Corporate Stakeholder Responsibility and value creation: British American Tobacco case study

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Introduction

The business environment is even more challenging year by year than what it was expected to be, so companies worldwide need to reconsider their business models and strategies and come up with new and sustainable tactics able to drive, or preserve, the value creation for their shareholders. This thesis presents the shift that has interested the majority of companies’ business strategies in the 21st century through the analysis of one of the key solutions to such change, the Corporate Stakeholder Responsibility.

The idea to develop this topic get started with a meeting that I had the pleasure to hold with Mr Petrillo, the Head of Corporate Affairs and Regulatory Affairs of British American Tobacco (BAT). The thing that impressed me the most in such conversation was that even if the company produces and markets a seriously health harmful product and even if BAT operates in an industry prominently regulated, it is still able to experience billion of dollar of revenue year by year. Nevertheless, the company is profitable and seems to be immune to periods of crisis and the key of this success is the stakeholder responsibility, through dialogue, communication, and partnerships.

The idea that emerged after this meeting was simply that if you want to run a business in the nowadays environment, it is not enough to produce high quality products and sell them. The real added value of BAT is its ability in managing all the immaterial processes between the production and the sale of the pack of cigarettes, and the most important one is the management of relations. With BAT, and in the overall tobacco industry, I recognized the possibility to feel the worth and the instrumentality of the Corporate Stakeholder Responsibility to shareholder value creation.

The purpose of this dissertation is to go beyond the general corporate social responsibility concept in which the term itself is very confusing; indeed here is taken into consideration the evolution of the CSR through the stakeholder theory. The focus is on a specific aspect of the CSR that is considered to be the most business-related to the company’s day by day operations and as a matter of the fact it is an intangible key driver for the bottom line. We will have a conversation about business strategy and business responsibility toward the stakeholders, so what a business does and how it does it.

The thesis analyses the Corporate Stakeholder Responsibility according to two strong assumptions: the long-term goal of the company is the shareholder value creation and the business is stakeholder oriented from the point of view that companies have to
manage for stakeholders because they are a vital step in the value creation process. So, in the elaboration of this work has been adopted the *instrumental perspective* of CSR seen as a mean to take advantage in the market with the final goal to deliver higher returns to shareholders. Furthermore the thesis attempts to explain and assess the effects of CSR on corporate financial performance and on stock price.

The thesis has a double transversal approach that goes on one side from business strategy to corporate finance, and on the other side from theory to practice.

The first chapter introduces the stakeholder concepts and all the features linking the stakeholder to the company. Furthermore there is a presentation of the main theories supporting the central role of stakeholders in the business environment.

Going forward on this topic, various scholars devoted their attention in the study of core stakeholder principles and were developed many interesting criteria for assessing the role of stakeholders that are discussed in the opening chapter.

Generally speaking, in the former part the focus is on the introduction of the main character of the thesis in order to provide the reader with a solid knowledge of who stakeholders are, how they position themselves in relation to the companies, and how much companies know about their stakeholders.

Finally after an assessment of different categories of stakeholders, we start to discuss more in detail about the specific approach of the thesis in dealing with the stakeholder theory: the instrumental perspective of stakeholders.

In that way we start to outline the identity of the thesis and its goal. According to this, stakeholders are an essential “asset” for value creation and an efficient managing for stakeholders maximise the real long-term goal of multinationals, the shareholder value.

In the second chapter we are going to discuss the outcome resulting from the intersection of stakeholder theory and corporate social responsibility: the corporate stakeholder responsibility.

First of all, we provide the reader with a brief introduction to the wide topic of corporate social responsibility and then, we analyse the corporate stakeholder responsibility as an evolution of the more general CSR. Our attention will be focused on this specific aspect of the CSR because it is in our opinion one of the most valuable set of policies and practices that companies should take into consideration.

After the identification of which kind of CSR we are referring to, we investigate the role of CSR in the field of business strategy and value creation.
The CSR is perceived as a tool of competitive advantage and in the chapter we identify the main value-oriented activity related to that: management for stakeholders through effective communication and active dialogue.

In the last part we adopt the stakeholder perspective and we investigate how through a weak CSR, such stakeholders can affect the company. Furthermore we go through a brief consideration about the recent evolutions in the CSR field and we discuss common concerns about its voluntary nature and the inadequate role of international guidelines.

The third chapter examines the key topics underpinning the fundamental role of CSR in the shareholder value creation. This unit traces a significant shift from the theoretical perspective of the literature analysed in the first two chapters, focusing more on a practical approach and investigating the impact of Corporate Stakeholder Responsibility on the corporate financial performance (CFP).

In this part the study of the relationship CSR – CFP is enhanced through the analysis of different empirical readings that provide us with meaningful findings. From such analysis the chapter goes through an interesting debate according to which CSR can lead to value creation only if it is meant as stakeholder management or prioritization of some stakeholders. Whereas from another perspective the CSR cannot directly create value but it is a strategic tool to preserve value for shareholders; so the CSR from a risk management standpoint.

Also important in this chapter is the emphasis on the instrument that will allow companies to monitor better their relationships with stakeholders and that will drive to higher corporate social performance and higher corporate financial performance: the stakeholder reporting.

In the ending section, the chapter suggests an explanation of the CSR as a moral development of the organization, according to which three standard stages are identified. As we will see the interesting finding is that companies tend to stop at the middle level and only the government intervention can push such companies to reach the highest level of commitment.

The fourth chapter completes the whole picture of the CSR and its value creation aspect taking into consideration an innovative perspective.

As analysed until now, the adoption of the best CSR practices is one of the multiple factors that allow the company to create value with a positive impact on the corporate financial performance, the bottom line for instance.
At the same time it is very interesting to analyse the value creation concept of CSR from the capital markets standpoint. In fact, in the fourth chapter we will see that the CSR is perceived as a positive driver for the investors’ decision-making and stock picking. This chapter wants to stress the idea of value creation as engaging new resources, such as capital, to be invested. Obviously if a company with an efficient CSR is able to attract more capital with respect to the ones that do not, this is synonym of value creation. According to that, if the company can benefit from more equity, it enables such firm to enlarge the business, to invest, and in the end to deliver higher returns to its shareholders.

The structure of the thesis started from a more theoretical to a more and complete practical approach to the goal of the thesis, the stakeholder responsibility and the value creation. According to that the real added value of the fourth chapter is represented by the concrete business examples in which the CSR has had a huge impact and it has been possible through the conversations that, in May 2014 during my period of research in Washington DC, I had the honour to held with two of the most powerful CEOs in the businesses world, Sergio Marchionne (Chrysler Group LLC) and Helge Lund (Statoil Oil and Gas).

The chapter outlines the main non-financial pieces of information that investors really value when they invest, and in particular it is stressed the role of the integrated reporting developed by SASB with the aim to provide “materiality” to non-financial information. Indeed investors would seem to be more sensitive to these kinds of factors (environmental, social, and governance) that are able to shape positively their confidence. In the chapter are reported the CSR key success factors that the CEOs identified as vital for the profitability and the sustainability of their particularly challenging businesses. This part concludes with some fascinating empirical examples, from the pharmaceutical industry to the energy sector, in which the lack/efficient implementation of CSR policies has influenced negatively/positively the stock price.

Last but not least, the fifth chapter includes the analysis British American Tobacco. The purpose of this part is to examine critically the case study focusing on the goal of the thesis, so the impact that the Corporate Social Responsibility can have on the value creation process.

This chapter is divided in four sections in which first of all are presented the motivations concerning why the choice of BAT. In this section we will underpin the controversial feature of the tobacco industry and the notion of CSR for BAT. From this section will
emerge that the company has a moral principle to behave in the most responsible way it can, according to the fact that CSR is not what the company does but how it does its business. And here we will see that the key success factor is stakeholder responsibility.

Secondly it has been thought to be useful introducing where BAT operates, the industry and the main challenges, always with a specific attention to the instrumental perspective of the CSR. BAT and the main tobacco players are companies that are not widely perceived by the public opinion (communication and marketing are not allowed by law), instead they are well known by the institutional opinion and by the lawmakers that as we will see play a crucial role in the tobacco industry.

Finally in the last two sections is examined the topic of how BAT creates value through CSR meant as coalition building and multiple-stakeholder dialogue. In addition is analysed the relationship between the stakeholder responsibility and the bottom line and which has been the stock price trend in the last twenty years.

Throughout this thesis I will try to investigate that an efficient Corporate Stakeholder Responsibility is able to create value for the shareholders but on the other side, I will adopt a critical approach stressing on the fact that the stakeholder responsibility is definitely part of business strategy of a company and not something that should be considered as a best practice of being socially responsible.
A – Part 1  Core principles of stakeholder and stakeholder theory

The first chapter provides the reader with a presentation of the stakeholder theory and of the core principles of stakeholders. In the opening part of the thesis are discussed not only the development of the theory in the last decade but also several methods of assessment to identify the role of the main stakeholders. The knowledge of the theoretical literature allows us to outline the identity and the purpose of this thesis in which the main focus will be the instrumental perspective of the stakeholder theory and its impact on shareholder value creation.

A.1 The concept of stakeholder

The stakeholder concept is something that has always been present in the business environment from the birth of the first corporations (around 1602) until nowadays. It is a key concept for understanding how businesses and corporations work and it is very curious that it has been taken under analysis only in the last decades. This topic has recently taken the attention of many professionals and experts and in particular in the early 90’s two big international conferences about the stakeholder theory were planned: the Toronto conference in 1993 and the conference in Finland in 1994. The agenda of these meetings were based on three main ideas: the identification of purposes and values of corporations, the role of the stakeholders in the value creation process and finally the concept of leadership and competitive advantage arising from serving other people, called stakeholders.

The first definition and examination of the stakeholder idea was given by the Stanford Research Institute (SRI) in 1963, according to which the stakeholders are:

“Those groups whose support is vital for the life of the corporation”

It represented the first light perception of such concept that was then developed in a structured theory by R. E. Freeman in late 1980’s called stakeholder theory.

Actually, in order to speak more precisely about the investigation of the stakeholder concept, it is useful to know that it was analysed by hundreds of scholars who considered the main idea and developed it in several different fields such as the business strategy one or others in the corporate social responsibility one\(^2\).

We can already get that one of the main issue that we are going to analyse will be: managing stakeholders, is it about ethic or business strategy? And furthermore does it have an impact on corporate performance?\(^3\)

Principally on the basis of putting together both ideas the real challenge for corporations is how you can create value from this great system of social collaboration (human process of joint value creation) for all stakeholders and at the same time delivering higher performance.

Even if it is hard to find one true definition of stakeholder, let us try to understand why their role is *vital* through a set of definitions collected from different scholars and economists spread from 1960’s to nowadays.

First of all, it would appear pertinent to highlight that a stakeholder is who support the organization and can affect or be affected by achievements of the organization’s objectives\(^4\).

Generally speaking, stakeholders have an interest in firm’s survival so they have the ability to influence the organization actions.

It appears to us that they have a legitimate claim on the firm established through the existence of an exchange relationship such as exchange transactions and moral responsibilities.

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\(^2\) See Annex 1 for the 76 definitions from 1963 to 2003 of “Stakeholder concept”. All of them are really important milestones to get the real meaning of what we are dealing with. This concept has been used and explained in the literature by various authors in very different ways with diverse and often contradictory meaning, evidence and arguments.

\(^3\) It is still an open question and in Part 1 and 2 I will attempt to analyse the influence of an efficient stakeholder management (from the CSR point of view) on the performance of corporations. Furthermore, I will try to answer the issue if the CSR actions can have an impact on stock price and though if they can influence the stock picking.

Basicall, they supply the firm with critical resources that are crucial for the productivity and the sustainability of the business. It can be raw materials, money, facilities and so on.

It is interesting to consider the idea of stakeholder from the reciprocal connection viewpoint. Indeed, if we admit that they depend on the firm and the firm depends on them, then they are members of a cooperative scheme for mutual benefits and partners for the achievement of mutual advantage. All this underlines that the firm has a responsibility to all participants in the firm that have a stake or a claim in the business and that can benefit from or can be harmed by the corporate actions.

Finally, we have to highlight that stakeholders are people who can help the corporation. It is everyone in the community who has a stake in the success or in the failure of the business, so in what the company does: decisions, policies, practices and goals of the organization.

