Shareholder vs stakeholder theory management essay

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His views reflect Adam Smith's view that firms operate solely for the purpose of making a profit which contributes to the overall well being of society. Any business activity is justified as long as it increases the value of the firm to its shareholder (Cochran, 1994). Friedman (2005) acknowledges one reason for the existence of firms and that is to make a profit for its shareholders. According to Friedman, firms do not exists to change the world or to do good. He pushes the Shareholder Theory to the extent that he declares as theft or violation of management responsibility any form of donation by the firm, be it in time, in kind, or in monetary measures, by the managers from the investors o the firm (Ruf et al, 1998).

Shareholder theory has been widely misinterpreted and quoted in its extreme sense. Carroll (1998) qualifies that although Friedman does insist that the only responsibility of the firm is to record profits for its shareholders, he goes on to state that the firm must operate within acceptable legal and societal parameters.

The Shareholder perspective of a firm has been widely challenged over the past years. Authors such as Low and Cowton (2004) and Agatiello (2008) argue that the sole mission of firms to be profit maximisers is incorrect and inappropriate. Today's modern organisation is so complex that reducing it to such simple terms and motivations oversimplifies the same nature of the commercial organisation. Spence (2001) writes that the Stakeholder Theory has emerged as an alternative for the Shareholder Theory of the firm. According to Freeman (1984), the term stakeholder can be traced back to management literature of 1963 when the term was defined as " those groups without whose support the organisation would cease to exist".

Stakeholder theory recognises that firms have a much wider base of interested parties other than the shareholders and holds that the firm must honour its duties and responsibilities towards all of the parties. The shareholders are simply one group of the several groups which has a claim on the firm (Heath and Norman, 2004). Deck (1994) gives an interesting interpretation of the Stakeholder Theory. While he recognises that the objective of an organisation is to create wealth and distribute this amongst its investors, he explains how the investors are not only represented by the shareholders, but, in fact can and do take the form of other groups such as employees and the society in general, who invest knowledge and skills in the firm. Indeed Halal (2000) argues that the resources invested by stakeholders are roughly tenfold that invested by the shareholders. Post et al (2002) claim that risk is not only limited to financial exposure but also includes risks to employment, career opportunity, environmental impact and quality of products and services. If a firm fails, employees lose their jobs and possibly also their retirement plans. In line with this argument, firm benefits should not only be distributed to the financial investors, but profits should be divided amongst all those bearing risk within the organisation.

2. 2 The Triple Bottom Line

A win-win outcome for organisations and stakeholders is that created by the Triple Bottom Line (Elkington, 1998). This is an attempt to shift business towards a stakeholder-based approach. The idea behind the 3BL paradigm is that a corporation’s success should be measured not just by the traditional financial bottom line, but also by social/ethical and environmental performance (Norman and MacDonald, 2004). The ‘ People, Planet, Profit’ triangle postulates how profit is to be perceived from three perspectives. A positive triple bottom line reflects an increase in the company's value, including both its profitability and shareholder value and its social, human and environmental capital (Savitz, 2006). Even if the three aspects of sustainability – environmental, social and economic – already existed, Elkington's principle played a crucial role in shaping initiatives such as the Global Reporting Initiative and the Dow Jones Sustainability Indexes (Berkovics, 2010). The novelty of the 3BL lies in the contention of its supporters that the fulfilment of its obligations to communities, employees, customers and suppliers should be measured, calculated, audited and reported, just like financial performance had been for the past hundred years. The major fallacy of the 3BL approach is that whilst authors speak of the benefit of measuring the benefits accruing from three perspectives, no one has suggested how to use the data on social performance to calculate some form of net social bottom line. Adding up the financial pluses and deducting the minuses is much easier than summing up the environmental achievements and shortcomings of a firm (MacDonald and Norman, 2004).

2. 3 Defining CSR

In his seminal work entitled Social Responsibilities of the Businessman, Bowen (1953) defined CSR as the entrepreneur's obligation ' to pursue those policies, to make those decisions or to follow the lines of action which are desirable in terms of the objectives and values of society'. It is because of this work that authors such as Carroll (1999) and Windsor (2001) have declared Bowen to be the ' Father of CSR'.

