, to such action. However, there are no precise rules as to how to conduct interpretive research (Chua, 1986). Within accounting this has led to 'interpretive theories' such as stakeholder theory and legitimacy theory being researched in a number of different ways, some of which are more orientated towards distant, large-scale sampling methods than others.
3. See, for example, Chua (1986, pp.615-616) who provides an interesting illustration in relation to two items of accounting research on budgetary control systems, one from within mainstream accounting and the other from an interpretive perspective.
4. It is the author's contention that is it not, but this is a personal judgement on an issue which scientists of different research traditions are unlikely ever to agree upon. A more detailed discussion is outside the scope of the present study. Aspects of the positivists-phenomenologists epistemological debate were addressed in Chapters 1 and 4 which provided references for further reading. This debate is, however, directly relevant to the present study in that the author's preference for studying CED using non-positivist methodology did not conform to accepted scientific tradition. As a compromise, permission was granted to include a section within the thesis which took an alternative perspective to that presented in Chapter 9. It is this alternative perspective which forms the subject matter of the present chapter. However, the analysis which follows cannot do justice to that alternative interpretation. In its more complete form, such an account involves much more dialogue with the data, the researcher moving between the data and the respective theory, developing ideas, hunches and a sense of a story contained within the data in a grounded-theory sense, but without the formulation of 'hard' hypotheses. For an example of what such an account might look like in an accounting context, see Neimark (1992).
5. The emphasis on *all* life-forms departs from more traditional forms of analysis which are essentially anthropocentric because of their focus on human life only and thus, by implication, the assumption that human life is somehow more important than other forms of life.
6. Whilst some theories, such as economic agency theory, are firmly entrenched within their particular sociological paradigm, other theories are less rigid in their construction of, and assumptions relating to, aspects of reality and of the methods accepted within the research

community for exploring that reality. As demonstrated in Chapters 6 and 7, respectively, MST and OLT have both been explored from within both the positivist and interpretive research traditions.

7. Care needs to be taken in interpreting the results when presented in this way as it takes no account of relative quantities of disclosure. To illustrate the point, over the seven year period 19 companies were classified as 'disclosers' of environmental information in a particular year where the total amount of disclosure was 0.01units, the smallest unit of measurement used in the study.
8. An examination of the research database revealed that the source for these energy disclosures was not confined to one particular type of report (e.g. annual report and accounts, environment reports or social reports) and thus the significant increase in the number of companies reporting on energy issues in 1995 appears to have been influenced by the general rise in the number of documents overall.
9. The distinction between 'eco-efficiency' and 'eco-justice' is a familiar one in the context of sustainable development. See, for example, Gray *et al*., 1997; Owen, 1996; Stone, 1995; UNWCED, 1987.
10. The analysis provided in this and the following section uses the mean amount of CED as the main statistic for illustrating trends in environmental disclosure over the period of the study. The mean was selected in preference to the median, notwithstanding the presence of outliers, given that the main concern here is with general trends in CED over time.
11. 'Management and Accounting Information' ('AccPP') represents the number of pages devoted by senior management to statutory and voluntary financial and supervisory/management information, including the statutory accounts and the directors' report. The balance of the total number of pages thus represents the volume of space devoted to all other forms of non-statutory information, including social and environmental disclosure. A small amount of double counting is acknowledged in Figure 10.2 in relation to environmental disclosure (CED) made in accordance with accounting and reporting requirements and which, therefore, are included in both the Total CED and AccPP. However, the amount involved over the entire period of the study is only 6.39 pages. Therefore, in view of the small amounts involved, no adjustment has been made to the data reported in this chapter.
12. By design (see Chapter 8), interim reports (i.e. quarterly or semi-annual reports) were excluded from the study. As noted in Chapter 8, at the time of formally starting this project (1997), interim reports were included but subsequently withdrawn for practical reasons. A brief examination of these reports suggested that (i) these reports did not increase significantly in terms of volume over the period of the study and (ii) such reports tend to contain little or no voluntary information, the latter being consistent with the findings of Adams *et al.*, 1998.
13. The average amount of Total CED reported by Benelux and German companies, by year, was as follows: 1989, 3.08 pages; 1990, 3.44 pages; 1991, 4.52 pages, 1992, 5.03 pages; 1993, 5.74 pages; 1994, 7.10 pages; 1995, 18.82 pages. See Chapter 9, Table 9.34.
14. The analysis presented here is limited to the period of the study. Extending this beyond 1995, to include for example, 1996 and 1997 (as originally intended), would provide a better context in which to judge the significance of the change between 1994 and 1995.
15. These figures exclude the classification 'other environment'. The amount of pages classified as 'other' also rose significantly over the period, from a mean of 0.35 pages in 1989 to 3.38 pages in 1995. Much of this increase can be attributed to the significant increase in the number of environment reports. These reports were found to contain a number of blank pages and blank portions of a page but which nevertheless have been included as part of environmental disclosures. The issue of blank pages and blank portions of pages was addressed in Chapter 8.
16. Systemic in this sense refers to the economic system as a whole. Evidence of systemic shifts in environmental disclosure for economies as a whole are important because they suggest that changes may be taking place with the tacit support of the various power-based institutions within society, including the government. As such, it may be useful to explore such changes through theoretical perspectives such as classical (i.e., Marxian) political economy which operate at a higher level of resolution than EAT, MST or OLT. Classical political economy, which views social and environmental disclosure as an important aspect of capital's attempts to maintain its dominant position in societies through existing power asymmetries and inequalities, (see, for

example, Arnold, 1990; Cooper, 1988; Cooper, 1992; Cooper and Shearer, 1984; Puxty, 1986; Tinker *et al*., 1991), is considered briefly in Section 10.6 below.

17. Both Campbell (2001), in the case of a small (10) sample of large UK companies and Deegan and Gordon (1996), in the case of a large (197) sample of large Australian companies, report a rising trend in the volume of environmental disclosure over time. Deegan and Gordon highlighted particularly the increase between 1988 and 1991, whereas Campbell (2001) reported a significant rise in 1990 and thereafter.
18. Of the 27 first-timers, only 21 provided identifiable reasons for publishing their first corporate environment report. Of these 21, ten gave more than one such reason. Table 10.7 summarises the reasons given by these 21 companies.
19. However, Spencer-Cooke (1994) also reports a gap in environmental information flows between companies and the financial community in the early 1990s. Specifically, she found that financial analysts were not viewed by companies as a priority audience for environmental information, the most important being employees, shareholders and public authorities.
20. Under economic agency theory, management is assumed to act beyond what is legally-required only when it is in it's own interest to do so. From this perspective, a more efficient and/or effective environmental management system or more sophisticated environmental cost recording system will be introduced only where it is perceived to bring net economic benefits to the firm. Moreover, it is assumed that management would incur the wrath of shareholders for incurring costs which do not result in the improved financial performance of the firm. Hence, the focus on policy and product issues rather than full cost pricing could be suggested as being due to management's perception that it is the former rather than the latter which are important to the continued financial success of the firm and thus to their own economic interests in terms of job security and economic rent. Spicer (1978a), for example, argues that it is the threat of sanctions against firms whose behaviour is considered by sections of society to be socially undesirable which may induce such firms to improve, for example, their environmental performance (e.g. in relation to pollution control). In the absence of any perceived threat, management is said to have no incentive to improve environmental performance.
21. The depiction of corporate social and environmental reporting practices within an explicitly bourgeois framework is consistent with earlier attempts to classify CSR practice along a simple duopoly of reactive or active patterns of behaviour (see, for example, Guthrie and Parker, 1990). Such an interpretation of CSR has come in for strong criticism from those employing the wider framework provided by classical (i.e. Marxian) political economy (see, for example, Arnold, 1990). Gray *et al*. (1995b) appear to accept both interpretations, recognising that, even though to classify CSR as simply reactive or proactive is too simple, some elements of CSR *are* bourgeois and therefore should be interpreted as such.
22. As noted in Chapter 2, various steps have been taken to introduce voluntary and regulatory rules governing environmental reporting within the European Union, including the European Commission's voluntary EMAS regulation (CEC, 1993b, 2001a) and the recently-introduced Dutch requirements on environmental reporting by selected 'dirty' industries at site level. However, to date, no country in the world has sought to require companies to prepare and publish environment reports at corporate level (i.e. for the operations of a company and its subsidiaries as a whole).
23. It is this issue more than any other which presents the greatest challenge to those, including professional accountants, who are engaged by companies to provide an independent verification of corporate environment reports. Such reports, to have credibility in the eyes of the wider community, must arguably present a 'true and fair' view of the company's 'environmental results', taking into account the many and varied aspects of the relationship between economy and ecology, and thus requiring the inclusion of the good, the bad as well as the ugly. However, our limited and partial knowledge and understanding of this complex relationship implies that the issuing of a 'true and fair' opinion on corporate environment reports is presently beyond the scope of our expertise and competence (for a discussion of some of these issues, see, for example, Gray, 2000).
24. Although today the separation of 'politics' from 'economics' is very much taken for granted within schools and universities, this is a relatively recent phenomenon. Up to the latter part of the

19th century studies of the political economy would have been carried out on the implicit understanding that society, politics and economy were indivisible (Gray *et al*., 1996). Much of the theoretical groundwork that led to the breaking up of 'political economy' into separate disciplines of contemporary social science took place in the 18th and 19th centuries by neo-classical economists whose principal concern was with the production of material wealth in relation to the activities of the state (Abercrombie *et al*., 1994).

25. There are two major traditions within political economic theory, one being 'classical' or Marxian (generally associated with Karl Marx) and the other 'bourgeois' (mainly associated with economists such as John Stuart Mill and David Ricardo). The difference between the two concerns the importance attached to structural conflict within society (Gray *et al*., 1996). Classical political economy sees structural conflict, inequality and the role of the State as lying at the heart of socio-political analysis, whereas bourgeois political economy is more concerned with the social interactions between the various different groups in society which is seen as essentially pluralist, taking as given the structures and institutions within that society. Marx's economics was essentially that of the classical school, particularly of Ricardo, to whom Marx was deeply indebted, although Marx elevated economics out of its preoccupation with agriculture and steady states (Bannock *et al*., 1992). Whilst today 'political economy' is often used as a code word for 'Marxism', or 'classical' political economy, the theoretical origins of the latter owe much to 'bourgeois' political economists such as John Stuart Mill (1857) and Ricardo, who embraced concepts such as social class, labour value, the division of labour and moral sentiments (Abercrombie *et al*., 1994; Bannock *et al*., 1992; Flew, 1983).
26. Table 10.8 is not intended to represent an exhaustive listing of the major key geo-political events during the period 1989 to 1995. Rather, it is an overview of some of the key geo-political events which were the subject of comment and discussion in the corporate reports included in the present study. Whilst such a summary is obviously biased, partial and incomplete, it is argued to provide a reasonable overview of the social construction given by Europe's largest companies to geo-political events during and surrounding the period 1989 to 1995.
27. The conclusion of the 8th and final round of the GATT negotiations in 1994 was hugely significant in this context, bringing to a formal conclusion geo-political negotiations which were set in motion almost 50 years before with the General Agreement on Tariffs and Trade (GATT). GATT forms part of the Bretton Woods economic system created after the end of the Second World War, along with The International Monetary Fund (IMF) and The World Bank, to create a stable trade and economic world environment under proposals from the USA and the UK. The Protocol of Provisional Application of the General Agreement on Tariffs and Trade, concluded in 1947, entered into force in 1948. The GATT completed 8 rounds of multilateral trade negotiations, the last of which, the Uruguay Round, concluded with the signing of the Final Act on April 15, 1994, in Marrakech, producing the World Trade Agreement, administered by the World Trade Organization (WTO). The WTO was established on January 1, 1995 by the Final Act of the Uruguay Round of negotiations.
28. This perception of a clash of interests between the environment and the economy has taken on many different forms, but at its root is a growing realisation that one (the economy) is endangering the other. It is in this arena that much of the present discourse surrounding the debate about 'sustainability' takes place. Capitalism, as a social system, seeks (though advertising) to increase human consumption of goods and services. Corporations use their economic power as a means of increasing demand for goods and services. However, this can have consequences, sometimes severe, for the environment, and human experiences of the environment, particularly where the demands placed on the environment are so great as to give rise to concerns not just over the state of the environment itself but also of the quality of human life within that environment (e.g. concerns over global warming and ozone depletion).
29. It is impossible to overemphasise the importance of this construction in the context of how Western liberal economic democracies will determine the lives of present and future generations. Recourse to 'scientific evidence' such as in the case of genetically-modified organisms (GMOs) and global warming does *not* provide an acceptable, reliable basis on which to decide 'quality of life' issues given that we simply do not know the full consequences over the long-term. Thus, just because 'experts' are not aware of any harmful effects does not guarantee that harm is not taking

place or will not take place in the future. In this situation, the only rational, sane alternative is to adopt the precautionary principle and ban potentially harmful substances and activities until such time as they can be *proven* not to be harmful to human and other life-forms. In essence, it is for the producers, users and traders of potentially harmful substances to prove beyond any reasonable doubt that man-made substances are not harmful to the environment and those whose existence depends on it.

30. Whether business can deliver 'sustainability' depends ultimately on the human construction given to it. A weak, economics-based interpretation such as that offered by Holliday *et al*. (2002) is clearly inconsistent with strong, ecological-based interpretations such as that offered by Gray (1992). In that context, the tone of current and future debates about the role of business in contributing towards a 'sustainable' society will depend largely on the extent to which one section of society is able to influence perceptions on what 'sustainability" really means. In other words, the debate will not be about facts but about beliefs and the relative power asymmetries which contribute towards the general ascendancy of particular beliefs within society as a whole.
31. It is in this context that the role of the accountancy profession, particularly FEE, its European representative body, through its association and support for GRI's (2000, 2002) *Global Reporting Initiative*, has such serious and damaging consequences for ensuring a just and democratic outcome of the sustainability debate. To the extent that business and accountancy's conceptions of sustainability are equated with the trivial, petty concept of 'triple bottom line' reporting (TBL) (see, for example, Elkington, 1997; Adams and Jackson, 1999) this debate has been successfully captured and controlled by those whose very interests are served by the status quo.
32. Examples of statements from companies included in the present study as to their primary goals and missions include: Allianz *Annual Report 1993*, p.9: " ... the primary objective remains increasing profitability …"; Bekaert *Mission & Beliefs Statement*: "4. We believe that the free enterprise system is the best framework within which to fulfil our mission"; Bayerische Hypotheken-und Wechsel-Bank *Annual Report 1994*, p.7: "Germany can only achieve a position as a location for industry and financial services ... if everyone ... foster[s] a system in which market forces can come into play and develop freely"; Bayerische Vereinsbank, *Annual Report 1991*, p.14: "Competition, combined with a sense of social responsibility, ensure that society's divergent interests are reconciled. The framework for this is a social market economy"; Delhaize *Annual Report 1995*, p.11: " ... the future for the Group includes: growth of market share, growth of profits and growth of shareholders' equity ..."; Mannesmann *Annual Report 1995*, p.5 'Letter to the Shareholders' from the Chairman of the Board of Management: "We run your company with the main focus on profitability and increasing shareholder value."
33. Many of the companies in the present study expressed a clear concern for and commitment to environmental protection: BASF *Annual Report 1993*, p.34: "The ecological properties of our products are just as important to us as their performance"; Beiersdorf *Annual Report 1991*, p.7: "We act in an ecologically responsible way to protect the environment and conserve the natural basis of our life"; Commerzbank *Annual Report 1991*, p.28: "We are committed to achieving progress that is socially acceptable and does not harm the environment"; DaimlerBenzChryzler *Annual Report 1994*, p.2: "We owe it to future generations to use our natural resources prudently and sparingly. This sense of responsibility must be reflected in all our thoughts and activities throughout the Group"; DSM *Annual Report 1989*, p.11: "It is widely and increasingly felt that more stringent measures need to be taken to cope with the environmental problems confronting us today. DSM endorses this need …"; Goldschmidt *Annual Report 1994*, p.11: "Responsibility for protecting the environment and for ensuring the safety of our employees is as important as the pursuit of our economic objectives"; Pakhoed *Annual Report 1995*, p.17: " ... the highest priority is given to the protection of the environment ..."; Preussag *Annual Report 1991/92*, p.48: "The global threat to the environment is becoming a growing challenge in many ways. It is the moral duty of the industrialised nations today to treat natural resources economically, to produce in a way which is non-polluting, and to assist the less developed countries in their endeavours to safeguard the environment"; Tractebel *Annual Report 1990*, p.9: "The Tractebel Group is acutely aware of the importance of the environment"; Unilever *Annual Review 1992*, p.22: "Concern for the impact of Unilever's operations upon the environment is an important consideration in developing our commercial strategies" and *Environment Report 1995*, p.1: " ... environmental

performance is a central issue for the Company and one which has a direct bearing on long-term business success".

34. A number of companies, particularly those in Germany, were clearly concerned that an over-zealous approach to environmental protection would cause considerable *economic* harm to their business: BASF *Annual Report 1991*, p.34: "... legislation is becoming increasingly stringent ... In terms of the cost involved the additional environmental and safety benefits are relatively slight"; Bayer *Annual Report 1991*, p.7: "... we are becoming increasingly concerned about the direction of environmental policy in Germany. The situation seriously threatens our international competitiveness"; Petrofina *Annual Report 1992* 'Letter to Shareholders', p.8: "The company ... is preoccupied with a multitude of constraints, environmental ones in particular, which weigh heavily on the industry as a whole"; RWE *Annual Report 1993/4* 'Message from the Chairman', p.5: "A national CO_2 tax or energy tax, which already plays a pioneering role in environmental protection, would not be in line with ecological or economic requirements; it would further unilaterally hamper the country's industrial prospects, with dire consequences for business"; Thyssen *Annual Report 1990/91*, p.23: "In view of the very little potential left for reducing emissions, additional demands for environmental protection at our plants and production sites increasingly reach the limit of what is technically possible. Each heavy outlay would only result in marginal improvements for the environment"; VEBA *Annual Report 1995*, p.65: "Rising costs make it difficult to argue the case in favour of environmental protection when other company objectives also have to be considered, such as maintaining competitiveness and maintaining jobs"; Wacker-Chemie *Annual Report 1991*, p.3: "The ever-increasing mass of regulatory legislation is a powerful restraint on innovative forces. Legislation does not always take account of what is technically possible and economically acceptable. It has led to lengthy and unpredictable procedures for new plant and processes, as well as a disproportionate rise in environmental protection costs".
35. Table 10.9 is intended to provide an indication of the general nature of business' construction of sustainability over the period of the present study. Time and space preclude a more detailed investigation here, although it should be pointed out that a significant number of statements of this nature were made by these companies over the period of the study.
36. As shown in Figure 10.1 earlier in this chapter, although the amount of CED relating to sustainable development was not equivalent to other more popular categories of disclosure, there was a significant increase in the mean number of pages over the period of the study (rising from 0.003 pages in 1989 to 0.015 pages in 1995). The relatively small amount of reporting space devoted to sustainability issues reflects the fact that corporate statements on this subject were relatively short, comprising usually no more than one or two paragraphs. What is important in this context is that over the period of the study the number of references to sustainability in corporate reports increased dramatically, the content of these statements revealing the substance of management's stance in relation to sustainable development (see Table 10.9).
37. The Brundtland Report (UNWCED, 1987) does set out some very serious social and environmental challenges for the developed world. However, the definition of sustainable development provided therein, i.e. development which "…. meets the needs of the present without compromising the ability of future generations to meet their own needs" (UNWCED 1987, p.8), is too general for practical purposes. The most common practical interpretation is probably that sustainable development requires the integration of environmental, social and economic considerations into decision-making (Gilpin, 1996). However, this too is unworkable because it does not provide a decision rule for those situations where these three considerations are in conflict with one another. Similarly, the ICC *Business Charter for Sustainable Development* is essentially concerned with environmental *management* from a business perspective and sees economic growth as providing the conditions in which protection of the environment can be best achieved. As such, it subsumes the environment within the economic, thereby transforming the sustainability agenda into one which does not harm the essential role of business in capitalist societies.
38. It might be contended that this focus on the eco-efficiency aspects of sustainability is a logical response on the part of business given that there are severe 'allocation' problems in trying to address some of the many complicated aspects of full cost accounting (FCA) for environmental

externalities such as acid rain, global warming, loss of biodiversity, etc. Whilst it is certainly true that these difficult allocation problems have yet to be properly addressed by business (see, for example, Bebbington *et al*., 2001; Hibbitt and Kamp-Roelands, 2001, 2002a), it is particularly naïve to assume that the decision of business not to go down the FCA route is motivated purely by this kind of reasoning. Why, for example, have large business organizations been so keen to adopt so-called triple bottom line reporting (TBL) (GRI, 2000, 2002) in preference to more sophisticated and meaningful forms of accounting for the environment? The answer lies perhaps in the fact that TBL does not challenge the basic conflict between economic development and sustainability, whereas FCA and other more substantial forms of accounting do (see, for example, Gray, 1992; Bebbington and Gray, 2001; Hibbitt, 1999).

39. Elkington (1997) states that business, via its lobby organizations such as ICC and BCSD, had invested "… a growing amount of energy and senior management time … in preparing its position for the 1992 Earth Summit" (p.60). However, Elkington also states that "[M]ost of the hundreds of companies that limbered up for the 1992 Earth Summit by signing the Business Charter for Sustainable Development, devised by the International Chamber of Commerce (ICC), had little idea of the deeper logic of sustainable development. As far as they, and the thousands of companies which have signed up since, were concerned, the basic challenge was simply one of "greening", of making business more efficient and trimming costs" (p.71). The extent to which leading industrialists and business leaders were conscious of a serious 'clash' between economy and ecology is an important issue in this context, but not one which is addressed in any detail here. Suffice to say, it would seem naïve to suggest that the challenges posed by sustainability were simply seen in eco-efficiency terms by all business leaders, bearing in mind the political disquiet being expressed by the Third World and NGOs at international and inter-governmental conferences in the 1990s.

Chapter 11

Summary, conclusions and closing remarks

The argument, therefore, is not simply that the dominant patterns of economic development ... are wrong morally. It is that they are now counter-productive. They are no longer generating net benefits, but net costs; and these costs are increasing. Change is therefore imperative. This change needs to be not just in the patterns of economic development, but in the model which informs them. We need to reassess what we mean by economic and social progress; and move to a path more likely to achieve it.

The Real World Coalition (1996, p. 12)

11.1 Introduction

The purpose of this closing chapter is fourfold: firstly, to summarise the results and main conclusions of the research investigation; secondly, to provide an appraisal of the empirical evidence in terms of its support for theory, highlighting confirmations of and differences from prior research and to draw attention to new findings; thirdly, to provide 'food for thought' in terms of public policy issues, notably the role of the accountancy profession in the field of corporate environmental reporting; and lastly, to propose a radical agenda for action in relation to the role and direction of future academic research in this area.

As set out in Chapter 1, the present study was motivated by a concern to explain and interpret the underlying nature and causes of corporate environmental disclosure (CED) amongst large European companies. This concern was expressed in the first part of the research question (Chapter 1, Table 1.1) which raised the deceptively simple but arguably important question: "Why do companies provide environmental disclosure?" The second part of the research question, which follows on from the first, asked: "What implications do these explanations have for the role of corporate environmental disclosure and reporting in relation to matters of public policy?" The research approach adopted for the purposes of addressing these research questions (as set out in Chapter 8) provided for a systematic investigation into CED for a sample of 90 large Benelux and German companies over the seven-year period from 1989 to 1995[1]. This investigation was performed by employing both cross-sectional (Chapter 9) and longitudinal (Chapter 10) analyses. Both analyses were based on a total of 1,011 corporate reports over the seven-year period (Chapter 8, Section 8.13), comprising 630 annual reports, 70 social reports, 50 environment reports, 137 reviews of the year, and 124 other reports (Chapter 8, Table 8.5). In relation to the cross-sectional analysis, three theories (i.e. economic agency theory (EAT), managerial stakeholder theory (MST) and organizational legitimacy theory (OLT)) were employed using the hypothetico-deductive method of research. Each of the theories was explored in detail (Chapters 5, 6 and 7, respectively) in order to arrive at a set of testable hypotheses in each case, which, based on prior CSR research (Chapter 3), predicted an association between variations in the volume of CED and variations in other explanatory variables. These other variables were presented in the form of either firm

characteristics or socio-political influences within an overall conceptual framework on the association between the firm and CED (Chapter 3, Figure 3.1) in the context of the wider relationship between business and society. In doing so, the investigation adopted a *teleological* construction to the application of these three theories in the context of CED (Chapter 1, Section 1.1). Put simply, the phenomenon of CED is seen as something which takes place not by accident or chance but as a result of a conscious, deliberate act on the part of management toward some pre-conceived economic, socio-economic or socio-political end. In relation to the longitudinal analysis, a fourth theory, political economy of accounting theory (PEAT), provided a supplement to the investigation (Chapter 10, Section 10.6.4) in offering a radical, critical interpretation of the role of CED from a socio-political perspective.

The rest of this chapter is structured as follows. Section 11.2 summarises the key findings of the study in relation to the cross-sectional analysis. The key interpretations in relation to the longitudinal analysis are set out in Section 11.3. Section 11.4 summarises the main limitations of the investigation. A discussion of the key findings and interpretations in the context of the first part of the research question is provided in Section 11.5. The second part of the research question, which addresses matters of public policy, is set out in Section 11.6. These matters are considered from a normative (as opposed to a descriptive) point of view in the context of both the recent upsurge of interest in corporate social responsibility (CSResp) and sustainable development and the role of the accountancy profession in lending credibility to corporate reports in these areas. The normative theme is continued in Section 11.7 which provides a critical commentary on current developments in corporate social and environmental reporting and lays down a serious challenge to researchers, accounting practitioners and consultants engaged in CSR. The final section (11.8) offers a personal entreaty for accounting researchers and practitioners to stay with 'the big picture' in terms of the overarching, omniscient struggle between economic development on the one hand and human, social and ecological justice on the other.

11.2 Key findings from cross-sectional analysis

The key findings of the cross-sectional analysis part of the study are summarised below. These findings are presented in relation to the various hypothesised associations between variations in the volume of CED and variations in other, explanatory variables (or, more correctly, assumed proxies for these variables) under EAT, MST and OLT, respectively. These findings are subject to the limitations set down in Section 11.4 below.

Economic agency theory (EAT)

The *Rochester School brand of agency theory* (Thornton, 1984) (see Chapter 5) predicts that management's behaviour will be motivated by a concern to minimize agency costs while maximizing their own self-interest (Cormier and Magnan, 1996; Felton, 1982; Jensen and Meckling, 1976; Thornton, 1984; Watts, 1977; Watts and Zimmerman 1978, 1986, 1990). This model of managerial behaviour was employed to develop the following set of testable hypotheses:

H_1: There is a positive association between *political visibility* and CED.

H_2: There is a positive association between *industry environmental sensitivity* and CED.

H_3: There is a positive association between *contracting and monitoring costs* and CED.

For these purposes, four surrogates were employed as proxies for the firm characteristic *political visibility*, i.e. total assets, the number of employees, capital employed, and profits (EBIT). The firm characteristic *industry environmental sensitivity* was related to the sensitivity of an industry's activities to the natural environment based on *a priori* assumptions as to the environmental sensitivity of the eight industry sectors chosen for the study (see Chapter 8, Section 8.10)[2]. The third firm characteristic *contracting and monitoring costs* was measured by two key market variables, *financial leverage* using the two ratios (i) long-term debt to total assets and (ii) long-term debt to equity, and *dividend cover* using the ratio of dividends to unrestricted retained earnings. For each hypothesis, statistical regressions were performed to test for an association between the respective (proxy for) explanatory variable and CED for each of the seven years of the study. The results reported in Chapter 9 are consistent with the predictions of EAT in relation *to political visibility* (H_1) and *industry environmental sensitivity* (H_2). These results require that the null hypotheses under H_1 and H_2 be rejected. Notably, in contrast to the findings of Gray *et al*. (2001), who highlight the absence of a stable relationship between CSR and political visibility for UK companies over a similar period, the results of the present study suggest the presence of a much more stable relationship in the specific context of CED for mainland European companies (Chapter 9, Table 9.4). Furthermore, the variables *industry sector* and *country* were both shown to be statistically significant (at the 5 per cent level) in terms of explaining variations in CED throughout the period of the study (Chapter 9, Table 9.4). The latter finding was reinforced by tests under H_2 (Chapter 9, Table 9.5) which showed that for all seven years companies operating in environmentally-sensitive industries disclosed more environmental information than companies operating in less environmentally-sensitive industries. In other words, the extent to which a company's operations impact on the natural environment is positively associated with the amount of CED throughout the period of the study. However, results of tests under H_3 in relation to the *contracting and monitoring costs* argument were not consistent with the predictions under EAT. Moreover, the direction of association was opposite to that predicted for a number of years, CED being *negatively* associated with the key market variables (Chapter 9, Table 9.6). Thus, the null hypothesis under H_3 cannot be rejected.