It would appear that, the main unit of analysis is the relationship between a business and the groups and individuals who can affect or are affected by it. In particular, the fundamental drivers of value creation are the stakeholder relationships.

Indeed, at any point in time a company does exist in a network of stakeholder relationships. Interaction is the key word and understanding how these relationships work is the main determinant for the success of the business.

As I said above, the stakeholder concept is something representing the oldest and solid basis of the market idea. Indeed, the market is the place in which you are able to give birth to a business, and if we multiply it for all over the world we have an infinite number of businesses that are defined as: *a set of relationships among groups, which have a stake in the activities that make up the business*.

No stakeholder stands alone in the process of value creation. The stakes of each stakeholder group are multifaceted and inherently connected to each other.

We can clearly understand that a business is made of different actors and the study of the stakeholders is useful to have a deeper knowledge of the different categories of people that are involved in this network of relationships.

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We should now consider two landmarks of the stakeholder concept developed by Freeman in 1984 and by Carroll in 1993\(^6\).

These two perspectives give us a specific example of how controversial can be such notion. According to Freeman, stakeholder is “any group or individual who can affect or is affected by the achievement of an organization’s purpose” whereas according to Carroll it is “individuals or groups with which business interacts who have a stake, or vested interest, in the firm”. These definitions seem to differ in scope. Actually the former is focusing on the “affect or affected by” concept, while the latter is stressing on the “stake” notion described as claim, right or interest.

This set of definitions, however, does have some commonality. Each for instance, has at least two points in common: the stakeholder and the entity with whom the stakeholder has some connection, such as an organization, an individual or a society. So, different points of view but same subject.

The key for the right interpretation of such topic will be just having a deeper understanding of the surrounding environment you are dealing with. Then it will be just a matter of deciding which perspective would be more suitable in such context.

All this underlines that there is no better way to interpret the stakeholder concept than going beyond all the hundreds scholars’ definitions and starting considering a number of evolutionary and revolutionary approaches related to them.

This represents the main idea of the definition of what are stakeholders but now let us see which are the most common groups of stakeholders that have a special relationship with corporations\(^7\).

With regard to the identification of who are the stakeholders, we have the so-called primary (or definitional) stakeholders\(^8\):

- Shareholders or financiers

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\(^8\) The analysis “primary versus secondary” considers basically the former that are those stakeholders that have direct business dealings with the company, whereas the latter are those, such as NGOs, who can affect the operations of the company. A deeper investigation will be discussed in this chapter.
Customers
Suppliers and distributors
Employees
Local communities

It represents and describes the standard system of cooperation but in modern times the stakeholders’ list has expanded and we have to consider other categories such as:

- Competitors
- Governments, regulators, and other policymakers\(^9\)
- Financiers other than shareholders (creditors, bondholders, debt providers)
- Trade unions or trade associations of suppliers
- The media\(^10\)

The emergence of numerous stakeholder groups and new strategic issues require a radical rethinking of the traditional picture of the firm and provide us with a more robust way to understand the business. Basically, you have a global economy and you depend on each other and the success of the business relies on understanding the motivations of your partners.

As we can see in the graphs below, each stakeholder is playing a crucial role for the achievement of the company’s goals and furthermore each category can be active part with a meaningful impact in the decision making process.

In the description of Figure 2 we should highlight the importance of arrows that all go in both directions. They testify that be part of a social community means collaboration and cooperation and it represents a system in which everyone can contribute and receive benefits from such activity (inflows and outflows). We could interpret those arrows as contracts between the two parties called partnership agreements. A partnership agreement is only one contract among the ensemble of contracts serving to support the company. Besides, the fundamental specificity of the partnership agreement is the creation of a collective personality.

\(^9\) We will see in Part 4 that this category is particularly important for the business of British American Tobacco and represents a key stakeholder.

\(^10\) It is an example of stakeholder that may have influence but no stake.
Generally speaking, good relationships provide the basis of everyday activities and basically the glue of such relationships is the idea of trust. There could be divergent interests; but actually you are managing a common asset. Relationships and business, it is all about the ability to create something together and to coordinate the different players in a harmonic way in order to create value. The desire to create value for each other is vital and it is what makes capitalism\^{11} work. Last but not least, competition is important as well but our desire to compete is a second order property that can be accomplished only with a solid and adaptable network of relationships\^{12}.

![Figure 1. Map of stakeholders](image)

**Figure 1. Map of stakeholders**  

\(^{11}\) R.E. Freeman defined capitalism as the greatest system of social collaboration.  
Following this stakeholder map, we will now focus on the main groups involved in the value creation process, in terms of: nature of relationship, impact, ability and power of influence, interaction, responsibility and nature of the stake in the business\textsuperscript{13}. The shareholders (or financiers), they have a financial stake, they can affect what the organization does by talking to the board of directors and trying to influence the strategy. They are clearly affected by what the organization does because their financial well being partly depends on it.

The idea that shareholders have a special place at the center of the managerial model is an idea whose time has come and gone. So, according to a milestone of the stakeholder theory and the value creation, the business is represented by a set of relationships among several groups. It is not just shareholders and furthermore as we can see in the picture above (Figure 1), all the primary stakeholders are at the same level. Building and leading a great company has always been about managing for stakeholders. If you want to build and sustain a successful business, then the idea that we need to pay

attention only to one of these groups, the people who supply the capital, is deeply not correct.

According to R.E. Freeman: “the very nature of capitalism itself is putting together a deal, a contract, or a set of relationships among stakeholders so that all can win continuously over a long period of time”\textsuperscript{14}.

If we consider the directors, they are also stakeholders because they have a job in the company and their reputation may well depend on how the company performs. They are the people engaged in value creation and trade and they are responsible precisely to those groups and individuals who can affect or be affected by their actions. This means paying attention, managing and shaping relationships with customers, employees, suppliers, communities and financiers.

The BOD should consider all stakeholders, so they should consider their own personal positions. Not just their self-interests but they are allowed to consider the impact of the business on them as well.

It is thought that a redraw of the boundaries of managers’ job is required. It is about adopting a new managerial mindset; in particular they should focus on a deeper understanding of how the so-called “relationships among all stakeholders” work.

Despite everything the position of the managers seems to be controversial; indeed according to Aoki (1984) the directors are not seen as stakeholders but as referees between investors and employees\textsuperscript{15}.

Different considerations are made for the customers. They are receiving services and products from a business and therefore they can affect the business by buying more or buying less, complaining or advertising the good/bad service to friends. But they are also affected by the business because they are using the products.

The customer category is a stakeholder group of high importance. It is a kind of stakeholder that is really demanding from several perspectives such as price, quality, speed and customization. In addition, it is commonly known that companies redesigned key processes to be more focused on customers.


The Suppliers, they make profits by selling their products/inputs to the business. As a result they have a financial stake. Also if this business has a bad reputation and you are a supplier of it may be that bad reputation is going to rub off on you. An example of stake for suppliers could be that if they find a better, faster, cheaper way of making critical parts or services then both supplier and company win.

Suppliers are more like partners today and they are increasingly distinguished by service built on trust and partnership. Furthermore, we must remember that the supplier relationship has also changed with regard to certification and liability. ISO 9000’s program to certify attention to quality and ISO 14000’s program to certify best practices with regard to environmental management are both sources of competitive advantage.

The stake for employees takes into consideration different variables; they expect safety environment, wages, benefits and meaningful work. This category seeks for a stable relationship with its business. In return for doing a good job and loyalty, employees receive good wages and benefits and an implicit promise that the company would take care of them.

For example, employees have no legal power to “get rid of” a manager, nevertheless they could act in such a way as to damage the company directly, with a strike for instance, or indirectly (giving the company an unfavourable press as a bad employer). This type of action may come up with shareholders obliging the directors to step down, or reconsider their policy.

If we imagine the corporation as something distinct from the social body and from the stakeholders of whom it is composed, there is something in addition to the stakeholders that could form a community.

A community is the set of subjects linked by one or several factors of different natures (ethical, territorial, economic and so on). All factors that lead these subjects to have increasing relations between each other than with the others members of the society.

It is about the feeling of belonging to the community, sharing a common good.

It signifies that all the stakeholders of whom it is composed belong more to the corporation than to other communities. As a matter of fact, it is based on social links and economic phenomena such as work, production and consumption.

Dealing with local community (or society in general) we have to say in particular for big organizations that that their business can have a big impact on the well-being of the local community. There is a very interesting example from the past when in 1980’s a lot
of UK mines were closed down and the local communities were based entirely around the mines. The majority of people either worked in the mine or in other companies whose business was related to the mining process.

As the mines were closed it meant that the town was closed as well, communities collapsed and people moved away. The whole infrastructure was based around that business involving thousand of people.

If we consider Internet, mobile phones and the most advanced technology, the new businesses could have an impact on how society works and how people behave.

Companies have a real impact on communities and being located in a welcoming community helps a company creating value for its others stakeholders.

Furthermore, we must remember that the presence of government(s) has an enormous effect on business and according to the fact that businesses are the engine for the growth, the legitimate role of government is to regulate the business in the public interest.\(^{16}\)

To appropriately manage the primary relationships with customers, suppliers, employees, communities and financiers, executives must spend time and resources understanding and dealing with governments in a strategic fashion\(^{17}\).

Finally it would appear pertinent to underline that others such as government NGOs, media, environmentalist, these groups are important because they can affect how you create value for the primary stakeholders.\(^{18}\)

Today’s executives need to take into consideration the role of NGOs and Special-Interest Groups\(^{19}\) (SIGs) due to the fact that they have a strong influence\(^{20}\) on the businesses and it can be a key variable in setting the business strategy. A clear example can be given by

\(^{16}\) The watchdog principle.

\(^{17}\) If we think only about the tobacco or pharmaceutical businesses we can see the heaviness of the influence of governments actions.

\(^{18}\) Customers- suppliers – employees and executives working inside the company – communities - people providing the capital, the financiers (primary or definitional stakeholder).

\(^{19}\) The SIG is a community with an interest in advancing a specific area of knowledge, learning or technology where members cooperate to affect or to produce solutions within their particular subject of interest, and may communicate, meet, and organize conferences.

\(^{20}\) For example Nike discovered the importance of the responsibility chain when NGOs complained about the labour practices of the factories that supply Nike with products. Nike had to rethink its supplier relationships from start to finish.
the fact that considerable work has been done at the UN and other NGOs to develop sets of global principles of conduct for multinational corporations.

The complexity of understanding the system of individuals constituting stakeholders arises from their multiple personalities, linked to the several roles an individual may play. The very same individual may play different roles in the economic, political or social contexts.

So, if we consider the concept of stakeholder from a wide perspective, it could be anything from an individual customer all the way up to the entire population of the planet.

The definition is sometimes controversial; it is a very wide definition.

The multiplicity of identities opens up opportunities for strategic management of stakeholders. It is about business and strategy, so if a group can affect you then you need to deal with it\textsuperscript{21}.

A.2 Techniques for stakeholder analysis

After the exposition of the main groups of stakeholders that in standard conditions a company might have to cope with, let us now consider the basic ways through which a company can differentiate multiple levels of stakeholders simply wondering who is important for my business/activity.

Basically, managers do not have much problems understanding who can affect them and who they can affect. The problems may arise when you consider how to differentiate stakeholders and your value creation model. So if you divide them up in the wrong way, for example you divide them for political purposes and you do not understand the basic underlying economics, then you are liable to make mistakes.

Another interesting case could be also if you divide stakeholders in two groups such as those dealing with an economic impact of a product and those which are dealing with the social impact of a product, then you miss the fundamental interaction between them. Basically, there are several different ways of analysing stakeholders.

One of the possible ways of breaking up different types of stakeholders is using a matrix-based methodology called Mendelow Map (see Figure 3). It is based upon two main variables that are necessary when assessing stakeholders. In particular they consist of:

- Level of Power → How much power they got;
- Level of Interest → How much interested are they in the activities of the organization;

Principally on the basis of the power/interest matrix we have the possibility to split the stakeholders in four main areas, according to which you are able to identify and classify which kind of stakeholder you are dealing with. The four groups are:

- Minimal effort (low power - low interest)
- Keep informed (low power - high interest)
- Keep satisfied (high power - low interest)
- Key players (high power - high interest)

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The key players (*Group D*); if you have very powerful stakeholders it suggests that they could choose to do a lot to the organization. If they are also very interested in the organization, the chance is that they will do a lot to the organization. So every stakeholder who is very powerful and interested cannot be ignored.