In today’s world of increased globalisation, environmental awareness, recessionary pressures and high insecurity, there are increasing pressures on entrepreneurs and organisations to deliver increased societal value (Jenkins, 2006).

Weber (2008) posits that although the concept of CSR is widely discussed, a universally accepted definition still needs to emerge (Turker, 2009). Further Van Marrewijk (2003) claims that a ‘ one solutions fits all’ explanation of CSR is virtually impossible as the concept takes on a different meaning for each organisation, depending on the levels of awareness and ambition of the firm itself.

In the 1970’s authors of the subject began to indicate that the emphasis on ‘ responsibility’ implied accountability. That, according to Carroll (1979) was too narrow and static an interpretation in order to fully picture the social efforts of the firms. As a result of this criticism two new concepts emerged: Corporate Social Responsiveness (CSR2) and Corporate Social Performance (CSP). CSR2 links CSR with strategic management and stresses the proactive approach required from companies. CSP offered a managerial framework to deal with CSR and attempted to measure it.

Frederick (1994) refers to CRS2 as a conceptual transition from the philosophical aspect of CSR to the more action-oriented approach. Several authors such as Ackermann and Bauer (1976), Vallentin (2009), Sethi (1979) also support this view. Others like Carroll (1979) however argue that the term responsiveness is not an appropriate replacement for responsibility. He argues that any action which is not the fruit of reflection and responsibility is not exactly a refinement of a concept which merely encourages responsibility. Firms may indeed be responsive and irresponsible!

CSP emerged as a multidimensional concept which embraced the interaction of social responsibility, social responsiveness and the policies corporations designed to address such issues (Watrick and Cochran, 1985). CSP therefore focuses attention from corporate motivations to corporate action and implementation. Although the term CSP tends to give a more dynamic and pragmatic interpretation of the concept it has not been left uncriticised. Authors such as Davenport (2000) look at CSP as a theoretical creation of the scholars. The terms CSR, CSR2 and CSP are often used interchangeably and today, much of the literature simply uses the single term CSR to mean both the firm’s acceptance of responsibilities and the actions and policies it undertakes in the area (Ciliberti et al 2008).

The writings of McGuire (1963), Davis (1960), and Sethi (1975) all concur that CSR describes the responsibilities of a firm which extend beyond what is the legal obligations of the firm. In other words, CSR starts where the law ends. Carroll (1979) is also in support of this view and in his work in 1991 presents a Pyramid of Corporate Social Responsibilities to include all, economic, legal, ethical and discretionary responsibilities which emanate from the existing operations of organisations. Although Carroll presents his model in the form of a pyramid with the economic concerns of the firm as the base, he tells us that his model does not, in fact portray a continuum and that the four facets of organisational responsibility are not mutually exclusive.

Discretionary

Responsibilities

Be a good

corporate citizen

Ethical

Responsibilities

Be ethical

Legal

Responsibilities

Obey the Lay

Economic

Responsibilities

Be profitable

Figure 2: The Pyramid of Corporate Social Responsibility

Carroll (1991)

In 2003 Schwartz and Carroll presented the different facets of CSR in a different format. This time they moved away from the pyramid structure which seems to have implied some form or natural progression from one level to another and presented their model in the form of a Venn diagram. Furthermore they only included three of Carroll's earlier CSR aspects. Schwartz and Carroll (2003) represented the economic, legal and ethical responsibilities but omitted the discretionary category. Indeed it is inappropriate to regard discretionary and philanthropic activities as responsibilities.

Purely

Ethical

Purely

Legal

Purely

Economic

Ethical / Legal

Legal / Economic

Ethical / Economic

Legal / Economic / Ethical

Figure 3 : The Three-Domain Model of CSR

Schwartz and Carroll (2003)

2. 4 A Modern Interpretation of CSR

In 2001 The European Union presented a Green Paper entitled ‘ Promoting a European Framework for Corporate Social Responsibility’. In this paper CSR was defined as ‘ a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis’. Pivato et al (2008) argue that this is one of the most common interpretations of CSR and it is consistent with recent academic literature. Stakeholder theory gained importance in the 1990’s and continues to maintain its position as a focused area of study in CSR (Wang, 2008).