In summary, the empirical results under EAT (Chapter 9, Tables 9.3 to 9.6) provide evidence that the firm characteristics of industry sector, country and political visibility are related to CED, whilst firm characteristics associated with contracting and monitoring costs are not. Further tests to assess the combined explanatory power of the four proxies for political visibility, while controlling for both size and industry (Chapter 9, Table 9.7), produced statistically significant results (at the 5 per cent level) for all years, the amount of variability in disclosure explained by these characteristics (i.e. the adjusted *R*-squared values) ranging from 0.27 (1995) to 0.55 (1990). In terms of the relative importance of the firm characteristics included in this modelled relationship, industry sector and country were shown to be *more* significant than the four proxies for political visibility. Moreover, in some cases these proxies were shown to be negatively associated with CED (Chapter 9, Table 9.7). These results suggest the need for a more detailed understanding of the association between political

visibility and CSR/CED, particularly in terms of specifying the interaction between the different elements of political visibility in more complex models[3].

Managerial stakeholder theory (MST)

The managerial (i.e. organization-centred) model of stakeholder theory (see Chapter 6) predicts that managerial behaviour will be motivated by a concern to manage the firm's various stakeholder groups in accordance with the degree to which these different groups are perceived to be able to harm or be harmed in the firm's pursuit of its long-term strategic goals (Ansoff, 1965; Freeman, 1983, 1984, 1986; Pfeffer and Salancik, 1978; Sturdivant, 1979; Thomson, 1967; Ullmann, 1979, 1985). This general model was used to develop the following set of testable hypotheses:

H_4: Management perceives some stakeholder groups to be *more important* than others.
H_5: There is a positive association between *stakeholder importance* and CED.
H_6: There is a positive association between the extent of *senior management's direct involvement in formulating the firm's environmental policy* and CED.

Hypothesis H_4 tests *intra-firm* stakeholder importance, i.e. whether the relative importance of stakeholder groups differs significantly from one group to another[4]. Results reported in Chapter 9 showed shareholders, employees, customers and consumers and public authorities, respectively, to be the most important stakeholder groups in terms of the firm's business as a whole (Chapter 9, Table 9.8). In contrast, the least important stakeholder groups were, respectively, environmental organizations, non-participatory owners/lenders, and other pressure groups and NGOs. A statistically significant difference was found between the perceived importance of stakeholder groups (Chapter 9, Table 9.9). Results in relation to (i) firms' direct engagement with stakeholders (Chapter 9, Table 9.8) and (ii) the extent to which their communication of environmental information was aimed at meeting the needs of stakeholders (Chapter 9, Table 9.14) provided corroborative evidence in support of the finding that management perceives stakeholder groups differently. In particular, an examination of the extent to which a firm's environmental reporting was directed at different stakeholder groups (Chapter 9, Table 9.14) showed that such reporting was directed primarily towards employees, public authorities and internal management. Overall, these results provide support for the hypothesis that some stakeholder groups are perceived by management as being relatively more important than others. Thus, the null hypothesis under H_4 is rejected. Tests of association between *stakeholder importance* for stakeholder groups as a whole and CED (Chapter 9, Table 9.11) were consistent with the alternative hypothesis and thus the null hypothesis under H_5 is rejected. These results suggest that a not insignificant proportion of the variability in CED across firms may be explained by stakeholder importance. Results in relation to tests of association between stakeholder importance for *individual stakeholder groups* and CED were consistent with the prediction in terms of a positive correlation in each case, although the strength of the correlation varied widely from one group to another (Chapter 9, Table 9.12). Further analysis suggests that the specific influence of *individual* stakeholder group importance on CED is weaker than a *general* stakeholder importance effect. These findings suggest that, in the context of explaining CED, *intra-firm* stakeholder importance (i.e. differences in the relative importance of stakeholder groups within firms) may not be so important as *inter-firm* stakeholder importance (i.e. differences in the perceived importance of stakeholders as a whole across firms). Tests under

H_6 in relation to the predicted positive association between CED and the extent of top management's involvement in the formulation of the firm's environmental policy were not statistically significant although the direction of association was as predicted (Chapter 9, Table 9.18). Thus, the null hypothesis under H_6 cannot be rejected. Whilst top management is likely to be involved in formulating a firm's environmental policy, these results suggest that such involvement does not necessarily influence the firm's environmental disclosure strategy.

In summary, the empirical results under MST provide evidence to support hypotheses that management perceives stakeholder groups differently (H_4) and that CED is influenced by management's perceptions of stakeholder importance (H_5). However, the results provided only weak evidence to support the suggestion that the former influences the latter. Although there are significant *intra-firm* differences in several aspects of stakeholder importance, it is management's perception of stakeholder importance *as a whole* which appears to have a much greater influence on CED as compared to their perceptions of the relative importance of *individual* stakeholder groups. Further research is needed to explore more fully what is going on here. One possible interpretation is that, in terms of a firm's constructive management of environmental issues, annual, social and environment reports are *not* particularly sensitive to the wants, needs or concerns of *individual* stakeholder groups but *are* sensitive to management's general perception of stakeholder importance. In other words, firms are not using corporate annual, social and environment reports to dialogue with individual stakeholder groups but as vehicles for a more broad-brush communications strategy for the management of stakeholder relations. It could be conjectured, for example, that socio-political pressures from *specific* stakeholder groups are responded to through other, more effective channels of communication such as regional or site-based environment reports and regional or local social and employee reports. Further research into the *processes* underlying the production and dissemination of environmental information through corporate stand-alone environment reports (see, for example, Rovira, 2002) may help to shed further light on this particular aspect of CSR.

Organizational legitimacy theory (OLT)

The organizational (i.e. bourgeois) model of legitimacy theory (see Chapter 7) predicts that managerial behaviour will be motivated by a concern to manage the organization's social legitimacy in response to any perceived change in the values, norms, customs and attitudes of the wider society within which a business organization operates (Boulding, 1978; Dowling and Pfeiffer, 1975; Lindblom, 1994; O'Donovan, 2002; Parsons, 1956, 1960; Pfeffer and Salancik, 1978). This general model was used to develop the following set of testable hypotheses:

- H_{7a}: There is a positive association between *political visibility* and CED.
- H_{7b}: There is a positive association between *industry environmental sensitivity* and CED.
- H_{7c}: The political visibility-disclosure association is *stronger* in the case of companies operating in environmentally-sensitive industries compared to those operating in less-environmentally sensitive industries.
- H_{8a}: There is a positive association between *social pressure from environmental groups* and CED.
- H_{9a}: There is a negative association between *environmental performance* and CED.

$H_{7d, 8b, 9b}$: CED will form part of a corporation's public relations machinery aimed at influencing society's perceptions by biasing disclosures away from information which presents the firm as acting irresponsibly in relation to environment issues.

As with EAT, four surrogates were employed as proxies for the firm characteristic *political visibility*, i.e. total assets, the number of employees, capital employed, and profits (EBIT). A measure for *industry environmental sensitivity* was also obtained based on field research into the relative impact which environmental non-governmental organizations (ENGOs) perceive each of the eight industry sectors has on the environment. Socio-political influences associated with *social pressure from environmental groups* were measured by field research into the extent of campaigns by ENGOs. Similarly, a proxy for *environmental performance* was derived from environmental performance (eco-)ratings provided by ENGOs. ENGOs were presented as a key interest group (or 'relevant public') which both reflect and influence the norms, values, customs and attitudes of a society in relation to environmental issues. Under OLT, ENGOs are not viewed as 'stakeholders' in the firm but as 'stakeholders' in society as a whole. Thus, even though the expressed views of business organizations suggest that ENGOs are not very important to the firm (Chapter 9, Tables 9.7 and 9.13) such groups may nevertheless influence managerial behaviour in relation to its disclosure strategy in the context of a predominantly bourgeois perspective of the business-society relationship.

Although the political visibility argument under OLT (H_{7a}) differs from that under EAT[5] (see Chapter 7, Section 7.7 and Chapter 9, Section 9.7.1), the tests of association between political visibility and CED are the same under both theories. Thus, the findings of a statistically significant positive association between the four proxies for political visibility and CED are also consistent with the predictions under H_{7a}. The null hypothesis under H_{7a} is therefore rejected. Similarly, it is also possible to apply the same test of association between *industry environmental sensitivity* and CED under both EAT and OLT. However, OLT's emphasis on the 'relevant publics' provided the opportunity to explore other, socio-political aspects of the industry sector-disclosure relationship by soliciting the views of ENGOs in relation to industry environmental sensitivity. Based on field research, the chemicals sector was found to be perceived by European ENGOs as having the most environmental impact with the banking and insurance sector perceived as having the least environmental impact (Chapter 9, Table 9.19). The results of tests of association between CED and industry environmental sensitivity, based on the responses of ENGOs, provided evidence of a statistically significant positive association for six years out of seven with the direction of association being as predicted for all seven years (Chapter 9, Table 9.20). Thus, the null hypothesis under H_{7b} is rejected. These results are particularly instructive since they suggest a better understanding of the industry sector-disclosure relationship might be revealed through exploring the perceptions of 'relevant publics' rather than relying on a simple binomial, *a priori* classification of industry sectors. The industry-size-disclosure relationship was also examined under OLT by testing the hypothesis that this relationship is much more sensitive in the case of environmentally-sensitive industry sectors than it is for less environmentally-sensitive industry sectors (H_{7c}). Put simply, H_{7c} asserts that size is a more important moderator of CED for environmentally-sensitive companies than for less environmentally-sensitive companies. The results as reported in this study (Chapter 9, Table 9.21) did not support the alternative hypothesis and thus the null hypothesis under H_{7c} cannot be rejected. Given that these results contradict those

of previous studies (Deegan and Gordon, 1996; Gray *et al.*, 2001; Hackston and Milne, 1996), evidence in support of hypothesis H_{7c} remains equivocal. The inconsistency of results of this and prior studies into the industry-size-disclosure relationship suggests the absence of a unique and/or stable relationship. Thus, researchers need to exercise greater care over claims as to the cause and nature of this relationship.

Tests under hypothesis H_{8a} were performed using data gathered from ENGOs on the extent to which these groups conducted *environmental campaigns* against the sample companies. A review of the nature of these campaigns and the ways and means by which ENGOs seek to influence CED (see Chapter 9, Tables 9.21 to 9.23) suggests that these groups are active rather than passive in relation to the environmental disclosure and performance activities of large business organizations. However, tests of association between social pressure on companies from environmental campaigns by ENGOs and CED (Chapter 9, Table 9.26) did not support the alternative hypothesis. Although the direction of association was as predicted, the results were not statistically significant (at the five per cent level). Based on this evidence, the null hypothesis under hypothesis H_{8a} cannot be rejected. These results represent a partial rebuttal of OLT, suggesting that social pressures through the campaign activities of ENGOs do *not* influence corporate behaviour in relation to disclosure practice (although of course ENGOs may influence corporate behaviour in other aspects of the business-society relationship – see, for example, Newell, 2000). The results are, however, consistent with other, new empirical evidence reported in this study (Chapter 9, Tables 9.7 and 9.9) which showed ENGOs as being unimportant to large businesses organisations relative to that of other sections of society.

Further research is clearly needed to explore whether the activities of ENGOs influence corporate disclosure behaviour. One possible interpretation of these findings is that ordinarily management does not feel threatened by the day-to-day campaign activities of ENGOs. Rather, it may require something unique or extra-ordinary, such as the *Exxon Valdez* disaster in the case of Exxon or the *Brent Spar* debâcle in the case of Shell, for sustained, high-profile campaigns to garner sufficient public support, through the mass media, to bring about discernible change in managerial disclosure behaviour. In other words, it is possible that business is insensitive to the normal day-to-day activities of ENGOs, but *is* sensitive to negative issues or events (see, for example, Deegan and Rankin, 1996; O'Donovan, 2002; Patten, 1992; Walden and Schwartz, 1997) which, coupled with active campaigning by NGOs and the mass media, brings a corporation or a whole industry into the public spotlight[6]. It is also worth noting that, since the mid- to late-1980s, under a 'third wave' of environmentalism (Bendell, 2000), ENGOs have placed more emphasis on market-orientated campaigns and on seeking partnerships with business. Such a shift in policy, if systemic, would suggest that ENGOs have accepted a market-based solution to the sustainable development debate. Though it would be wrong to suggest that all ENGOs have moved in this direction, there is considerable case-study evidence of ENGOs working in partnership with business in a number of industry sectors including the timber trade (Bendell and Murphy, 2000), mining companies (Ali, 2000) and fisheries (Weir, 2000). It has also been suggested that the growth in the size of many NGOs, particularly during the mid-1980s, meant that the richer NGOs, i.e. those with sizeable assets, could not afford the risk of litigation undertaken by companies against their direct actions (Newell, 2000). This factor may also have played a part in the decision of the largest ENGOs, such as Friends of the

Earth, Greenpeace, and WWF, to shift away from confrontations towards more collaborative forms of engagement with big business (see, for example, McCormick, 1991). The apparent changing nature of business-NGO relationships in both Europe and North America towards 'partners for sustainability' (Elkington, 1997; Elkington and Fennell, 2000) suggests the need for more detailed investigations into the nature and extent of ENGOs' influence on corporate social and environmental disclosure behaviour.

The hypothesis that a negative association exists between *environmental performance* and CED (H_{9a}) is based on the assertion under OLT that poor environmental performers are likely to use environmental disclosure as part of a concerted exercise in legitimation. A proxy for society's perception of environmental performance was obtained from ENGOs who were asked to evaluate each company's environmental reputation ("eco-rating") based on their knowledge of the company and its activities. Field-based results (see Chapter 9, Table 9.31) suggest that it is the environmentally-sensitive sectors, particularly chemicals, which have the worst reputation. However, generally meagre ratings were awarded for all eight industry sectors, suggesting that ENGOs have a relatively poor opinion of the corporate sector as a whole in relation to environmental performance issues. Test results presented in this thesis (see Chapter 9, Tables 9.29 and 9.31) support the alternative hypothesis and thus the null hypothesis under H_{9a} is rejected.

The final hypothesis tested under OLT (H_{7d}, H_{8b}, H_{9b}) asserts that CED will be biased in favour of the company as part of a corporation's legitimation strategy aimed at manipulating society's perceptions. The disclosure of 'bad' news was shown to be diminutive in comparison to 'good/neutral' news throughout the period of the study (Chapter 9, Table 9.34), with a statistically significant difference between 'bad' CED and 'good/neutral' CED in each of the seven years (Chapter 9, Table 9.35). These results suggest that management was biased in its reporting of environmental issues, avoiding almost exclusively the disclosure of information that presented the organization in an unfavourable light[7]. The evidence reported here supports the alternative hypothesis under OLT (H_{7d}, H_{8b}, H_{9b}) and thus the null hypothesis is rejected. These results are consistent with prior CSR empirical studies which have found a strong tendency amongst corporate management towards the selective use of favourable rather than unfavourable CSR in corporate reports (see, for example, Brown and Deegan, 1998; Deegan and Gordon, 1996; Knoops and Pupping, 1990; O'Dwyer and Gray, 1998; Roberts, C., 1991; Van Nuffel *et al*., 1995) and with the widely-held perception that managers choose to highlight 'good' news whilst withholding 'bad' news (Benston, 1982; Blacconiere and Patten, 1994; Harte and Owen, 1992; O'Donovan, 2002; Pföhler, 1996; Stray and Ballantine, 1996; Verrecchia, 1983)[8]. The results are also consistent with known examples of companies' efforts to keep bad news hidden even when management is aware of health dangers (Cahan *et al*., 1997)[9]. These findings are particularly relevant in the context of recent efforts by the accountancy profession to lend credibility to corporate environment reports through the provision of assurance statements. This issue is addressed in more detail in Section 11.6 below.

In summary, the results presented in this thesis support the hypotheses under OLT that the firm characteristics of political visibility (H_{7a}) and industry environmental sensitivity (H_{7b}) are related to CED. However, results in relation to the hypothesis H_{7c} that size is a more important moderator of CED for environmentally-sensitive companies than less

environmentally-sensitive companies did not support this particular aspect of OLT. Similarly, the results of tests under hypothesis H_{8a} provided a partial rebuttal of OLT because they suggest that social pressures from ENGOs do *not* influence CED and thus appear to invalidate the general proposition put forward in prior CSR research that external pressure groups influence CSR (see, for example, Adams *et al*., 1998; Deegan and Gordon, 1996; Tilt, 1994). However, evidence was provided in support of OLT that poorer environmental performers provide more CED (H_{7c}). Results also supported hypotheses $H_{7d,\ 8b,\ 9b}$ that management uses CED in attempting to manipulate the relevant publics' perceptions of the organization as evidenced by a bias away from the disclosure of information which presents the firm as harmful to the environment. The latter finding is consistent with a growing body of research which suggests that disclosure of environmental information by large corporations, even where that information relates to environmental impacts, is little more than public relations 'greenwash' designed to present the firm in a biased, positive light (see, for example, Coopers and Lybrand, 1993; Greenpeace, 1993; Greer and Bruno, 1996; Hines, A., 1991; Jones, 2000).

11.3 Key interpretations from longitudinal analysis

Chapter 10 provided a descriptive, longitudinal account of trends in CED over the period of the study and an interpretation of those trends. The latter permitted the inclusion of a fourth theory, 'classical' political economy of accounting theory (PEAT). The descriptive analysis of CED was presented along three fronts: popularity (Chapter 10, Section 10.3); volume (Section 10.4); and, form (Section 10.5). Looking at corporate communication strategies in overall terms, Benelux and German companies were found to have significantly increased the amount of space devoted to external reporting generally between 1989 and 1995, the total number of pages rising by some 30 per cent (Chapter 8, Table 8.5). The annual report and accounts remained the key corporate document throughout the period of the study. Although the annual report's share of the total volume of published information declined slightly over the period, it remained by far the most important single source of economic, social and political information by volume when compared to other corporate reports included in the study (Chapter 10, Figure 10.2). The majority of space in the annual report was devoted to accounting and management information ('AccPP'), the latter representing 40 per cent of total average information by volume in 1989, declining slightly to 37 per cent in 1995. However, whilst AccPP was found to constitute a significant element throughout the period of the study, much of the upward trend in the overall volume of disclosure was due to an increase in environmental disclosure, the mean number of pages of CED rising from three pages in 1989 to 19 pages in 1995 (Chapter 10, Table 10.3), a rise of 533 per cent over the period. Thus, whilst CED represented only 3 per cent of total disclosure by volume in 1989, it rose significantly over the period to 15 per cent by volume in 1995 (Chapter 10, Table 10.4). The growth in the amount of space devoted to CED relative to that of other information was due primarily to both an increase in the number of company-wide, stand-alone corporate environment reports and an increase in the size of these reports. The number of such reports rose from just two in 1989 to 24 in 1995, when there appears to have been a systemic (i.e. economy-wide) increase in the number of such reports (Chapter 8, Table 8.5).

Two key points are worth noting here. Firstly, the overall pattern of increasing levels of environmental disclosure amongst Benelux and German companies over the period of the

study is consistent with other longitudinal studies pertaining to similar time periods (Campbell 2001; Deegan and Gordon, 1996; Gibson and O'Donovan, 2000; Gray *et al*., 1995b; Moneva and Llena, 2000; O'Dwyer and Gray, 1998; Van Nuffel *et al*., 1995). Secondly, the findings provide justification for the inclusion of environment reports in the present study, adding support to calls from other CSR researchers to extend content analysis to include reports other than just the annual report accounts. Van Nuffel *et al*. (1995, p.5) for example argue that "… even though the annual report remains the most important source of company information, it should be noted that exclusion of other sources may result in an incomplete picture of the company's overall disclosure practices." Similarly, Unerman (2000), in conducting a content analysis of 100 years of CSR at Shell, concluded that his study would have "… missed a large part of Shell's CSR if it had focused exclusively on annual reports" (p.674). The findings of the present study serve to endorse the viewpoint that, in an era when companies are producing more and more stand-alone reports which address selected aspects of their environmental (and social) performance, future CED/CSR studies which focus solely on the annual report may not produce particularly helpful, relevant or reliable results.

Looking at the *nature* of environmental disclosure, the vast majority of CED was found to be auditable (as opposed to unauditable), voluntary (as opposed to mandatory) and reflecting favourable/neutrally (as opposed to negatively) on the reporting organization (Chapter 10, Table 10.6). Whilst a distinction between 'mandatory' and 'voluntary' CSR disclosure has been shown to be important in the context of UK companies (see, for example, Gray *et al*., 1995b, 2001), the results of the present study suggest that this distinction is not essential when studying CED by continental European companies. This obviously reflects the dearth of legislative requirements in this area at the present time (see Chapter 2, Sections 2.4 and 2.8), although of course it could change in the future. The emphasis on good/neutral news as opposed to bad news was overwhelming (Chapter 10, Table 10.6). In 1995, for example, 'bad' news represented less than one per cent of total CED. Whilst the overall volume of CED increased over the period (Chapter 10, Figure 10.4), the amount of space devoted to reporting 'bad' environmental news actually *decreased* over the period of the study.

In seeking to provide an interpretation of these trends, four theoretical perspectives were employed (i.e., EAT, MST, OLT and PEAT), each of which may be seen as providing alternative accounts or 'stories' of the same underlying phenomenon but viewed through different theoretical frameworks or 'lenses' (Chapter 10, Section 10.6). Drawing conclusions from these diverse perspectives largely depends upon the view taken about the social responsibilities of companies in the context of the business-society relationship. Thus, under EAT, the trend in CED by Benelux and German companies over the period of the study was interpreted in terms of management's increased efforts to influence agency costs in the capital markets. Conversely, trends in environmental disclosure, when viewed through the lens of MST, are seen as part of the on-going process of pro-active stakeholder management. In contrast, OLT views CED as an instrument of social negotiation by which management seeks to legitimise the company's activities and performance. From this perspective, the overwhelming absence of bad news as reported in the present study is seen as part of a legitimation strategy aimed at constructing an environmentally-benign image of the firm. The fourth theoretical framework, PEAT, offers the most critical interpretation of trends in CED, reflecting its Marxian depiction of social conflict under the business-society relationship (see Chapter 4, Section 4.7). The central concern of PEAT in this context is with the way in which

management uses corporate reports to preserve existing institutionalised power asymmetries and social inequalities which privilege money capital over labour. By extending this analysis to include the natural environment, a picture was presented of the challenges posed by the as yet "… barely understood agenda of sustainability …" (Bebbington *et al*. 2000, p.3) to the present business hegemony. From that standpoint, environmental disclosure is seen in the context of an underlying capitalist agenda with CED merely forming part of a systematic, institutionalised socio-political process which privileges money capital over natural capital. As such, whilst an empirical analysis may offer useful insights into trends in CED over time, the general nature of these trends was suggested by PEAT as simply forming part of an elaborate cloaking exercise the overall aim of which is to distract society's attention away from questions about the moral justification of the existing social system, i.e. industrial capitalism.

11.4 Limitations

The research method and results as presented in Chapters 8, 9 and 10, respectively, and summarised above, are subject to a number of general qualifications. The more important qualifications in the context of the present study are summarised below. Other more specific and/or minor qualifications and limitations have been referred to previously in the main text of this thesis and are not repeated here.

11.4.1 Research method

The following limitations in relation to the research method should be noted:

(i) Data capture using content analysis (Chapter 8, Section 8.2)

The extent to which one can use the data gathered is controversial. Some regard detailed statistical analysis of content analysis data as both unnecessary and possibly inconsistent with the quality of the data itself (Campbell, 2001). Indeed, such 'over-analysis' of what some regard as 'muddy' data would suggest that statistical analysis assumes a quality to the data which it simply does not possess. Thus, CSR researchers have been careful not to claim too much of social and environmental disclosure data because of the potential for errors in both the coding and the counting (Milner and Adler, 1999; Unerman, 2000). Hence, such data is more properly seen as *indicative* rather than *absolute* (Campbell, 2001). Deegan and Gordon (1996, p.189), for example, when using content analysis based on word count conceded that their method of measurement was not undertaken to yield figures that are exact or precise, but rather "… to provide an indication of systematic trends in environmental disclosure policies". Whilst this does not mean that the results reported in this and prior studies are to be discounted completely, it does suggest that researchers need to be aware of the constraints involved when relying predominantly on content analysis alone for data collection (O'Donovan (1999a).

(ii) Disclosure taxonomy (Chapter 8, Section 8.4) and *Interrogation instrument* (Chapter 8, Section 8.8)

Based on nine defined categories of CED, the disclosure taxonomy relies on the general acceptability of these category definitions. Although these categories are drawn substantially from prior research they have been adapted to meet the specific needs of the present study

and thus their general acceptability is unknown. Similarly, the interrogation instrument used for recording the data gathered using content analysis has not been tested for reliability. Although adapted from that used by Gray *et al*. (1995), this is the first time that this particular instrument has been used.

(iii) Eco-rating (proxy for environmental performance) (Chapter 9, Section 9.7.4)

The present study's reliance on a reputational scale as a measure of environmental performance follows other studies which have sought to use such scales when testing for a relationship between social performance and social disclosure but which have differed in their level of refinement and have yielded conflicting results (Ullmann, 1985). In the specific context of environmental performance, in the absence of detailed, generally-agreed, publicly available environmental performance indicators, the views of external stakeholder's other than just ENGOs are likely to provide a better indication of overall environmental performance. Future research which focuses on refinements to the measure of environmental performance, for example, by developing an overall index based on the perceptions of a firm's various internal and external stakeholders, would help to establish more conclusively the existence of a relationship between environmental performance and CED.

There are also a number of qualifications relating to the use of mailed questionnaires to both the sampled companies and ENGOs (see Chapter 8, Section 8.15):

(i) Obtrusiveness

The use of mailed questionnaires scores well in terms of context sensitivity but poorly in terms of obtrusiveness. Obtrusiveness refers to the ways in which subjects react to being the source of scientific information, thus introducing bias into the data being analyzed (see, for example, Webb *et al*., 1966). It is possible that either or both samples constitute a self-selected set of companies and/or ENGOs that have a particular desire to participate in a study of this kind. For example, as noted in Chapter 9 (Section 9.6.1), tests of stakeholder theory relied on the responses of the 32 companies which completed the company questionnaire. Such responses may be biased in the sense that they are more responsive to stakeholder demands that the 58 companies which did not. In the case of the questionnaire to ENGOs, it was not possible to estimate the total population due to lack of available data and thus it is not possible to estimate the number of respondents and non-respondents as a percentage of the whole population (see Chapter 8, Section 8.15).

(ii) Non-response bias

The issue of non-response bias to questionnaires (i.e. bias which is introduced into the inferences drawn from responses to mail questionnaires due to the presence of a large proportion of those in the sample who fail to return the questionnaire) should also be borne in mind. The response rates achieved in relation to the two questionnaires (see Chapter 8, Section 8.15) lie towards the lower end of the 30% to 50% range and therefore some concern may be expressed over the degree to which confidence can be expressed in the results reported in the present study. As indicated in Chapter 8, Section 8.16, the approach adopted in the present study has been to apply appropriate statistical tests of questionnaire data reliability. One area where some concern may be expressed over data reliability is in relation to the responses of the ENGOs owing to the low response rates and missing values. As described in Chapter 9 (Section 9.7.4), statistical tests were performed where appropriate to

provide evidence of the variability of these responses both across and amongst ENGOs using the variance components procedure.

(iii) Non-coterminous periods

The responses to both sets of questionnaires were received subsequent to the period covered by the study. In the case of the questionnaire to companies, responses were received in 1998. Responses to the questionnaire to ENGOs were received in 2000. As various test of associations have been performed between certain variables based on the questionnaire responses and CED data relating to the period of the study (1989 to 1995), it is possible that the results of these tests would have been different had the responses to the questionnaires been received on a date more commensurate with the time of reporting[10].

11.4.2 Research results

The following limitations in relation to the research results should be noted:

(i) External validity (Chapter 8, Section 8.10)

As the sample of companies includes only large, mostly publicly-listed Benelux and German firms the results of the study cannot be assumed to extend to medium and small companies. Rather, it is highly probable that the level of disclosure found is significantly greater than would be the case if smaller companies had been included (Adams *et al*., 1998), environmental reporting remaining primarily a 'big' company phenomenon (ACCA/UNEP, 2002). For the same reason, while the results of the study may be a useful guide to the environmental reporting practices of entities of other large, publicly listed companies, it would perhaps be inappropriate to generalise these findings to other business entities that are not subject to the same reporting requirements or public attention.

(ii) Content analysis data (Chapters 9 and 10)

All conclusions drawn in this study about CED relate only to the *quantity* of disclosure, not necessarily to the level of corporate environmental performance or activity. This distinction is important. A firm may be highly active in terms of environmental responsibility programmes and pursue a high standard of environmental care, but may choose not to focus on such activities in its communications with the general public through corporate annual, social and environment reports. Conversely, some firms may have very little concern for environmental responsibility and/or have relatively low standards of environmental care, but choose to make extensive environmental disclosures in order to enhance their corporate image (Cowen *et al*., 1987). Similarly, no attempt has been made to fully evaluate the *quality* of environmental information disclosed in the company reports used, such an evaluation being outside the scope and aims of the research. Whilst some attempt has been made to provide an indication of the *nature* of CED (see Chapter 8, Table 8.1), a general qualitative framework would be needed to assess the overall quality of corporate environmental disclosures by European companies. Consequently, care should be taken not to infer that increased quantities of CED necessarily reflects an improvement in the overall quality of corporate environmental reporting.

(iii) Tests of association (Chapter 9)

These tests provide only evidence of *correlation* between two sets of data, and not evidence as to *causation*[11]. Moreover, the fact that tests of the hypotheses under EAT, MST and OLT were all performed in conjunction with a series of auxiliary statements (i.e. assumptions) implies that it is not possible to know for certain whether the tests have confirmed or refuted the theory itself (Blaug, 1980).