Finally you have got to take them seriously, deal with them, listen to them and manage them.

The governments represent a clear example of this category (high power – high interest) and they represent those who can take actions to affect the accomplishment of an organization’s goals.

Whereas if you have a stakeholder who is not very powerful and does not seem to be very interested on you (low power – low interest), it should not be so crucial for the success of your activity and basically what you need is just a minimal effort (*Group A*). Consequently, you cannot find any particular benefit in dealing with this stakeholder.

Dealing with the other two cases is a little bit different and there is a difference between how you may address these two kinds of stakeholders.

The first circumstance (*Group C*) could be the one in which there is somebody who is very powerful but who does not seem to be very interested; and it is about those to keep satisfied (high power – low interest).

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If we imagine a lot of government authorities for instance, those are very powerful. They generally would rather just leave your company alone and the general rule is that if you upset the government department you have to expect to be investigated and possibly penalized or punished. If you keep them satisfied there is no need to do anything in particular, just do not upset them and you will never hear from them.

Finally, the last case consist of a stakeholder which is very interested but who does not have much power (*Group B*). In a certain sense he cannot do anything to you but he is demanding a lot of information from you, so keep him informed.

The danger of all stakeholders is that potentially they move into the top left box where you have to deal with them. So, as long as they are very interested but not so powerful, just keep them informed and the interest level will be satisfied. But it is very important to bear in mind that stakeholders which are not very powerful may become powerful sooner or later, so give them all the information they deserve otherwise strong reputational consequences may arise. For example from a small stakeholder not satisfied you could find a group of small stakeholders that together are even much more powerful than what you expected.

Furthermore, stakeholders in *Group C* may move in to *Group D* if their interest in a specific project increases. Moreover, those in *Group B* may become empowered by access to key players.

This analysis seems to be based on practicalities, and basically who is interested and powerful cannot be ignored because of what it might do to you.

Let us consider a cigarette manufacturer and the children who might smoke those cigarettes. The children of course do not have much power and being children they might not have an interest on it. If a cigarette company knows that small children are illegally smoking their cigarettes many people would argue they have some sort of responsibility to try either to look after these children or stop them smoking.

So, one of the main limits of the Mendelow matrix analysis is that it is based on practicalities and it does not investigate the ethics (moral obligation).

Another way of breaking up stakeholders would be internal versus external²⁴.

When we use the word internal stakeholders we are referring to people such as directors and employees. So, anyone inside the organization that is going to know things

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about the organization that the outside world (such as governments etc.) does not know and that might affect the way you deal with those stakeholders.

Furthermore we can divide the stakeholders on the basis of "who is most affected by the organization", the so-called narrow-wide analysis. In such method we consider the narrow stakeholders as the most affected and the opposite is true for the wide stakeholders.

In this perspective, you are able to look to stakeholders from a more ethical point of view rather than a practical one.

Following this set of brake-down techniques, we will now tackle the primary versus secondary method.

Basically, looking at stakeholders from the opposite standpoint, the first question that an executive could wonder is: “who could most affect the organization? So, not what an organization can do to them but what they can do to the organization”.

For example a company may decide to talk with a regulator or with the government because they know that they could get into trouble if they do not. It is purely looking at what might happen because your long-term goal is sustainability of the business, so profitability.

In addition to these techniques a basic distinction is active versus passive25.

This differentiation takes into consideration who are the stakeholders most likely to do something and you should bear in mind that who has the power to do something could harm your company. So, try to anticipate the claim of the active stakeholders.

Voluntary versus involuntary: it is very interesting method through which breaking up stakeholders because we deal more with moral ethics rather than practicalities. This method seems to suggest that each voluntary stakeholder, anyone who is adversely affected by a business could in theory avoid being affected by that by disappearing off somewhere else.

For example if a business is damaging the environment producing lots of pollution in the air and it is affecting the ozone layer, so the weather condition that we all suffer, the entire population of the world has become an involuntary stakeholder. There is no way to avoid being affected by such business, so no choice, and no other solutions.

Here the argument is that therefore maybe the organization has a moral duty to take account of those stakeholders.

An involuntary stakeholder cannot escape the impact of a business so the moral duty of
the business is higher and in this field we facing a fostering of CSR campaigns that are
getting more common in such big corporations.
It would appear that we could differentiate stakeholders in several ways and it is a
useful filter for understanding better which the parties are involved in your business
and which role do they play.
This step seems to be necessary but not sufficient for a completely meaningful analysis.
Adopting an executive viewpoint, rather than the business schools perspective, we want
to specify the principle of “who and what really count” in a corporation.
There are three main criteria\(^{26}\) for the construction of a hierarchy of stakeholders,
depending on a certain context:

- Power to influence the firm;
- Legitimacy of the stakeholder’s relationship with the firm;
- Urgency of the stakeholder’s claim on the firm;

This distinction regarding how important is a stakeholder compared to one another was firstly introduced by Carroll in 1993. It implies that if a stakeholder has either power or legitimacy, then he needs to be managed and those, which have more than others, need to receive more attention by the management team.

An additional criterion that might distinguish stakeholders could be the strategic utility based upon the probability of interaction with the organization and the potential level of impact.

The real issue here is to whom executives should pay attention, why they should consider certain stakeholders and how do they prioritize such relationships.

The answer to this complicated subject was given in 1997 on the basis of what managers identify to be the main attributes of a key stakeholder (power-legitimacy-urgency).

Subsequently, this study, underlines that through these attributes, then we are able to come up with seven stakeholder categories plus one non-stakeholder category, each characterized by different behavioural patterns.

According to this method of assessment, if just one attribute is recognized then it is not sufficient and implies a low priority level, two of them suggest moderate priority, and if all three are perceived by managers we deal with high priority level.

Nevertheless, a more theoretical point of view supports the inadmissibility of a hierarchy structure of stakeholders.

We could agree that the hierarchy configuration is based upon a principle of exclusion that is in a certain sense problematic. Here we are assuming that basically all stakeholders are important and all their interests should be taken into consideration.

The interests of all legitimate stakeholders have inner value and no single set of interests is assumed to dominate the others.

This critique to the hierarchy structure appears simply meaningless due to the fact that should be merely understood as a way of classifying stakeholders on the basis of their stake.

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28 See Figure 4.
It does not want to point out that one group will be disadvantaged or not taken into consideration, absolutely not. It is all about “each group will be given the level of priority it deserves” on the basis of the attributes discussed above.

One of the key points that we are going to take under analysis is the conflict between shareholders and stakeholders although it will turn out to be that their interests are mutual and above all linked.
A.3 Shareholders versus Stakeholders: sustainability means higher value creation for both

One of the biggest myths of the last 30 years is that if a manager pays attention to the stakeholders, he will miss to respond to the shareholders’ interests, that from this point of view are the most important.

This is one of the worst ideas that have been developed in the last decades due to the fact that it is not stakeholders versus shareholders because their interests are jointed.

Indeed, if we consider how do we create value for shareholders, you must necessarily manage for stakeholders. So, there is absolutely no trade-off between these two groups and you can create even more value if you understand how the stakeholders’ interests go in the same direction.

There is too much uncertainty and too much complexity in this business environment of the 21st century that if you do not take care of all the players that surround you, you will not be able so sustain your success and your leadership. In addition, it is even more though because you need to understand each relationship among those players and try to manage and shape them in order to drive all these interests in the same direction.

Concerning this topic there is an interesting debate that shows R. Edward Freeman theory versus Andrew L. Friedman theory. The latter is seen as the advocate of maximising profit for shareholders, whereas the former is a supporter of the stakeholder theory and taking care about stakeholders.

Actually, Friedman was against social responsibility idea but what we need is corporate stakeholder responsibility and if we have that, we do not have conflict between shareholders and stakeholders. For example a company could implement certain actions that respond to the long-run interests of shareholders but at the same time those will have positive social effects on the surrounding community.

Basically, it is about short-term results for long-term benefits.


30 Shareholders are stakeholders owning the biggest stake.

It is strongly believed that the only way to create value for shareholders in today’s world is to pay attention to customers, suppliers, employees, communities and shareholders at the same time. Furthermore, with the development of the stakeholder theory, we are now facing a revolution of ideas and of the basic concepts that were linked to the shareholder theory: profit maximization and high returns.

In such a complex economic environment it is not enough to make businesses, it is not enough to make money. Now, an entrepreneur needs to make business better and if he does not take into consideration all the new key variables, his business will be neither successful nor sustainable. All this underlines that major strategic shifts in the business environment require major conceptual shifts in the minds of managers, such as moving away from the idea of the society composed of individual entrepreneurs.

A clear example could be moving from a hypothetical idea of: “Why not delay spending on new products for customers in order to keep earnings a bit higher?” to “How can we invest in new products and create higher earnings, so that both stakeholders and shareholders are satisfied? ”.

The main idea underlying this study is to reinterpret the business; not as self-interests, sheer maximization of profit or competition but trying to figure it out as a set of components that make it great, such as: good products for customers, suppliers that want to work with you and make you better, employees with their minds always motivated and finally you, the firm, that have to be a good citizen in the community. This is how you create value for shareholders

Driving all these interests in the same direction at the very same time and being able to reach a win-win result, justifies that profit is just an outcome of an efficient and harmonic system in which the teamwork can create value jointly.

In reality we have to distinguish shareholders and stakeholders because specific features characterize them. The stakeholders are the people who show up everyday their work and that passionately engage in the purpose of the organization, whereas the shareholders are those who invest the capital because they want to make short-term money.

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33 Causality nexus according to the instrumental perspective of stakeholder theory.
With regard to stakeholders, they need to be invested for the long-term and must be emotionally engaged.

It seems to be clear enough that the literature on this topic always shows two dissimilar viewpoints: Friedman versus Freeman or better shareholders versus stakeholders\textsuperscript{34}. According to Friedman the publicly held corporations have a final goal that is: make money for their shareholders. If we admit that, the responsibility of management is strictly and uniquely for shareholders. Above all, the consideration of all other interests is perceived as a wrong practice unless the management can demonstrate that such consideration matches with the best interests of shareholders.

Generally speaking, the debate in based on the concept that shareholders are the holders of the shares and so of the company. The role of the manager, according to this perspective, is serving the owner’s interests and finding profitable opportunities to make them as better off as possible.

An interesting observation could be that we identified a legal fiduciary duty to shareholders and a moral non-fiduciary duty to run the firm in the interest of the stakeholders\textsuperscript{35}.

It is commonly thought that you, as an entrepreneur, have to choose among business without ethics or ethics without business. But this is not the point and this is why Friedman and Freeman perspectives are closer than what we expected. Indeed, it is easier and it is not a matter of ethics although of giving the right meaning to the cohesion and interaction of stakeholders’ interests so that the management can provide a better performance to everybody, shareholders included.

In conclusion, it is strongly believed that following the stakeholder theory means to address the focus of management on relationships in terms of critical success factor in running a firm.

It would seem usual and commonly accepted that managers cannot ignore stakeholders, but the turning point that can reveal to make the difference is the way they deal with them. So, the stakeholder theory forces such focus.


Just to conclude, here below, some quotes of CEOs and scholars have been selected with the intention to have a clear understanding of what is the stakeholder theory perception in the real business environment compared to the academic world.

“Serving all your stakeholders is the best way to produce long term results and create a growing, prosperous company...Let me be very clear about this: there is no conflict between serving all your stakeholders and providing excellent returns for shareholders. In the long term it is impossible to have one without the other.”

CEO of Medtronic Bill George, Authentic Leadership, 2006

“In America for instance, shareholders have a comparatively big say in the running of the enterprises they own; workers...have much less influence. In many European countries, shareholders have less say and workers more...In Japan managers have been left alone to run their companies as they see fit – namely for the benefit of employees and of allied companies, as much as for shareholders.”

The Economist, 1993

“All I can say is that if the other three parties: customers – suppliers – community are properly taken care of, then the stockholder will benefit in the long pull.”