More recently, in October 2011, the EU Commission published a new policy on CSR wherein it states that for a firm to meet its social responsibility it ‘ should have in place a process to integrate social, environmental, ethical and human rights concerns into their business operations and core strategy in close collaboration with their stakeholders’ . The EU also put forward a new definition of CSR as ‘ the responsibility of enterprises for their impacts on society.’ The EU intends that firms will abide by their responsibility when they respect the applicable legislation and aim for collective agreements between social partners. Another important aspect of the new EU approach to CSR is the fact that the emphasis is not only on the private sector firms only, but the maximisation of the creation of shared value for society is now also expected of public sector firms.

This new policy advances an action agenda for the three year period up to 2014 covering eight distinct areas which detail how the EU intends ensuring that firms embrace this CSR concept. This action plan aims to enhance the visibility of CSR and the dissemination of good practices; improve and track levels of trust in business; improve self-and co-regulation processes; enhance market reward for CSR; improve company disclosure on social and environmental information; further integrate CSR into education, training and research; emphasise the importance of national and sub-national CSR policies and better align European and global approaches to CSR.

The EU commission reports that small and medium sized firms are the predominant form of enterprise in the European Union (EU Commission, 2012). The EU further claims that if Europe and its enterprises are to reap the full benefit of CSR, then it is imperative that SMEs engage fully in CSR and are recognised for their initiatives. This is very challenging as CSR has traditionally been the domain of the corporate sector, but recognition of the increasing importance of the SME sector has led to an emphasis on their social and environmental impact (Jenkins, 2004)

2. 5 CSR and SMEs

‘ Micro, small and medium-sized enterprises are the engine of the European economy. They are an essential course of jobs, create entrepreneurial spirit and innovation in the EU and are thus crucial for fostering competitiveness and employment’ (Verheugen, 2005).

In 2003 the EU revised its 1996 definition of an SME and within the 27 member states, today an SME is a firm with fewer than 250 employees and with a turnover of less than €50 million or balance sheet totals of less than €43 million. Apart from these quantifications, firms must be independent, i. e. separate from an economic group that is stronger than itself.

< 10

Medium Sized Firms

Small Firms

Micro

Firms

Enterprise Category

Head Count (Annual Work Unit

Turnover

Balance Sheet Totals

â‰¤ €2

million

â‰¤ €2

million

â‰¤ €10

million

â‰¤ €10

million

â‰¤ € 50 million

â‰¤ €43

million

< 50

< 250

OR

OR

OR

OR

Figure: 4 EU Definition of an SME

Source: EU Commission (2003)

The EU reports that even in 2012 SMEs have kept their position as the backbone of the European economy, with around 20. 7 million firms accouting for more than 98% of all enterprises of which 92. 2% are firms which employ fewer than 10 people (Wymenga et al 2012). Wymenga (2012) reports that in 2012 SMEs accounted for 67% of total employment, at around 87 million people and 58% of gross value added.

The Maltese economy is one of the smallest economies in the EU: this implies that the relevance of SME’s for the domestic economy is indeed crucial. There are a little less than 30, 000 firms in Malta, and with the exception of 44 large firms, the rest employ less than 250 workers. In fact, the economy is dominated by micro-sized firms (95. 1%). Small and Medium-Sized firms in Malta account for 4. 7% of business organisations, employ 41. 8% of the labour force and account for 38. 3% of the island’s value-added.

Micro firms employ 34. 4% of the labour force in Malta and account for 26. 3% of the value added (EU Commission, 2012).