(iv) Independence of yearly data (Chapter 9)

The data collected for the purposes of the present study were subjected to various analyses using a number of different statistical tests run against each year's data. Treating each year of the study as providing a separate data set with which to perform statistical analysis assumes that one year's data set is independent of that of other years. However, this assumption may not be completely valid, particularly in the case of CED, given that what companies disclose in one year may have an influence on what is disclosed in subsequent years. Similarly, the size (e.g. total assets) of a company in year n will clearly have an influence on its size in year $n+1$. As such, even though the study looks at seven different periods, these periods may not necessarily reinforce each other.

(v) Tests of stakeholder theory (Chapter 9, Section 9.6)

For the reasons set out in Chapter 9, these tests have been performed against 1995 CED data only. More research into the association between the perceived level of stakeholder importance and CED is needed to substantiate the claims made in this study.

11.5 Discussion

As described previously in Chapter 3, the claims of CSR researchers and the predictions of theory suggest that there are many factors which influence the extent of CSR/CED. Over the last 30 years or so, a growing body of CSR research, an increasing proportion of which is explicitly theorised, has provided considerable insights into the underlying nature and causes of CED. The present study differs from this prior research in a number of important respects. Firstly, the study has looked at environmental disclosure made by companies in several different European countries rather than companies domiciled in a single country. Secondly, it has looked at such disclosures made by companies across eight industry affiliations, these affiliations being perceived to differ in terms of their relationship with and demands upon the natural environment. Thirdly, the study has looked at environmental disclosure appearing in a variety of different corporate economic, social and environment reports rather than just the annual report and accounts. Fourthly, it has looked at disclosure trends over a seven-year period rather taking a snap-shot of a single period. Fifthly, the study has employed several different theories, rather than just a single theory, which provide different explanatory variables with which to test the predictions of these theories. Lastly, recourse has been made to a variety of different research techniques, i.e. empirical research, field research and content analysis, for the purposes of deriving measured values by which to test for an association between CED and other explanatory variables as well as to interpret trends in CED over time. These features of the study, when taken together in combination, provided for a unique, cross-sectional and longitudinal study of environmental disclosure, one which is not only systematic in terms of its investigation of underlying relationships but also multi-

paradigmatic in terms of drawing out the diverse 'stories' of CED in the context of the business-society relationship.

Looking first at the hypothetico-deductive, cross-sectional analysis (Chapter 9), the results reported in this thesis provide partial support for the predictions of EAT, MST and OLT, respectively. That is, some of the predictions were shown to be well-founded, whereas others were not. In the case of EAT, for example, successful predictions were reported in relation to political visibility and industry environmental sensitivity but not in relation to contracting and monitoring costs. Further research is needed to explore the latter in other contexts given that, as noted by Gray *et al*. (2001), inconsistency of prior results is not an uncommon feature of CSR research. As such, it is quite possible that tests of the contracting and monitoring costs hypothesis may prove to be successful in other studies which cover different contexts and/or different time periods. In seeking to draw some general, overall conclusions from these results, a number of observations may be made. Firstly, the successful predictions of both EAT and OLT lend support to a growing body of research which has highlighted the importance of four firm characteristics: (i) industry affiliation; (ii) home-reporting country; (iii) size (i.e. total assets, capital employed and number of employees); and (iv) profitability (i.e. EBIT). The results reported here provide evidence which show that for large, mainland European companies CED *is* related to these four characteristics. As similar results have been reported elsewhere in relation to studies of European and UK companies (Adams *et al*., 1998; Gray *et al*., 1995), this growing body of evidence provides strong support to the predictions of theory and claims of prior researchers in a European context. Secondly, in relation to profit, the findings of the present study suggest that, contrary to prior claims and the results of previous studies (see, for example, Freedman and Jaggi, 1988; Hackston and Milne, 1996; Ljungdahl, 1999a, b; Moneva and Llena, 2000), the profitability of the company *does* appear to be positively associated with CED. Thus, prior claims that profitability is *not* a determining factor of corporate behaviour in the context of environmental disclosure appears both premature and overstated. Thirdly, in relation to MST, although prior use of this theory in CSR research remains marginal, the results as reported here suggest that MST may provide a useful heuristic when seeking to understand the nature and causes of CED in particular and thus, by implication, CSR in general.

Fourthly, the successful predictions of OLT in relation to political visibility, industry environmental sensitivity and poor environmental performance reinforce a growing body of work which presents the legitimacy management by large firms as the most popular explanation for variations in social and environmental disclosure both across firms and over time (see, for example, Buhr, 1998; Campbell, 2001; Deegan and Rankin, 1996; O'Donovan, 1999a; Patten, 1992; Wilmhurst and Frost, 2000)[12]. The results also supported the prediction that management would attempt to manipulate or influence society's perceptions of the firm by introducing bias into how an image of the corporation is socially constructed in relation to environment issues. However, predictions that size would be a more important moderator of CED for companies in environmentally-sensitive industries compared to companies in less environmentally-sensitive industries were not substantiated, nor were claims that social pressures from ENGOs are positively associated with CED. These two findings are not insignificant and further research is needed to substantiate more clearly the claims of prior studies in these areas. The size-industry-disclosure hypothesis, for example, has been used in a number of studies (see, for example, Adams *et al*., 1998; Deegan and Gordon, 1996;

Hackston and Milne, 1996) to support arguments under OLT as to the underlying causes of CSR/CED. The present study casts doubt on these claims and thus raises questions rather than providing clear-cut answers when using OLT to explain variations in CED across firms. Similarly, prior claims that variations in the level of pressure from environmental groups may be one of the causes of variations in environmental disclosure across companies (see, for example, Adams *et al*., 1998 Deegan and Gordon, 1996; Tilt, 1994) are not supported by the results of the present study. Again, further research into the influence of social and environmental pressure groups on CSR/CED is needed to substantiate these claims more fully[13].

It may be concluded therefore that each of the three theories used in the present study is empirically valid (when working within the positivist tradition - see Chapter 1, Table 1.3) in the sense that each theory has something to offer when seeking to understand why firms voluntarily provide environmental disclosure. However, it is not readily apparent from the results presented here whether one theory is more helpful than another in a polyglot context, partly because the predictions of each theory were only partially fulfilled and partly because even where the prediction was well-founded the underlying theoretical explanation can vary from one theory to another. In other words, associations between CED and other variables may still give rise to confusion and uncertainty because the same data set can take on quite different interpretations, depending on the chosen theoretical framework, even though there is general agreement amongst researchers from different standpoints on the veracity of the raw data itself (Ryan *et al*., 1992). As Ljungdahl (1999b) argues, although several studies have drawn upon various theories - e.g. agency theory, stakeholder theory and legitimacy theory - to explain the observed relationships, the same corporate characteristics - e.g. size - may be used to support any one of the proposed theories. Inter-theory comparisons of this sort cannot be done in an objective or value-free manner[14]. As explained previously (see Chapters 1 and 7), all theories are value-laden (Hanson, 1958), coming pre-wrapped in layers of ideological baggage that adopt assumptions about the world and how that world functions and/or should function[15]. These values not only influence the research paradigm and associated theory selection processes but also the degree to which the 'story' told by each theory is perceived to be consistent with some aspect of external 'reality'. The conclusions drawn from any piece of research are based on a process of reasoning, some of which is conditional, to support the line of argument employed. In most cases, the conclusions drawn hinge on a chain of suppositional reasoning, each supposition (i.e. assumption) differing in terms of its strength and validity (Ryan *et al*., 1992). Within the accounting and business finance research community, agency theory holds a prominent position, primarily because of the assumptions it makes, *inter alia*, about human behaviour and the behaviour of capital markets (see Chapter 5). In contrast, CSR researchers generally find such assumptions too narrow and simplistic when corporate disclosure behaviour is seen in a wider socio-political context (see, for example, Gray *et al*., 1995b, 1996)[16]. Thus, one researcher may well conclude that the successful predictions of EAT in relation to political visibility and industry environmental sensitivity, as reported here, verify EAT's validity in explaining CED, with the unsuccessful predictions in relation to contracting and monitoring costs suggesting that further work is needed to improve the specificity of the theory in this area. Conversely, other researchers may find the explanation provided by EAT for CED as inconsistent with their own perceptions of the workings of the 'real world', preferring the explanations provided by OLT.

The fact that each of the three theories (i.e. EAT, MST and OLT) used in the present study provided predictions which were not supported by the results reported here should not be interpreted as a chronic rebuttal of these theories[17]. Rather, it is perhaps more appropriate to judge these results in the light of a large and growing body of CSR research which has failed to establish a consistent, unique or stable relationship between social and environmental disclosure and other explanatory variables (see, for example, Adler and Milne, 1997; Gray *et al*., 2001; Preston, 1983; Ullmann, 1985). Indeed, the absence of such a stable or unique relationship has been suggested as providing a sufficient explanation for the inconsistency in prior results (Gray *et al*., 2001). In this context, it is perhaps more helpful to take a broader, long-term perspective by recognising that the phenomena of CSR/CED and CSResp are manifestations of the values, attitudes, norms and states of contentment and security within Western developed societies which are not stable but vary over time, influenced by events and activities that bring about changes in the level of cultural contentment, social awareness and sense of responsibility[18].

From this perspective, the extent to which various possible factors influence or change managerial behaviour in relation to social and environmental issues at a particular point in time is not constant but ever-changing. This does not mean that researchers are unable to explain, predict or understand which factors are prominent at a particular point in time, but it does mean that there is a need to avoid accepting the calcified view that a particular firm characteristic or socio-political influence will *always* be prominent and that, consequently, one or more particular theoretical perspectives will always be relevant or helpful. As such, Ullmann's (1985) challenge to CSR researchers to come up with a comprehensive theory explaining *why* companies make social and environmental disclosures may simply be a practical impossibility because of the complex, multi-faceted and mutable nature of the phenomenon itself and of the political processes which surround it. As Gray *et al*. (1995b) conclude:

> *It is apparent to us that CSR practice is a complex activity that cannot be fully explained by a single theoretical perspective or from a single level of resolution. The 13 years covered by this article have seen major changes in the disclosure practices of UK companies which, individually and collectively, offer insights into corporate behaviour and the role(s) that social disclosure plays in that behaviour. There is little doubt in our minds that other theoretical analysis from different levels of resolution could offer other observations about the development of UK social reporting practice* (p.67).

Whether throwing a lot of theories and data at the problem is the panacea some (see, for example, Adler and Milne, 1997) perceive it to be remains questionable. Nevertheless, the results of the present study suggest that, for the time being at least, existing theories do have a valid role to play in offering insights into managerial behaviour in relation to CED, and thus, by implication, CSR. However, notwithstanding the fact that variations in CED across firms do seem to be related to a firm's home-reporting country, size, profits and industry affiliation, its environmental performance, and its perceptions of stakeholder performance, the amount of variability in disclosure explained by these particular characteristics and influences suggest that other factors are also at work. In seeking to identify some of these other explanatory factors, Ljungdahl (1999a, b), based on a series of 20 interviews with representatives of

Swedish companies having a relatively well-developed environmental reporting history, identified factors, both internal and external, affecting the decision to disclose environmental information. The results of Ljungdahl's study are summarised in Table 11.1 below. Based on the results of his interviews, Ljungdahl (1999b, p.2) states "… both company-internal factors and external institutional factors are important in explaining companies' disclosure behaviour." Ljungdahl also found that the number of first time adopters, i.e. companies reporting on environmental issues for the first time, increased rapidly over time and therefore suggested that there may be some diffusion process taking place in various recognisable phases, similar to that in the case of innovation diffusion theory (see Rogers, 1983).

Table 11.1
Factors affecting the decision to disclose environmental information

External institutional factors/motives	Internal factors/motives
► Media interest and public opinion	► Management interest and support
► Customer pressure and questions	► Presence of managerial 'change agents'
► Competitors' reporting practice	► Well-developed environmental organization
► Pressure and praise from ENGOs	► Active company reporting strategy
► Environmental reporting awards	► Competitive advantage – improved image
	► Towards 'sustainability'

Source: Ljungdahl (1999b)

Ljungdahl argues that first time adopters of environmental reporting take up this practice at different stages depending on the various factors identified in Table 11.1 above, suggesting that:

> *… the internal organization and strategic factors are most evident in the relatively early adopters and the late adopters are more affected by external institutional factors … [the latter] would appear to be important in explaining the rapid diffusion of ER practice in the mid-1990s* (1999b, p.2).

Whilst Ljungdahl's analysis is helpful, it does not diminish the value of other studies which have found strong associations with firm characteristics and CSR/CED. Rather, it increases the choice of possible influencing factors available to researchers seeking to predict, explain and understand social and environmental disclosure. From this perspective, the challenge confronting those who employ hypothetico-deductive research methods such as logical positivism to investigate, empirically, specific relationships under theory (see Chapter 4) is to develop observable surrogates which successfully capture these other explanatory variables for the purposes of statistical modelling. Such other variables have already been suggested in prior research, including external institutional factors (Ljungdahl, 1999a, b), organizational culture (Crane, 1997; Filios, 1985) and ethical relativism (Lewis and Unerman, 1999). Similarly, prior accounting research has suggested the influence of distinctive factors within specific cultural contexts which not only have sway in terms of both management and accounting practices (see, for example, Hofstede, 1980, 1991; Gray 1988) but also in terms of the social pressures on corporations to behave in socially-responsible ways (see, for example, Douglas and Wildavsky, 1982; McCormick, 1991; Muller-Rommel, 1989). However, whilst

the modelling of such relationships may, potentially at least, significantly improve our understanding as to the nature and causes of CED, serious doubts exist over whether it is possible to measure these elements when employing hypothetico-deductive research methods (Gray *et al*., 2001). As such, other research methods which currently lie outside of 'normal science' may provide alternative stories which add to our overall understanding of what is a complex phenomenon[19].

Such an alternative approach to hypothetico-deductive research was presented in Chapter 10 where interpretive analysis (see Chapter 4, Section 4.6) was employed for the purposes of interpreting trends in CED over the period 1989 to 1995. Interpretive, longitudinal analysis essentially involves interplay between data and theory, searching for trends and then trying to interpret those trends based on certain *a priori* understandings about relationships between organizations and society. These *a priori* assumptions are used to formulate general understandings about the changes that are taking place within society over a specific time period and the main determinants of those changes. In Chapter 10, the observed trend of increasing levels of environmental disclosure by large Benelux and German companies over the period of the study was presented against a backdrop of rising international concerns in relation to environmental and social issues and a number of key international programmes towards sustainable development. The latter was presented as the overarching public policy issue of the present time, addressing the relationship between humankind and the environment and the associated responsibilities that go with humankind's role as the self-appointed, sole trustee of the planet. From this perspective, each of the four theories (i.e., EAT, MST, OLT and PEAT) was employed to provide an account or 'story' of the increasing trend in the popularity and amount of CED over the period 1989 to 1995. Each of these different 'stories' has value in its own right, although the extent to which one is convinced by the explanations offered by them ultimately depends on a chosen set of values, beliefs and assumptions. A simple, narrow, neo-classical economics interpretation of trends, for example, may seem perfectly rational in a markets-based context amidst growing concerns from the investment community over possible negative cash flow and thus share value consequences arising from tougher environmental protection measures. This argument can be extended further to incorporate other 'non-market' stakeholders such as employees, consumers, customers and the general public under MST, whereby CED takes on the role of appeasing the concerns of the wider society who are perceived as being able to assist or hurt the firm in terms of its long-term strategic objectives. In contrast, the account offered by bourgeois political economy (OLT) places emphasis on the way in which CED is used to manipulate the perceptions of the relevant publics, the overwhelming absence of bad news as reported in the present study being seen as part of a legitimation strategy aimed at constructing an environmentally-benign image of the firm.

Under a longitudinal analysis, the present study reported a significant increase in the overall level of CED by Benelux and German companies over the period, the mean number of pages rising from just three pages in 1989 to almost 19 pages in 1995 (Chapter 10, Table 10.3). However, in comparison to the total volume of information disclosed, the amount of CED was relatively small[20]. Whether it is appropriate to expect *higher* levels of environmental disclosure than those reported here depends on one's viewpoint. For example, it might be argued that an average of 15 per cent by volume of reporting space devoted to CED in 1995 (1,694 pages of out of a total of 11,388 pages) is *above* expectations, particularly for a study which included

firms in the less environmentally-sensitive industries and which may have no private information to disclose because of the fact that, *inter alia*, there were no major environmental problems for these firms to report. However, the scenario of no environmental problems to report seems unrealistic. There has been widespread knowledge of significant environmental problems related to consumption patterns and Western life-styles since the late 1960s, many of which were the subject of international voluntary agreements and protocols (see Chapter 2, Section 2.7 and Chapter 10, Table 10.8). In addition, as a result of the national policies of the governments of EU Member States, European firms in both environmentally-sensitive and less environmentally-sensitive industries have had to address a host of environmental issues and thus, ostensibly, have large amounts of internal data available to disclose to the public should they choose to do so. Whether the resulting levels of disclosure match the seriousness which these issues deserve is a much more subjective matter. Moreover, whilst increased levels of CED may imply that firms give higher priority to environmental issues in their disclosure strategies, it does not imply that it leads to improved levels of environmental performance. Prior studies (see, for example, Fekrat *et al*., 1996; Rice, 1993; Wiseman, 1982) have found no association between CED and environmental performance. Such findings illustrate the potential abuse of environmental disclosure in constructing a positive, benign image of the firm and highlight the socio-political (rather than decision-usefulness or accountability) function served by corporate reports as part of the total arsenal of language, images and rhetoric used for the purposes of social legitimation.

In the context of the latter, the account offered by PEAT suggests that rather than focus on the *technical* aspects of the discourse, i.e. in terms of the quality and subject-matter of disclosure, concern should be with how disclosure may be used to preserve the present hegemony in which the role of business in a capitalist-owning democracy is as custodians of wealth-creation, the market place and welfare functions. Under the latter analysis, CED is assumed to serve a much more pervasive and disconcerting role in distracting society's attention away from a 'crisis of capitalism' as represented by the challenges which any serious approach to sustainability poses to the business hegemony. That is, if the over-arching socio-political framework within which CED is studied is one which addresses head-on the serious issues raised by a genuinely altruistic concern with issues of social justice and ecological protection, what matters is *not* the efforts of the business organization to improve the eco-efficiency of its production processes and products or the quality of its environmental management information systems, despite the obvious *economic* benefits, but the extent to which, in running the business along normal commercial lines, i.e. in accordance with 'the rules of the game', the firm has improved or worsened non-economic aspects of human and non-human life as defined by a commitment to social justice and ecological preservation. Such a perspective challenges not just the privileged position of the business organization but also the role of other institutionalised structures such as government and accountancy in supporting such privileges. Adams *et al*. (1998), for example, argue that CSR/CED may be used not just to improve the image or reputation of the company but may also be seen as being useful as far as national governments are concerned:

> *If companies voluntarily disclose information, not only may they reduce external or public demands for greater controls on their freedom of action, but the Government may also be able to use such disclosures as a justification for not introducing more social legislation or regulations. ... Thus voluntary*

> *disclosure has little to do with social responsibility and accountability, but may be seen as a useful way of re-enforcing the Government's 'free market' ideology and anti-legislative stance* (p.17).

From this perspective, a focus on the business organization is fundamentally misplaced since the 'problem' is not the firm but the social system itself, i.e. global, industrial capitalism. At a structural level, PEAT perceives CED as a source of political power used by 'big business', with the support of national Governments, to preserve existing social inequalities and wealth asymmetries through domination, exploitation, deprivation, manipulation, mediation, suppression, mystification and obfuscation. In other words, irrespective of the environmental disclosure by the management, it is the legitimacy of the social system itself not the business organization which troubles a classical political economy perspective. Hence, whilst it has been argued that a serious approach to sustainability is in the long-term interests of *business* and thus investors (see, for example, Elkington, 1994, 1997; Zadek *et al*., 1997), the primary concern from an economics (as opposed to an ecological) perspective in this context is with economic efficiency (see, for example, Holliday *et al*., 2002; WBCSD, 1996). To the extent that these *economic* goals can be achieved through improved environmental policies, programmes and management systems and the improved environmental performance of products and processes at a corporate level (Chapter 10, Figure 10.1), threats to the social system itself through a strong construction of sustainability either do not enter into the debate or are prevented from doing so (see, for example, Beder, 1997; Gray *et al*., 1993; Krut and Gleckman, 1998; Krut and Moretz, 2000; Welford, 1997)[21].

Thus, whilst an empirical analysis may offer useful insights into the causes of and trends in CED over time, the underlying nature of these causes and trends may simply form part of an elaborate cloaking exercise (CED being the 'Emperor's new clothes') which seeks to distract attention away from more critical issues that raise important and disturbing questions about the moral justification of the existing business-society hegemony. In that context, increased levels of CED by both Benelux and German companies over the period of the study, the vast majority of which does not present the company in a negative light, are entirely consistent with the perspective that such disclosure has a socio-political role at a macro-economic level which has little or nothing to do with issues of corporate social responsibility and accountability. It is this critical, political economy perspective which challenges and seriously questions much of the arguments underlying the recent upsurge in interest in corporate social and environmental responsibility and reporting from various sections of society, including national governments, the accountancy profession and other self-appointed bodies such as CSR Europe, FEE, GRI, ISEA and SustAinability who claim to be acting in the public interest. Rather than increase corporate social responsibility and accountability, a 'classical' (i.e. Marxian) political economy perspective argues that the activities of such organizations merely form part of what may be termed the bourgeoning, bourgeois bazaar for excuses which permits capitalism, supported by passive national governments, to evade, avoid and deny responsibility for the widespread levels of social injustice, social exclusion and ecological destruction currently being carried out in the name of globalised free trade, economic development, individual liberty and freedom of choice. Dillard (1991), for example, argues that accounting and reporting, as we know it, are so deeply embedded in the prevailing social system that "… the potential for change is highly constrained other than as dictated, or allowed, by the system. A fundamental change in the underlying economic

structure must occur before change can occur in accounting technology" (p.24). From this point of view, corporate accounting and reporting simply serve to legitimise capitalism:

> *Recognition that accounting is determined by the system within which it is embedded indicates the limitations of accounting, as a technology of capitalism, in providing a legitimate critique of the dominant structure. The accounting system is one component constructed by the system in order to perpetuate itself* (Dillard 1991, p.25).

The normative issues surrounding the extent to which corporate environmental disclosure, as one element of the broad field of corporate accounting and reporting, can and/or should seek to change the underlying economic structure are considered below in the closing sections of this thesis.

11.6 Public policy implications

Up to this point the central focus of the present study has, for the most part, been positivist in nature, the aim being to provide descriptive explanations for corporate environmental disclosure practices by large European companies from within different theoretical perspectives. These explanations have value in their own right, providing both the means (however questionable those means may appear to others) for supporting a particular philosophical and ideological position and for defending that position publicly. However, *all* research in the social sciences has an underlying normative agenda, in terms of what 'should be' rather than just 'what is', irrespective of whether that agenda is expressed or implied. In the remaining paragraphs, the study steps outside the boundaries of a purely descriptive framework to adopt an explicitly *normative* position in considering some of the moral issues surrounding the role and purpose of CSR/CED, firstly, in terms of public policy issues and secondly, in relation to a future research agenda.

Those engaged in CSR research are generally motivated by public interest and public policy concerns. Recently, for example, CSR researchers have begun to question the justification for CSR from a societal perspective where CSR appears to serve to the corporate (private) interest rather than promoting the public good (see, for example, Deegan *et al*., 2002; O'Dwyer, 2000, 2001b). Hence, research results in this field are usually perceived of as a means to an end rather than an end in themselves. It has been suggested, for example, that an important reason for improving our understanding of the factors which influence corporate social and environmental reporting lies in the value which such greater understanding can bring to those working to improve the relevance, completeness and objectivity of such information (Adams *et al*., 1998). However, such a perspective is questionable in a socio-political sense because it suggests that CSR *can be* 'relevant', 'complete' and 'objective', thereby denying other perspectives, such as, for example, deep ecology, which hold opposing views[22]. Similarly, CSR research has been used to gauge the usefulness of corporate social and environmental disclosures to stakeholders, supporting claims for the introduction of mandatory reporting (Deegan and Rankin, 1997; Moneva and Llena, 2000). This approach is also questionable because it assumes, albeit implicitly, that mandatory reporting of environmental issues can be a significant engine for social change[23]. Conversely, a critical perspective to CSR regards such views as "… ridiculous …" (Cooper 1988, p.186). Others, such as Gray *et al*. (1996), argue that the challenge of CSR (and thus CED) is to make the

loss of democracy and accountability more visible while simultaneously demonstrating, normatively speaking, how democracy and accountability *can* be improved. The latter perspective is perhaps prompted by a combination of pragmatism and optimism which promotes the use accounting and reporting as mediums for raising social awareness in the hope that by doing so it will lead to real social and political change. Whether such hopes are well-founded in terms of the likelihood of CSR/CED rectifying presently perceived social and environmental injustices remains a matter of debate (see, for example, Tinker *et al*., 1991).

The notion that improvements *should* be made to the quality and scope of corporate environmental reporting is itself a normative position, suggesting that there is a reporting 'gap' under the present system of corporate disclosure. The present study does not address this issue directly but does suggest, through its finding of increased levels of CED over the period 1989 to 1995, that there was at least a *presumption* amongst the executive management of large European companies that it needed to alter is communications strategy with respect to environmental issues. Various theories were put forward suggesting what these reasons might be, ranging from purely self-interested economic motivations (under EAT) through to socio-economic (under MST) and socio-political (under OLT and PEAT) motivations. These alternative, theoretical explanations mirror, to some degree or other, the various motivations underlying numerous private and public initiatives that have emerged over the last 10 years or so to improve the relevance, quality and reliability of corporate environmental reporting (see Chapter 2). Generally speaking, governments and others such as the global accountancy profession, have faced three choices in relation to corporate reporting of environmental issues in this context:

(i) do nothing;
(ii) improve the *financial* reporting of environmental issues through legislation and/or voluntary measures which have the support of recognised bodies; and/or,
(iii) improve stand-alone, corporate reporting of environmental issues through legislation and/or voluntary measures which have the support of recognised bodies.

The 'do nothing' approach would be consistent with a neo-classical economics perspective (see, for example, Benston, 1982) which argues that CSResp and CSR are best left to market forces. In effect this means that managers are left to decide for themselves what is appropriate (this argument was used by Dutch employers during discussions with the Dutch authorities in the 1980s concerning the extent to which government regulations should be introduced to control the activities of organizations – see Chapter 2, Section 2.8). The fact that CED increased over the period of the study, and that the content of these disclosures addressed issues of concern to the financial markets, could be interpreted as confirmation that regulatory interference in this area is unnecessary (Chapter 10, Section 10.6.1). In practice, however, as set out in detail in Chapter 2, legal and professional developments since the late 1980s have *not* taken a 'do nothing' approach. Rather, there have been a whole host of initiatives and proposals which have focused on improving the frequency, quality and content of corporate environmental reporting. The arguments for doing so are equally numerous, but principally fall into one or more of the following categories:

- it is good for business and the global economy (the 'business case' argument);

- the markets (and other privileged sections of society) need/want to be kept informed (the decision-usefulness argument); and/or
- stakeholders or society have a 'right to know' (the 'accountability' argument).

These various arguments have been used in one form or another by CSR researchers, the accountancy profession and various European governmental and non-governmental bodies which have sought to improve corporate environmental reporting by European companies. The most obvious regulatory/quasi-regulatory examples in this context are the EU's *Eco-Management and Audit Scheme* (CEC, 1993b, 2001a) and the introduction of mandatory environmental reporting requirements in the EU Member States of Denmark, the Netherlands and Sweden (see Chapter 2, Table 2.4)[24]. Similarly, the European Commission (CEC, 2001b) recently published its recommendations on the recognition, measurement and disclosure of environmental issues in the annual accounts and annual reports of companies (item (ii) above). However, many EU companies are already required to report much of the information referred to in the EC's recommendation under existing company law and accounting GAAP (see, for example, the UK's Financial Reporting Standard (FRS) 12 (ASB, 1998) and the International Accounting Standard (IAS) 37 (IASC, 1998)), especially where such information is material (Collison, 2003)[25]. Moreover, as discussed in Chapter 2 (Section 2.4), the EC's proposals are severely restricted by the conventional financial reporting framework given that the latter constructs a "… profoundly narrow image of all possible interactions between the 'world' and the organization…" (Gray *et al.* 1996, p.3). Rather, the focus of the traditional financial reporting framework is exclusively on transactions and events which affect, or are likely to affect, the *financial* position and results of the reporting entity[26]. Other non-governmental, voluntary initiatives which fall under item (iii) above, notably those of UNEP, GRI, the Institute of Social and Ethical Accountability (ISEA), as well as various environmental reporting awards, notably the ACCA and EERA award schemes (see Chapter 2), have encouraged or sought to construct alternative forms of corporate reporting which broaden the concept of accounting to include not just the economic but also the social, ethical and environmental dimensions of the business-society relationship[27]. The European accountancy profession, in particular, through its representative body FEE, has been particularly involved in these voluntary initiatives, notably through the development of position papers on a generally accepted framework for environmental reporting (FEE, 2000) and on providing third-party assurance statements in relation to environment reports (FEE, 1999b) and triple bottom line (TBL) reporting (referred to, mistakenly, as 'sustainability reporting') (ACCA, 2003b; Elkington, 1997, 2001; GRI, 2002; Sustainability/UNEP,1996a)[28].