CEO of Sears Robert E. Wood, 1950

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36 Recently has been always more common the shareholder activism phenomenon. An interesting case could be the one of Apple and Carl Icahn, one of the main shareholders.

37 In Germany for instance we have employees’ representatives participating in the board of directors, the so-called codetermination laws of Germany. They require employee representation on second-tier boards of directors. Furthermore an interesting case is the Companies Act of Great Britain, in which managers should take into consideration the stakes of employees in the decision making process.

38 According to the Japanese corporate governance model the companies are seen as a network of stakeholders (suppliers, customers, lending institutions and so no) interrelated and tied by a common good.
“The view of stakeholder management (Corporate Stakeholder Responsibility) and favourable financial and market performance (Corporate Social Performance) go hand in hand.”

Clarkson, Deck & Shiner, 1992

“The satisfaction of multiple stakeholders need not be a zero sum game. The benefits to one stakeholder group need not come entirely at expense of another.”

Preston & Sapienza, 1990

“Only investors and employees are significant stakeholders and managers are essentially referees between these two stakeholder groups.”

Aoki, 1984
A.4 Stakeholder theory: the tripod approach

The stakeholder theory is the study that allows us to discover the real world beyond a corporation made of people and responsibilities and not just money or products/services. Actually, profits, higher stock price and above all the performance are only the outcome of an efficient management for stakeholder.

The stakeholder theory plays a key role in the managerial aspect of the firm and in particular in the decision making process. The stakeholder is seen as an end and not as means. Indeed the core basis of the theory is to reconceptualise the role of the stakeholder who must actively participate in shaping the future path of the firm in which has the stake.

In order to have a strong basis on the main concepts involved in the stakeholder theory, it is considered necessary a brief recalling of the main four pillars supporting such theory.

The first one is an extract from the work of Freeman in 1984, in which he asserts that a company has relationships with many stakeholders that influence or are influenced by its choices.

The second one is based on the assumption that the theory deals with the nature of these interactions in terms of both procedures and outcomes for the corporation and its constituents.

The third one is mainly focused on the concept of intrinsic value associated to the interests of each stakeholder and it is clearly specified that no interest can govern the others, in particular the shareholders one.

The fourth and last one underpins the strategic value associated to the stakeholder theory with a specific emphasis on the managerial decision making process.

The literature related to the stakeholder theory is wide and miscellaneous, but there is an interesting path that we could go through and it begins with the study of Donaldson & Preston.

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39The theory does not imply that all stakeholders should be equally involved in all processes and decisions.

According to them it can be examined from three different perspectives, all crucial and mutually supportive:

- **Figure 5.** The three perspectives of the Stakeholder Theory, Donaldson & Preston (1995).
  

- Descriptive/empirical accuracy
- Instrumental power (cause-effect relationships)
- Normative validity

These three approaches are correlated one to another but at the same time they present several differences.

Descriptive or empirical because, the stakeholder theory provides us an accurate description of what the company is, was or will be. Basically, as we have seen previously the focus is on the concepts of: interests, relationships, collaboration and value creation. From this angle the stakeholder theory is useful to describe and explain certain circumstances linked to the corporation and certain behaviour of the people involved in the value creation process⁴¹.

⁴¹ The stakeholder theory has been used to describe: the nature of the firm (Brenner & Cochran 1991), the way managers think about managing (Brenner & Molander 1977), how board members think about the
The external ring represents the empirical observation meaning that what has been theorized should be perceived in the real world. The main idea is based upon the presentation and explanation of interactions that are observed in the businesses world. Instrumental power. It describes the stakeholder theory as taking advantage of the contingent model using a set of conditions "if...then". It is helpful to investigate all the relations that arise between an efficient stakeholder management and the accomplishment of the corporation goals.

According to the instrumental approach, if a company effectively manages for stakeholders, then will have the opportunity to achieve a successful performance in terms of profitability, growth and stability. Lots of studies concerning the corporate social responsibility from the stakeholder perspective have been done principally on the basis of the instrumental approach. The result has shown that for those with compliance to stakeholder principles and practices the achievement of corporate performance objectives was comparable or better than competitors.

The instrumental point of view is an intuitive way of thinking about the corporation and about how it investigates specific relations between stakeholder management (cause) and corporate performance (effect).

Finally the instrumental approach is characterized by its hypothetical nature: "if you want to achieve (avoid) results X, Y, or Z, then adopt (do not adopt) principles and practices A, B or C".

Let us consider the basic framework of the organization. It shows the main characters interacting each other in order to deliver the higher value through their activities. Stakeholders and managers are linked in this sense bilaterally and instrumentally to the corporation; furthermore the success in satisfying multiple groups of stakeholders will translate into higher corporate performance in favour of shareholders.

interests of a stakeholder (Wang & Dewhirst 1992) and how some corporations are actually managed (Clarkson 1991; Halal 1990).

42 The contingent theory asserts that the predicted outcomes are contingent on behaviour of a certain type.


44 See Annex 2, table of principles of stakeholders.

The normative validity consists of two important concepts representing the key criteria of the stakeholder theory: interests and value.

Firstly and more precisely, it is necessary to accept that the stakeholders have legitimate interests. Such interests represent the fingerprint of each individual stakeholder and at the same time the company should have any equivalent interest in them.

Secondly, all stakeholders are different with different stakes, each of them with a specific intrinsic value.

The normative idea is based upon the association of ethical or theoretical guidelines/best practices for the operations and management of organizations. Differently to the previous approaches the normative one is definitely categorical: "do this (do not) because it is the right (wrong) thing to do".

Basically the normative perspective is the hart of such theory. According to the philosophy of stakeholder management there should be a real correlation between the empirical evidences, and the basics of the normative literature.

These three different angles of analysis can be shortly summarized for their focus respectively in: actually what happens, what happens if certain practices are implemented, and what should happen in perfect conditions without externalities.

A.5 Hybrid and integrated models of the stakeholder theory

The study and the research on the stakeholder theory went well beyond and developed in several ways year by year.

Thomas M. Jones and Andrew C. Wicks developed a new way of thinking about the stakeholder theory in which basically they have developed a unique hybrid model combining the instrumental and the normative approaches: the convergent stakeholder theory\textsuperscript{48}.

According to Wicks and Jones the convergent theory is able to deliver an added value with respect to the others theories. Indeed, it reveals several practices through which executives can run a company and do business, both ethical and effectively feasible.

In order to speak more precisely about this topic we could make some considerations such as what moral obligations, to stakeholders and to shareholders, should the theory place on managers? The key answer that has been addressed to this issue is that first of all the stakeholders’ interests are as valuable as the shareholders’ ones and above all, they have to be treated as ends and not as means\textsuperscript{49}.

Furthermore even if aiming to a single approach to consider the stakeholder theory, the real and great challenge is trying to frame the right nature and purposes of the corporation and the activities of stakeholders who actively participate in the process. After that you know the rules, you know the main players and you are able to play the game.

According to this hybrid theory, each perspective that is either completely normative or totally instrumental is definitely incomplete and wrong. In addition to this, the separation of the theory in three different approaches is incorrect and the normative and instrumental features should flow into a unique theory.

The purposes of this theory are, first of all the need to develop a good and ethical theory; secondly, taking care of stakeholders’ interests and finally developing an integrated study in the stakeholder theory.

The convergent stakeholder theory represents an integrated presentation of this topic based on conceptual importation, theoretical reciprocity and theoretical unity. The


\textsuperscript{49} \textit{Ibidem}. 
integration process considers that equal methodologies must be used in analysing and summarizing the normative and instrumental theory, so that can be merged in a harmonic way.

The main concern in this study has been the coherence of the concepts treated and above all the practicability; because generally speaking this theory represents a new way so interpret the existing one. In this study Jones and Wicks care about the fact that directors could create moral/ethical business environments and make them viable and profitable for shareholders.

This integrated theory provided an interesting outcome that is given by seven main principles\textsuperscript{50} that summarize the main concepts and considerations taken under analysis so far.

The proposal of the new convergent stakeholder theory among scholars opened an interesting debate and the firsts disapprovals arrived.

The two main scholars were Linda Klebe Treviño and Gary R. Weaver\textsuperscript{51}. The main claims were first of all that this new perspective of the convergent theory did not move so ahead with respect to the previous one. Secondly, they criticized that Jones and Wicks did not consider any variables empirically testable. Indeed the main point against the convergent stakeholder theory was that the integration into the model of the descriptive/empirical perspective was not taken into consideration, therefore the theory was incomplete.

Weaver and Treviño considered fundamental the empirical angle, particularly because they analysed some papers written by MBA alumni concerning ethical dilemmas faced in the job environment. The results was that the executives of these small and large corporations, with a stable and profitable business, did not take into consideration all the legitimate stakeholders. So, through the analysis of several case studies they highlighted that the empirical investigation could not be ignored.

In the development of this research, we meet again the concept of stakeholder salience\textsuperscript{52}

\textsuperscript{50} See Annex 3 – The convergent stakeholder theory principles.


based on the three key variables analysed previously:

- Moral legitimacy of a stakeholder’s claim;
- Power of a stakeholder to influence a firm;
- Urgency of a stakeholder issue;

Using these three variables and debating against the convergent theory, was really curious that in case of high legitimacy, low power and low urgency, the stakeholder salience was definitely low. It meant that in such a case the directors would not devote their attention to these low salience stakeholders despite their high legitimacy. And this concept goes completely against the normative approach, so stressed in the hybrid model.

So, this approach tries to reconsider and to reconceptualise the previous theory but this time the necessary observation will be integrating instrumental theory with both descriptive (special real cases applications) and normative ones.

According to this approach the key word is *stakeholder research tradition*. It is based on shared concepts and it includes multiple and wide theories all focused on the same domain of observed phenomena; in this case the stakeholder theory.

If we consider the normative perspective is important to underline that the attention to all stakeholders involved in the business is the best solution in terms of moral and performance reasons. In the meanwhile, the empirical perspective, through which we have knowledge, plays a key role. It is a fundamental variable able to justify when and why executives do not devote the right attention to the legitimate stakeholders, in contradiction with the normative philosophy.

Finally, according to the outcomes developed in the research of Weaver and Treviño, the normative, instrumental and empirical/descriptive theories represent a tripod. All of them play a crucial role in the stakeholder theory system.

The empirical analysis tells us if managers act solely in the interest of the corporation; the normative one, gives us the recommendation to react to these incorrect practices; and last but not least, the instrumental shows us the likely outcomes always on the basis of “if...then” construction.

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Raymond F. Zammuto\textsuperscript{54} has developed an additional perspective with the main focus on the relation between multiple constituency models and organizational effectiveness. The key dilemma of this study is: \textit{“whose preferences should be satisfied through the distribution of the outcomes of organizational performance?”}\textsuperscript{55}

Zammuto tried to answer this question and in particular which interests should be weighted most heavily in the allocation of the performance results.

The analysis concerns with four additional approaches that have some points in common with the previous three, and are:

- Relativistic
- Power
- Social justice
- Evolutionary

These four standpoints are examined under two basic assumptions: the value-based and the time-specific nature of the effectiveness idea.

Beginning with the definition of the relativistic approach, it is important to stress its empirical and descriptive nature. It consists of gathering information about the company performance from a set of multiple stakeholders actively involved in the business environment.

With regard to the power perspective, it is basically a resource dependence model and it asserts that each stakeholder is in control of strategic/crucial resources.

Unfortunately, this approach stands that managers should go for satisfying the stakes of the most powerful stakeholders to ensure that the corporation preserves access to the critical inputs controlled by those constituencies.

A different approach is followed by the social justice perspective that relies on two main principles: equal rights to everybody and the possibility to have social and economic inequalities only in case that such disparities are intended to be in favour of the least advantaged groups/individual within the society.


\textsuperscript{55} Ibidem.
Finally the evolutionary model is the one on which Zammuto put the higher emphasis due to the use of context and time driven analysis.

The attention in such case is put over the concept of the dynamic social context. If a practice revealed to be successful at a certain point in time, it is not equally possible that it will be at another.

An effective performance, in such conditions, is the one able to increase the adaptability and flexibility of the business. Indeed, according to Zammuto, the ability of the firm in dealing with tough periods, turmoil for instance, is trying to adopt a different outlook shifting from the issue of whose interest should come first into how could I manage divergent interests in order to succeed in the long run.