< 10

Medium Sized Firms

Small Firms

Micro Firms

Enterprise Category

Head Count (Annual Work Unit

Turnover

Balance Sheet Totals

â‰¤ €2

million

â‰¤ €2

million

â‰¤ €10

million

â‰¤ €10

million

â‰¤ € 50 million

â‰¤ €43

million

< 50

< 250

OR

OR

OR

ORFox (2005) contends that all organisations impact on society and the environment in a number of ways through their operations. For this reason, CSR is important in large and small firms alike (Moore and Spence, 2006). The importance of SMEs in CSR literature has, however been overlooked (Perrini and Minoja, 2008; Ciliberti et al, 2008, Moore and Spence, 2006). A study carried out by Jenkins in 2004 reveals that much of the thinking about CSR in SMEs is based on unfounded assumptions. It is erroneously assumed that large companies are the norm and therefore, as a consequence all CSR approaches have predominantly been designed and are intended for large firms. Further, it has been presumed that small firms are ‘ little large firms’ differentiating themselves from large corporations merely on the basis of size (Jenkins, 2004). It is clear that SMEs are not miniature large companies, and as such the same practices which have been designed for large firms are difficult to ‘ fit’ to small organisations (Williamson et al, 2006). A study of Swiss multinational companies (MNCs) and SMEs reveals that contrary to what is perceived by much of the literature on the subject, small firms possess several organisational characteristics that could promote the integration of CSR practices as core business functions, while MNCs possess the disposition to enhance communication and reporting on CSR. CSR is therefore not a function of company size, but rather of company characteristics (Spence, 2011 et al).

Structure is one of the factors that distinguishes large from small firms. While large firms tend to organise themselves with a bureaucratic structure and formalisation, small firms are characterised by loose informal working relationships (Perez-Sanchez, 2003). The behaviour of small firms is strongly dependent on the characteristics and management style of the owner himself, whilst in large firms this is not so strongly felt (Tilley, 2000). Perrini (2006) argues that small firms are mostly owner-managed and are run on personal relationships. Gond and Igalens (2008) pin the level of CSR commitment by SMEs as directly dependent on the personality and personal convictions of its managing director. Age plays a significant role here, with the younger owner/managers display greater CSR awareness; gender has no impact on CSR deployment (Ede et al, 2000). Some authors are in disagreement as to whether the educational background of the owner/manager has any bearing on the level of CSR activity. (Ede et al, 2000; Spence et al, 2000). Spence et al (2007), confirm this claim and go one step further by asserting that it is the director’s vision for the future of his business and his understanding and perception of internal resources which determine CSR engagement in SMEs. Bonneveux et al (2012) report that the capacity of a director to locate and integrate new resources is fundamental to the integration of CSR measures and initiatives. The correlation between CSR engagement by SMEs and the perception and motivation of the firm's director and how he sees and reacts to CSR issues is thus reinforced.

Ownership and management in large firms are more separate and distinct than they are in small firms. In small firms, control remains in the hands of one of the owners, possibly putting him in a position where he can make personal choices with respect to the allocation of resources (Spence and Rutherfoord (2001). Given this particular management characteristic, the choice of CSR engagement in SMEs is mostly determined by the personal attributes of the owner/manager. A study of US SME's employing between 5 and 500 workers suggests that efforts to influence owners and managers to implement environmental CSR initiatives such as for example waste reduction need great focus on changing individual attitudes (Bennington et al, 2012). Stewart et al (2011) also confirm the link between leadership and the successful uptake of CSR and sustainability in SMEs.

According to the shareholder perspective postulated by Friedman (1970) the owner of a small business has the right to follow their own ethical beliefs in the allocation of organisational resources as they own the business and therefore it follows that they are using their own funds to finance any CSR activity. This is not so in large firms where ownership and control are separate and the investor of the funds does not have any say on how the funds he has contributed are being divested. In support of CSR engagement even based on a shareholder perspective of the firm, Stewart et al (2012) report measurable results in terms of business performance which can be directly attributable to the SMEs greater social and environmental engagement. The study highlights the relationship between learning, the development of organisational values that underpin CSR and improved business performance within the SME context.

Perrini (2006) contends that SMEs are, at many times stretched by multitasking, troubled by the limited cash available, and controlled by an informal mechanism. On the other hand, large firms are more likely to engage in carefully planned, formal, strategic management (Jenkins, 2004).