There is no doubt that these developments and initiatives have gone some way, perhaps a long way, towards improving both the number of companies reporting on environmental issues and the quality of that reporting. As such, there is an argument for suggesting that, from an *economic* perspective, and perhaps even a *socio-economic* perspective, things are moving in the right direction. However, as indicated above, any consideration of public policy issues cannot be divorced from some underlying *socio-political* agenda. As noted by Cooper (1988, p.183):

> *The boundaries of corporate responsibility are closely related to the definition of property rights, their existing distribution, and the ownership of the means*

> *of production. When property is privately owned for private interest, and when its control is concentrated into a very small section of society, as in capitalist societies, then resources that cannot easily be exploited by individuals are treated as "social" goods. And because social goods typically cannot be traded they do not have a market price and are treated as if they have no value. ... Clean air, trust, social harmony, community health and safety do not have market prices. Without a price, their worth tends to be devalued.*

Geo-political developments since the late 1980s, particularly the rise of the global corporation under free trade treaties such as the EU, WTO and NAFTA (see Chapter 10, Section 10.6.4) have had a significant impact upon the context within which any public policy and public interest debate takes place (see, for example, Korten, 1995, 1999)[29]. A critical perspective on issues of corporate social responsibility, for example, questions not only why corporate accountability might be expected to flow through corporate reports (rather than through the courts, the state, or the values of the internalised values of the managers) but also why corporate managers have the freedom to act as socially-responsible citizens in the first place or be expected to act in the interests of all sections of society (Cooper, 1988). Similarly, a critical examination of the role played by accounting processes and practices, and of the accounting profession itself, cannot but be alert to the "… fragility of our world and how much we as accountants or more generally as part of the human race have seriously plundered our planet" (Loughlin 1999, p.73). The socio-political analysis of CED as presented in this thesis, under both OLT and PEAT, highlights the strong susceptibility of social and environmental reporting to image-creation and exploitation. From a classical political economy perspective, for example, management, with the assistance of the accountancy profession, consultants, advisers and researchers, are accused of using corporate disclosure to socially-construct an image of the firm that is neither objective, independent, nor value-free, but one that is designed to serve a specific end-game, namely the preservation of existing power asymmetries, social inequalities and injustices which privilege the financially-wealthy (see, for example, Neimark, 1992). Adding the concept of 'sustainability' to this analysis raises the stakes in terms of the degree to which both the business organization, its executive management and those providing accounting and consultancy services to business organizations have an *economic* interest in preserving the status quo. Whilst 'sustainable development' and 'sustainability' are now firmly on the international political agenda (Bebbington, 2001), it remains the case that "… few people have any real conception of what sustainability will mean for particular economies, industry sectors, companies or products" (Van Dieren and Van Swigchem 1995, p.17).

In essence, concepts such as 'sustainable development' and 'sustainability' are merely *human* constructions of phenomena which rely on a set of norms, values, customs and beliefs that give historical and socio-political context to how the world *should be* rather than describing a world that actually exists. Einstein's eloquent description of the inherent limitations to human knowledge and understanding provides a salient reminder to all those who would presume to comprehend the complex, arcane and mysterious issue of 'sustainability':

> *In our endeavour to understand reality, we are somewhat like a man trying to understand the mechanism of a closed watch. He sees the face and the moving hands, even hears its ticking, but he has no way of opening the case. If he is*

> *ingenious he may form some picture of a mechanism which could be responsible for all the things he observes, but he may never be quite sure his picture is the only one which could explain his observations. He will never be able to compare his picture with the real mechanism and he cannot even imagine the possibility of the meaning of such a comparison* (Albert Einstein, as quoted in Peck 1993, p.79).

From this perspective, in the context of current developments in corporate social and environmental reporting, the issue is not whether what is reported is 'fair', 'balanced' or 'complete', since this is simply *nonsensical*. Rather, perceptions of what is going on can be better understood by considering whose interests are being served by what has been socially-constructed[30]. Social constructions of the current, growing tensions between the public policy goals of economic growth on the one hand and sustainability on the other by economists, accountants, politicians, business leaders, academics and NGOs are not homogeneous but exist along a continuum that represents a complex, wide-ranging set of needs, emotional insecurities, fears, attitudes, values and beliefs. As such, there is no single, widely-accepted view as to what public interests and public policy goals a society should pursue, what goals are achievable or the associated costs and benefits, in social, ecological and economic terms, of those goals (see, for example, Elkington and Hailes, 1998; Real World Coalition, 1996, 2001). Nevertheless, the various sections of society mentioned previously have attempted and are continually attempting to influence the outcome of this debate. The loudest and most politically-influential voice in this context is arguably that of 'big business' which seeks to promote the business case for sustainable development. The 'business case' (see, for example, Elkington, 1994, 1997; Zadek *et al*., 1997) argues that the goals of economic growth and sustainability are *not* mutually-exclusive. In sharp contrast, a spiritual ecology perspective (see, for example, Kumar, 2000, 2002; Lovelock, 1982, 2001, 2002) argues that they are and always will be[31].

Somewhere in the middle of these two opposing viewpoints lies the perspective, prompted by concerns about what is 'politically pragmatic and acceptable' (Tinker *et al*., 1991), that it is possible to make capitalism human without a social revolution (see, for example, Gray *et al*., 1987, 1988, 1991, 1995d, 1996). Whilst a considerable amount of time and energy has been devoted to greater corporate social and environmental accountability since the mid-1990s, these developments have, almost without exception, failed to address the concerns raised in the classical political economy analysis set out in Chapter 10 of this thesis. In short, the most high-profile organizations to have emerged out of the recent upsurge of interest in corporate social responsibility and sustainability, notably, ACCA, the European Commission, FEE, GRI and ISEA, as well as developments in environmental management accounting (see, for example, Bartolomeo *et al*., 2000; Bennett and James, 1998) and corporate ethical accountability (see, for example, Gonella *et al*., 1998; Zadek, 1993, 1998; Zadek *et al*., 1997) all promote a vision of corporate social, ethical and environmental responsibility and accountability which does *not* challenge the present business-society hegemony. This is reflected not only in a very weak interpretation of 'sustainability' but also in a 'business case' perspective which posits that it is for business to decide, *ultimately*, what and how to report on social and environmental matters[32]. Perhaps the most significant and disturbing aspect of this debate, which has largely gone unchallenged (from within these organizations and institutions at least), is the fundamental assumption that it is possible to have economic

growth *and* ecological sustainability. This 'having our cake and eating it' syndrome has become so widely accepted amongst business, researchers, consultancy firms and the accountancy profession, through concepts such as the 'sustainable enterprise', the 'sustainable economy', 'sustainability reports' and 'sustainability assurance' that their has been an effective marginalization and exclusion of alternative perspectives which reject out of hand this deeply-flawed, brutish and morally-repugnant assumption, thus leaving unchanged and unchallenged the present business hegemony.

It is easy to understand why the executive management of large business organizations, aided by governments, various advisers and consultants and business-funded lobby organizations would seek to promote and foster forms of corporate social responsibility and reporting which allow or adopt the construction and 'verification' of reports to give the impression that business can deliver on the undeliverable without changing the basic rules of the game. Such approaches effectively allow management to claim that they have addressed and solved, or are in the process of addressing/solving, issues of social justice, social exclusion and ecological protection, and proceed to carry on doing what they are hired to do and what they do best – make money for their shareholders. Rather than develop forms of reporting which provide a more balanced, 'warts and all' account of the *full* cost of business activities in social, human and ecological terms, developments to date have simply resulted in sophisticated forms of public relations half-truths, rubber-stamped by self-appointed independent 'experts', mostly from the accountancy profession[33], who provide empty, fatuous forms of 'third-party' assurance (see, for example, Ball *et al*., 2000; Gray 2000, 2001, 2002; Kamp-Roelands, 1996, 1999, 2002; O'Dwyer, 2001b; Owen *et al*., 2000; Owen and Swift, 2001). A move towards more complete, balanced and fair corporate social, ethical, environmental or 'sustainability' reporting requires that the executive management of large business organizations are completely honest and open about what they can and cannot deliver *under the present social system*. However, business is predominantly a 'can-do' culture and it is far from easy to persuade the executive management of large, multi-national companies to state clearly what they *cannot* do. Under the present social system in the developed world, particularly as regards the demands of the money capital markets and a global, free-market economy, the executive management of large business organizations *cannot* deliver on anything other than trivial, inconsequential forms of stakeholder democracy, social justice and ecological protection or, consequently, on sustainability, but they *can* deliver on efficiency[34]. However, as discussed above, one of the ways in which these challenges could be made more manifest (and thus perhaps at least improve the chances of meeting them) is through a research and education action programme which places issues of corporate social and environmental accountability at the heart of economic, social and political analysis. These issues are considered briefly in the next section.

11.7 Future research agenda

Corporate social accounting is, as the term implies, essentially a process of 'accounting for' something or other which helps human beings to make sense of the world around them. In other words:

> *... it involves a process of making sense of situations. Accounting as an artefact, i.e. as a collection of specific theories, conventions, and practices, is*

> *a tangible product of this sense-making process As such, it must be understood in relation to the context in which it is set, and of which it makes sense* (Davis *et al*. 1982, p.307).

The forms of corporate accounting and reporting that have emerged and developed over time have mirrored the changes that have taken place in the way society itself is organized, such as, for example, from feudalism to capitalism (see, for example, Burchell *et al*., 1980). These changes, whilst remaining within the capitalist mode, continue today. In the specific context of CED, the significant practical developments in social, ethical and environmental reporting to have emerged and developed since this project began (1994) have drastically changed the landscape of corporate reporting practices over the last ten years. At the present time (2003), there are a whole host of governmental, regulatory and non-governmental voluntary reporting guidelines for corporate reporting on the economic, social, ethical and environmental aspects of business operations (see Chapter 2, Sections 2.6 and 2.7). There is at least a possibility that these fresh developments will lead to the generation of new images of the business organization, images which will allow powerful new insights to emerge of the relationship between business and society in general and of the relationship between economy and ecology in particular. However, these developments have been largely ignored by the vast majority of university accountancy and business finance departments throughout the world, particularly those in the United States and continental Europe, the latter preferring to research and teach traditional areas of accounting, management and finance from within a 'positive' economics paradigm[35]. As Mathews (1997, p.505) states:

> *... the failure to get social and environmental accounting into the undergraduate curriculum is a major disappointment. In general, the next generation of accounting professionals are almost as poorly prepared to evaluate new developments (and embrace them where appropriate) as were past generations.*

Similarly, recent efforts to encourage more substantive research into the field of social and environmental accounting in Europe (Bebbington *et al*., 2000) have highlighted the extent to which researchers are still not getting the financial and institutional support needed to help develop this area of accounting education and research. With the exception of the UK, and perhaps Spain, the rest of Europe continues to show only marginal, erratic interest in an area that has gained widespread, institutional support from supra-national bodies such as the European Commission, the European Parliament and the United Nations. The implications of this for accountancy practitioners and researchers are clear. Not only are they ill-prepared to assist their corporate clients and students in moving towards more holistic forms of social understanding, responsibility and accountability, they are also poorly equipped to compete in a market place that is becoming over-populated with an increasing variety of disciplines gearing-up to provide new services for corporate reporting in the twenty-first century (see, for example, Zadek and Merme, 2003)[36]. One of the most disturbing aspect of these developments is the tendency amongst qualified accountancy practitioners and experienced researchers to assume that they already possess, or can acquire in supermarket-trolley fashion, the required knowledge, competences and *social understanding* to teach, train, research and provide services in this field. Lack of education at both undergraduate and post-graduate level in developing a post-modernist, post-structuralist understanding of the wider

social, political, ethical and ecological aspects of corporate social responsibility and social and environmental accounting (see, for example, Gray and Collison, 2001; Owen *et al*., 1994) may be a critical factor in this context, particularly as regards the nonsensical nature of many so-called forms of 'sustainability' reporting which the universities, large accounting firms, research institutes and non-governmental bodies seem so eager to be associated with at the present time. Re-directing this will require a major change to university undergraduate and post-graduate teaching and research programmes. For the time being, at least, the will to implement such changes is absent from all but a tiny minority of education institutions. This is a perilous state of affairs, not least because it reinforces the status quo of 'the business case' when the need for an alternative, more holistic, socio-political understanding of the relationship between business and society has never been greater.

Recent developments in the practice of corporate social, ethical and environmental reporting also raise important issues for those engaged in and dedicated to CSR research. Despite over 30 years of active, committed work on the part of a small but growing number of researchers (see, for example, Gray, 2000; Mathews, 1997), academics are still a very long way from being able to offer any firm conclusions as to the nature and causes of CSR/CED. Although the evidence, including that presented in the present study, seems to suggest that there are certain factors which influence CSR/CED, there are many unresolved issues as well as issues over which the empirical evidence is either inconclusive or contradictory. In reality, whether any *stable* relationships exist between CSR/CED and other explanatory variables both across firms and over time is still debatable (Hackston and Milne, 1996). This unsettled situation is compounded by a lack of standardization in the research techniques employed with regard to sampling and measurement techniques such that it is difficult to draw any firm conclusions on these relationships. Moreover, available data on trends in CSR/CED over time remains few and far between with relatively few content analysis studies having been published up to the present time. Such studies are invaluable because they provide an insight into how management respond to the changing social, political and economic climate in which disclosure and discourse occurs. Thus, it is necessary that CSR research continue to be conducted along a variety of different avenues, with researchers employing one or more existing and/or new theories to explore the possible influence of other firm characteristics and socio-political influences in accordance with the general model presented in Chapter 3 (Figure 3.1). However, a broader, long-term perspective suggests that it is extremely unlikely that any one theory is able to provide *all* the answers, *all* the time and in *all* situations to the type of research questions posed by the present study. Thus, to the extent that existing theories come to be seen as inadequate in this context, CSR researchers will need to go outside their own discipline to 'borrow intellectually' (Laughlin, 1999) from other disciplines which may provide the theoretical and methodological perspectives needed to address complex social, political and economic phenomena such as CSR and CED.

A further, important aspect concerns the implicit or explicit end-game which underlies CSR/CED research and practice. One of the most important challenges facing CSR researchers is the question of whether CSR/CED research can reverse the loss of democracy and accountability as claimed by the radical Marxian (i.e. classical) political economy analysis. As Gray *et al.* (1996) have stated:

> *Until there is a great deal more political will in governments, a far more informed and active demos, an explicit recognition of the failings of liberal economic democracy and/or a reintroduction of human values and ethics into the corporate world, CSR and social accounting must be restricted to less than radical initiatives and so stand (potentially at least) guilty as charged by the Marxian analysis* (p.27).

Much of CSR/CED research, particularly research that has employed OLT and PEAT, has highlighted the way in which social and environmental disclosure is used for political rather than decision-making or accountability purposes. This has spurred CSR researchers to devote efforts towards developing new forms of social and environmental accounting which highlight the extent to which the current forms of business activity and financial reporting are directly implicated in social injustice, social exclusion and environmental degradation (see, for example, Bebbington and Gray, 1996, 2001; Bebbington and Tan, 1997; Bebbington and Thomson, 1996; Bebbington *et al*., 1999, 2001; Gray, 1992). Such attempts to make *fully explicit* the negative social, human and ecological consequences of business activities, through concepts such as full cost accounting (FCA) and at *truly* 'accounting for (un)sustainability', remain marginalized, partly because so few companies are willing to participate in the development of forms of accounting which would 'spill the beans'. As noted by ACCA/UNEP (2002), of all the issues addressed by the accountancy profession in relation to the environmental/sustainability debate, FCA is the least developed. Similarly, as noted in the judges' report for the most recent ACCA UK Environmental Reporting Awards, one of the leading reporting award schemes of its kind:

> *Few reporters discuss and report progress on more challenging global and impact issues such as climate change and full cost accounting. In general, attempts at environmental management accounting or at full cost accounting are not being made. While the related performance data on CO_2 emissions are disclosed, the wider discussion on climate change and its implications for the organization in the future is lacking* (ACCA 2003b, p.38).

As with business, the accounting profession appears much more willing to address and foster market-led and market-based initiatives such as carbon trading, emission rights and greenhouse gas verification (see, for example, FEE 2003b). Similarly, companies have been more eager to adopt other, much less intrusive and challenging forms of accounting and reporting, such as those developed by GRI (2000, 2002) and ISEA (1999). As a result, there is a very real risk that, rather than making the absence of democracy and accountability more visible, these other forms of reporting will simply permit large corporations to continue masking the true extent of their social, human and environmental impacts. A radical, critical perspective on accounting suggests that "... the controlling interest within the dominant economic system, having gained power as a result of the system, controls the specification of accounting activity" (Dillard 1991, p.12). From this viewpoint, it is seen as highly improbable that CSR/CED would focus on "… exposing the weaknesses of that economic system in such a way that would contribute to a critique leading to rational evaluation of social arrangements" (Dillard 1991, p.12)

CSR researchers *not* engaged in the critical, radical agenda of strong forms of sustainability which stress the need to *replace* the existing social system (i.e. global, industrial capitalism)

itself run the very real risk of simply engaging in the discourse of 'pettiness that plays so rough' (Dylan, 1987). Such research is *petty* in the sense that simply investigating what, how and why companies report is an irrelevance when seen in the context of a social system (global industrial capitalism) that is directly responsible for global ecological devastation and social injustices on an unprecedented scale. Similarly, CSR research is *rough* in the sense that it leaves unchallenged a social system that places little worth on aesthetic, moral, ecological or spiritual values but focuses exclusively on efficiency in the utilitarian exploitation of natural, social and human capital and the egotistical accumulation of monetary wealth. The latter issue is controversial and many mainstream accounting researchers and practitioners will be uncomfortable with the suggestion that they are somehow implicated in fostering widespread social injustice, social exclusion and environmental degradation. But while current forms of corporate reporting continue to leave out of the equation the direct and indirect, non-market social, human, cultural and ecological impacts, it is impossible to provide any reliable assessment of the full benefits and costs derived from the private pursuit of economic wealth under global industrial capitalism. Developments in FCA and other forms of holistic reporting associated with a serious approach to 'accounting for (un)sustainability' (see Chapter 2, sections 2.4 and 2.5) would arguably go some way towards creating a truer, fairer and more even-handed basis for corporate accountability and reporting. Accounting has an important role to play in this regard by signalling, through forms of FCA and stronger forms of 'accounting for sustainability', what is likely to happen if there is no change to the current business-society hegemony. Much more research effort therefore needs to be directed towards improving past attempts in this area (see, for example, Bebbington *et al*., 2001)[37]. However, it is naïve to assume that research efforts to bring about such change will go unchallenged. As noted by Owen *et al.* (2000), a cornerstone of the radical, Marxian critique of mainstream or middle of the road (Tinker *et al*., 1991) social and environmental accounting programmes is that they are too easily captured, and thus made impotent, by powerful, dominant economic forces which have a vested interest in maintaining the status quo. Current trends in the practice of social and environmental accounting and reporting, notably the emergence of 'sustainability' reporting (GRI, 2000, 2002), suggest that the process of 'managerial capture' (Power, 1997) is already well advanced.

Whether it is any indeed any longer possible for accounting researchers and practitioners to wrestle back the more radical elements of CSR is debatable. At best, the "greening of accounting" project (Bebbington and Gray, 2001; Bebbington and Thomson, 1996; Bebbington *et al*., 1994, 2001; Gray, 1990a, 1992, 2002; Gray and Bebbington, 2001; Gray *et al*., 1993, 1995a, d) is under serious threat from organizations such as CSR Europe, FEE, GRI and ISEA which merely offer a bourgeoning bazaar of excuses for the status quo. At worst, the project is dead in the water. This is not to suggest that studies which attempt to *understand* social practices, their development and their effects, such as that presented here, are not of value. Quite the reverse; they can offer valuable insights into understanding the society in which we operate and the role played by accounting and reporting within that society. However, if CSR research has a purpose and that underlying purpose is *social change*, which it arguably is for the vast majority of CSR researchers, there remains a question mark over the degree to which the *practice* of CSR can ever be effective in bringing about the desired transformations required to attain a 'true, free and just life' (Laughlin 1987) for all sections of society. To date, many of the new forms of social accounting that have

emerged over the last thirty years or so, including human resource accounting, employee reporting and employee reports, socio-economic statements, environment reports, social reports, triple bottom line (TBL) reports have simply developed from crude public relations documents to more sophisticated forms of the same. In short, the demos is still *not* being informed of the true, total cost of the operations of business activities or of the limits which the present system places on business organizations that seek to deliver on social justice, ethical responsibility and ecological restoration. From that perspective, researchers and practitioners have hardly begun to address the really important agenda issues which any serious approach to CSResp and CSR implies.

11.8 Staying with the 'big picture' – a personal plea for humility, reverence and sanity

As outlined above, even if accounting and reporting practices were reformed to provide more equitable and robust forms of corporate accountability, it is debatable whether this would bring about significant change in social behaviour. For example, most members of society are already aware, through the mass media, of current social and ecological 'crises' in one form or another. Put simply: "Who needs a weather person to tell which way the wind blows?" It is widely recognised that, notwithstanding the enormous economic benefits it brings to a privileged minority, the mechanism of global industrial capitalism imposes significant social and ecological burdens on a growing, significant proportion of the world's population, particularly those most vulnerable and those on the lower rungs of the ladder of economic prosperity (see, for example, Brown *et al*., 1995, 1998, 1999; Handy, 1995, 1998; Korten, 1995, 1999; UNICEF, 1995)[38]. Similarly, there is a growing body of work which argues that the natural environment *is* in major crisis in the sense of failing to support human and/or non-human life (see, for example, Goldsmith, 2003; Lovelock, 1982, 2002; Porritt, 1990; Robertson, 1978; Silver, 1990).

From that perspective, the burning issue of our age is not whether we need to become *more* aware of the social and ecological burden of our social system (through, for example, more equitable forms of CSR) but what steps we are prepared to take to *reverse* the decline in human values, the quality of life and the state of the planet. In essence, this is the real challenge of sustainability. To date, efforts by accounting researchers, practitioners and consultants to address this challenge have, almost without exception, focused on the *symptoms* of social injustice and ecological devastation rather than the underlying *causes*. However, if these issues are to be addressed comprehensively, critically and decisively, this must involve questioning the system itself, i.e. capitalism[39]. The radical agendas of deep and spiritual ecology, for example, posit that the only intelligent, shrewd and rational way forward is to replace the present system of global industrial capitalism with a workable alternative, one which combines a commitment to individual and social emancipation with a commitment to universal responsibility and reverence for *all* living things (see, for example, Devall and Sessions, 1985; Drengson and Inoue, 1995; Kumar, 2000, 2002; Merchant, 1995; Metzner, 1999; Naess, 1973, 1984; Norgaard, 1985; Suzuki, 1998). In a recent commentary, HRH The Prince of Wales (2002) made an impassioned plea for balance and harmony in a challenging and disturbing critique of the way commerce, science, technology, education,

agriculture, architecture and medicine have resulted in the decimation of the Earth and the diminution of spirituality, seeing his own life as being motivated:

> *... by a desire to heal – to heal the dismembered landscape and the poisoned soil; the cruelly shattered townscape, where harmony has been replaced by cacophony; to heal the divisions between intuitive and rational thought, between mind, body and soul, so that the temple of our humanity can once again be lit by a sacred flame; to level the monstrous artificial barrier erected between Tradition and Modernity and, above all, to heal the mortally wounded soul that, alone, can give us warning of the folly of playing God and of believing that knowledge on its own is a substitute for wisdom* (2002/2003, p.9).

The commentary represents a serious challenge to many sections of society, including business, government, accountants, researchers and scientists. The Prince's basic message is that their actions are currently out of step with the long-term sustainability of human well-being as well as the well-being of the planet. Accountancy, both mainstream practice and research, appears oblivious to such concerns. Rather than put resources into developing new forms of social and environmental accounting which show that something may be seriously wrong with the present social system, the profession chooses to support initiatives such as those of the FEE (2002), GRI (2002) and ISEA (1999) which provide corporate management with a 'get out of jail free card' by spinning out the 'win-win-win' fable of the 'sustainable global corporation operating in the sustainable global economy'. Similarly, rather than support and foster new, alternative approaches to accounting research which place value on intuition, interpretation and understanding, university economics faculties and accounting departments remain wedded almost exclusively to redundant scientific traditions which deny the existence of anything that cannot be 'proved' according to the logical positivist tradition and refuse to acknowledge the existence of normative values in research agendas under the 'positive' economics tradition.

Any social or natural system which puts all its eggs in one basket not only takes unnecessary risks but also creates disharmony, disintegration and dysfunction. So it is within the world of accountancy. One on side, representing the vast majority, are practitioners and researchers whose avowed *amoral* outlook is guided by principles of 'neutrality', 'independence', 'objectivity' and the search for 'truth' and 'accuracy'. On the other resides a small minority who have had the courage to ask the difficult questions, displaying a sense of anxiety and unease which emanates from an intuitive understanding that something is terribly wrong and that fundamental changes have to be made. These two groups are, sadly, no longer talking to each other. They have their own research journals, their own practice groups and their own contact networks. The bridges that were built in the halcyon days of the social and environmental accounting movement of the early 1970s have long since collapsed under the strain of institutionalised intellectual tyranny (Arrington, 1990)[40]. Much of mainstream corporate accounting research and practice remains largely unchanged by and removed from the interpretive and critical, postmodern accounting research schools which have sought to broaden, enrich and challenge the dominant narrow, 'positive' economics tradition which currently counts for what call Kuhn (1970) describes as 'normal science'. Conversely, those engaged in 'revolutionary science' (Kuhn, 1970) continue to chip away at the edges,

highlighting the serious metaphysical and philosophical anomalies between the accepted paradigm (logical positivism) and 'new world' views that are opening up before us.

The radical, critical and interpretive schools of accounting research remain marginalized, particularly in mainland Europe, with relatively minor participations in both the arena of public practice and academic discourse. Nevertheless, if we *choose* to see the glass as half-full rather than half-empty, then we may also cling to the hope that, in the not-too-distant-future, as 'progress' gives way to panic, and later as panic is replaced by inner reflection and the search for higher levels of human consciousness and understanding, a new, alterative set of values, customs, norms, attitudes and beliefs will emerge. The global industrial economy is not only unrealistic and undesirable, it is the epitome of unrealism (Goldsmith, 2003). The evident, endowed role of the professional accountant, whether in practice, business or academia, is to serve society by helping it heal itself, regenerate its soul and recover from the intellectual superciliousness which privileges empiricism and reason over intuition and love.

Notes

1. Some relevance has obviously been lost due to the fact that the data reported in this investigation are now out of date. It would no doubt have been interesting to extend the period of the investigation through to 2000 but time and resource constraints meant that this was simply not possible. A more detailed explanation of the reasons for choosing the period 1989 to 1995 and of the considerable amount of time and effort required to carry out a project of this kind are given in Chapter 8.
2. The eight industry sectors included in the study were classified as between environmentally sensitive and less environmentally sensitive (see Chapter 8 for details). On this basis, the four environmentally sensitive sectors were: Chemicals; Extractive; Mechanical Engineering and Metallurgy; and, Energy Utilities. Similarly, the four less environmentally sensitive sectors were: Banking and Insurance; Consumer Goods; Travel, Tourism and Transport Services; and, Retail and Leisure (see Appendix 5 for details).
3. The extent to which, individually and collectively, the four proxies for political visibility in the present study 'capture' the political visibility characteristic of firms is difficult to assess in the absence of a more detailed empirical investigation. However, it seems reasonable to argue that the concept of corporate political visibility is a function of several different firm characteristics, the relative importance of each varying both across firms and over time. From this perspective, corporate political visibility may be construed as a complex, dynamic and multifaceted phenomenon, dependent upon a variety of factors including size and profitability.
4. Hypothesis H_4, although not a test of association, is relevant in the context of the model of stakeholder theory explored here because it explores *intra-firm* stakeholder importance. From this perspective, stakeholder pressure on business organizations may be perceived as occurring on three different levels: (i) in aggregate, i.e. from stakeholder groups collectively; (ii) individually, i.e. from individual stakeholder groups; and (iii) at a sub-aggregate level from several different stakeholder groups in combination, i.e. 'clusters' of stakeholder groups.
5. The basic premise underlying EAT in relation to the political visibility argument is that politically visible firms are targets for criticism from the political sector, particularly regulatory authorities (Watts, 1977; Watts and Zimmerman, 1978). Such firms are said to use various strategies designed to reduce the threat of political interference from the political sector, including CSR. Researchers have reinforced this argument by successfully predicting an association between (proxies for) political visibility and CSR (see, for example, Belkaoui and Karpik, 1989; Ness and Mirza, 1991; Trotman and Bradley, 1981). Under OLT, the concept of political visibility is viewed differently, reflecting a wider socio-political perspective on the relationship between business and society (see Chapter 4, Table 4.3). Essentially, certain business organizations, notably those which are large in size or operating in socially-sensitive industries, are seen as more

exposed (i.e. politically visible) to social pressures from various interest groups within society. This exposure is said to make such organizations easy targets for criticism from such groups, particularly social activist and campaign groups that seek socially-responsible behaviour. Such criticisms effectively represent challenges to the organization's social legitimacy. Politically visible organizations are seen as responding to such challenges by using, *inter alia*, CSR/CED to re-define the terms of the social contract, to manage public impressions and reduce the business organization's exposure to the social and political environment.