Zammuto associates to the organizational effectiveness two pioneering concepts: the elements of fact and the elements of value. The former are precisely the facts that are observable in the real world, the latter reflect the ideal state of a system.

In the elements of value we cannot take advantage of the descriptive criteria. Indeed the elements of value provide the guidelines for the assessment and explanation of facts. This methodology advanced by Zammuto would seem to drop into another kind of hybrid model made of normative and empirical approaches56.

We have seen many scholars debating one each other on which could be the best approach to adopt in analysing the stakeholder theory, but actually they seem to be all very similar and only some minimal aspects make sound each of them slightly different. It is important to highlight that hundreds of papers and researches have been made on this topic and apart from fewer concepts developed by Freeman, we still do not have a commonly accepted view on such topic.

The aim of this chapter was exactly taking under analysis the stakeholder concept and the main interesting paths related to the stakeholder theory and their pros and cons analysis.

Since managing for stakeholders and more generally the stakeholder theory do not have an instruction book, the main idea that is worthwhile to consider when dealing with the theory of stakeholders and the corporation is to do multiple evaluations of the performance outcomes both from stakeholder perspective and from manager perspective.

56 Ibidem.
Finally, it is strongly recommended to implement a method based on heterogeneous considerations of the very same observation, instead of comparative evaluations of several corporations from a single perspective. The rationale of this approach finds its meaning in the consideration that investigating the same concept from the same angle will provide you with always the same answer and in such a dynamic environment it is unacceptable and furthermore misleading.
B - Part 2 From Corporate Social Responsibility to Corporate Stakeholder Responsibility

The second chapter, according to the previously introduced stakeholder theory, wants to illustrate the fundamental evolution of the CSR: from the Corporate Social Responsibility to the Corporate Stakeholder Responsibility.

The purpose of this chapter is to present the CSR from this new perspective that goes beyond the general notion of social responsibility and that is considered to be the most valuable for the value creation. Within this perspective, the thesis gives an assessment on both, the power of CSR as active part of business strategy and how a weak CSR can be harmful for the sustainability of the business.

Finally, in the last section are included some considerations about the voluntary nature of CSR and the recent updates in the geopolitical context with a focus on India and its mandatory CSR.

B.1 Introduction to CSR

Actually there is not a unique definition of CSR, we have plenty of definitions, but generally speaking the underlying concept is the fact that since businesses takes resources from society, then they are supposed to give value back to the environment in which they operate, to the communities, employees and so on.

Taking into account the evolution of the CSR from the 1950’s, the role of corporations in society has been seen from two different schools of thought.

According to Milton Friedman the first one is that corporations are driven by self-interest: “the business of business is business”. Here the focus is on maximising efficiency and profits\(^{57}\).

> “Corporate Social Responsibility is a dangerous distortion of business principles. If you find an executive who wants to take on social responsibilities, fire him. Fast.”

Peter Drucker, Management Guru, 2004

The second narrative, which claims that corporations have an enduring capacity to operate on the basis of ethical way of doing business\textsuperscript{58}.

This philosophy is based on the concept of legitimacy, according to which corporations exist because the society gives them the right to do so. Though corporations should have a certain sense of responsibility.

\textit{“Corporations could and should be a major force in resolving environmental and social concerns in the 21\textsuperscript{st} century.”}

William Ford Jr, CEO Ford Motor Corporation, 2012

The truth lies somewhere in between.

The problem with the efficiency and legitimacy dichotomy is that one category tries to define the other. But just to wrap up the CSR core principle, it is all about a win-win strategy\textsuperscript{59}.

This is why we have a complex issue such as sustainability that immediately becomes transformed into equal efficiency.

Nevertheless what happens when a corporation accumulate wealth at the expense of society? So which are the conditions that permit the corporations to accumulate wealth and more importantly how corporations and economy could be governed to prevent environmental and social damages?

The interpretation of the explosion of CSR all over the world is that CSR has now become an ideological movement intended to legitimate the power of large transnational corporations.

Recently researches in the extractive industries in indigenous communities have shown that these corporations are using CSR as a weapon to elude legislation and often with the collusion of very corrupt governments.

If we start to look outside the corporation at the forces that shape what a corporation does, we need to study the interactions of market, state and civil society actors that constitute the political economy of CSR.


The study of the CSR has always ended up with the idea that a corporation is responsible for everything, but accountable for nothing.

We need a reconciliation of economic, environmental and social interests.

CSR is seen by the most scepticism viewpoint as a corporate propaganda to protect the growing corporate power.

The corporations from this perspective would seem to have the duty to protect the interests of shareholders above all other interests, a duty to make profits.

But the corporations can do something about the harmful impact of their activities and according to the CSR philosophy we should reconceptualise the idea that corporations exist to concentrate power and wealth in the hands of few individuals.

CSR is proposing to use corporate power to create change rather than opposing and challenging the power of corporations. It is a mechanism thorough which changing the business as usual and it needs to happen.

The term itself is very confusing and used in different ways by different people.

The most powerful conception about CSR is from the large organizations perspective in which if you talk about CSR you are having a conversation about business strategy and not charity projects; it is about business responsibility and not environmental issues, what a business does and how it does it.

In Controversial industries (banking industry) CSR is more an excuse for culture of compliance rather than regulation (to ward of regulation, regulation is the biggest fear of most business corporations). So if it would become mandatory something interesting can happen.

Talking with business people on the issue of CSR, there are concerns on the way CSR is currently used and it is a very strong “feel-good” factor.

Energy sector, tobacco industries invest a huge amount of money in CSR, and ironically enough, millions of people die around the world from their products.

The way in which CSR gets used at that level does not play into a feel-good; it is almost like a therapy because the economic world in in big troubles and this really does help economy to get on with business. CSR practices are not something that you can enforce just when the business environment is in a bad period, such as a crisis in which you observe lack of trust for instance. CSR is not just the right way to keep going, there is something more.

Corporate stakeholder responsibility means sustainability and it is an active component of the business itself. It is definitely about business strategy.
Somebody thinks that CSR is essentially dead in its principle. In the US for instance, they were pushing extremely hard for the conception of what they call CRG, which is “compliance, risks and governments” they were really pushing for that. But now we moved into another perspective, indeed the future is ESG which is “environmental social and governments” and unfortunately we do not have good measures on that at the moment even though a first model has been developed in South Africa, called King Report on Corporate Governance⁶⁰.

The primary goal that come out from such code is that first of all the company law and the corporate governance codes apply to every corporation private, public or governmental. The second main point is that is crucial to keep the focus on the notion of sustainability⁶¹.

The key issue is not corporate governance but it is the governance of corporation for society and it definitely means that there is the need that other groups are involved in corporate decision-making process.

The role of fund managers in dealing with this issue, we can probably agree that increasing profitability and shareholder value are not necessarily congruent with high standards of corporate social responsibility. However they can certainly damage profitability and shareholder value because of the reputational impact that bad or failure in CSR that you can have.

The Norwegian⁶² and Swedish⁶³ governments have been proposing an original estimate to have binding laws to regulate large corporations and it quickly moved into a

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⁶⁰ It is a code of corporate governance issued by the judge Mervyn E. King Committee on Corporate Governance. It has been described as “the most effective summary of the best international practices in corporate governance”. It is based on principles and practices and consists of three reports issued in 1994 (King I), 2002 (King II), and 2009 (King III). The key milestones of the code are: leadership, sustainability and good corporate citizenship. Furthermore it includes an integrated approach that involves all stakeholders. According to Mervyn E. King it is an integrated way of considering governance, strategy and sustainability and in addition he said: “leaders should direct the company to achieve sustainable economic, social and environmental performance”. It encourages all companies to adopt the applicable principles from the code otherwise explain why: apply or explain approach.


⁶² In Norway, since 1992 all corporations must state in their annual report and accounts (AR&A) the extent of any significant environmental impact, and if significant, the measures taken. The act on the Right
voluntary mechanism. Nevertheless it is not mandatory, so there is not the requirement of disclosure and for some corporations miss the public available data.

The rise of CSR since the early 90’s is full-blown but it appears to be still inadequate and not really designed to hold a corporation accountable\(^6_4\) when things go wrong.

BP for instance, the energy-fuel-lubricants-petrochemical corporation, put millions of dollar in CSR policies after the BP oil disaster in the Gulf of Mexico in April the 20\(^{th}\) 2010 and as soon as we look at their website, in the sustainability section, a big quote appears:

“We strive to be a world-class operator, a responsible corporate citizen and a good employer. We believe we have a positive role to play in meeting growing energy demand around the world” and furthermore, “we believe that the best way for BP to achieve sustainable success as a company is to act in the long term interests of our shareholders, our partners and society\(^6_5\).”

Generally speaking, the point would seem to be always how you can do business responsibly taking care of all the stakeholders and the evidences taught us that a big quote on your website does not mean practicing CSR.

So, what could happen if multinationals start to take CSR policy seriously? And under what conditions could CSR hold corporations to account? How responsibility and ethics do characterize the company's operations?

The common practice among corporations dealing with CSR is that everybody is saying that they are doing it but in reality a very few are and those who are doing it are doing it rather badly.

to Environmental Information (2002) affords all citizens the right to receive environmental information from private enterprises and public bodies upon request.

\(^6_3\) In Sweden in 1999 all corporations that require an environmental permit were forced to include environmental information in their annual report and accounts (AR&A).

\(^6_4\) Hold to account, means requiring corporations to give an explanation of what they do or requirements to change what they do or how do they do.

\(^6_5\) www.bp.com
B.2 CSR through the stakeholder point of view

The first commonality linking the CSR to the stakeholder theory and the stakeholder concept is that there is not a single widely accepted definition of both. According to the perspective of this thesis we will obviously consider the CSR from the stakeholder viewpoint because: stakeholders mean relationships, relationships mean business, managing relationships according to the corporate stakeholder responsibility approach means profitability and above all sustainability of the business, and finally value creation for all stakeholders and even more for shareholders.

Among all the definitions\textsuperscript{66} that have been associated to the corporate social responsibility the most interesting one considering stakeholders impact was developed by Palazzo and Basu in 2008, according to which:

“...we can define CSR as the process by which managers within an organization think about and discuss relationships with stakeholders as well as their roles in relation to the common

\textsuperscript{66}See Annex 4 and 5 for all the definitions of CSR from 50’s to nowadays and CSR perception: US vs. European countries.
good, along with their behavioural disposition with respect to the fulfilment and achievement of these roles and relationships67.”

As we can see in Figure 6 this interpretation of the CSR represents one of the most recent one and it would seem to give the right and integrated flavour of this concept. The graph shows exactly the development that this notion has followed in the last decades going through the stakeholder theory and developing in the advanced form of corporate stakeholder responsibility.

Through the analysis of the stakeholder theory we have the opportunity to re-examine the idea that business and ethics do not go together. One of the main features of the stakeholder theory is the assumption that stakeholders are not products, not accounts, not assets but living breathing human beings, they are people. The added worth that a group of people is able to create is intangible and its name is relationship.

The basic concept that will be the link between ethics and business is that if we consider a specific stakeholder category it is not just customers but people with faces and names that will provide you with crucial inputs. The stakeholder management is a way of thinking about business and ethics together considering what are the effects of this business on those that are both outside and inside the corporation.

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The goal of capitalism is profit and making money but from the stakeholder theory perspective we are able to highlight the human connection that is granted through the relationships. Managing relationships means managing an efficient communication with respect to each stakeholder: clear, well-organized, concise and detailed agreements. Thinking about stakeholders is definitely is thinking about business and ethics at the same time.

We need a system that is responsive and responsible to their stakeholders. Ethics is about who you are and what/how do you do your business, what am I trying to achieve and finally how I am creating value for all the stakeholders.

The stakeholder responsibility builds on the broad notion of responsibility. Responsibilities are things that you are supposed to attend to. With this focus we are just asking, rather than focusing on corporations, what is the stakeholders need to be doing and what are their responsibilities.

We tend to focus on stakeholders and their rights, this drove attention to the spiral of rights that basically are responsibilities. It underscores the importance of what stakeholders do with the opportunities that they have in the firm, so do they act responsibly or did they slack?

The point is the interaction between the corporation and society and different stakeholders. It is a critical important piece of the puzzle, but if you are only talking about that piece, you are missing the business ethics that is an important part of the overall scenario.