Jenkins (2004) tells us that most SMEs are more likely to be concerned about the day-to-day survival then by understanding concepts such as CSR. He contends that the term CSR alienates some of the small firms and that the language used needs to be simpler. In this respect, the European Commission has propo9sed the term ‘ Responsible Entrepreneurship’ in lieu of social responsibility of SMEs. Jenkins research however reveals that small firms regards CSR as an ‘ all embracing’ concept involving three pillars: sustainability; awareness of and responsibility towards a range of stakeholders, the relative importance of whom varies from one firm to another. This implies that most SME’s describe CSR on the lines of the stakeholder theory. Jenkins (2004) reveals that SMEs are consistent in their identification of stakeholders and point towards the environmental management, employees, the community/society, and the supply chain. It is not at all surprising that SMEs focus their initiatives on the local community. SME owner/managers usually live in the same area in which the firm operates (CSR Europe, 2003). SMEs, in fact, rely much more that large firms on the prosperity of the community in which they operate as most of their customers and employees come from the surrounding area.

Castka et al (2004) confirms that SMEs and large firms are not only different in nature but also in the way in which they approach CSR. They found that small businesses approach CSR informally and do not usually have pre-determined objectives or formal procedures for measuring the performance of objectives to external stakeholders. Further, large firms are more likely to adopt formal instruments to design CSR initiatives such as codes of conduct, ISO certification and social reporting (Graafland et al (2003). Large firms tend to integrate CSR as part of their business operations whilst SMEs consider CSR as an ‘ add on’ activity (Jenkins, 2004) and conduct CSR on an ad-hoc basis usually unrelated to their business strategy.

Jenkins (2004) argues that the motivation for CSR engagement differs between large and small firms. Jenkins (2006) explains that the growing visibility and the increased impact of large firms globally have called for greater accountability and transparency. On the other hand, small firms remain largely invisible and are not driven by external pressures, but rather by ‘ an internal drive to ‘ do the right thing’ or ‘ putting something back’ or ‘ showing entrepreneurial spirit’ (Jenkins, 2004). The force which drives SMEs to engage in CSR activities is therefore more ethical rather than commercial. Gupta et al (2012) conducted a study of Indian SMEs in which they highlight the many benefits which accrue to SMEs engaging in CSR initiatives. Small and medium-sized firms actively engaging in CSR were reported to enjoy an endless list of advantages amongst which were improved image, reputation, trust and understanding. Firms also secured a better market position and improved financial performance; increased attractiveness to potential recruits, increased employee motivation, cost savings and increased efficiency, efficient risk management systems and more business overall. CSR can be the stimulus for increased motivation and productivity amongst a firm's workforce (Salquin et al, 2007; Berger-Douce, 2008). An awareness and understanding of the challenges posed by CSR can actually form an excellent basis for organisational differentiation and competitive advantage (Kechiche et al, 2012). Not all academics concord and Jenkins (2006) asserts that SMEs undertake CSR simply for its own sake and refrain from using it as a method of self promotion as the large firms do. According to Fassin (2008), CSR is a rather informal action, and therefore more intuitive rather than strategic and for this reason, SMEs will hardly enjoy all the benefits that CSR engagement implies.

Jenkins (2004) emphasises that owner/managers of small firms are mainly preoccupied with the economic viability of their firms and spend a large part of their time and energy focusing on this aspect of their business. One main feature of SMEs is that the owner/manager is the person who deals with the day-to-day operations of the firm as well as other projects. This is distinct from large firms, where there is a dedicated CSR department with resources being specialised for this function. For this reason, time and resources are identified as the greatest constraints which SMEs face with respect to investing in CSR initiatives. Gupta et al (2012) also claim that the initial cost of CSR is at times higher for SMEs as they conduct small business and they justified request for government assistance and support in the implementation of CSR in the firm. The owner/managers of the UK firms studies by Jenkins revealed that they difficulties trying to convince reluctant employees to involve themselves in CSR activities. Furthermore, the excessive number of short term projects, the lack of information (Berger-Douce, 2008), the problems with measuring intangible benefits and the difficulties of making connections in a small community where other common adversities faced by SMEs. SMEs also meet difficulties which are related to the market, particularly restrictions in applying environmental and/or societal legislation because of its complexity and the rigidity of procedures. SMEs complain of the lack of adequate support services and infrastructure (Kechiche et al, 2012).