6. Further insight into the potential influence of ENGOs in this context is provided by Gray *et al*. (1995a). They report that changes in organizational behaviour (concerning its response to the environmental agenda) as a result of the attention of environmental groups were associated with shocks or jolts to the organizational system from sustained campaign activities of ENGOs. In other words, ENGOs appear to be more effective where they are able to penetrate an organization's 'protective shell', jolting the organization into questioning its current business practices thereby creating the potential for real change. It may be, for example, that this 'protective shell' in the case of very large European companies is hard for ENGOs to crack in the absence of some extraordinary event or set of circumstances.
7. The fact that managers and directors of large corporations appear reluctant to disclose negative environmental information is also consistent with a *Rochester School* of accounting (see Chapter 5) analysis. Benston (1982), for example, argues that, "It would be a form of self-destruction (or masochism) for corporate officers to report voluntarily that they had polluted a river or discriminated against minorities. But they are likely to report on their social progress in areas and in ways that would yield benefits in the form of better employee, customer, public and government relations, and that would mitigate the costs that pressure groups might be able to impose" (p.98-99). Benston posits that corporate officers and directors would tend to report events in the annual report and accounts that are 'socially responsible' but that, in the case of externalities, the enormous difficulties involved in placing monetary values on the related social costs and benefits implies that it is not surprising to find "… that the reports generally are favourable to the companies" (1982, p.99).
8. There is also evidence from companies themselves that corporate reports are used as part of a public relations campaign. ABN AMRO, for example, in its 1994 annual report and accounts states that corporate communications are used "… to build up an image … that finds widespread social acceptance …" (p.88).
9. Hearings of the House of Representatives in the US in the 1980s, prior to the passing of the Superfund (see Chapter 2, Section 2.4), into hazardous waste dump sites highlighted the case of Hooker Chemical Corp., which had used Love Canal as a dump site. During the course of these hearings, six present and former executives testified to the fact that the company was aware of the possible dangers to health at the site as long as 20 years previous (Cahan *et al*., 1997). When questioned, a former company official revealed that even though the company was aware of health dangers it did not inform people near the site because the managers "… did not feel that [Hooker Chemical Corp.] could do this without incurring substantial legal liability" (US House of Representatives 1979, p.665, as quoted by Cahan *et al*. 1997, p.42). Both Newman and Breedan (1992) and Boulton (1995) highlight the risks to and dilemmas faced by companies which publish information that other companies may be afraid to divulge and it is far from clear that companies will gain credit from being completely honest as is claimed by some (see, for example, DTTI, IISD and SustainAbility Ltd., 1993).
10. As indicated in Chapter 8, the investigation was originally intended to include the years 1996 and 1997 but resource constraints and time overruns meant that the investigation had to be restricted to the period 1989 to 1995 only.
11. Statistical analyses which seek to relate one variable to another have an established credence in accounting research, with scientific credibility and value neutrality being sought through the pursuit of statistical "explanations" of economic and social life (Cooper, 1988). However, statistical techniques used to test for correlation between two data sets merely establish the probability that both variables are *associated* with one another, either positively or negatively, and the strength of that correlation. The fact that two variables are associated with one another does not establish whether one is antecedent or causes the other, nor does it establish that they are

causally-related since other factors may be involved (Abercrombie *et al*., 1994). See, for example, Spicer's (1978a, 1980) response to the criticisms of Chen and Metcalf (1980) in which Spicer stresses his findings as *associations* between variables and not *caused* relationships. Moreover, *causal* explanations cannot succeed in the social sciences because they assume human beings are like natural objects, which is obviously incorrect given that human behaviour is partly determined by perceptions and ideology, i.e. the perspectives and meanings which are given to the world.

12. It is difficult to explain precisely why the bourgeois version of legitimacy theory is so popular, although one probable factor is an *intuitive* feeling amongst CSR researchers that it is 'closest to the truth'. Whilst the traditional, Western model of 'rational' behaviour (a common theme in 'positive' economics) denies the value of instinct, intuition, and spirituality in guiding human action, an increasing element of post-modern and post-structural thought, particularly within spiritual ecology, is suspicious of conventional Western forms of logic, reasoning and problem formulation. Arrington (1990), for example, draws on Rorty (1987) in offering the concept of *solidarity* (the quality of life) as an alternative view on the nature of accounting knowledge, the latter being knowledge that is deemed useful for the construction of a good community and as the guiding ethic of research.
13. The present study did not seek to assess the extent to which corporate management is aware of the agendas of ENGOs. It may well be that management adopts a calculated "wait and see" approach, remaining informed as to the general agenda of environmental pressure groups but reacting only to specific issues and events where these are perceived as a material threat to the success of the business or industry in which it operates (Freeman, 1984). Thus, whilst ENGOs may not rank as an important stakeholder group or relevant public (Chapter 9, Table 9.8), ENGOs may influence managerial behaviour in other ways, e.g. via product boycott campaigns.
14. Even when employing a polyglot of theories which yield a more realistic view of organizations, inconsistencies in the underlying theoretical explanations imply that choices as to which explanation is the more convincing will be determined more by intuition and belief than by empirical evidence. For a polyglot of theories approach to be useful implies that the different theories used are complementary with one another (Eisenhardt, 1989). Thus, whilst in theory the use of agency theory in combination with other theories may help to capture greater complexity and realism (as argued by Eisenhardt, 1989), this only works in practice if the other theoretical insights offer *consistent* underlying explanations. The fact that this is not necessarily the case, as demonstrated by the present study, serves only to highlight the underlying *normative* differences between the dominant, neo-classical economics tradition (notably, the careful development of restrictive assumptions and logical propositions) and behavioural and organizational research traditions which lie outside of traditional economics (see, for example, Hirsch *et al*., 1987).
15. Hanson (1958) is credited with coining the term 'theory-laden', expressing the notion that the language researchers use to describe observation is conditional upon a variety of linguistic rules and widely-held theories. In other words, linguistic terms used when describing observations depend for their meaning on the rules of the language concerned and on a variety of built-in theoretical assumptions, thereby 'contaminating' empirical research with subjective values. Kuhn (1970) and Lakatos (1970) took this argument further by stating that observation is so completely theory dependent that the distinction between theory and observation is rendered meaningless (see Chapter 4). In an accounting context, the *Rochester School of Accounting's* claim that positive accounting theory (Watts and Zimmerman, 1978, 1979, 1986) is somehow free from value judgements and normative positions has been shown to be completely groundless (see, for example, Tinker *et al*., 1982; Whittington, 1987).
16. As set out in detail in Chapter 5, the central argument of the *Rochester School's* model of EAT in relation to managerial behaviour is that all such behaviour is motivated by greed. As such, all forms of managerial behaviour including CSR/CED are seen simply in the context of the 'nexus of contacts' between agent and principal, other sections of society being marginalized. To most CSR researchers, such an analysis is viewed as both narrow and unrealistic partly because to suggest that *all* behaviour is based on greed is seen as lacking common sense and partly because of its exclusion of so much of neo-pluralistic society within which the business organization *must* operate. The *Rochester School's* model of agency theory may be relevant to a study CSR in certain specific, cultural contexts such as New York, Chicago and other parts of the United States

where there exists a relatively extreme version of liberal economic democracy and where 'big' business is heavily involved in the funding of political parties, personalities and political campaigns. However, to suggest that this is the *only* reason for CSR/CED in other parts of the world, particularly the European Union which has a long history of socially-benevolent governmental and supra-governmental policies, is highly questionable.

17. Accounting as a scientific discipline is hardly in the luxurious position of being able to discard theories at the drop of a hat. As noted by Whittington (1987), the central issue for accounting theorists and researchers is "… that *all* approaches to accounting theory are, at the present time, in a fairly rudimentary stage of evolution and desperately need further constructive development" (p.335).
18. The lack of stable or unique relationships in this context implies that CSR researchers may need to relax the 'relative explanatory power' requirement which theoretical propositions must satisfy under a formal application of the logical positivist approach. This requirement (see Popper, 1959) states that a theory must be able to explain or predict the subject matter as good as any competing theory (Lee, 1991). Thus, where competing theories are subjected to empirical testing, weak theories are rejected according to their relative deficiency in explanatory power, leaving only the stronger theories to be subjected to further empirical testing through verificationism/ falsificationism. Such an approach may not be relevant in the context of CSR/CED if, as research evidence appears to suggest, the social world does not posses the universal laws which (may) exist in the natural world. Rather, as described in Chapter 4, it may be more appropriate to adopt an interpretivist approach whereby the meanings and understandings ascribed to the social world are not seen as fixed or immutable but subject to iteration, each new iteration bringing new meanings to the same set of human actions such that over time, through a process of *hermeneutic analysis*, the reading of human behaviour evolves to a higher state of subjective understanding. Boland (1982), for example, makes a similar argument in challenging the notion that accounting theory construction is a logical and technical process. Boland's central argument is that accounting theories are not immutable but must adapt to constantly changing institutional and political characteristics of society. See also Lowe *et al.* (1983) for a discussion of the drawbacks of using simple theories to explain complex political processes.
19. According to the positivist school, only by applying the methods of natural science can the social sciences (including accounting) ever gain the status and legitimacy of the natural sciences in relation to prediction, explanation and control (Lee, 1991). This all-consuming concern with emulating the natural sciences is sometimes described as the 'physics envy' syndrome. However, the difficulties involved in capturing social reality in formal propositions, quantifying them and then subjecting them to quasi-experimental research methods effectively shuts out other theories which are based on different ontological, epistemological and methodology assumptions (see Chapter 4). Whilst much of prior CSR research has been content to draw upon positivist methodology (see Chapter 3), the interpretivist approaches, notably ethnography (see, for example, Dey, 2000, 2002; Dey *et al.*, 1995) and case studies (see, for example, Rovira, 2002), are increasingly being seen as offering much-needed *understanding* into the nature and causes of CSR/CED. Indeed, it may be suggested that the positivist research approach has now served its purpose and that all new, emerging understandings are more likely to come from an interpretist approach to CSR. In contrast, the more critical research approaches, such as classical political economy and spiritual ecology, may play a vital role in terms of highlighting the extent to which attempts to merely *understand* aspects of the social world are deficient in terms of bringing about radical social change.
20. The low level of corporate disclosure of environmental data continues at the present time. For example, the European Commission in its recent communication on the treatment of environmental issues in the annual report and accounts states (CEC, 2001b, recital 4): "… voluntary disclosure of environmental data in the annual accounts and annual reports of companies is still running at relatively low levels, even though it is often perceived that enterprises face increasing costs for pollution prevention and clean-up equipment and for waste clean-up and monitoring systems, in particular those enterprises operating in sectors that have significant impacts on the environment."

21. The role of governments in this process is clearly important. In a neo-pluralist vision of society (see Chapter 6, Section 6.2) the 'process of government' is seen as essentially holding society together by managing the vast variety of interest groups in such a way as to ensure a reasonable level of consensus (Bentley, 1908/1993). However, this task is possible only if the major sections of society can be 'accommodated' (Richardson, 1993). Given the growing tension between the pursuit of the public policy goals of economic growth and environmental protection, national governments and other supra-national governmental bodies have sought to foster, along with business, the perception that these two public policy goals are *not* mutually exclusive under the banner of 'sustainable development'. To suggest otherwise would effectively exclude a significant number of interest groups, notably environmental pressure groups, from the policy process, thereby threatening the stability of a society itself. Since the essence of mainland European democracy involves the so-called 'co-optation' of interest groups into the policy process (Heisler and Kvavik, 1974), it is very difficult to see how the agenda of some of the more powerful environmental pressure groups such as Greenpeace, Friends of the Earth and WWF can in fact be 'accommodated' without some softening of that agenda. In that context, the absolute necessity to control the 'sustainable development' debate becomes important not just for business and governments but also for society as a whole. It is for this reason that the radical agenda of stronger forms of sustainability, such as that offered by the spiritual and deep ecology movements, represent such a threat to so many vested interests.
22. For an introduction to the deep ecology literature see, for example, Devall, 1980; Devall and Sessions, 1985; Drengson and Inoue, 1995; Merchant, 1995; Naess, 1973, 1984; Norgaard, 1985.
23. The degree to which 'environmental accounting' and 'environmental accountants' can bring about *real* change in organizational behaviour in relation to the environment and sustainability is still unclear (see, for example, Gray *et al*., 1995a). Power (1992), for example, argues that change in accounting *can* have a significant influence on conceptions of the organization but that the direction of this influence is unpredictable. However, based on the analysis of conventional accounting practice in relation to environmental issues as presented in Chapter 2 (notably Section 2.8), it seems clear that mainstream accounting and accountancy is still having little, if any, positive influence on this process.
24. Although these mandatory requirements apply to sites only and not business organizations as a whole they are important in a public policy context because they demonstrate that a 'do nothing' approach was not accepted by the Member States concerned. In other words, the national governments of Denmark, the Netherlands and Sweden were no longer prepared to leave the issue of corporate environmental reporting purely to market forces. This implies that firms could not be trusted to do the job themselves (see Chapter 2, Section 2.8 for details of the reasons why the Dutch government introduced mandatory corporate environment reporting in the Netherlands). However, as indicated in Chapter 2, relying on site-based reports in this context is problematic given that such reports are *not* a reliable measure of environmental performance for the corporation as a whole. Put simply, reporting on measures taken to reduce environmental impacts in one line of business or geographical area may simply mask more serious negative environmental impacts which have been 'exported' to other lines of business or geographical areas of the same organization which go unreported (Adams *et al*., 1998). If the public policy agenda of the EU Member States is to improve corporate environmental performance structurally, then there needs to be a move towards requiring companies to manage and control and be accountable for their global, i.e. company-wide, environmental impacts (see, for example, Hibbitt and Kamp-Rolands, 2001, 2002a).
25. The current focus of environmental reporting by EU companies in this context is away from 'end-of-pipe' and clean-up costs towards reporting on investments in clean, 'environmentally-friendly' technology, cleaner production methods and the operating costs incurred of more effective and efficient internal management of environmental issues. However, cleaning up of contaminated sites is still a significant problem in the former East Germany and is likely to be a significant issue for some of the former Soviet-block countries about to join the EU. Under the EU's fifth geo-political enlargement, 13 countries are now waiting to join the European Union: 10 central and eastern European countries - Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia and Slovakia - and three Mediterranean countries: Cyprus, Malta and

Turkey. In addition, two recent US studies (Repetto and Austin, 2000a, b) provide detailed evidence which suggests that US companies may be over-valued because of exposure to potential future environmental costs. Hence, there has been some welcoming of the EC recommendation in the context of improving the quality of financial reporting (see, for example, Collison, 2003).

26. The European Commission's recent communication on the treatment of environmental issues in the statutory annual report and accounts (CEC, 2001b) extends the scope of such issues to include "… the type of environmental information that is appropriate to be disclosed … with regard to the company's attitude towards the environment and the enterprise's environmental performance …" (Annex, 1. Scope, paragraph 3). However, this recommendation is restricted to matters which "… may have consequences for the *financial position of the company*" (CEC, 2001b, Annex, 1. Scope, paragraph 3, emphasis added) and thus does not address the wider social, ethical and political issues which any serious approach to the environment requires.
27. For a detailed review of the various practical responses of the global accountancy profession to various aspects of the sustainable development debate, see, for example, ACCA/UNEP, 2002; Drieënhuizen *et al*., 1998.
28. In this context, Elkington (1997) defines 'sustainability' as "… the principle of ensuring that our actions today do not limit the range of economic, social, and environmental options open to future generations" (p.20). However, this construction of sustainability needs to be understood in the context of Elkington's political ideology which is based on the acceptance of capitalism, i.e. that "... the free enterprise system offers the best hope …" (1997, p.35) of moving towards a sustainable society and that "... sustainable development will increasingly be delivered by business through markets" (*op cit*., p.118). As such, Elkington's crusade is towards a different form of capitalism, variously called 'new age capitalism', 'sustainable capitalism' or 'stakeholder capitalism', but capitalism nonetheless. The notion that capitalism is the *only* possible alternative for human society is a perspective but not one that is accepted by critical social theorists, radical structuralists, radical humanists, deep ecologists or spiritual ecologists. However, by ring-fencing the construction of 'sustainability' within a capitalistic framework, the model of TBL reporting as subsequently adopted by GRI (2000, 2002) effectively shuts out other 'accounts' of sustainability which would seriously challenge what business can deliver in terms of social and environmental justice. In other words, the discourse over what sort of world we want to leave to future generations is confined to one which does not question the basic mechanism of capitalism. In that context, Elkington's (1996) conception of sustainability represents the capitalists' saviour, providing capitalism with a 'get out of jail free card' in the form of TBL, 'sustainability audits', stakeholder engagement, etc. Whilst Elkington clearly recognises that capitalism "… may not be the best option as far as the planetary ecosystem is concerned…" (1997, p.55), a more critical, radical perspective is more likely to regard a vision of some form of 'sustainable capitalism' as doing no more than filling in the cracks of an unjust and fatally-flawed system.
29. Today, just 500 corporations control 70 per cent of world trade, and of the biggest 100 economies over half are corporations (Goldsmith, 2003; Korten, 1995). None of the executive management of these huge entities is democratically accountable to the demos.
30. Much has been and is being written by professional and non-professional bodies such as FEE, GRI and ISEA about the fairness, objectivity and completeness of corporate social, environmental and 'sustainability' reporting. It is of course in their interest to construct this perception since many of the individuals involved have a direct interest in serving clients desirous of an 'independent, objective audit'. As I have been at pains to argue elsewhere (Hibbitt, 1994, 1997, 1999, 2001), much of what has been written by these organisations in this context is arrogant, ideological nonsense. Similar concerns have been expressed elsewhere by other members of the accountancy profession on this issue (see, for example, Gray, 2000, 2001; Gray and Bebbington, 2000; O'Dwyer, 2001b; Power, 1991, 1997a, b).
31. The word 'ecology' as used here should not be confused with the ideology of 'environmentalism'. The word 'ecology' derives from two mystery words of the ancient Greeks, *oikos*, which means 'house' or 'home' but also refers to the astrological domain of the planetary spirit, and *logos* which can mean 'story', 'meaning' or 'mystery' (Moore, 2003). Ecology when used in its spiritual context is thus concerned with the "… the mystery of what it means to have a home on this Earth, to be at home in your world and with yourself. … Ecology is a sacred art, understood

only by theology. It is the primary work of all of us, no matter what we do. It is the primary thing, the only thing. You are either an ecologist or a lost soul." (Moore 2003, p.2). A more practical, day-to-day, understanding is gained from Schumacher's (1973) *Small is Beautiful*, emphasising the beautiful as well as the small.

32. All of the organizations mentioned here – FEE, GRI, and ISEA – have an underlying socio-political agenda in relation to CSResp and CSR which leaves the present social system fundamentally *unchanged*. The European Commission for example, resorts to a distinctly anthropocentric, utilitarian view of the environment by defining it as "… the natural physical surroundings and includes air, water, land, flora, fauna and non-renewable resources such as fossil fuels and minerals" (CEC, 2001b, Annex 2. Definitions, paragraph 1). GRI, for example, has yet to attempt to define 'sustainability' simply privileging Elkington's (1997) triple-bottom line (TBL) construction (see, for example, Hibbitt, 1999). Similarly, CSR Europe, a business-funded lobby organization representing the interests of European big business, argues in an open letter to Romano Prodi, President of the European Commission, that CSResp is and thus, normatively speaking, *should be* "… voluntary and business-driven" (CSR Europe, 2002). Many other business organizations, industry associations and associated advisers have jumped aboard the TBL bandwagon, claiming that this represents a form of 'sustainability accounting' (see, for example, Casella Stanger, *Partners in Innovation Project* "Topic Briefing Sustainability Accounting", 2003). This process of 'managerial capture' (Power, (1997b) by business is yet another disturbing aspect of the way in which an altruistic concern for social and ecological justice is being lost amidst the discourse of pettiness and triviality.
33. According to the latest KPMG/WIMM (2002) international survey of corporate social and environmental reporting, a significant increase in the number of Top 100 companies in 11 countries included verification statements from third parties in their environmental, social and 'sustainability' reports, the percentage increasing from 18% in 1997/8 to 25% in 2000/2001. Of the 117 Top 100 companies from 19 countries included in the latest KPMG/WIMM (2002) survey which had these corporate reports verified, 65% were performed by the major accountancy firms (the rest being performed by 'technical firms' (16%), certification bodies (11%) and others (8%)).
34. This is not to deny that business organizations and industries cannot improve on aspects of social, ethical and environmental performance. They clearly can and many are making significant positive steps in this regard (see, for example, Bendell, 2000; Birkin, 2003; ESRA, 2003; Hawken *et al*., 1999). However, anything other than a very watered down version of sustainability demands not just that these aspects of business performance are improved but that the terms on which business is conducted are fundamentally revised such that it is social justice and ecology which decide the means and terms of trade rather than Adam Smith's 'invisible hand'. Such changes are still incomprehensible to most business leaders, economists, accountants and researchers. Yet unless such changes are implemented, a state of anything approaching 'sustainability' will remain an impossible dream.
35. A serious approach to social and environmental accounting has yet to be undertaken within the economics faculties and accounting departments of Dutch universities. Despite many initiatives in the areas of CSR and CSResp, the most disturbing aspect of this omission is the apparent refusal of Dutch universities either to consider CSR and CSResp outside the confines of the traditional research paradigm (logical positivism) or to challenge the stereotypical 'business case' literature which continues to shy away from the unpalatable implications of capitalism in the context of sustainability. Unless and until alternative, more radical perspectives are adopted, fostered and encouraged, accountancy as taught and researched within Dutch universities will continue to slide down the slippery slope of anachronism.
36. Organizations such as GRI and ISEA, for example, are busily engaged in the promulgation of reporting and verifications standards for social, ethical, environmental and 'sustainability' reporting. The accountancy profession's recent public image problems stemming from the ENRON and WorldCom debacles place it in a difficult position in terms of trying to assert its superior technical knowledge, competence and skills in these new, emerging fields. There are also good reasons for being concerned about the consequences of the accountancy profession simply trying to put old wine (traditional audit expertise) into new bottles (environmental accountability and audit) (see, for example, Armstrong, 1991; Power, 1991). Nevertheless, it is evident from

both the poor technical form and content and resulting poor quality of reporting and verification carried out in accordance with standards developed by organizations such as GRI and ISEA that there is much that the accountancy profession has to offer in these matters. To inspire confidence in the verification function (Limperg, 1985), requires that financial auditors 'get off the fence' and take a much more critical approach to these areas. Indeed, unless the profession takes a much more assertive and dominant role, the current level of corporate-consultancy 'spin' used to exploit, manipulate and mystify social injustices, social inequalities and environmental destruction will simply continue under the guise of 'officially-approved' corporate social responsibility and accountability to the point at which society will have little or no confidence in the communication and opinion of officials. Accounting researchers too have a vital role to play in terms of shining a light on the hollow, self-serving, unbalanced and amateurish nature of current trends in social, ethical, environmental and 'sustainability' reporting and verification. The need for accounting practitioners and researchers to combine together in wrestling back the CSR and CSResp agenda from its current quagmire is paramount. By doing so, the profession could more justly claim to be working to protect the public interest.

37. It is important to stress, in this context, that humankind is currently a very, very long way from the development of a reporting system which might be described as 'accounting for sustainability'. In fact, there must be real doubts, in terms of the limits of our own comprehension of all known-facts and the number of trade-offs required between accuracy, relevance and practicality, whether such a reporting system is ever achievable. These issues sit uncomfortably alongside more recent developments in triple bottom line (TBL) reporting which have generated so called 'corporate sustainability reports' (GRI, 2000, 2002; Adams and Jackson, 1999) and the accountancy profession's attempt to market its members' assurance services in the verification of such reports (FEE, 2002).
38. Though the selected use of statistics is a crude way to illustrate the point, the situation in the United States, so often held out as a beacon of democracy, offers a telling indictment of 'economic development'. In the US, according to Moore (2002), the infant mortality rate in many cities is currently higher than that of Kenya's capital Nairobi (*op cit.,* p.xxi), there are 44 million Americans (out of a total adult population of 154 million, i.e. approximately 29 per cent of adults), who cannot read or write above a fourth-grade level, i.e. who are 'functional illiterates' (*op cit.,* p.86) and 45 million people have no health cover (*op cit.,* p.206). In relation to the environment, after eight years of the Clinton administration, the average miles per gallon for US vehicles went *down* from 26 to 24.7 miles per gallon, the increasing fuel demand being one of the reasons the Bush Administration tried to persuade (unsuccessfully) the US Senate to permit oil companies to drill for oil in the Artic National Preserve in Alaska (*op cit.,* p.125) and in July 2001 the Bush Administration refused to endorse the Kyoto Protocol to reduce greenhouse gas emissions (which cause global warming) despite the fact that the protocol had previously been negotiated by more than 160 nations including the US (*op cit*, p.126).
39. To even suggest that, for any serious commitment to ecological restoration and social justice, capitalism is the problem not the solution is both reckless and foolhardy for any self-respecting individual. So much of the modern, human world is dependent on this system surviving that even to suggest *thinking about* an alterative is outside the boundaries of 'rational' thought. However, it is this issue which has concentrated the minds of many of those involved in radical change, including myself, through a commitment to unconditional love, universal responsibility, reverence for all life-forms and a path to higher levels of human consciousness. Whilst a discussion of these issues is clearly outside the scope of the present study, I believe it remains the only 'rational', judicious way out of the madness which continues to plague the world from behind the masks of 'progress', 'economic choice' and 'individual liberty'. The sheer number of humans now occupying the planet, which has more than doubled since 1950, *reduces* economic choice and individual liberty if there is to be social equality and ecological restoration. Pretending otherwise is just another form of self-delusion. For all of us, it is time to grow up, to put aside these childish things, to accept the responsibilities of adulthood and to begin the process of healing. All time spent doing otherwise is time wasted.
40. Arrington's (1990) critique of a tyrannical-style rule by the intellectual mainstream centres on the way in which mainstream accounting research and practice "… has kept public interest research

marginalized" (p.2). As evidence of this marginalization, Gaffikin (1988), for example, refers to the influence of Nicolas Dopuch, long time editor of *The Journal of Accounting Research* (JAR) whose influence on the scope and direction of accounting research is to be found in his comments, as editor of JAR, that he sought to kill "… the traditional form of normative theorizing" (Dopuch 1979, p.80 as quoted by Gaffikin 1988, p.24). It is certainly true that a number of refereed journals now exist which serve as a discourse for public interest accounting, notably *Accounting, Auditing and Accountability Journal* (AAAJ), *Accounting, Organizations and Society* (AOS), *Advances in Public Interest Accounting* (AIPIA) and *Critical Perspectives on Accounting* (CPA). However, mainstream accounting practice and research continues to be wedded to "… the discourse of accounting modernism …" (Arrington 1990, p.6) as advocated in Abdel-Khalik and Ajinkya's (1979) seminal work with its insistence upon empiricism through the use of hypothetico-deductive research methods. This stranglehold on methodology and thus, by implication, epistemology and ontology, has effectively ostracised a research community that seeks to offer alternative views on the role of business, governments and other institutions in society and of the effects of these institutions on society, minorities, women and the environment. Faced with this dilemma, it is perhaps not surprising that the more radical forms of social and environmental accounting have yet to enter mainstream financial accounting theory or practice.

International environmental reporting and disclosure requirements

This appendix provides summary details of mandatory and important voluntary corporate environmental reporting developments and initiatives in European and other First-world countries as at autumn 2003[a]. These details refer, where applicable, to requirements and guidelines in relation to the annual report and accounts and to stand-alone environment reports. Countries are listed in alphabetical order, starting with European countries.

***Austria and Germany*:** There are no specific legal reporting requirements in relation to the annual accounts. In relation to environment reports, however, the EMAS Regulation (CEC, 1993b, 2001a) is favoured by their respective governments which offer positive subsidies and benefits in relation to production licences and public procurement for those companies which comply with EMAS. Hence, there are strong political incentives for companies to adopt the EMAS regulation in both countries. Moreover, prior to the EU's adoption of EMAS, there was a long-established tradition of mass balances and environmental reporting in both countries. Several manuals have been published in both Austria and Germany on best practice in environmental reporting and for interpreting the EMAS requirements. The voluntary approach reflects the long-standing Austrian and German tradition of environment reports and mass balances. Certain large companies in highly polluting industries are required to report emissions to local authorities and all companies have to submit a waste prevention plan to local government agencies when changing their production processes. In western Germany there are an estimated 50,000 contaminated sites, with the number in the former East Germany expected to be much higher (Windeyer, 1992).

***Belgium*:** There are no specific legal reporting requirements in relation to the annual accounts or specific environmental reporting requirements covering all companies. However, under article 4.1.8 of the VLAREM II (1995) certain companies are required to issue an annual environment report, these companies being those listed in Appendix I to VLAREM I and mainly concern Class I and Class II hazardous activities (KPMG/WIMM, 2002).