The stakeholder responsibility matters for a variety of reasons but there are at least five particularly important points that we should consider:

- How ethics and business are fundamentally connected. Ethics is not something that we bring from outside, it is embedded in the day-to-day activities of business. Ethics and business are two things that tend to go together.

- Really understand why bad things happen in organizations. Empirical evidences (Enron for instance) showed us that when really bad things happen in a

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company, it usually is not just a few individuals but there are lots of people involved. Not necessarily people who actively did things that were horrible but certainly who knew about it, who allowed to go on and based on their position should have done something. The language of stakeholder responsibility pushes us to look more carefully and more systematically on the behaviour of all the stakeholders. How many people really knew that these things were going on and why did not they say something.

• All managers should be nervous today, according to the recent scandals affecting most of corporations. If you do not manage actively your company you could be the next Enron or Arthur Andersen. It is important creating an environment where I can be confident that my company is not going to have a disaster. It is crucial for managers thinking about how people cooperate and act responsibly together. So actively manage the company.

• Thinking about companies that have a great result in terms of performance and value creation. Where do they get this extra value? These companies are those who have stakeholders loyalty, companies that found way to get their supply chain, employees to act with a high level of responsibility. Let us consider a real example of successful corporation, in which many people have noted how special it is to fly with Southwest Airlines. Employees have a passion for customer service; they really care about what customers have to say and making sure that the flying experience is very positive. They found a way to activate a sense of responsibility. They found a way to engage their employees and it translated in greater performance.

• The stakeholder responsibility is a way to frame how I am going to deal with huge problems such as the example of Nike\textsuperscript{70} that was accused of encouraging and fostering horrible labour practices. The reality was that Nike did not own any of these factories and did not make a single product; basically it is just a marketing company. But because their products were made in these factories

\textsuperscript{70} \url{www.nikeinc.com}; see at Corporate Responsibility Report.
people thought they were the bad guys doing horrible things and its reputation were hit. Nike started collaborating with those groups who were fighting against the corporation and a new cooperative arrangement was made. Nike is spending millions of dollars to go and check in the factories that actually do not own. They had to take care of their supply chain and be sure that it worked responsibly. So, nowadays CSR is part of the investments that a company must consider.

The idea of corporate stakeholder responsibility complements the corporate social responsibility. The language of stakeholder responsibility is not intended to take the focus off the corporation. They are complementary notions, we need to be thinking about the organization as a whole but we need to not just focus on the company. The consideration of stakeholders intended as business ethics complete the entire picture of the corporation and CSR. Furthermore, the stakeholder responsibility emphasizes the fact that our mutual success depends on how we act, and if we perform responsibly we can accomplish things that benefit each other, we can be a better company.

The language of stakeholder responsibility can be used as a tool to engage and motivate stakeholders or to try they to do things they did not do previously. The focus as we have seen in the chapter one is completely on the quality of value-driven relationships. The corporation and management cannot do everything, you have to rely on your people and on supply chain partners otherwise you are vulnerable. There are several ways through which a manager can instil a sense of ethics in their stakeholders and in key relationships. For example one of the things that can be done is be thoughtful about whom they interact with and who the stakeholders are, because having the right partners make the difference.

Several scholars concentrated their attention on the interesting relationship between the CSR and the stakeholder theory71. It is considered of particular significance the definition of three models of engagement with stakeholders designed by Munilla and Miles in 200572:

1. Compliance: CSR expenditures assume the meaning of "cost of doing business";
2. Strategic: CSR represents a core investment for the well being of the business;
3. Forced: CSR is a cost that we could consider as a tax forced by the stakeholders.

According to the authors, the first and the third ones weaken the power of the firm in creating value and above all competitive advantage.

The aim of this discussion is exactly to underline the strategic value of this “intangible asset” that is the importance of an active and effective relationships management.

In addition, in order to provide a meaningful and integrated analysis of this topic we could take into consideration also the professional perspective that should be based more on practicalities and real case studies.

The Business Roundtable Institute for Corporate Ethics\textsuperscript{73}, an association of CEOs managing more than 10 million employees and $6 trillion of annual revenues, developed a report on the link between ethical behaviour and business practice. Through several researches and interviews this organization tries to accomplish its goal that is represented by coming up with new competences for corporations to develop. In this case it is about the CEOs perspective on how to implement the CSR mindset throughout the firm and in its overall value proposition.

The following statement perfectly contextualize what does CSR-CSP (corporate social performance)-CFP (corporate financial performance), as a single body, mean:

\begin{quote}
"Your company’s products improve customers’ lives.

Suppliers want to do business with your company because they benefit from this relationship.

Employees really want to work for your company and are satisfied with their remuneration and professional development.

And you are a good citizen in the communities where you are located; among other things, you pay taxes on the profits you make."
\end{quote}


You compete hard but fairly.
You also make an attractive return on capital for shareholders and other financiers."  

It shows an innovative and different version about the role of relationships that are not seen with a merely instrumental perspective, although as the engine of the value creation process. It has two fundamental features for key stakeholders that are ethics and values. 

In the work of the Business Roundtable, thanks to several researches and empirical evidences, have been recognized four levels of duty to stakeholders that can be considered as best practices to engage them:

1. Basic value proposition: customer richer and happier, value proposition to all other stakeholders involved in the activity;  
2. Sustained stakeholder cooperation: dynamic environments require new strategies, rethink the engagement process for each stakeholder;  
3. Understanding of broader social issues: lots of issue that are not business related but you must consider them and deal with them. Proactive attitude is required in order to have a flexible structure of your firm able to deal with externalities that could negatively affect your business;  
4. Ethical leadership: connections between ethical values and positive firm outcomes such as sustained profitability and high innovation. Understanding stakes, priorities and concerns of the stakeholder.

This represents what managers and above all the corporation should achieve in order to have a sustainable and profitable business. 

Now, the point is how could I reach these four levels of commitment and the answer is given by the elaboration of ten basic principles that provide the corporation with the best solutions to build strong and stable relationships with all stakeholders, definitely healthy for your business.

74 Ibidem.
75 See Annex 5 and 6, The table of Principles for CSR and different CSR perspectives: US vs. European countries.
76 Ibidem.
The first observation has the focus on bringing stakeholder interests together over time due to the fact that the value creation is a joint process. Furthermore has been done a clarification about the role of profit, that is contemplated as a measure or even better as a scorecard indicating how well the corporation is managing all the stakeholder relationships. And finally always remember that all interests are mutually reinforcing each other.

Secondly, the following principle refers to R. E. Freeman conception of stakeholder, who recognizes that stakeholders are real and complex people. Basically, through an economic activity you can create things for others and with others and if them, employees for instance, are strongly motivated and devoted to the company, your performance will be more valuable day by day.

The third one, analyses the point of how to deal with multiple stakeholders’ issues simultaneously. Basically, you have to satisfy all of them sooner or later, so the main recommendation is to find the key able to come you up with a mutually useful solution.

Going ahead, one of the principles highlights two important variables that are necessary and transversal to all the value creation process: intensive communication and dialogue with all the parties. This process is really useful because allows you with the knowledge of whom you are dealing with and then you are ready for the next step: negotiation with primary and secondary stakeholders.

The principles not only consider what is better to do, but also what is strongly discouraged. For example, it is specifically recommended to avoid the government intervention in behalf of stakeholders, because then you would be forced to act in a certain way. It would not represent the optimal situation that you can prospect for your interests, and it could be even worst considering the reputational effect.

In addition, in order to have a deeper understanding of the corporate stakeholder responsibility we should definitely consider it as an asset and as a necessary, essential and vital investment. It has no risks and really high returns. In this case we can recall the strategic perspective developed by Munilla and Miles in 2005.

The final suggestion is to manage stakeholders constantly, updating and monitoring each one of your relationships. The Business Roundtable pushed a lot on the energetic role of the corporation.

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In this way, according to the best practices it is thought that the corporation will be able to achieve the higher level of performance or better, as it is described in the Business Roundtable report, “able to act in order to fulfil your dreams and their dreams”. According to the view of the CSR from the stakeholder perspective it is exactly how corporations and executives should behave and in such way we could include the CSR in the strategic business and management process field.

Recently has been discovered that we are moving toward a new approach called *Triple Bottom Line (social – economic – environment)* in which companies because of the changing buying behaviour of customers are no more focusing solely on the economic results but also on their impact on society and environment\textsuperscript{78}.

\begin{figure}
\centering
\includegraphics[width=0.8\textwidth]{triple-bottom-line.png}
\caption{The Triple Bottom Line.}
\end{figure}

Let us summarize the key features that characterize the CSR in 21\textsuperscript{st} century.

First of all, CSR is the key to create value in condition of change. We are in an environment that is really fast growing and you have to rethink on daily-basis your strategy if you want to be sustainable and to lead the industry in which you “play”.

Then, CSR is not just social responsibility (environmental issues and so on) but it is also wondering continuously how we are going to live together, the business, the company and all the stakeholders, and at the same time how we can create value together.

Finally, the question that arises at this point is what actually happens in reality and the answer is that there has been certainly a shift in the attention toward the CSR, but eventually most of corporations still perceive it as a “profit-spending” activity instead of a “profit-making” one.

At the same time it would seem that a radical rethinking of the consumer/investor behaviour has taken place. Indeed, the following chapter will attempt to provide evidences testifying that corporations applying effective CSR policies will benefit of higher attention from investors, so of a higher financial performance.

The CSR can be more than a theory if it is effectively applied through the stakeholder engagement. In this sense the firm will be able to achieve a competitive advantage sustainable in the long run.

The right interpretation of the CSR in the investor mindset can be recap in three main pillars, fundamental for the investment decisions:

- **Figure 9.** The three pillars of CSR driving the investors’ behaviour.
  
  *Source: Primary data.*
According to the international corporate governance network\textsuperscript{79} (ICGN\textsuperscript{80}) there are clear policies in promoting CSR in the areas of interest of investors.

A clear example is given by the appointment of a specific board, called shareholders responsibilities committee that has been developed with the final aim of influencing international policy developments regarding the duties of investors. With the growing attention in the CSR field, such committee produced guidance on institutional investor responsibilities and there are two important sections defined as guidance on principles of external, and internal responsibilities.

So, in the next chapters we will shift the focus on value creation and the role/behaviour of investors in this area.

\textsuperscript{79} \url{www.icgn.org}

\textsuperscript{80} The ICGN is an investor-led organisation of governance professionals that has the goal to inspire and promote effective standards of corporate governance to advance markets and economies worldwide. This happens through: influencing policies, connecting peers and informing dialogue.
B.3 CSR: from stakeholder responsibility to business strategy

It would be interesting considering the broader notion of corporate social responsibility developed by the World Business Council, according to which the CSR is nothing more than the commitment of business in providing a sustainable economic development working with all stakeholders and at the same time providing them with a better quality of life, and a better environment.

The WBC identifies several areas of interest that can be intended as CSR:

- Ethics and corporate governance;
- Environmental and charity policies;
- Health and safety;
- Human rights;
- Managing human resources;
- Social issues;
- Corporate philanthropy;
- Customer satisfaction;
- Disclosure and communication policies;
- Managing relationships or the so-called management for stakeholders.

All this areas are interdependent one each other and share the common good: the business or even better the corporation.

After having showed in which cases we speak about CSR, let us now consider a more theoretical approach.

The corporate responsibility can be divided in three main categories: the corporate financial responsibility, the corporate social responsibility and the corporate environmental responsibility. These three categories respectively imply three categories of performance: the financial performance known as profit, the social performance in which the key variable is people and all the related issues and finally the environmental performance meant as planet.

81 www.wbcsd.org
How the corporation and its directors can be responsible? Simply using some standard tools such as integrity, fairness, transparency, accuracy, sustainable development and human being carefulness.

And what about the benefits that an efficient CSR can generate on behalf of the company? Above all, the company receive essential improvement on its brand image with respect to clients, suppliers, and media and almost certainly to its potential investors (but the analysis of this last category seems to be controversial to certain extent and it will be discussed afterwards). CSR, no doubt, is positive reputational effect. The CSR represents the right way of shaping the corporate identity and allows you to build a business that is healthy, socially accepted and sustainable in terms of profitability. The sustainability per se implies the capability of the firm to engage all the different stakeholders that will move from a simply “exchange” perspective to a “belonging sense” perspective that will motivate all the parties involved in doing their best. In addition the application of CSR policies increases the consensus and the trustworthiness of the company’s operations.