Despite the adversities faced, Castka et al (2004) reveal that SMEs acknowledge that there is a need for them to conduct business in a socially responsible manner. When researching Swedish SMEs, Pettersson et al (2012) found that CSR activities become more important for some stakeholders, particularly in times of difficulties and revealed an increased need for CSR engagement. They report that SMEs can strategically use CSR activities in order to develop a competitive advantage through differentiation by creating societal advantage. They claim that CSR activities become more important for some stakeholders, particularly in times of difficulties. Jenkins (2004) posits that SMEs are often active members in their community. In support of this Perrini (2006) reports that 50% of European SMEs are engaged in socially responsible activities. He explains how there is a positive correlation between the degree of involvement and the size of the enterprise with 48% of very small firms, 65% of small and 70% of medium sized firms being engaged in CSR activities. A study of Danish SMEs carried out in 2005 (Danish National Labour Market Authority) identified seven areas of CSR deployment, namely, the workforce, the environment, stakeholder engagement, marketplace activities, supply chain activities, internal management activities and charitable and voluntary activities. The study revealed that work-force related CSR activities were most diffused with 54% of all CSR activities, environmental activities occupied 51% of all initiatives and supply chain activities only occupy 22% of all initiatives. On the other hand, the barometer of sustainable development within French SMEs (CROCIS, 2007) reports that 96% of firms in the Paris area had implemented sustainable development measures while 47% of these firms had good links with the community through sponsorship deals, charitable events, back-to-work/employability schemes etc. Other academics, (Saulquin et al, 2005; Berger-Douce, 2008) are in support of this picture and confirm that employees appear to be well treated in the majority of SMEs. Fox (2005) reports that the most likely reason for SMEs to engage in environmental management is when this becomes critical in attracting and retaining business either locally or internationally. Saulquin et al (2010) affirm this by reporting that there is great sensitivity by SMEs to the wellbeing of their employees and their community links. In support of this, other authors claim that large companies influence the behaviour of small firms in their supply chain in particular in relation to environmental protection, labour and human rights, health and safety (Jorgensen and Knudsen, 2005). Worthington et al (2006) tells us that UK SMEs invested in a range of CSR activities and the most common forms of CSR deployment ranged from donating to local causes and charities, sponsorships of local events and organisations, support for local schools and colleges, environmental initiatives, ethical purchasing and staff related activities.

2. 6. Capability Maturity Model

Fassin (2008), contends that most SMEs regard CSR as rather informal action and refers to it as an intuitive initiative rather than strategic process. On the other hand, Spence et al (2011) affirm that MNC are often seen to assume responsibility by implementing CSR-related organisational practices and structures which permit them to interact directly with civil society. Further, however, MNC’s are often accused of using CSR as a front to cover up the more real business practices. Indeed it is important to analyse the depth and effectiveness with which organisations embed CSR within their operations so as to distinguish between CSR ‘ talk’ and CSR practice (Spence et al, 2011).

The Capability Maturity Model is an organisational model which describes five evolutionary stages in which a firm manages its processes. An organisation which treats CSR as an ‘ ad hoc’ activity will be at the initial stage. As the firm matures in its approach to CSR and embraces CSR more and more as part of its core business practice it starts to progress through the next four levels, namely: managed, defined, qualitatively managed, optimizing. The maturity levels offer a structure to the discipline needed for continuous improvement.

This paradigm is useful to determine the reason behind different levels of organisational CSR commitment and what it takes for a firm to progress to the next level of commitment.

Level 1

INITIAL

Level 2

MANAGED

Level 3

DEFINED

Level 4

QUANTITATIVELY MANAGED

Level 5

OPTIMIZING

Process unpredictable,

Poorly controlled and reactive

Processes characterised for projects,

and is often reactive

Processes characterised for the

Organisation and is proactive

Process measured,

and controlled

Focus on process

improvement

Figure 5: The Capability Maturity Model

Humphrey, 1989