***Denmark*:** Denmark has environmental regulations governing both stand-alone environment reports and the annual accounts. In relation to stand-alone environment reports, the *Green Accounts Act* was adopted by the Danish Parliament, the *Folketing, in* June 1995[b] as an amendment to Chapter 5 of the Danish Environmental Protection Act. The amendment was introduced in the form of a statutory order from the Danish Ministry of Environment and Energy (Danish Environmental Protection Agency, 1996), the primary objective of which is to increase corporate and public interest in environmental issues and to encourage enterprises towards more active and targeted environmental initiatives (for a review, see for example, Vedso, 1996). Under the Act, with effect from fiscal year 1996, around 1,200 Danish enterprises have had to publish *Green Accounts*, while approximately 200 firms have utilised the option of submitting a voluntary account. In 1998, 1,032 green accounts were made public, of which 173 were voluntary (Danish EPA, 2000)[c]. The duty to file *Green Accounts* rests on companies operating in nine environmentally-sensitive sectors, including iron and steel, processing, oil and gas, chemicals, animal processing and power and heat generation. Under the *Green Accounts Act*, Danish companies are required to submit *Green Accounts* annually to both local and governmental authorities. The main content of the report consists of three elements (Vedso, 1996):

- *company information in general,* including name, location, main activities, local environmental permits, etc.;

- *a directors' report* which must inform readers with no expert knowledge, *inter alia*, as to why the chosen information is considered relevant; if and to what extent employees have been involved in the making of the green report; and, hazardous materials that poses a threat to the health and safety of employees; and,
- *a resource consumption report* which must specify, *inter alia*, the main usage of energy, water and materials as well as any harmful (polluting) substances of major volume to the extent these are used in production processes, emitted by the company to air, water and soil or contained in the company's products or wastes. The resource consumption element of the report reflects a material-flow based approach of reporting on inputs and emissions/releases of polluting substances.

Management is not required to sign the report although it is considered best practice. Similarly, an auditors' opinion is not required but if an audit is performed the auditor's report must also be included in the *Green Account*. There are no specific demands as to the environmental auditors' qualifications and s/he can be internal or external, as with the EMAS regulation. Companies registered under EMAS may seek exemption from the requirement to submit *Green Accounts* by submitting the annual statement and verified EMAS-report as alterative valid documents. (For a review of both the positive and negative benefits arising out of the Danish experience with mandatory environmental reporting, see, for example, Bebbington, 1999; Danish EPA, 2000, 2003.)

The legislation regulating green accounts was modernised in 2001 and 2002, by the *Green Accounts Act 2001* (Law no. 258/2001) and Statutory Order. no 594/2002, respectively, to take account of developments in green accounting and international reporting, as well as general developments in society (Danish EPA, 2003). The material-flow based approach remains unchanged but the accounts have been expanded to include more information on waste and waste handling and the environmental behaviour of the company. In addition, certain procedural arrangements have been introduced which give local authorities a direct role in the green accounts process. The new requirements have two objectives: (i) that the accounts present information which is of interest to the public, e.g. how well the company complies with regulations, complaints by neighbours and others, and other information relating to environmental policy, demands on suppliers and waste generation and handling; and (ii) that companies are motivated to work systematically with environmental issues. The revised Green Accounts Act also introduced important changes to the administrative framework. To improve the credibility of green accounts, local authorities are now required to draw up a statement to be published as an integral part of the accounts. The statement must reflect whether the environmental data is in line with knowledge which the authority has about the company through its permitting and controlling work. However, the scope of the statement is limited to only part of the accounts, with certain aspects, such as the more management-related issues, being exempt. Although an improvement in credibility could have been achieved through external, mandatory audits, the Danish Parliament chose not to go down this route. Apparently, it was feared this would impose too large a financial burden on companies and that there would be very little added bonus beyond the credibility issue.

In relation to the annual report and accounts, the Danish Parliament passed a new law in May 2001 which, *inter alia*, requires management to report on environmental in issues in the annual report. Under the new Danish Financial Statements Act (2001), effective for financial years beginning on or after 1 January 2002, enterprises of reporting classes D (i.e. listed companies and state-owned public limited companies) and C (i.e. other enterprises whose size exceeds certain defined limits[d]) are now statutorily obliged to report certain environmental information in the Management Review (previously called Directors' and Management's Report) section of the annual report. Section 99 of the new Act provides that

Management's Review should, *inter alia*, describe the enterprise's impact on the environment and measures taken for the prevention, reduction or remedy of environmental damage. For these purposes, the environment is defined as natural physical surroundings, such as air, water, flora, fauna and non-renewable energy resources such as fossil fuels and minerals. In deciding what to disclose in the management review in relation to environmental issues, the management of an enterprise need to consider a number of issues, including the following:

- at a general level, the primary role of the annual report within Danish society has shifted from a focus on investors' information requirements to a broader focus taking into account the public interest and reflecting the transition from an industrial to a knowledge-based society;
- this more holistic approach to enterprise reporting is seen as encompassing an account of the way in which the management of an enterprise manages environmental issues and of the enterprise's administration of environmental responsibility; and,
- management's assessment of environmental issues must take into account the requirement for the annual report to provide a true and fair view of the enterprise's financial results and position and thus environmental disclosures under the new Act fall within the scope of the external statutory audit; and,
- more thorough and specific information on environmental issues and information not required for the purposes of a true and fair view may be presented in a supplementary report.

In relation to the last point, the Act specifies that supplementary reports must be clearly separated from and placed after the statutory components of the annual report and that such reports must give a true and fair view within the framework of generally-accepted guidelines. Under the new Act, the management of an enterprise may omit a description of environmental issues *only* if the environment is not important to the operations of the enterprise. Consequently, there is an implied obligation on the part of management to perform a review exercise to determine which environmental issues are of importance to its financial position and future prospects. Such a review would be expected to include a mapping of specific environmental impacts of the enterprise, both at the present time and in the future, which could influence its operations and financial development. Following on from which, management would then be in a position to address (i) what actions have been taken to remedy any environmental damage resulting from environmental impacts which are of importance to the enterprise's financial position and development, (ii) how a reduction of environmental impacts is taken into account as part of day-to-day operations and (iii) what steps and investments have been made to reduce future environmental impacts and the expected effects arising therefrom. The exact form and nature of the disclosures required under the new Act are intentionally vague with management being expected to apply the new requirements as is relevant and appropriate to the specific circumstances of each enterprise. In practice, it is expected that by considering the issues described above, management would be in a position to provide a summary report in the Management Review section of the annual report on the enterprise's specific circumstances in relation to environmental issues. Information prepared in compliance with reporting obligations for green accounts under the Green Accounts Act (see above) may provide a workable basis for environmental disclosures required under the new Act, although there are two important differences which may restrict the degree of overlap. Firstly, reporting under the Green Accounts Act is at site level, whereas reporting in the management review section of the annual report is at enterprise level, i.e., for the enterprise or group of enterprises as a whole. Secondly, in relation to the concept of materiality, issues considered to have a material environmental impact for the

purposes of the green accounts are based on a technical environmental review, whereas environmental issues in the management review are assessed for materiality from the perspective of having to provide a true and fair view of the enterprise's operations and state of affairs. Thus, in theory, enterprises that are required to prepare green accounts could omit to report on environmental issues in the management review section of the annual report on the grounds that environmental impacts are not material for the purposes of presenting a true and fair view.

***France*:** There are no specific French regulations concerning the preparation of environment reports. However, under Government Decree no. 2002-221 revising Article no. 148-1 2002 (February 2002), all French listed companies issuing statutory annual reports are required, from 2003 onwards, to publish in the statutory annual report a review of their social and environmental activities (PriceWaterhouseCoopers, 2003)[e]. *Article 1* of the decree covers social and employment matters and contains a list of items that are required to be disclosed including: the number of full-time and part-time workers; the number of new recruits and lay-offs; information concerning employee reduction programmes and employment safeguarding programmes; efforts to find new employment for workers laid-off; equality in employment between men and women; and, the employment of and integration of handicapped workers. *Article 2* deals with environmental issues and requires all companies to report on the environmental consequences of their business activities relative to the effects of and nature of the industry in which it operates, including the following specific information:

- water, raw material and energy consumption, together with measures taken to improve energy efficiency and the use of renewable energies, soil utilisation conditions, air, water, and soil emissions with damaging effects on the environment;
- measures taken to limit impacts on biological stability, natural environments, protected species of animals and wildlife;
- steps taken towards environmental evaluations and certification;
- measures taken to ensure compliance with environmental regulations and legislation;
- company expenditures on environmental impact prevention;
- internal environmental management services, resources devoted to the reduction of environmental risks, internal organization for the management of environmentally-damaging accidents, such as pollution, the consequences of which may extend outside the company;
- the amount of environmental risk provisions and guarantees set aside (except in the case where this information may prejudice the company in a current dispute or lawsuit); and,
- the amount of compensation paid during the financial year arising from judicial decisions in relation to environmental matters and actions carried out for the repair of damages resulting therefrom.

Under *Article 3* of the decree, responsibility for its implementing is vested in various government ministries, including the Ministry of Economy, Finance and Industry, the Ministry of Employment and Solidarity, the Ministry of Justice and the Ministry of Regional Planning and Environment, according to their respective areas of responsibility.

***the Netherlands*:** Dutch companies are governed by laws which require some firms to produce an environment report. There are no specific environmental rules in relation to the annual report and accounts although the Dutch accountancy profession has recently issued guidance on social and environmental matters. In relation to stand-alone environment reports, a Dutch regulation was introduced in 1997 as an amendment to the *Environmental*

Management Act, 1993. Effective from 1 January 1999, the regulation imposes new statutory reporting requirements on Dutch companies judged to have serious adverse effects on the environment (see, for example, Drieënhuizen, 2001a). The centrepiece of the new legislation is a system of voluntary agreements, known as covenants, which the Dutch government has negotiated in consultation with companies to achieve its long term social policy objectives in relation to pollution control and environmental clean-up based on the *Nationaal Milieubeleidsplan* (National Environmental Policy Plan) (NMP, 1989) under which companies are held responsible for reducing the impact of their activities on the environment (Drieënhuizen, 2001a). However, rather than being directed at all companies, the regulation is restricted to industrial sectors which are considered to impose a heavy environmental burden, including base metals, chemicals, food industry, petroleum and coal processing, power generation, airports, textiles and waste incineration facilities. The regulation does not apply to all companies in these sectors, but only those larger companies which are considered to account for the greater proportion of polluting emissions or which account for a major proportion of the environmental burden and, for such companies, only to establishments (i.e. operating sites) which are considered to have serious adverse environmental impacts. Thus, the regulation applies to production units (operating sites) only and not companies' activities as a whole. Consequently, whether a company is caught by the legislation is determined by the activities at specific industrial sites, not on the basis of a company's overall activities. As a result, the regulation applies to approximately 260 production sites. This compares to estimates of the number of potentially contaminated sites in the Netherlands as being over 100,000, with the cost of remediation estimated to be in the region of $45 billion (Windeyer, 1992). In addition, the status of each of the 260 sites may change and fall outside the scope of the regulation where environmental performance is dramatically improved or where the nature and scale of the production processes is significantly altered (EAAR, 1996).

Companies caught by the new regulation are prompted to publish annually two types of environment report, each for a specific audience: (i) a report to the governmental authorities (copies of which are available to interested parties on request); and, (ii) a report to the general public, the latter to be released in accordance with certain procedures. The reports submitted to the governmental authorities ('government reports') must meet certain requirements in relation to content and quality to enable the authorities to ensure that the company has complied with all relevant legislation, monitor the implementation of the *National Environmental Policy Plan* and meet its international reporting obligations. As a result, the requirements are quite detailed and include the provision of information on emissions of quantities of ozone-depleting gases, sulphur dioxide (SO_2), nitrogen oxide (NO_X) emissions, information on soil pollution, soil clean-up and the company's policies on environmental control. Government reports are verified by the Government's own authorities in accordance with their own practices and procedures.

The rules governing the content of reports released to the general public ('public reports') are much less detailed and it is largely left to the market in terms of what companies themselves decide to disclose. As a minimum, the law requires that the public report shall be formulated concisely and in a manner that is intelligible to the general public. The public report is intended to inform all stakeholders including local residents, employees, business partners and organizations within the community. It must also contain an overall description for the reporting year of:

- the nature of and the activities and processes at the business establishment, i.e. production unit;
- the adverse effects on the environment caused by the production unit, including a summary of relevant quantitative data;

- the technical, organizational and administrative measures taken and facilities installed by the company at the production unit to protect the environment; and,
- major changes during the reporting year and developments that are expected to occur in the following reporting year.

Although not a requirement, there is an assumption that the public report will include information on environmental management systems and policies, prevailing laws and regulations and the site's environmental performance. However, there is no requirement for companies to provide information on the environmental performance of individual products, or of environmental impacts upstream or downstream, i.e. the environmental impacts of products and materials acquired from the company's suppliers and business partners or from the use or re-use of the company's products, respectively. The *Environmental Management Act 1993* includes a provision for the independent verification of public reports. However, this provision was not brought into force at the time the new regulations were introduced. Since then, the Dutch Ministerie van Volksgezondheid, Ruimtelijke Ordening en Milieu (VROM - Dutch Ministry of Housing, Spatial Planning and Environment) has announced that a provision for the independent verification of public reports is to be introduced at a later date, although no official indication has been given of when this might be. Currently, a number of private sector organizations are voluntarily engaged by Dutch companies to provide verification statements in relation to corporate environment reports, including accountancy firms. Guidelines on the implementation of the public report have been released by the private sector under a co-operation between the Dutch employers' organization (VNO-NCW) and Stichting Natuur Milieu (Foundation for Nature and the Environment). Drieënhuizen (2001b) estimates that the number of Dutch corporate environment reports for 1999, the year for which the new environmental reporting requirements first came into effect, was around 300 of which 260 were legally required and the rest voluntary. Of these 300, approximately 10 per cent include a verification statement by independent experts.

In relation to the statutory annual report and accounts, the Dutch annual reporting guidelines were revised in 2003 by the insertion of sections 400.117-123 which recommend (i.e. as best practice) that the directors' report of the annual accounts of all limited companies include a review of environmental, social and ethical matters[f]. The guidelines recommend the inclusion of the following information in the directors' report:

- *general aspects*: including major challenges for the company which determine its strategy, the influence of stakeholders, the interrelation between economic, environmental and social aspects as well as social aspects concerning the company's products and services;
- *environmental aspects*: including environmental pollution controls, use of resources and efforts in the production chain;
- *social aspects*: including labour issues, health and safety, education and training, diversity and development opportunities, human rights issues (e.g. rights of employees, corporate policy in relation to child labour, forced labour and non-discrimination), integrity (i.e. policy in relation to corruption) and aspects of social/community involvement;
- *economic aspects*: financial contributions to society at large (e.g. taxes) and financial contributions to stakeholders (e.g. customers, suppliers, employees, shareholders, money lenders and government).

For each of these aspects, the guidelines recommend that companies pay specific attention to a number of issues, including: dialogue with stakeholders (e.g. corporate policy, major considerations in this area, codes of conduct); management of stakeholder relations (e.g. tasks

and responsibilities, governance structure and management information systems); feedback on performance and results (e.g. reporting on measures implemented and performance achieved including comparison with policy and expectations); and, future developments. In addition, for companies publishing separate 'sustainability' and/or corporate social responsibility reports, the Dutch accountancy profession published separate guidance notes at the end of 2003 which provide companies with guidance on reporting on economic, social and environmental issues.

***Norway*:** Although not a Member State of the EU, Norway was the first European country to establish reporting requirements through the *Enterprise Act, 1989* which introduced an amendment to the *Annual Accounts Act*. This amendment requires the directors' report in the statutory annual report to include information on emission levels, contamination and details of measures planned and performed for cleaning up the environment. However, rather than lead to the disclosure of detailed quantitative information, in practice the amendment was generally interpreted as requiring a simple, brief statement confirming that all relevant legislation has been complied with (Roberts, C., 1992). A further amendment was introduced to the *Annual Accounts Act* in 1994, with a subsequent amendment in 1998, compelling companies that require permits in accordance with the *Environmental Protection Act* to report on these permits, including whether they need to be renewed or if emission limits have been exceeded, in the directors' report of the annual report and accounts. These regulations were tightened in 1998 under the *Regnkapsloven 1998* (*Accounting Act, 1998*) which came into force on 1 January 1999, and which provides stricter rules regarding environmental disclosure in the to the directors' report of the statutory annual report. These requirements apply to all companies irrespective of size. The *Accounting Act, 1998* requires a minimum level of disclosure for a list of specified items in relation to (i) 'the working environment' and (ii) 'the external environment'. Items of disclosure required under item (i) include a general overview of measures having a significant impact on the working environment, together with specific details in relation to, *inter alia*, the rate of absenteeism due to sickness and damages, the latter being distinguished between accidents, injuries to persons and damages to materials. In relation to item (ii), the Act requires extensive information on 'inputs' and 'products' which can have a significant impact on the environment, together with details on these impacts and measures taken or planned to prevent or reduce negative environmental impacts. Items of disclosure under 'inputs' include energy and raw materials consumed, pollutants, including noise and environmental impact due to transport. Disclosure items in relation to 'products' include the type and quantity of dangerous chemicals and waste left after disposal of products, and the impact on the environment resulting from product use.

Norway has no mandatory requirements for separate corporate environment reports although there is a voluntary guideline for environmental reporting, *NS 9440 Miljørapportering – Retningslinjer* (NS 9440 Environmental Reporting – Guidelines) initiated and developed by the Norwegian Standards Association (NSF, 2000). The standard, which applies to *virksomhet* (operations, enterprises, business, etc.) and covers all types of organization including sites as well as companies, irrespective of size and activity, provides instructions on how to produce periodic environment reports. The latter includes a description of the organization's operations, processes and environmental performance and covers environmental issues such as emissions, waste and noise. Independent audit of such reports under NS 9440 is optional but the standard requires that verification/attestation results be presented or a statement be provided that no verification has been performed. NS 9440 does not appear to be in the nature of a total quality management (TQM) standard for internal purposes, such as the International Standards Organization's ISO 14001, but is directed more towards assisting Norwegian companies in reporting to the general public in the context of

sustainable development. There is also a recommendation under the *Accounting Act 1998* that additional details be provided in an environment report if such a report is relevant having regard to the nature of the company's operations.

***Spain*:** In Spain, corporate environmental reporting via stand-alone environment reports is an entirely voluntary practice. Similarly, for companies quoted on the Spanish stock market, the Spanish Securities and Exchange Commission (Comisión Nacional del Mercado de Valores) does not require any environmental disclosure (Moneva and Llena, 2000). However, recent changes to Spanish company law require specific reporting in the annual report and accounts on environmental matters. The *Plan General de Contabilidad* (PGC), which provides general accounting rules under Spanish law, was amended with effect from 1998 to require certain environmental disclosures in the notes to the financial statements of all Spanish companies (Larrinaga, 1999; Larrinaga *et al*., 2001; Woodward *et al*., 2003). This requirement was introduced under Royal Decree 437/1998 which provided a catch-all application of disclosure requirements contained in an *adapted PGC* (i.e. modified to reflect the individual characteristics of a particular industry) issued for the specific features of the electricity utility industry. As a result of the Royal Decree, under what is known as *Environmental Disclosure Standard 437/98*, with effect from 1998 all Spanish companies had to disclose detailed environmental information in the notes to the statutory annual accounts (for details, see Larrinaga *et al*., 2001). However, with effect from 4 April 2002, a new Spanish accounting standard, *Resolución de 25 de marzo de 2002, B. O. E. no. 81,de 22-3-2002*, was adopted on the 'Recognition, Assessment and Reporting of Environmental Aspects in the Annual Accounts' of Spanish companies. This new standard is of general application and effectively relegates Royal Decree 437/1998 to the status of a specific standard for the electricity industry. The new standard represents an attempt to bring Spain more into line with current EU thinking as set out in the European Commission's 2001 Green Paper *Promoting a European Framework for Corporate Social Responsibility*. The standard provides a definition in relation to a company's 'environmental responsibilities' as well as defining what is meant by 'environmental activity' and covers the following areas of accounting:

- environmental expenses, environmental assets, environmental liabilities and contingent liabilities;
- compensation due from third parties;
- long term obligations in relation to environmental remediation; and
- other information to be provided in the notes to the accounts.

***Sweden*:** Sweden, like Denmark, has regulations governing both the annual accounts and stand-alone environment reports. Although there are no laws requiring stand-alone environment reports at a corporate level, under an amendment introduced in 1989 to the Swedish *Environmental Protection Act 1969*, all operations (i.e. production sites, factories, etc.) that require special permits because of environmental hazards must submit an annual environment report to the authorities (usually the municipal or county environmental protection office). These reports are site-based and must provide details, *inter alia*, of emissions to the environment and of environmental activities undertaken during the year (Ljungdahl, 1997). However, although officially available to the public on request, these reports are difficult to access due to their voluminous nature and the high level of technical knowledge that is required to understand them. As such, the primary target group for these reports is the technical experts at the local environmental authority who monitor the production sites' compliance with the law and with the permits that have been granted. The types of operations requiring special permits are listed in an appendix to the *Environmental Protection Act (as amended)*. In practice, this includes mainly large production units in

environmentally sensitive industries such as mining and metallurgy, certain manufacturing processes, notably chemicals and paper and pulp industries.

In relation to the annual report and accounts, an Accounting Committee was established by the Swedish government in the early 1990s to consider various changes to Swedish accounting legislation including environmental reporting issues (Ljungdahl, 1997). In its final report, published in November 1996, the Committee recommended, *inter alia*, an amendment to the Swedish Accounting Act requiring the company's directors to include information in the directors' report in relation to the effects on the environment of the company's business activities. According to Ljungdahl (1997), these proposed changes were modest and broad, reflecting the Accounting Committee's decision-usefulness approach to accounting information under which information, including environmental information, included in the annual report should be relevant to the needs of investors and creditors in making economic decisions. Consequently, the Committee avoided any consideration of the requirement to disclose environmental information that might be useful to other stakeholders from an accountability or decision-usefulness perspective. The Committee's recommendations were introduced into law in 1997 as an amendment to the Annual Accounts Act 1995 (*Arsredovisningslagen*) (revised to comply with the EU Accounting Directives), in the form of a proposal from the Government to the Swedish Parliament (No. 1996/97:167, entitled *Miljoredovisning och miljoinformation i naringslivet* (roughly translated as "Environmental reporting and information in the business sector") and applying to all annual reports with effect from 1999. The amendment to the 1995 Act requires companies to provide certain additional information in the directors' report of the statutory annual report on the environmental impact of a company's business operations. However, in deference to the Accounting Committee's recommendations, the amendment is restricted to companies whose business activities are considered as posing major threats to the environment as set out in the *Environmental Protection Act*. Companies that require special permits in accordance with this Act are already required to submit an annual environment report to the relevant authorities (see above). The additional disclosure requirements include whether the permits need to be renewed or if emission limits have been exceeded, together with a description of the environmental impacts and an indication of the company's dependence on the environmentally impacting/regulated business, preferably as a quantitative measure. These requirements apply to approximately 25,000 sites, although it is unclear how many actual companies are involved as a company can own more than one site. However, they apply only to environmental impacts resulting from the company's manufacturing processes and do not extent to environmental impacts resulting either from the use or re-use of a company's products (i.e. 'downstream' environmental impacts) or the environmental impacts of products and materials acquired from the company's suppliers and business partners (i.e. 'upstream' environmental impacts) (Ljungdahl, 1997). This restriction is in deference to the *Environmental Protection Act*, *1969 (as amended)* which is nationally based and somewhat outdated in its interpretation of environmental impacts (for example, in ignoring product impacts). The reporting requirements apply to operations in Sweden carried out by Swedish companies. However, they also apply to foreign companies operating in Sweden through a Swedish subsidiary at one of the 25,000 sites where the company is (i) required to compile an annual report (this applies to all joint stock companies registered in Sweden) and (ii) seeks an environmental permit (or is required to notify the authorities about changes in the operations, e.g. increased production volume) for the site.

***UK*:** There are no requirements for UK companies to publish separate environmental reports. However, there are two particular pieces of UK legislation which will impact on what businesses, particularly, large businesses, choose to report on in relation to environmental

issues in the statutory annual report, namely, *The Combined Code* and *The Company Law Review*. The Combined Code forms part of the UK's Financial Services Authority's (FSA) listing requirements for companies whose shares are traded on the stock market. Under the combined code, listed companies are required: (i) to report that the company has a risk programme, including controls, in place; (ii) to review these controls annually; and (iii) to report on how the company's directors responded to any weaknesses identified. Environmental risks fall within the range of risks which confront a business and thus there is an expectation that businesses, particularly those with considerable direct environmental impacts, will address these issues in their statutory annual report. In July 2001, under the Company Law Review, the UK's independent *Company Law Review Steering Group* produced its final report into the first fundamental review of UK company law for over 40 years following an extensive period of consultation (see DTI, 1999, 2000, 2001). The Steering Group's recommendations aim to simplify and modernise UK company law for all UK companies and will lead to a new Companies Act.

The area of proposed change which will have a direct impact on corporate environmental reporting is the Group's recommendation that all 'economically significant' companies be required to produce a Statutory Operating and Financial Review (OFR) which addresses a range of non-financial issues, including social and environmental matters. The recommendation states, "… where the directors consider them to be material to achieving the objectives of the Statutory Operating and Financial Review, that policies and performance in relation to environmental, community, social, ethical and reputational issues, including compliance with relevant laws and regulations, be disclosed in accordance with details to be developed by the UK's Accounting Standards Board (ASB)" (for a review, see, for example, KPMG, 2001a, b). The content of the OFR is proposed to be determined on the basis of what is material to the company, not what is material to society. The latter recommendation has generated considerable confusion since it appears that companies which have significant negative environmental impacts but which have no environmental policies would not be required to report on their environmental impacts in the OFR (Kelly, 2003). These matters may become clear during the legislative process, the UK government having pledged to introduce the Companies Act legislation as soon as practicable. In overall terms, however, the British Government has demonstrably moved away from a 'pluralist approach', under which company directors would have had legal duties of accountability to a wider range of shareholders than just shareholders (see DTI, 1999), to an 'inclusive approach', the latter merely requiring that directors have regard to all the relationships on which the company depends and the implications of their actions "... with a view to achieving company success for the benefit of *shareholders as a whole*" (DTI, 2000, viii, emphasis added).

In relation to stand-alone corporate environment reports, although there are currently no mandatory reporting requirements for UK companies, the British Government is encouraging more and better environmental disclosure by UK companies as part of its voluntary, market-led approach to sustainable development. The Department for Environment, Food and Rural Affairs (DEFRA), in association with the Department of Trade and Industry (DTI), published a set of voluntary environmental reporting guidelines in November 2001 (DEFRA, 2001). These guidelines are intended to provide a framework for assisting UK companies in reporting on key environmental impacts and the environmental issues relevant to them. The guidelines also contain guidance on the form and content of environment reports, including environmental performance indicators, and the verification of such reports by third parties. The guidelines are intended for reporting of environmental issues by all types of organization, large or small, industrial, commercial, or public sector and suggest various forms of reporting including a separate environmental section in the annual report and accounts and stand-alone

environment reports. The guidelines provide specific guidance on particular categories of environmental impact, such as greenhouse gases, ozone depleting gases, resource use, transport, energy, water pollutants, hazardous waste and noise pollution. However, the guidelines are prepared from the perspective of the company's management in the context of 'efficient environmental management' (DEFRA, 2001 p. 15), as with EMAS and ISO 14001. As such, the level of *additional* accountability which results from these guidelines is unlikely to pose a seriously challenge to business conceptions of accountability and sustainability.

In contrast to Europe, there has been little in the way of regulatory developments for stand-alone corporate environment reports in other parts of the developed world, although a number of regulatory and non-regulatory provisions are beginning to emerge:

North America: There are no requirements for US companies to publish separate environmental reports. However, companies with more than ten full-time employees are required to submit data on their emissions of 307 different toxic chemicals to the US Environmental Protection Agency's under the Agency's *Toxic Release Inventory* (TRI), such information once filed being publicly available. However, these companies are not required to produce systematic corporate level or site-level level reports. The most stringent requirements for US-listed companies are those of the Securities and Exchange Commission (SEC) (these are described in Chapter 2, Section 2.4 of the main text). In *Canada*, the Securities Commission requires listed companies to provide details of current and future financial or operational effects arising from compliance with environmental protection requirements in the Annual Information Form (AIF).

Japan: There are no specific accounting or company law requirements in relation to environmental issues for the annual report and accounts (for a recent review of corporate environmental reporting by Japanese companies, see, for example, Elkington *et al*., 1998). The absence of consistent, publicly available environmental data means that corporate environment reports are the primary source of information for assessing a company's environmental performance[g]. However, The Ministry of the Environment, Government of Japan (2001a, b) issued formal guidelines in 2001 in relation to environmental reporting by Japanese companies[h]. The guidelines consist of three sets of guidelines: (i) *Environmental Reporting Guidelines*[i]; (ii) *Environmental Accounting Guidelines*; and (iii) *Environmental Performance Indicators Guidelines*. The *Environmental Reporting Guidelines* are suggested to be used in preparing stand-alone environment reports, whereas the *Environmental Accounting Guidelines* refer to a mechanism for presenting a company's environmental activities on a quantitative basis, showing both environmental costs (in monetary terms) and the effects of environmental protection measures (in physical term), comparatively. The *Environmental Performance Indicators Guidelines* deal with information on environmental 'burdens' for presentation in an environment report. Both the *Environmental Reporting Guidelines* and the *Environmental Accounting Guidelines* were revised in March 2002 to include information on the latter in a stand-alone environment report.