If we consider that the corporate social responsibility is not mandatory, it could be seen as a mean of differentiation and of competitive advantage. The corporations should consider it as an opportunity to think different and make their business faster and more visible in the marketplace.

According to the fact that the CSR is not mandatory, corporations that are interested in applying voluntarily such best practices usually take into consideration different guidelines or codes such as the guidelines of the OECD, the Global Compact principles of the United Nations\(^82\), several kinds of certifications (ISO, EMAS, FSC etc.), Code of Ethics and so on.

The UN Global Compact\(^83\) represents one of the most valid organizations that tackled the CSR issues as a crucial one for the future path of all the businesses.

In April 2014 at the UN headquarter in NY has been presented the book *Responsible Leadership: Lessons From the Front Line of Sustainability and Ethics* by Mark Moody-Stuart\(^84\). In the book he goes through questions like:

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\(^{82}\) See *Annex 7* for the Global Compact Principles of the UN.

\(^{83}\) [www.unglobalcompact.org](http://www.unglobalcompact.org)

\(^{84}\) Chairman of the Foundation for the Global Compact and Vice Chair of the Global Compact Board, he has long helped to develop strategic direction to the UN Global Compact.
“The real challenges start when it [wealth generated by business] is not used constructively. What do you do? What are the responsibilities of the company in a country when things are not going well?”

It is about the history of the last 20 years of corporate engagement with sustainability, ethics and responsibility. The involvement of such big organization shows us the fast growing importance that is associated at this topic, in which the corporations and their businesses are perceived as engine of the change of a situation that has not been considering for such a long time what and who was surrounding the economic activity.

- Figure 10. Some extracts from the most popular newspapers' headlines concerning with CSR. Source: http://docenti.luiss.it/caroli/files/2010/04/vodafone.pdf
In the interesting case of Vodafone Corporation\textsuperscript{85} it is showed that CSR is:

"Corporate Responsibility represents the total impact of the business on society. A collection of corporate strategies that increases the Company’s economic value, with respect for the environment and social aspects, considering the rightful expectations of our stakeholders."

According to Vodafone the CSR is exactly a core component of its strategic plan and the company will benefit with a higher financial performance, but the consideration of environment, social aspects and stakeholders will be a step necessary to reach the competitive advantage\textsuperscript{86}.

In a recent study made by the Institute for Business Values in 2008, a sample of Italian companies was selected and asked to rank a the principles that push them to CSR issues and they answered in the following manner:

1. Ethical justifications
2. Relationships with stakeholders
3. Customer loyalty
4. Community relationship
5. Economic result

Once again we have the demonstration that the corporate social responsibility is always more associated to the “managing for stakeholder” concept than to the other notions that have been introduced previously.

The CSR born as a tool in order to discourage the irresponsible and inefficient use of inputs, and in particular of the most valuable one, the human being that is able to create and add value in each step of the value process.

\textsuperscript{85} http://docenti.luiss.it/caroli/files/2010/04/vodafone.pdf

\textsuperscript{86} Ibidem.
B.4 Management and communication: the perfect equilibrium for an efficient CSR

The CSR is, according to Vodafone, a *collection of corporate strategies* ready to be used and able to lead you to the top results both in terms of financial performance and in terms of brand image.\(^{87}\)

When we say, ready to be used, probably it is not correct because it is harder than what it seems. Indeed, recalling the consideration that CSR is not mandatory implies that once you have decided to implement it voluntarily then the only way to make it valuable is up to you.

Dealing with a non-regulated topic like this can be a great opportunity for corporations and the two key words that will allow you to gather positive effects are: efficient communication and disclosure.

The point is exactly making a differentiation between, on one hand the so-called corporate responsibility (meant as the operations and the investments that are made) and on the other hand the communication/disclosure that you provide.

\[\text{Figure 11. Higher performance through efficient communication and management of CSR.} \]  
\[\text{Source: Primary data.}\]

\(^{87}\) *Ibidem.*
The question in this sense is at which of these two variables does the market react? The answer is "depends" on the industry of belonging of the corporation, but actually the market is mostly captured and influenced by the communication.

The disclosure and so the communication activity about the operations and the internal procedures is entirely up to me (voluntary), so if a corporation decides to go for it, it will be necessary to know to whom you are referring to and how to do it.

As we see before there are some guidelines reporting the best practices but it is just something that is recommended and not required and so completely flexible to your interpretations.

The nature of the interpretation could be different from corporation to corporation and is totally subjective. Eventually it will be all about a matter of trust about my way to do the disclosure, communication and not the way I apply the corporate responsibility.

The impact of my communication could be direct or indirect, so slower.

If it is a kind of direct it will mean that the market and the investors are reactive and that they actually appreciate the way you communicate your CSR and in practical term in will turn into real value for the firm.

The choice to go for a CSR strategy implies a lot of expenses in terms of resources, from time spending to money spending, so we can confirm one more time that it is a core investment being part of your business strategy.

The point of view that this thesis would like to highlight is that applying CSR policies to the business of a company does not mean just being the good and perfect citizen at whom everybody should look at. CSR, is a strategy, is a new way to strengthen the visibility of your corporation in the investors’ mindset. CSR is definitely looking for a competitive advantage in the long run.

The CSR can be misunderstood depending on the field in which it is applied. Indeed, it is important to make a clarification between the final goal of a corporation and the goal of a different kind of organization called foundation (a charitable organization for instance). The big difference among them is that the former is characterized by the profit for the corporation and it should not be seen as something immoral or wrong. It is just the outcome of an economic activity that finds in its inner nature the goal of deliver the higher performance possible. Whereas in the case of foundations, it is all about reaching a certain level of performance able to generate profits for the community, environment and so on. So the foundation has, first of all, a different identity and it leads to a different goal.
We have seen that there has been deep evolution across the CSR concept, going through the stakeholder theory and finally developing into what we define corporate stakeholder responsibility.

The responsibility in this sense put the emphasis on the feeling of partnership inside and outside the company. In particular, it optimizes the dialogue between the parties, the sharing and combination of different skills and competences, and finally a common monitoring. In that way the partnership has an instrumental validation for the company and at the same time you have the right balance between the social values and the achievement of valuable financial performance. This is how the stakeholder theory shapes the social responsibility topic.

That is why some corporation like Vodafone decided to go in two different ways\(^{88}\): the business activity proper of the company and the Vodafone Foundation.

Strategic choice for a higher reputation perception or just deciding to help people with socially ethical activities? It is still an open question that only the managers can answer but for sure Vodafone has spent 18% of the € 190 mln of overall investments in CSR in 2010\(^{89}\).

It is exactly what almost always happens, that the foundation (or the social responsibility aspect) is seen merely as a vehicle for promotion and advertisement of the corporation. The foundation is the expression of the other face of the corporation, the one dealing with the social responsibility.

\(^{88}\) www.vodafone.com

B.5 Corporate Stakeholder Responsibility: how stakeholders may influence the corporation decisions and CSP

Until now we have discussed about the centrality of the stakeholder in the value creation process, it is necessary to manage the relationship in an efficient way and you will reach a sustainable and profitable business. But CSR means not only understanding who your stakeholders are and what do they want, indeed CSR is also investigating about which means they will try to exploit in order to shape their relationship with the corporation\textsuperscript{90}.

The analysis of which kind of influencing strategies the stakeholder will use is crucial and it enables managers to have a better understanding and managing of stakeholders’ behavior. As we underlined several times up to now, the economic activities and the overall environment is always more competitive and challenging, so the managers are required with an higher level of attention about the management for stakeholders because a mistake in the relationship management could negatively affect the corporate social performance and the corporate financial performance.

According to Jeff Frooman\textsuperscript{91}, the types of influence strategies applied by the stakeholders can be comprehended in terms of resource leadership. It means that through the investigation of the resource relationships, that link the firm and stakeholders, the managers have a key determinant in the understanding of how the company will be influenced and above all, how the very same company will respond.

It seems that this approach will differ according to the kind of corporation and stakeholders involved. Indeed, it is important to place the firm in its proper context.

When we deal with stakeholders and their interests we have to take into consideration two main kind of stakeholders: the strategic and the moral. The main difference between them is that the former are those who can affect the firm and you have to manage such interests, whereas the latter category is that influenced by the firm and here the activity that is required is much more balancing those interests.


From the corporation point of view, the real stakeholder is who can really affect you in terms of decision making process and firm’s behavior, so the strategic stakeholder.

The company can understand how will be influenced through the analysis of what ties itself to the strategic stakeholder, that is the relationship. It shows which are the attributes of the conversation that will take place between the two actors and how they will interact.

According to Frooman the focus should be on the resource dimension of the relationship because the conversation that managers and stakeholders usually have is about what I can give to you and what can you give to me, and finally about what we can do together.

The resource dependence approach gives us the possibility to define four types of stakeholder influence strategies:

- **Withholding.** It is the strategy according to which the stakeholder suspends the process of providing a resource to the corporation with the final aim of making the firm change a certain attitude or behavior. For example could be represented by employees who withhold labor by going in strike. This strategy determines if the company receive or not the inputs.

- **Usage.** In this case the strategy applied by stakeholders is slightly different to the extent in which the firm continues to receive the resources but with some constraints.

- **Direct.** The direct strategy is that in which the stakeholder is directly controlling the flow of inputs to the corporation.

- **Indirect.** The indirect strategy is also known as communication or alliance strategy. In this case the stakeholder under analysis informs a potential ally (another stakeholder, the media for instance) about the behavior of the firm and for which reasons such behavior is perceived as undesirable.

From this point of view it would seem that the company depends more on stakeholders than the stakeholders are on the firm.

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92 Ibidem.
Another interesting output that the resource dependence is able to provide is the definition of four types of corporation-stakeholder relationships:

- **Firm power.** The power is a key factor in situation showing stakeholders and the corporation with opposite interests. On one side the firm should try to drive all the interests in the same direction for the so-called common good. On the other side the power could be used as a vehicle to influence the more dependent party among the two.

- **High interdependence.**

- **Low interdependence.**

- **Stakeholder power.** This kind of relationship denotes the low level of dependence of the stakeholders on the firm.

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**Figure 12. Stakeholder Influence Strategies.**

After the definition of the different kinds of relationships and the potential strategies that could be applied, it is useful to consider the right way to mix them up.

The study of Frooman\(^93\) provides us with four propositions answering to the question: which strategy may a stakeholder use in order to influence the firm, on the basis of a certain relationship?

The first proposition identifies an association between low interdependence and withholding strategy. The proposition recommends this strategy in a case like this because in this sense you, as a supplier for instance, will make your resources more desirable for the company.

The second one, shows firm power related to indirect usage. This strategy has the aim of strengthen the importance of the stakeholder that is suffering from the company supremacy.

The third case, takes into consideration the stakeholder power and the direct withholding strategy.

Finally the last proposition considers high interdependence and direct usage strategy.

This analysis could be understood from both the perspectives, the one of the corporation and the one of the stakeholders. We would like to stress the concept that knowing how stakeholders may try to influence a firm is vital knowledge for any manager in order to shape the proper strategies for preventing such actions or for defending from them.

\(^{93}\) Ibidem.
The research of Frooman taught us that in managing for stakeholders is definitely recommended to prevent and avoid situation in which your stakeholders are too much powerful with respect to you or situation in which you are they are not happy with your behavior.

The added value of maintaining a friendly business environment in your activity is that there will be a shared atmosphere of collaboration and cooperation, and not a continuum war of strategies in order to influence the other party.

The most effective and efficient practice is cultivating mutually beneficial systems of stakeholder relationships because you, as the corporation, want to lead the process in order to end with a win-win outcome.

The key for the success and for a great corporate financial performance is to build a system, made of company-relationships-stakeholders, able to be responsive and adaptive to changes in the surrounding environment.
B.6 CSR 2.0, a forecast of developments in the business strategies of corporations

Some reflections should be done in dealing with future trend in the field of the CSR\textsuperscript{94}. A new and very critical approach sees corporations wondering about which are the reasons and the components of my business that depict me as acting irresponsibly and unsustainably.