The guidelines, as the name suggests, do not carry the force of law and there is no real political pressure on Japanese companies to follow them. Moreover, there are no plans at present to make the guidelines a legal requirement on listed Japanese companies. The guidelines make no recommendations on whether companies should report at site, regional or global level, or as to whether the environment report should be subject to an external audit, although this issue is to be addressed in a future review. The Japanese Government's decision to pursue a voluntary rather than a regulatory approach to environmental reporting is influenced by a number of cultural and social factors. Notably, there is no social pressure for

such reporting regulations, Japanese companies enjoying a generally favourable reputation in voluntary environmental management, pollution prevention and energy efficiency since the 1970s as evidenced by the high number of ISO 14001-registered companies (Japan has the highest number in the world, at 7,155 companies; Germany is the next best with 2,500 companies). Moreover, although the guidelines are not binding on Japanese companies, a close working relationship exists between big Japanese companies and the Japanese government such that, informally, the guidelines carry significant weight in the business world. In addition, Japan is a culture where 'keeping up appearances' is important, so once one innovative company sets an example other companies in the same industry are normally quick to follow. These socio-political factors mean that, in practice, the Japanese government sees little need to regulate corporate environmental reporting. Approximately 350 listed Japanese companies (out of approximately 1,800, i.e. around 20%) currently issue separate stand-alone environment reports on a voluntary basis (ACCA, 2000).

Australasia: In *Australia*, there are over 200 federal, state and territory laws relating to the environment, environmental regulation being principally the domain of state (as opposed to) federal legislators (Gibson and O'Donovan, 2000). Although the Australian government passed the Commonwealth Environmental Protection Act in 1994, there is still no national uniform environmental regulation applicable to listed companies, notwithstanding a plethora of voluntary reporting guidelines (for cases in point, see, for example, Frost, 2001) and professional guidance from the accountancy profession on accounting for the restoration and rehabilitation of abandoned mining sites (AASB, 1989; AASB UIG 4, 1995). However, following changes to Australian corporate law as part of the federal government's Corporate Law Economic Reform Programme, Section 299(1)(f) of the *Corporations Act* requires that with effect from 1 July 1998 Australian companies must include in the directors' report of companies whose "… operations are subject to any particular and significant [Australian] environmental regulation under the law of the Commonwealth or of a State or Territory …" details of the entity's performance in relation to any such regulation (see, for example, Frost, 2001; Gibson and O'Donovan, 2000). However, just what this means in practice appears to be unclear (Watts, 2000). The requirement for environmental reporting seems to have slipped through the due legal process more by accident than by design, being a last minute compromise between political parties over which the Australian Government was never completely comfortable (Frost and English, 2001) Due to the provision's ambiguity, it was referred to the Australian Parliamentary Joint Committee on Corporations and Securities which recommended that section 299(1)(f) be deleted (Frost, 2001). The legislation is currently under review and was expected to be repealed in view of the comments from the Australian Securities and Investments Commission (ASIC), which appeared to expect difficulties to emerge as companies began to comply with the new provisions (Gibson and O'Donovan, 2000), and opposition from Australian industry (Frost, 2001). However, despite a process to have it removed, Section 299(1)(f) remains in force for the immediate future. Frost (2001), in an exploratory investigation of Section 299(1)(f) in effecting change in corporate environmental reporting behaviour, reports a significant increase in the number of Australian companies reporting on, and the level of information provided in relation to, environmental performance, suggesting that a voluntary approach to corporate environmental reporting may be inadequate. In *New Zealand*, some initial efforts were made at making environmental reporting mandatory in terms of stand-alone reporting but were defeated amidst political turmoil.

Notes

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b. Law no. 403/1995 and Statutory Order from the Danish Ministry of Environment and Energy No. 975/1995 of December 13, 1995, on the duty of certain listed activities to draw up Green Accounts, inserted as section 35A of the Danish Environmental Protection Act of 1994.

c. These details are provided on the web site of the Danish Environmental Protection Agency at http://www.mst.dk/homepage.

d. Specifically, other enterprises than those of reporting class D that exceed two of the following limits in two consecutive years: Revenue > DKK 40 million; Balance sheet total > DKK 20 million; number of employees > 50.

e. Full details relating to the French decree can be found at www.environnement.gouv.fr. For an overview, see, for example, ACCA (2003b).

f. A draft revision to the Dutch annual reporting guidelines was published in 2002. A final version was released in 2003 which will be effective for reporting years from 2004. Although not mandatory, these recommendations represent best practice and would be taken into account by a Dutch court of law when considering whether a company's annual accounts complied with company law.

g. According to a recent study (Metrick, 2001), Japanese firms voluntarily report environmental policies, achievements and costs but do not provide hard data on emissions, energy use and water use consistently.

h. The English language web site for the Japanese Ministry of the Environment gives access to the environmental reporting guidelines at www.env.go.jp/en/index.html.

i. The *Environmental Reporting Guidelines* (Ministry of the Environment, Government of Japan, 2001a) is a lengthy document of some 60 pages providing detailed and comprehensive guidance on environmental reporting structured into four chapters: *Why environmental reporting*; *Desirable Environmental Reporting*; *What should be included in Environmental Reporting*; and, *Towards Continuing Improvement of the Guidelines*. The guidelines were drafted by a committee of 12 individuals (p. 6) which includes a strong representation from the accountancy profession, business and academia.

Definition of corporate environmental disclosure (CED)

Key decisions rules:

- *Corporate environmental disclosure (CED) = Environment + Energy + Health & Safety*
- *Nine subcategories of CED:*

(1) *Environmental policy (NB: The word policy is to be interpreted quite widely and is not restricted to sentences which contain the word "policy"):*

- actual statements of policy, statements of formal intentions, commitments and targets;
- reference to compliance with statutory or regulatory provisions;
- general statements of "the company will, the company does" nature;
- mission statements, targets and company strategies in relation to environmental protection and improvement such as contained in chief executive's forewords to environment reports;
- reference to compliance with voluntary codes of best practice, industry codes, charters, voluntary schemes and initiatives, etc. (such as the chemical industry's *Responsible Care Programme* and the *Montreal Protocol* on CFCs).

(2) *Environmental management, systems and audit:*

- environmental management systems (including references to total quality management (TQM), ISO 14000 series, EMAS Regulation, BS7750, etc.);
- environmental management programmes, tools and initiatives including performance indices and emissions monitoring systems;
- reference to management responsibility;
- management and control systems for pollution prevention, reduction and environmental improvements in relation to air emissions, water effluents, noise, odours, etc.;
- reference to environmental review, scoping, plant audits, assessments including independent attestation;
- environmental verification statements and environmental audit reports by external verifiers, auditors, etc.;
- staff training in environmental management;
- inclusion of environmental aspects in management decision-making.

(3) *Environment – product and process-related:*

- waste(s), recycling, packaging;
- land contamination and reclamation;
- material use (including water consumption);
- product impact assessments;
- product stewardship - concern for the entire life cycle of a product from the extraction of raw materials to eventual waste disposal and/or recycling ('cradle to grave' analysis);
- product and process-related - pollution emissions, water effluents, waste, consumption of raw materials, consumption of energy, consumption of water, air emissions, noise, odours, etc.;

- product and product development including life cycle design, upstream and downstream product/process research programmes and initiatives, analysis and development;
- input/output analysis (including eco-balances, eco-profiles, mass balances, inflow/outflow analysis, etc. in quantified, non-monetary terms);
- environmental incidents and accidents related to products and processes.

Except in so far as it is part of the business (e.g. waste disposal, environmental technology)

(4) *Environmental financially – related data:*

- environmental costs charged to the profit and loss account for environmental expenditure, additional environmental expenditure arising from changes in legislation, assessments as to future environmental expenditure, etc.;
- accounting policies in relation to environmental costs and expenditures (including recognition of expenditures creating assets);
- capital expenditure and future commitments;
- environmental spending;
- environmental liabilities and contingent liabilities;
- reference to financial/economic impact;
- eco-instruments and eco-taxes;
- environmental cost accounting (not full cost accounting – see 'sustainability' below);
- discussion of financial benefits and opportunities ('eco-efficiency');
- investment and investment appraisal;
- financially-quantified inflow/outflow analysis, eco-balances, etc.;
- discussion of environment-economic interaction;
- banks – finance/funding of public and private environmental projects, environmental protection, including quality of life, water, urban waste, recycling, etc.;

(5) *Environmental stakeholder relations:*

- any reference to stakeholder relations, including concepts such as 'stakeholder dialogue', 'the stakeholder society', consultation with stakeholders, or dialogue with stakeholders or the outside world in the context of environmental issues;
- contact addressed on health, safety and environmental (HS&E) matters, reply forms for more information on HS&E matters, etc.;
- references to stakeholder groups in relation to environmental issues including: legislators and regulators (e.g. the European Commission); national governments, government departments and agencies; employees and their representatives; equity investors; non-equity investors including banks and other lending institutions; insurers and other business advisers; local communities; consumers and customers; suppliers; non-governmental organizations (NGOs) (e.g. pressure groups); educational establishments including schools, colleges and universities; the media, including newspapers, television, journalists, etc.; the 'silent stakeholders', including future generations, the unborn, the bio-sphere and all other forms of non-human life.

Except in relation to health and safety issues or sustainability – see below

(6) *Sustainability:*

- any mention of sustainable development or sustainability, the Rio Summit, Agenda 21, the Brundtland Report, etc.;
- any reference to future generations, inter- and intra-generational equity, social (eco)-justice, etc.;
- any mention of plans or attempts to develop systems of accounting for sustainable development, sustainability, full cost accounting, full price accounting, or similar initiatives.

(7) *Environment – other:*

- landscaping and habitats, public amenity provision;
- references to published environment reports;
- environment education and publicity;
- references to environmental reporting awards, internal prizes and award schemes;
- other' pages of environment reports, including cover pages, contents pages and index pages, production/plant site contacts and addresses, blank parts/sections/pages devoted to health and safety matters;
- definitions and abbreviations.

(8) *Energy:*

- energy saving and conservation;
- use/depletion/exploration of new sources; efficiency; insulation, etc.;
- actual statements of energy policy;
- statement of formal intentions, commitments and targets;
- utilisation of waste materials for energy production;
- reference to compliance with statutory or regulatory provisions;
- energy management systems;
- energy (efficiency) audits.

Except in so far as it is part of the business (e.g. oil exploration companies) [1]

(9) *Health and Safety:*

- actual statements of employee health and safety policy;
- statement of formal intentions, commitments and targets;
- reference to compliance with statutory or regulatory provisions;
- health and safety at work;
- toxic hazards (e.g.) to employees and the public;
- any reference to health and safety law;
- information to employees on health and safety matters;
- days lost through illness, stress, industrial injury, etc.;
- health and safety issues in relation to the transport of hazardous substances;
- health and safety management systems;
- health and safety studies and audits;
- employee training in relation to health and safety;
- health and safety incidents and accidents.

Appendix 3

Sample of companies by country and industry sector

Geographical region/Industry sector	Chemicals	Extractive	Mechanical engineering & metallurgy	Energy utilities	Total ES	Banking & insurance	Consumer goods	Trav tourism transp servic
Benelux	5	4	7	4	20	5	6	5
Germany	6	6	7	6	25	8	10	2
Total A primary sample	**11**	**10**	**14**	**10**	**45**	**13**	**16**	**7**
Nordic	5	5	7	3	20	5	5	5
Switzerland	2	6	9	3	20	7	7	2
UK	6	7	5	7	25	6	6	6
Total B	13	18	21	13	65	18	18	13
Totals (A + B)	24	28	35	23	110	31	34	20

Source: *The Times 1000 1997*. Where: ES = Environmentally-sensitive sectors (chemicals; extractive; mechanical engi
and LES = Less Environmentally-sensitive sectors (banking and insurance; consumer goods; travel, tourism and transp

Appendix 4

Benelux and German companies by country and industry sector

Company name[a]	*Industry code*	*Industry Sector*	*No. of reports*	*AR*	*SR*	*ER*	*RY*
Benelux (40 companies)[b]							
ABN AMRO (NL)	5	Banking and Insurance	7	7	-	-	-
Aegon Insurance Group (NL)	5	Banking and Insurance	9	7[c]	-	-	-
Ahold [Koninklijke] (NL)	8	Retail and Leisure	7	7	-	-	-
Akzo Nobel (NL)	1	Chemicals	18	7[d]	-	3	7
Arbed (LUX)	3	Mechanical Eng. & Metall.	7	7	-	-	-
Bekaert (B)	3	Mechanical Eng. & Metall.	11	7	-	-	-
Bols Wessanen [Kon.] (NL)	6	Consumer Goods	7	7	-	-	-
CBR Groupe (B)	2	Extractive	7	7	-	-	-
CMB (B)	7	Travel, Transport & Tour.	7	7	-	-	-
Cockerill Sambre [Groupe] (B)	3	Mechanical Eng. & Metall.	8	7	-	-	-
Delhaize (B)	8	Retail and Leisure	7	7	-	-	-
DSM (NL)	1	Chemicals	12	7	2	2	-
Electrabel (B)	4	Energy Utilities	14	7	6	1	-
European Investment Bank (LUX)	5	Banking and Insurance	15	7	-	-	7
Generale de Banque (B)	5	Banking and Insurance	7	7	-	-	-
Generale de Belgique [Sté] (B)	3	Mechanical Eng. & Metall.	7	7	-	-	-
GIB Group (B)	8	Retail and Leisure	7	7	-	-	-
Gist-Brocades (NL)	6	Consumer Goods	7	7	-	-	-
Glaverbel (B)	3	Mechanical Eng. & Metall.	7	7	-	-	-
Hagemeyer (NL)	6	Consumer Goods	7	7	-	-	-
Heineken (NL)	6	Consumer Goods	15	7	-	1	7
Hoogovens [Koninklijke] (NL)	3	Mechanical Eng. & Metall.	7	7	-	-	-
D'Ieteren (B)	8	Retail and Leisure	7	7[e]	-	-	-
ING Group (NL)	5	Banking and Insurance	15	7[f]	7	1	-
KLM (NK)	7	Travel, Transport & Tour.	7	7	-	-	-
Minorco (LUX)	2	Extractive	8	7	-	-	-

Nederlandse Gasunie (NL)	4	Energy Utilities	8	7	-	-	-
Nedlloyd [Koninklijke] (NL)	7	Travel, Transport & Tour.	7	7	-	-	-
Ned. Spoorwegen (NL)	7	Travel, Transport & Tour.	11	7	-	-	4
Pakhoed [Koninklijke] (NL)	7	Travel, Transport & Tour.	14	7	7	-	-
Petrofina (B)	2	Extractive	8	7	-	1	-
Royal Dutch/Shell (NL)	2	Extractive	23	7	-	-	7
Sara Lee/DE (NL)	6	Consumer Goods	7	7	-	-	-
SEP (NL)[g]	4	Energy Utilities	27	7	-	-	5
Sidmar (B)[h]	3	Mechanical Eng. & Metall.	7	7	-	-	-
Solvay (B)	1	Chemicals	9	7	-	2	-
Tessenderlo [Groupe] (B)	1	Chemicals	7	7	-	-	-
Tractebel (B)	4	Energy Utilities	7	7	-	-	-
UCB (B)	1	Chemicals	9	7	-	-	-
Unilever (NL)	6	Consumer Goods	22	7	-	1	7
Benelux Reports -Total			403	280	22	12	44
Germany (50 companies)							
Allianz	5	Banking and Insurance	8	7	-	1	-
Altana	6	Consumer Goods	7	7	-	-	-
AVA	8	Retail and Leisure	7	7	-	-	-
BASF	1	Chemicals	14	7	-	7	-
Bayernwerk	4	Energy Utilities	9	7	-	-	2
BAYER	1	Chemicals	24	7	-	1	7
Bayerische Hypotheke-und Wechsel-Bank	5	Banking and Insurance	15	7	-	1	7
Bayerische Landesbank Girozentrale	5	Banking and Insurance	9	7	-	2	-
Bayerische Vereinsbank	5	Banking and Insurance	8	7	-	1	-
Beiersdorf	6	Consumer Goods	8	7	-	1	-
BEWAG	4	Energy Utilities	21	7	7	-	7
BMW	3	Mechanical Eng. & Metall.	16	7	-	-	7
Brau und Brunnen	6	Consumer Goods	7	7[i]	-	-	-
Commerzbank	5	Banking and Insurance	14	7	-	-	7

Appendix 4

Daimler-Benz	3	Mechanical Eng. & Metall.	8	7	-	1	-
Deutsche Bank	5	Banking and Insurance	14	7	-	1	3
Douglas Holding	6	Consumer Goods	7	7[j]	-	-	-
Dresdner Bank	5	Banking and Insurance	11	7	-	-	3
Dyckerhoff	2	Extractive	9	7[k]	2	-	-
Fresenius	6	Consumer Goods	7	7	-	-	-
Goldschmidt [Th.]	1	Chemicals	10	7[l]	-	2	-
Hapag-Lloyd	7	Travel, Transport & Tour.	11	7	-	-	4
Heidelberger Zement	2	Extractive	8	7[m]	-	-	-
Henkel KgaA	6	Consumer Goods	26	7	-	4	7
Herlitz	8	Retail and Leisure	9	7[n]	-	1	-
Hoechst	1	Chemicals	19	7	-	5	7
Hornbach Holding	2	Extractive	10	7	-	-	3
ISAR-Amperwerke	4	Energy Utilities	11	7	1	-	3
Karstadt	8	Retail and Leisure	14	7	-	-	7
Lufthansa	7	Travel, Transport & Tour.	9	7	-	1	-
Mannesmann	3	Mechanical Eng. & Metall.	16	7	6	-	2
Merck	1	Chemicals	12	7	2	2	-
Münchener Rück (Munich Re)	5	Banking and Insurance	10	7	2	-	-
Otto Versand	8	Retail and Leisure	10	7	-	1	-
Preussag	3	Mechanical Eng. & Metall.	7	7	-	-	-
Ruhrgas	2	Extractive	7	7	-	-	-
RAG (Ruhrkohle AG)	2	Extractive	14	7	7	-	-
RWE	4	Energy Utilities	12	7	-	-	-
Saarbergwerke	2	Extractive	14	7	7	-	-
Schering	6	Consumer Goods	31	7	7	1	6
Spar Handels	8	Retail and Leisure	7	7	-	-	-
Sudzucker	6	Consumer Goods	7	7	-	-	-
Thyssen	3	Mechanical Eng. & Metall.	16	7	-	1	3
VEBA	4	Energy Utilities	15	7	-	-	-
VEW	4	Energy Utilities	8	7	-	-	-
VIAG	3	Mechanical Eng. & Metall.	7	7	-	-	-
Villeroy & Boch	6	Consumer Goods	12	7	-	-	5
Volkswagen	3	Mechanical Eng. & Metall.	28	7	-	1	3
Wacker-Chemie	1	Chemicals	17	7	7	3	-

Wella	6	Consumer Goods	8	7	-	-	-
German Reports Totals			608	350	48	38	93
All Reports Totals			**1,011**	**630**	**70**	**50**	**137**

Notes

a. The companies listed here were selected from *The Times 1000 1997* (Barrow, 1996) list of top European companies, ranked
of these companies have changed their name or been taken over by or merged with other companies. Rathethan track such cl
as presented when originally selected. Companies shown in bold text represent those which responded positively to a questi
LUX = Luxembourg; NL = Netherlands; AR = Annual Reports and Accounts; SR = Social Report; ER = Environment re
Review of the Year.

b. The 40 Benelux companies are made up as follows: Belgium (17 companies), Luxembourg (3) and the Netherlands (20).

c. The insert *Facts and Figures*, published with the annual report for all years 1989 to 1995, has been treated as part of the annu

d. Akzo Nobel was formed as a result of the acquisition by Akzo of Nobel Industries in 1993, effective for accounting purp
report of the new group was the 1993 annual report. For the years 1989 to 1992, the annual reports used in the study were tho

e. For the years 1991 to 1995 the annual report of D'Iteren came in the fom of a boxed set comprising the annual report of D'
the patter being a subsidiary of D'Iteren. For the purposes of the study, this boxed set of reports was treated as the annual rep

f. The ING Group was formed as a result of a merger of Nationale Nederlanden (NN) and NMB in 1991. The new group, ret
annual reports in 1989 and 1990, one by NN and the other by NMB. Both sets of annual reports for 1989 and 1990 re include

g. SEP is Sep N.V., the Dutch Electricity Generating Board, a joint body comprised by the four largescale Dutch power-generati

h. Sidmar is a subsidiary of Arbed (see above) for the purposes of the study is treated as a sparate company.

i. Brau und Brunnen produces an abridged English version of the full German) annual report. However, these abridged versio
the present study because they are an English translation of the originals.To qualify as SFSs they must also be available in Ge

j. The annual reports of Douglas Holding for 1992 and 1993 were bilingual, i.e. two languages were used in thesame report,
these reports were thus divided into two halves vertically, with German text on the left and English text on the right, mean
twice. Both texts were included to reflect what was disclosed.

k. Dyckerhoff produces an abridged (English) version of the ful (German) annual report. However, these abridged versions do n

l. Goldschmidt produces an abridged (English) version of the full (German) annual report. However, these abridged versions do

m. Heidelberger Zement produces an abridged (English) version of the full (German) report. However, these abridged versions d

n. The annual reports of Herlitz for 1989 to 1993 were trilingual, i.e. three languages were used in the same report, German, F
presented side by side in newspaper print format. Content analysis was based on all three langauges on the basis that this a
presented in the report.

Industry Sectors

Ref. No.	*Industrial Sector*
1.	***Chemicals****: including Gases, Coal and Oil Products, Paint Manufacturing, Plastics and Detergents
2.	***Extractive****: including Quarrying, Oil and Gas Exploration, Mining, Forestry, Pulp and Paper, Building and Construction Materials
3.	***Mechanical Engineering and metallurgy****: including Machine Tools, Motor Vehicle Manufacturing, Motor Vehicle Components, Metallurgy, Industrial Plant and Materials and Products
4.	***Energy Utilities****: including Energy Production, Energy Distribution
5.	***Banking and Insurance***: including Banks, Life and Non-Life Insurance
6.	***Consumer Goods***: including Pharmaceuticals, Toiletries, Nutritional Products, Health and Beauty Products, Tobacco, Brewers, Distillers, Wine, Food Manufacturing
7.	***Travel, Tourism and Transport Services***: including Hotels, Shipping, Air Transport, Transport, Transport Services
8.	***Retail and leisure***: including Motor Distribution, Food and Drink Retailing, Stores, Food and Drink Wholesaling, General Trading.

Notes: * = classified, *a priori*, as environmentally-sensitive (ES) sectors (sectors 1 to 4), the other four sectors thus being classified as less environmentally-sensitive (LES) sectors. These sectors have been adapted from *The Times 1000 1997* (Barrow, 1996) reference book using three other sources: Gray *et al*., 1995c; UNEP IE, 1994; DTTI, IISD and SustainAbility Ltd., 1993. Sectors not included in the study are: Printing, Media, Publishing, Newspapers, Leasing, Rental, Distribution, General Manufacturing, Contracting and Construction, Aerospace and Defence, Agriculture and Fisheries, Other Trade and Services, Miscellaneous, Conglomerates, Other Financial and Other Services, Water.

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NEDERLANDSE SAMENVATTING
(Summary in Dutch)

Externe milieuverslaggeving door grote Europese ondernemingen
Een economische, sociale en politieke analyse van het gedrag van management

Dit onderzoek wordt gemotiveerd door de interesse om de onderliggende aard en oorzaak van het rapporteren van milieu-informatie door ondernemingen (corporate environmental disclosure = CED) te verklaren en te interpreteren. Deze interesse komt tot uitdrukking in het eerste deel van de onderzoeksvraag, die bedrieglijk eenvoudig lijkt, maar aantoonbaar belangrijk is:

Waarom rapporteren ondernemingen over milieu?

Het tweede deel van de onderzoeksvraag, die voortvloeit uit te eerste is als volgt:

Welke implicaties hebben deze verklaringen voor de rol van milieuverslaggeving door ondernemingen in relatie tot overheidsbeleid?

De onderzoeksaanpak, die gehanteerd is om deze onderzoeksvragen te bespreken (hoofdstuk 8) zorgt voor een systematisch onderzoek naar milieuverslaggeving voor een steekproef van 90 grote ondernemingen uit de Benelux en Duitsland over de zevenjaarlijkse periode van 1989 tot 1995. Het onderzoek is uitgevoerd door het toepassen van zowel cross-sectionele als longitudinale analyses. Met betrekking tot de cross-sectionele analyse (hoofdstuk 10), worden drie theorieën gebruikt (te weten de economische agencytheorie (EAT- hoofdstuk 5), managerial stakeholder theory (MST - hoofdstuk 6) en de organisatie-legitimiteitstheorie (OLT - hoofdstuk 7)). Hierbij wordt vervolgens de hypothetisch-deductieve methode van onderzoek gebruikt om tot drie groepen van toetsbare hypothesen te komen. Deze hypothesen voorspellen, gebaseerd op voorgaand onderzoek (hoofdstuk 3) en praktijk (hoofdstuk 2), een relatie tussen afwijkingen in de hoeveelheid CED door ondernemingen en de afwijkingen in andere verklarende variabelen. Deze andere variabelen worden gepresenteerd in de vorm van of bedrijfskenmerken of socio-politieke invloeden binnen een overall conceptueel raamwerk over de relatie tussen de onderneming en CED (hoofdstuk 3). Hierbij wordt voor het onderzoek een *teleologische* constructie gebruikt voor de toepassing van deze drie theorieën in de context van CED. Dat wil zeggen, het fenomeen CED wordt gezien als iets dat plaatsvindt, niet per ongeluk of toevallig, maar als resultaat van een bewuste, opzettelijke actie van de zijde van het management in de richting van een soort vooropgezet economisch, socio-economisch of socio-politiek doel. Voor het doel van de longitudinale analyse (hoofdstuk 9), wordt een vierde theorie, de politieke economie van de accounting theorie (PEAT – hoofdstuk 4), toegevoegd aan het onderzoek om een radicale, kritische interpretatie te geven van de trend in CED over de periode van het onderzoek.

De beweringen van onderzoekers en de voorspellingen van de gehanteerde theorieën suggereren dat er vele factoren zijn die omvang van CED beïnvloeden (hoofdstuk 3). De

laatste 30 jaren ongeveer, heeft een toenemende hoeveelheid onderzoek naar maatschappelijke- en milieuverslaggeving (CSR), waarvan een toenemend deel expliciet theoretisch analyseert, behoorlijk wat inzicht gegeven in de onderliggende aard en oorzaak van CED. Echter, dit onderzoek verschilt van voorgaand CSR-onderzoek in een aantal belangrijke opzichten. Allereerst wordt in het onderzoek gekeken naar milieurapportering door ondernemingen in verschillende Europese landen in plaats van naar ondernemingen gevestigd in één land. Ten tweede kijkt het onderzoek naar ondernemingen uit acht bedrijfstakken, die beschouwd worden als verschillend met betrekking tot hun relatie met en aanspraken op de natuurlijke leefomgeving. Ten derde, onderzoekt deze studie CED die voorkomen in een variëteit van verschillende economische, sociale en milieuverslagen in plaats van uitsluitend financiële jaarverslagen en verantwoordingen. Ten vierde, wordt gekeken naar de verslaggeving over een periode van zeven jaar in plaats van naar een momentopname van één jaar. Ten vijfde gebruikt het onderzoek verschillende theorieën in plaats van slechts één enkele theorie, die verschillende verklarende variabelen geeft om de voorspellingen van deze theorieën te toetsen. Tot slot, is gebruik gemaakt van een verscheidenheid aan onderzoeksmethoden, te weten veldonderzoek en inhoudanalyse, voor het verkrijgen van meetbare waarden voor CED en surrogaten voor verklarende variabelen, die vervolgens gebruikt kunnen worden voor het testen van een relatie tussen CED en deze andere verklarende variabelen, evenals voor het interpreteren van trends in CED in de tijd. Deze kenmerken van het onderzoek vormen tezamen, een unieke cross-sectionele en longitudinale studie naar milieuverslaggeving die niet alleen systematisch is in haar onderzoek naar onderliggende relaties, maar ook multi-paradigmatisch is vanwege het gebruik van de verschillende 'verhalen' over CED in de context van de relatie onderneming-maatschappij.

Cross-sectionele analyse (Hoofdstuk 9)

Bij EAT, werd de *Rochester School's brand of agency theory* gebruikt om de volgende set van toetsbare variabelen te ontwikkelen:

H_1: Er is een positieve relatie tussen politieke zichtbaarheid en CED.
H_2: Er is een positieve relatie tussen de milieugevoeligheid van bedrijfstakken en CED.
H_3: Er is een positieve relatie tussen contract- en monitoringkosten en CED.

Er werden vier surrogaten gebruikt voor de proxies voor politieke zichtbaarheid – Totaal van de activa, het aantal werknemers, werkkapitaal, en winst. De milieugevoeligheid van bedrijfstakken werd gerelateerd aan de gevoeligheid van de activiteiten van de bedrijfstak in relatie tot de natuurlijke leefomgeving. De contract- en monitoring kosten werden gemeten door gebruik te maken van twee belangrijke marktvariabelen, financieel hefboomeffect, gebaseerd op (i) de ratio lange termijn schulden in verhouding tot het totaal van de activa en (ii) de ratio van lange termijn schulden in relatie tot het eigen vermogen en dividend cover, gebaseerd op de ratio van dividend in relatie tot vrij-beschikbare ingehouden winsten. Voor iedere hypothese zijn statische regressies uitgevoerd om de relatie tussen het surrogaat voor de betreffende verklarende variabele en CED te testen voor ieder van de zeven jaren van de studie. De resultaten zijn consistent met de voorspellingen van EAT met betrekking tot politieke zichtbaarheid (H_1) en milieugevoeligheid van bedrijfstakken (H_2). Deze resultaten vereisen dat de nul-hypothese onder H_1 and H_2 wordt verworpen. Echter, de resultaten van de

testen onder H_3 met betrekking tot de contract- en monitoringkosten waren niet consistent met de voorspellingen onder EAT. Daarom kan de nulhypothese onder H_3 niet worden verworpen.

De tweede theorie, MST, voorspelt dat het gedrag van het management wordt gemotiveerd door de zorg om de verschillende stakeholdergroepen van het bedrijf te managen in overeenstemming met de mate waarin deze verschillende groepen door het topmanagement worden gezien als groepen die in staat zijn om het nastreven van de lange-termijn strategische doelstellingen door het bedrijf in gevaar te brengen of die daardoor in gevaar kunnen worden gebracht. Dit algemene model werd gebruikt om de volgende set toetsbare hypothesen te ontwikkelen:

H_4: Het management vindt sommige stakeholdergroepen belangrijker dan anderen.
H_5: Er is een positieve relatie tussen de belangrijkheid van stakeholders en CED.
H_6: Er is een positieve relatie tussen de mate van directe betrokkenheid van senior management bij het formuleren van het bedrijfsmilieubeleid en CED.

De empirische resultaten geven bewijs om de hypothesen H_4, and H_5 te ondersteunen en daarom wordt de nulhypothese van ieder verworpen. Echter, de resultaten geven slechts zwak bewijs om de suggestie te steunen dat het eerdere het latere beïnvloedt. Hoewel er significante interne bedrijfsverschillen zijn met betrekking tot verschillende aspecten van de belangrijkheid van stakeholders (te weten verschillen in het relatieve belang van stakeholdergroepen binnen bedrijven), gaat het om de perceptie van het management van de belangrijkheid van de stakeholdergroep *als geheel* die veel meer invloed lijkt te hebben op CED dan hun percepties van de relatieve belangrijkheid van individuele stakeholdergroepen. Deze bevindingen suggereren dat in de context van het verklaren van CED, de door het management ondervonden belangrijkheid van stakeholders binnen het bedrijft (intra) wellicht niet zo belangrijk is als de inter-firm stakeholder belangrijkheid (te weten de verschillen in de ondervonden belangrijkheid van stakeholders als geheel tussen bedrijven). Verder onderzoek naar het proces dat ten grondslag ligt aan de productie en verspreiding van milieu-informatie via afzonderlijke bedrijfsmilieuverslagen kan verder inzicht geven in dit specifieke aspect van verslaggevingsbeleid van het bedrijf. Met betrekking tot H_6, was, hoewel de regressiecoëfficiënten positief waren, geen van de resultaten statistisch significant (op het 5 procentniveau). Daarom kan de nulhypothese H_6 niet worden verworpen. Hoewel het top management waarschijnlijk betrokken is bij het formuleren van het bedrijfsmilieubeleid, suggereren deze resultaten dat deze betrokkenheid niet per definitie het milieuverslaggevingsbeleid beïnvloedt.

De derde theorie, OLT, voorspelt dat het gedrag van management wordt gemotiveerd door de zorg om de maatschappelijk legitimiteit van de organisatie te managen als antwoord op de ondervonden verandering in waarden, attitude en normen van de bredere maatschappij waarin het bedrijf opereert. Dit algemene model werd gebruikt om de volgende set van toetsbare variabelen te ontwikkelen:

H_{7a}: Er is een positieve relatie tussen politieke zichtbaarheid en CED.
H_{7b}: Er is een positieve relatie tussen milieugevoeligheid van bedrijfstakken en CED.
H_{7c}: De relatie tussen politieke zichtbaarheid en verslaggeving is sterker bij ondernemingen die in een milieugevoelige bedrijfstak opereren dan bij ondernemingen die opereren in een minder milieugevoelige bedrijfstak.

H_{8a}: Er is een positieve relatie tussen maatschappelijke druk van milieugroeperingen en CED.

H_{9a}: Er is een negatieve relatie tussen milieuprestatie en CED.

$H_{7d, 8b, 9b}$: CED zal onderdeel vormen van de public-relations machinerie van bedrijven gericht op het beïnvloeden van de percepties van de maatschappij door de verslaggeving te vertekenen door het niet opnemen van informatie die weergeeft dat een bedrijf onverantwoordelijk handelt met betrekking tot milieuaangelegenheden.

Dezelfde vier surrogaten werden gebruikt voor de proxies voor de kenmerken van politieke zichtbaarheid van het bedrijf (te weten totaal van de activa, aantal werknemers, werkkapitaal en winst) (H_{7a}). Een tweede meting van de milieugevoeligheid van bedrijfstakken werd verkregen door veldonderzoek naar de relatieve invloed die ieder van de acht bedrijfstakken heeft op de omgeving, zoals dit worden ervaren door niet gouvermentele milieu-organisaties (ENGOs). De socio-politieke invloeden verbonden met de maatschappelijke druk door milieugroeperingen werden ook gemeten door middel van veldonderzoek naar de mate van milieucampagnes door deze groepen. Op gelijke wijze, werd de proxy voor milieuprestatie afgeleid van milieuprestatie (eco-)ratings die aangeleverd werden door ENGOs. ENGOs werden gepresenteerd als key-belangengroep (ofwel 'relevant publiek') die de normen, waarden, gebruiken en attituden van een maatschappij in relatie tot milieuaangelegenheden zowel weerspiegelt als beïnvloedt.

Hoewel het argument voor politieke zichtbaarheid onder OLT (H_{7a}) verschilt van dat onder EAT, zijn de relatietesten tussen politieke zichtbaarheid en CED dezelfde voor beide theorieën. Daarom zijn de bevindingen van een statistisch significante positieve relatie tussen de vier proxies voor politieke zichtbaarheid en CED ook consistent met de voorspellingen onder H_{7a}. De nulhypothese onder H_{7a} wordt daarom verworpen. Op een gelijke wijze is het ook mogelijk dezelfde relatietesten toe te passen tussen milieugevoeligheid van bedrijfstakken en CED onder zowel EAT als OLT. Echter, OLT's nadruk op de 'relevante publieken' de mogelijkheid gaf om andere socio-politieke aspecten van de relatie omvang-bedrijfstak-verslaggeving te exploreren door ENGO's te verzoeken hun mening te geven over de milieugevoeligheid van de bedrijfstak. Gebaseerd op veldonderzoek blijkt dat Europese ENGO's de perceptie hadden dat de chemische sector de meeste milieu-impact had, en de bank- en verzekeringssector de minste impact had. De resultaten van de relatietesten tussen CED en milieugevoeligheid van de bedrijfstak, gebaseerd op de respons van ENGO's, geeft bewijs voor een statische significante positieve relatie voor zes van de zeven jaren met de richting voor de relatie als voorspellend voor alle zeven jaren. Daarom wordt de nulhypothese onder H_{7b} verworpen. Deze resultaten zijn bijzonder leerzaam omdat zij suggereren dat een vollediger begrip van de relatie bedrijfstak-verslaggeving zou kunnen worden gegeven door het exploreren van percepties van 'relevante publieken'. Een ander aspect van de relatie bedrijfstak-omvang van de verslaggeving is onderzocht door het testen van de hypothese dat deze relatie veel gevoeliger is in het geval van milieugevoelige sectoren (ES) dan in het geval van minder milieugevoelige sectoren (LES) (H_{7c}). Echter, de resultaten gaven geen bewijs voor de alternatieve hypothese and daarom kan de nulhypothese niet worden verworpen.

Testen onder hypothese H_{8a} zijn uitgevoerd door het verzamelen van gegevens bij ENGO's over de mate waarin deze groepen milieucampagnes hebben gevoerd. Een beoordeling van de

aard van deze campagnes, de wijze waarop en de middelen waarmee ENGO's CED proberen te beïnvloeden, suggereert dat deze groepen actief zijn in plaats van passief met betrekking tot de milieuverslaggeving en prestaties en activiteiten van grote ondernemingen. Echter, de relatietesten tussen maatschappelijke druk op ondernemingen door campagnes van ENGO's en CED ondersteunen niet de alternatieve hypothese. Hoewel de richting van de relatie was voorspeld waren de resultaten niet statistisch significant (bij het 5% niveau). Op grond van deze bewijzen kan de nulhypothese H_{8a} niet worden verworpen. Deze resultaten geven een gedeeltelijke weerlegging van OLT, en suggereren dat maatschappelijk druk door campagneactiviteiten van ENGO's het gedrag van ondernemingen met betrekking tot milieuverslaggeving niet beïnvloeden. De resultaten zijn echter consistent met ander nieuw empirisch bewijs uit deze studie die aantonen dat ENGO's relatief onbelangrijk zijn voor het management van grote ondernemingen, relatief ten opzichte van andere groepen uit de samenleving.

De hypothese dat er een negatieve associatie bestaat tussen milieuprestaties en CED (H_{9a}) is gebaseerd op de veronderstelling onder OLT dat ondernemingen met slechte milieuprestaties eerder geneigd zijn CED te gebruiken als onderdeel van een verwoedde poging om zich te legitimeren. Een proxy voor de maatschappelijke perceptie van milieuprestatie werd verkregen van ENGO's. Aan hen is gevraagd de milieureputatie ("eco-rating") van iedere onderneming te beoordelen, gebaseerd op hun kennis van de onderneming en zijn activiteiten. De resultaten van deze veldstudie suggereren dat het de milieugevoelige sectoren zijn, met name chemie, die de slechts reputatie hebben. Echter, in het algemeen zijn slechte waarderingen gegeven voor alle acht bedrijfstakken, hetgeen suggereert dat ENGO's een relatief lage opinie hebben van ondernemingen in het algemeen met betrekking tot milieuprestatieaangelegenheden. De testresultaten ondersteunen de alternatieve hypothese en daarom wordt de nulhypothese onder H_{9a} verworpen. De laatste hypothese (H_{7d}, H_{8b}, H_{9b}) veronderstelt dat CED zal worden bewerkt ten gunste van de onderneming als onderdeel van de strategie van de onderneming om zich te legitimeren en die gericht is op het manipuleren van de perceptie van de maatschappij. Het bewijs dat voortkomt uit de huidige studie is consistent met deze hypothese en ondersteunt de opvatting dat managers ervoor kiezen het 'goede' nieuws te belichten en gelijktijdig het 'slechte' nieuws achter te houden. Deze resultaten suggereren dat management bevooroordeeld is in haar rapportage over milieuaangelegenheden.

Longitudinale analyse (Hoofdstuk 10)

De longitudinale analyse, een beschrijvende analyse, is uitgevoerd voor de populariteit, de omvang en de vorm van CED over de periode 1989 tot 1995. Deze analyse was gebaseerd op een totaal van 1.011 verslagen over de zevenjaarlijkse periode. Deze verslagen bestaan uit 630 jaarverslagen, 70 sociaalverslagen, 50 milieuverslagen, 137 verkortjaarberichten van het jaar, en 124 overige verslagen. Gebaseerd op deze verslagen, hebben ondernemingen uit de Benelux en Duitsland tussen 1989 en 1995 de omvang van hun externe verslaggeving significant uitgebreid, de omvang van het aantal pagina's is bij sommigen uitgebreid met 30%. Het jaarverslag blijft het belangrijkste document voor de onderneming gedurende de periode van de studie. Hoewel het aandeel van het jaarverslag in de totale volume die gepubliceerd licht is gedaald over de periode bleef het voor het volume de meest belangrijke enkele bron van economische, maatschappelijke en politieke informatie als het vergeleken

wordt met andere rapporten in de studie die gepubliceerd worden door de onderneming. Het merendeel van de ruimte in het jaarverslag wordt besteed aan accounting en management informatie ('AccPP'), dit vertegenwoordigd in 1989 in volume 40% van de totale gemiddelde informatie , licht dalend tot 37% in 1995. Echter, hoewel AccPP een significant element vormt gedurende de gehele periode, wordt veel van de opgaande trend in volume veroorzaakt door een toename van de milieu-informatie. De groei in omvang van de ruimte die besteed wordt aan CED relatief ten opzichte van andere informatie werd voornamelijk veroorzaakt door een toename in de afzonderlijke milieuverslaggeving op groepsniveau en de toename in de omvang van deze verslagen. Kijkend naar de vorm van milieu-informatie, blijkt dat de enorme meerderheid van CED controleerbaar is (als tegenovergestelde van niet-controleerbaar), vrijwillig (als tegenovergestelde van verplicht) en een positieve/neutrale weerspiegeling (als tegenovergestelde van negatief) geeft van de rapporterende organisatie. De nadruk die lag op het goede/neutrale nieuws als tegenovergestelde van slecht nieuws was verpletterend. In 1995, bijvoorbeeld was 'slecht' nieuws minder dan één procent van de totale CED. Hoewel het totaalvolume CED toenam in de periode, nam de ruimte die besteed werd aan het rapporteren van 'slecht' nieuws werkelijk af gedurende de periode van de studie.

Bij het zoeken naar een verklaring voor deze trends, werden vier theoretische perspectieven gebruikt (te weten, EAT, MST, OLT en PEAT), ieder van deze kan gezien worden voor het geven van alternatieve uiteenzettingen of 'verhalen' voor hetzelfde maatschappelijke fenomeen vanuit verschillende optieken. Het trekken van conclusies uit deze verschillende perspectieven hangt grotendeels af van de mening die wordt ingenomen over maatschappelijke verantwoordelijkheden van ondernemingen in de context van de relatie onderneming-maatschappij. Onder EAT, wordt de trend in CED door Benelux en Duitse ondernemingen in de periode van de studie geïnterpreteerd in termen van een toenemende inspanning van het management om de agencykosten van de kapitaalmarkt te beïnvloeden. Vanuit de optiek van MST worden de trends in milieuverslaggeving, daarentegen gezien, als onderdeel van het doorlopend proces van stakeholdermanagement. In tegenstelling, ziet OLT CED als een instrument van maatschappelijke onderhandeling waarmee het management zich wil legitimeren voor de activiteiten en prestaties van de onderneming. Vanuit dit perspectief, wordt de overgrote afwezigheid van slecht nieuws zoals gerapporteerd in de huidige studie gezien als onderdeel van de legitimatiestrategie, gericht op het creëren van een positief imago van de onderneming. PEAT geeft de meest kritische interpretatie van trends in CED, gericht op de wijze waarop het management de groepsverslagen gebruikt om de bestaande geïnstitutionaliseerde asymmetrie en maatschappelijk ongelijkheid tussen arbeid en kapitaal in stand te houden. Door het uitbreiden van deze analyse met milieu, wordt een beeld gepresenteerd van de uitdagingen die het concept van duurzaamheid oproept voor de huidige overwicht van de onderneming in de maatschappij. Vanuit dat standpunt wordt CED gezien binnen de omvattende context van de onderliggende bedrijfsagenda, namelijk acceptatie door de maatschappij van de 'business case' voor duurzaamheid, waarbij milieu onderdeel vormt van het socio-politieke proces waarmee de bevoordeling van kapitaal boven milieu wordt versterkt. Als het PEAT raamwerk wordt gebruikt voor de analyse, dan suggereert de onderliggende aard van de trends in CED in de tijd dat zij deel uitmaken van een nauwgezette public relations exercitie met als doel de aandacht van de maatschappij af te leiden van de zoekende vragen naar morele rechtvaardiging voor de bestaande overwicht van onderneming in de maatschappij, in de context van een groeiende milieu-crisis.

Discussie

Ieder van de drie theorieën binnen de positivistische traditie (EAT, MST and OLT), die gebruikt zijn in deze studie is empirisch valide in de zin dat iedere theorie iets bijdraagt aan het zoeken naar een verklaring waarom ondernemingen vrijwillig milieu-informatie rapporteren. Echter, het is uit de hier gepresenteerde resultaten in een multi-interpretabele context niet direct duidelijk of de ene theorie daarbij meer hulp biedt dan de andere, deels omdat de voorspellingen van iedere theorie slechts gedeeltelijk uitkwamen en deels omdat hoewel de voorspelling goed gefundeerd was, de onderliggende theoretische verklaring varieert van de ene theorie tot de andere. Het feit dat ieder van deze drie theorieën voorspellingen gaf die niet bevestigd werden door de resultaten mag niet worden geïnterpreteerd als een blijvende weerlegging van deze theorieën. Het is zelfs beter deze resultaten te beoordelen in het licht van een grote en groeiende hoeveelheid CSR-onderzoek dat tot op heden heeft gefaald een consistente, unieke of stabiele relatie vast te stellen tussen maatschappelijke en milieuverslaggeving en andere verklarende variabelen. (Hoofdstuk 3).

In deze context is het misschien beter om een brede, lange-termijn visie in te nemen door te erkennen dat het fenomeen van CSR/CED en maatschappelijk verantwoord ondernemen (CSResp) uitingen zijn van de waarden, attituden, normen en situaties van tevredenheid en veiligheid binnen Westerse ontwikkelde samenlevingen die niet onveranderlijk zijn maar variëren in de tijd, beïnvloed door gebeurtenissen en activiteiten die veranderingen teweeg brengen in het niveau van culturele tevredenheid, maatschappelijk bewustzijn en verantwoordelijkheidsbesef. Vanuit dit perspectief is de mate waarin de verschillende mogelijke factoren die het managementgedrag beïnvloeden of veranderen met betrekking tot maatschappelijke- of milieuaangelegenheden op een bepaald punt in de tijd niet constant, maar steeds aan veranderingen onderhevig. Dit betekent niet dat onderzoekers niet in staat zijn te verklaren, voorspellen of te begrijpen welke factoren opvallend zijn op een bepaald tijdstip, maar het betekent dat er behoefte is aan het vermijden van het accepteren van de versteende mening dat een bepaalde onderneming, kenmerk of socio-politieke invloed altijd opvallend zal blijven en dat als gevolg daarvan, één of meer bepaalde theoretische perspectieven altijd relevant of behulpzaam zal zijn. De resultaten van de huidige studie suggereren dat ten minste voor dit moment bestaande theorieën een valide rol spelen bij het geven van inzicht in het gedrag van management met betrekking tot CED, en daarom impliciet bij CSR.

Echter, hoewel varianties in CED tussen bedrijven gerelateerd lijken te zijn aan het thuisland van de rapporterende organisatie, de omvang, de winst en de bedrijfstak, de milieuprestaties en hun percepties van stakeholderprestaties (Hoofdstuk 9), suggereert de hoeveelheid van veranderingen in verslaggeving die verklaard worden door deze specifieke kenmerken en invloeden dat ook andere factoren van invloed zijn. De uitdaging voor hen die de hypothetisch-deductieve onderzoeksmethode toepassen is om waarneembare surrogaten te ontwikkelen die met succes deze andere verklarende variabelen vast kunnen leggen voor het doel van statistische modellering. Hoewel modellering van dergelijke relaties ons begrip van de aard en oorzaken van CED aanzienlijk kan verbeteren, tenminste in potentie, blijven niettemin serieuze bedenkingen bestaan omtrent de mogelijkheid om deze elementen met succes 'vast te leggen' als de hypothetisch-deductieve onderzoeksmethode wordt gebruikt. Als zodanig kunnen andere onderzoeksmethoden alternatieve 'verhalen' over het fenomeen

CED blootleggen, die van toegevoegde waarde zijn voor ons begrip van de aard en oorzaak van CED. Zo'n alternatieve benadering is toegepast door gebruik te maken van de interpretatieve benadering (hoofdstuk 10) met als doel het interpreteren van trends in CED over de periode 1989 tot 1995.

De waargenomen trend van toenemende niveaus van milieuverslaggeving door grote Benelux en Duitse ondernemingen over de periode van de studie is beoordeeld tegen de achtergrond van toenemende internationale verontrustheid met betrekking tot milieu- en sociale issues en een aantal belangrijke internationale programma's gericht op duurzaamheid. Dit laatste werd gepresenteerd als het overkoepelende overheidsbeleid van de huidige tijd, dat ingaat op de relatie tussen de mensheid en het milieu en de daaraan gerelateerde verantwoordelijkheden die horen bij de rol van de mensheid als zelfverkozen, alleenheerser van de eco-systemen en andere levensvormen van de planeet. Vanuit dit perspectief werd ieder van de vier theorieën (te weten., EAT, MST, OLT and PEAT) toegepast om een uiteenzetting of 'verhaal' te geven van de trend van de toegenomen hoeveelheid milieu-informatie die gegeven wordt door ondernemingen uit de Benelux en Duitsland gedurende de periode van deze studie. Ieder van deze verschillende 'verhalen' heeft waarde, hoewel de mate waarin men kan worden overtuigd door de verklaringen die hierbij worden gegeven uiteindelijk afhangt van een gekozen set van waarden, overtuigingen en veronderstellingen. Een eenvoudige, beperkte neo-klassieke economische interpretatie van trends, kan bijvoorbeeld gezien worden als perfect rationeel in een markt-gebaseerde context temidden van groeiende zorgen van de investeerders over een mogelijk negatieve cash flow en dus consequenties voor de aandeelhouderswaarde als het resultaat van strengere milieubeschermingsmaatregelen. Dit argument kan verder worden uitgebouwd en andere 'niet-markt' belanghebbenden omvatten zoals werknemers, consumenten, cliënten en het algemeen publiek onder MST, waarbij CED de rol inneemt van de zorg van de maatschappij, die wordt gezien in staat te zijn de onderneming te steunen of te schaden bij het behalen van haar lange termijn strategische doelstellingen. De verklaring die wordt gegeven door de burgerlijke politieke economie legt, in tegenstelling, de nadruk op de wijze waarop CED wordt gebruikt om de percepties van het 'relevante' publiek te manipuleren, waarbij de enorme afwezigheid van slecht nieuws zoals gerapporteerd in de huidige studie wordt gezien als onderdeel van de legitimiteitstrategie die is gericht op het bouwen van een milieuvriendelijk imago van de onderneming bij dit relevante 'publiek'.

De verklaring die wordt gegeven door de klassieke politieke economie (PEAT) suggereert dat in plaats van de focus op de technische aspecten van de verslaggeving, in termen van kwaliteit en onderwerp van de verslaggeving, de aandacht moet liggen op de wijze waarop de verslaggeving wordt gebruikt voor het behouden van het huidige overwicht van ondernemingen, waarbij de rol van de onderneming in een kapitalistische democratie er een is van het beheren van rijkdomcreatie, de marktplaats en de welvaartsfuncties. Deze laatste analyse van CED wordt gezien als dienend bij een meer overtuigende rol in het weghouden van de aandacht van de maatschappij van de 'crisis van het kapitalisme' zoals gerepresenteerd door de uitdagingen waarmee iedere serieuze poging van duurzaamheid wordt geconfronteerd met het huidige overwicht van ondernemingen. Dat wil zeggen dat als het overkoepelende socio-politieke raamwerk waarbinnen CED wordt bestudeerd, er een is die zich bovenal richt op de serieuze aangelegenheden voortkomend uit eerlijke altruïstische zorg voor matschappelijke rechtvaardigheid en ecologische bescherming, dan gaat het niet

om de moeite die bedrijven nemen om eco-efficiency te verbeteren van haar productieprocessen en producten of om de kwaliteit van haar milieuzorg- en informatiesystemen, ondanks de duidelijke economische voordelen. Nee, het gaat dan juist om de mate waarin de onderneming, bij het legaal runnen van de onderneming binnen de normale commerciële grenzen, niet-economische aspecten van menselijk en niet-menselijk leven, zoals gedefinieerd in een verbintenis tot maatschappelijke rechtvaardigheid en ecologisch behoud, heeft verbeterd of verslechterd. Een dergelijk perspectief daagt niet alleen de geprivilegieerde positie van kapitaal binnen de liberale economische democratie uit, maar ook de rol van andere geïnstitutionaliseerde structuren, zoals overheden en het accountantsberoep, in het versterken van dergelijke privilegieer. Vanuit dit perspectief wordt de focus op de bedrijfsorganisatie gezien als fundamenteel misplaatst, omdat het 'probleem' niet het bedrijf maar het maatschappelijke systeem zelf is, te weten het mondiale industriële kapitalisme.

Daarom, hoewel een empirische analyse tot buikbare inzichten kan leiden in de oorzaken en trends in CED in de tijd, kan de onderliggende aard van deze oorzaken en trends, volgens PEAT, eenvoudigweg deel vormen van de uitvoerige verhullende praktijk (CED zijnde de 'Nieuwe kleren van de keizer') die probeert de aandacht van de maatschappij af te leiden van de meer kritische zaken die leiden tot belangrijke en verontrustende vragen over morele rechtvaardiging van het bestaande overwicht van ondernemingen in de maatschappij. In deze context, zijn de toegenomen niveaus van CED door zowel Benelux als Duitse ondernemingen over de periode van de studie, de enorme hoeveelheid die de onderneming in een positief daglicht zet, helemaal consistent met de visie dat dergelijk verslaggeving een sociaal-politieke rol heeft op een macro-economisch niveau, dat weinig of niets meer van doen heeft met zaken als CSResp en accountability. Het is dit kritische, politiek-economische perspectief dat veel van de argumenten, die ten grondslag liggen aan de recente plotselinge toegenomen interesse in CSResp en accountability uitdaagt en serieus betwist. Vanuit dit perspectief is de vraag niet of dat wat wordt gerapporteerd getrouw, gebalanceerd, volledig en juist is, omdat dat gewoonweg onmogelijk is. Het is meer dat percepties van wat er gebeurt beter kunnen worden begrepen door in beschouwing te nemen wiens belangen worden gediend door wat maatschappelijk wordt geconstrueerd. Maatschappelijke constructies van de huidige groeiende spanningen tussen overheidsbeleidsdoelstellingen van economische groei aan de ene kant en duurzaamheid aan de andere kant van economen, accountants, politici, leiders in het bedrijfsleven, academici en NGO's zijn niet homogeen, maar bestaan langs een continuüm dat een complex, wijd verbreedde set van behoeften, angsten, gedrag, waarden en overtuigingen weergeeft. Als zodanig is er geen enkele, wijd geaccepteerde mening over welke overheidsbelangen en overheidsbeleidsdoelstellingen de maatschappij zou moeten nastreven, welke doelstellingen haalbaar zijn of van de daarmee gepaard gaande kosten en opbrengsten, in maatschappelijke, ecologische en ecologische termen.

Veel van het CSR/CED onderzoek, in het bijzonder onderzoek dat gebruik maakt van OLT and PEAT, legt de nadruk op de manier waarop maatschappelijke en milieuverslaggeving wordt gebruikt voor politieke doeleinden in plaats van voor besluitvorming of stakeholderverantwoording. Dit heeft ertoe geleid dat CSR-onderzoekers hun inspanningen richten op het ontwikkelen van nieuwe vormen van maatschappelijke en milieu-accounting die benadrukken dat de mate waarin de huidige bedrijfsactiviteiten en financiële

verslaggeving zich direct vertalen in maatschappelijke onrechtvaardigheid, maatschappelijke uitsluiting en aantasting van het milieu. Ontwikkelingen in full cost accounting (FCA) en andere vormen van holistische verslaggeving gecombineerd met een serieuze benadering van 'accounting for (un)sustainability', bijvoorbeeld, zou leiden tot een eerlijker, getrouwer en meer gebalanceerde basis voor verantwoording en verslaggeving door ondernemingen. Het is echter de vraag of zelfs als de praktijk van accounting en verslaggeving zou veranderen, om meer rechtvaardige vormen van maatschappelijke- en milieuverantwoordingen te geven, dit zou leiden tot een significante verandering in maatschappelijk gedrag. Door recente ontwikkelingen in informatietechnologie en communicatie zijn de meeste mensen in de maatschappij zich waarschijnlijk zelfs bewust van de huidige 'maatschappelijke en ecologische crisis' in de een of andere vorm. Daarom is de brandende vraag van onze generatie niet wanneer we ons meer bewust worden van de maatschappelijke en ecologische last van ons systeem maar welke stappen we bereid zijn te nemen om de aftakeling van onze menselijke waarden, de kwaliteit van ons leven en de gezondheid van de planeet te keren.

Heden ten dage richten inspanningen van verslaggevingdeskundigen, management consultants en aan de universiteit verbonden onderzoekers met betrekking tot deze uitdaging, bijna alle zonder uitzondering op de symptomen van maatschappelijke ongelijkheid en ecologische vernietiging in plaats van op de onderliggende oorzaken. Echter, als deze zaken diepgaander, kritischer en stelliger worden behandeld, moet daarbij ook het systeem, te weten het kapitalisme, ter discussie worden gesteld. In essentie is dit de uitdaging van duurzaamheid. De radicale agenda's van diepe ecologie en spirituele ecologie, bijvoorbeeld, veronderstellen dat de enige intelligente, scherpzinnige en rationele manier voorwaarts is het vervangen van het huidige systeem van mondiaal, industrieel kapitalisme door een die de overtuiging van individuele en maatschappelijke emancipatie combineert met de overtuiging van universele verantwoordelijkheid en respect voor alle levende wezens.