The basis of these considerations found their effectiveness in a radical rethinking and innovation of the business model, internal and external policies and practices.

The first development in the CSR field considers that in the next years there will be a shift of the majority of the biggest corporations that will bring their attention on the main four features of the CSR: defensive, charitable, promotional and strategic\textsuperscript{95}.

In addition, with an increasing worldwide acceptance of the CSR in the business environment, it will be necessary a development of more detailed guidelines and codes because the Global Compact Principles of the UN do not represent a definitive and solid structure on which building a proper CSR strategy. The general guidelines that we discussed above are really useful in providing the general flavour of the CSR, they describe the best practices but the general opinion is that they are still far away from a valid and sufficient framework.

One of the main limits that have been associated to the CSR is its voluntarily nature. So it is strongly believed that all the companies in the next years will be incentivised by the governments in considering with higher attention CSR investments.

There will be a necessary improvement in the measurement of the CSR policies. The development of new tools and different approaches that will be able to identify and measure how companies have interpreted the CSR. Along with that, we will see the emergence of innovative CSR rating agencies.

One of the almost certain things will be the mandatory requirement of some of the main points concerning the CSR nowadays, but it is commonly thought that it will remain more than partially a voluntary procedure.

\textsuperscript{94} W. VISSER, \textit{CSR 2.0: Transforming the Role of Business in Society}, Lien Center for Social Innovation, 2011.

\textsuperscript{95} W. VISSER, \textit{The Age of Responsibility: CSR 2.0 and the new DNA of business}, J. Wiley and Sons, 2010.
One aspect of the CSR that could become mandatory is the disclosure of your CSR. It would consist of leaving you free to decide if going to CSR or not, but once that you have decided to go for it, you must follow certain established criteria.

As we discussed above complying with CSR policies can be a real opportunity for corporations in order to gain more visibility and at the same time taking care of the community. We should definitely consider it as one of the potential ways that, in an integrated system, can lead you to obtain a sustainable competitive advantage.

The CSR should in this sense represent a perfect scenario in which corporations are active part of something more than an economic process, indeed we will deal with “smart corporations” able to address the sustainability crisis in an efficient way.

The CSR perception that we got since the early 90’s is something that we could compare to a “wish-list”. A long list of issues (eg. environmental and so on) that are discussed but as soon as corporations had to put them in practice they needed financing and investments like that were not acceptable because paradoxically they did not have an economic return for the company.

Nowadays the economic environment has changed and it is even more competitive day by day. The resources are inadequate and there are always less key success factors available for the differentiation of your business. So now the corporation can see the added value and the worth in investing in CSR, indeed in the next chapter we will analyse the concept of CSR-CSP-CFP and the overall scenario of the value creation.
B.7 Compulsory CSR: the key for development in emerging countries

First of all let us make a brief consideration about the issue if voluntary codes of conduct of CSR work. The main observations reflect that going voluntary on this issue means just discouraging companies from adopting certain behaviours rather than encouraging and driving them into innovation, R&D, and good practices. The voluntary approach can be misleading due to the fact that it concentrates several interpretations of CSR, there is not consensus in what to include or exclude and actually in a survey of 2002 less than one up to four companies disclose CSR info.

An interesting founding on this issue concerns with a debate in early 1990’s between the G77\(^{96}\) and the OECD\(^{97}\). The G77 wanted a binding CSR code and actually they were pushing a lot for this because a lot of foreign investors were actually in such countries and mandatory laws of this kind would have helped not only the economy but also the local community to grow. On the other side the OECD was against mandatory CSR.

Nevertheless, according to a KPMG’s survey on a sample of the 250 largest companies in the world, the CSR reporting activity was in 1999 up 35% whereas in 2002 up to 45%.

It evidences that the more recent trend in the corporate life is represented by a higher level of transparency and disclosure about how they behave on behalf of stakeholders and shareholders. The communication of the CSR is a crucial aspect so the issue is if companies should follow certain criteria or otherwise they will be left to their own point of view of disclosure. So, still believe in voluntary and not binding CSR?

This question addresses the real limit of the corporate social responsibility that is the lack of mandatory international laws that can check if these companies are behaving fairly or not.

Furthermore the development of a common set of binding laws can lead the companies to apply a common and harmonized approach with respect to how implementing and how communicating CSR policies.

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\(^{96}\) The G77 represents the group of 77 developing countries.

The only country that required mandatory CSR, under certain circumstances and for companies with specific features, is India\textsuperscript{98}.

Another country that we have already mentioned and that is going in this direction is South Africa.

The new Companies Act\textsuperscript{99} in India was passed by the parliament and made the CSR mandatory\textsuperscript{100}. It came into effect recently since April 1\textsuperscript{st}, 2014 and more than 16,200 registered companies have to designate three members for their CSR committee from their BOD.

The CSR committee is supposed to elaborate and monitor the CSR policy, and in addition it must take under analysis the CSR activities. It represents now a fully regulated topic into Indian companies that cannot do whatever they want and must consider it as a CSR activity according to the new requirements included in the Companies Act.

CSR in now in India effectively part of the business and each strategic choice involving the corporate social responsibility will need to take approval from the BOD for CSR activities in accordance with its CSR policy and the decision of its CSR committee.

The Companies Act points out some financial requirements according to which such companies will be forced in investing in CSR activities.

In particular, all the companies with net profit of Rs 5 crore\textsuperscript{101} and more, Rs 1,000 crore turnover or Rs 500 crore net worth, will have to invest at least 2\% of their three-year average profit every year on CSR activities, starting from FY15.

The reform of the Companies Act, more precisely \textit{Section 135 and Schedule VII} of the 2013, related to corporate social responsibility (CSR), highlights the importance of full disclosure also through the company’s website. In addition to this CSR must be conducted by professional implementation using implementing agencies and any activity done must have been the part of the planned CSR policy.

Any other detail specifically referes to the time frame for instance, in which is specified that the project concerning the CSR activities should have a starting time and an ending time.

\textsuperscript{98} http://www.newindianexpress.com and http://commerce.nic.in (Government of India, Ministry of Commerce & Industry).

\textsuperscript{99} http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf

\textsuperscript{100} See \textit{Annex 8} for further info about the key points mentioned in the Companies Act about Corporate social responsibility and its applications.

\textsuperscript{101} Rs 5 crore are equal to roughly $834.000 (or €600.000).
Dealing more with practicalities it is specified that a company is eligible for mandatory CSR spending, but in the analysis of profit requirements, its profit from overseas branches and the dividend received from other companies in India will be excluded from the net profit criteria (Rs 5 crore).

Furthermore, according to these new rules, regulating the CSR, the corporate social responsibility activities will have to be taken within Indian boundaries, but will apply to foreign corporations registered in India.

An interesting consideration that emerged from the examination of the new Companies Act, in accordance to the CSR section, is that the regulator decided explicitly to define what is not corporate social responsibility. Here below a brief list of the main considerations:

- Mere compliance with rules or carrying out welfare initiatives for the staff does not fall in the ambit of corporate social responsibility (CSR)

- Under the new rules coming into effect, anything done the employees is not CSR, it is a human resource activity.

- Compliance with any rule or regulation is not CSR. Companies should take up this role and voluntarily do it beyond the rule.

- Unlike in the past, the companies will now be required to spend in structured manner. The old way of writing a cheque for religious cause or an activity that benefits their own workers will not be considered CSR.

- Any activity that has not been given board approval, passed by the board and does not have a board resolution number is not CSR.

- Activities such as donating funds to political parties or spends to benefit own employees and their families will not be counted as a company's CSR.

The case of India would seem to be the first step toward a regulated CSR, and with such new rules the CSR economy will grow many times both in India than in the global business environment. It is believed that in the next few years many countries will follow the Indian practice according to two key performance factors: the need for
sustainability and competitive advantage, and the need for integrating the interdependent interests of both society and corporations.

The forecasts report that the registered corporations in India will spend around Rs 20,000 crore (more than $3 Billion) in corporate social responsibility activities in FY’14 and FY’15. This huge number is useful to underline the importance that the CSR is going to get and in the meanwhile it will mean the need of many CSR professionals and consultants and other experts.

The reason behind this choice of the Indian Ministry of Law and Justice is grounded in the analysis of today’s world in which local communities and corporations must have a very close engagement in order to reach one, and only one direction. They decided to go beyond the application of the standards, the codes of conduct along with all general principles and guidelines. Their goal is binding rules for effective and efficient improvements for both companies (and fostering of competitiveness) and society (social issues).

With compulsory laws the Indian government decided to finalize a major distinction between the definition of voluntary and the one of mandatory CSR. By adopting the latter, in this way the government will regulate corporations to behave in the interests of the society.

Optimistically CSR is able to create a certain framework in which corporation and community stand and live together in harmony. The case of India will provide us in the next years with a certainly interesting feedback about the value of this new Companies Act and about this new way of implementing the CSR into business.

It would be interesting concluding this chapter with a consideration. According to the fact that India is one of the fastest growing economies in the emerging world, and the first country to mandatorily adopt Corporate Social Responsibility, it is evident that India has largely benefited from economic liberalization in the modern era.

So, should we get this signal as the addition development of these powerful emerging economies? The answer is definitely yes, because they know their country and they are so smart that found the way to exploit foreign investments into local communities development.

Mandatory laws to control multinationals’ business in developing countries and driving their investments and power do improve local communities: this will be the new discovery of the 21st century.
C – Part 3 CSR and Value Creation

The distinctive focus of this chapter is on the relationship between Corporate Stakeholder Responsibility and corporate financial performance (CFP). We will have the ability to investigate when and in which conditions the CSR can be a mean to create value for the shareholder. The analysis is supported by three empirical case studies in which the CSR emerges to be eventually a key success factor for the CFP only if through three different approaches: CSR as stakeholder management, CSR as stakeholder prioritization, and CSR as risk management tool. But in the latter case it implies more preservation of value instead of value creation.

Finally, the framework CSR – CFP is completed with the introduction of the stakeholder reporting, that as we will see, represents a strategic tool to manage stakeholders’ relations and to deliver higher value to shareholders.

C.1 Investing in knowledge of stakeholders leads to value creation

Managing for stakeholders has to deal with the allocation of several resources in an efficient way and above all being able to satisfy all the interests involved. This could be seen either as a mean or as an end, but it is really important to stress on the concept that the real goal of corporations is definitely higher performance and sustainable competitive advantage.

Trusting relationships make competitiveness and dealing with odd market environment easier to manage, let us try to analyse if it could be the reason why some corporations outperform others.

The aim of this chapter is to discuss the role of stakeholder theory, or better of CSR from the stakeholder perspective, in the strategy and performance field of corporations.

Managing stakeholders is strategy because it is about managing relationships vital for the acquisition of competitive resources.

The core idea here is not the CSR meant as social issues like the environment, but it is about effective management able to affect the firm performance. Indeed, the research in 2010 by Harrison, Bosse and Phillips showed a positive correlation between CSR and the financial performance of companies.

102 J. H. HARRISON, D. A. BOSSE, and R. A. PHILLIPS, Managing for Stakeholders, Stakeholder Utility
According to them the value creation can be much higher with the building of certain trusting relationships and even more if the concept of stakeholder theory will be definitely accepted, not as managing social interests responsibly but practically as managing a firm effectively.

In this study, they investigate and put a lot of importance on the utility functions of stakeholders because it is thought that once you know who are your primary stakeholders and how to manage them effectively, then you are able to take advantage of market imperfections and in the meanwhile to generate value-creation opportunities. They state that the shareholder value maximization is the goal of the organization but they add that it could come also in terms of reduction of the potential loss of value due to expenses in dealing with unhappy stakeholders, adverse regulatory issues and more in general about changes in the environment.

The three main steps that are considered by Harrison, Bosse and Phillips are:

- Knowledge of stakeholders’ utility functions;
- Value-creation opportunities;
- Sustainable competitive advantage.

According to this approach has been possible to identify a shift in the conception of corporate stakeholder responsibility from the more general social related issues to an advanced meaning associated to competitiveness and performance.

We have seen that the stakeholder in theory could be everyone dealing, directly or indirectly, with the corporation but along with the idea that we are moving toward a more practical and real analysis of these concepts, stakeholder is who really count. So, being aware of the fact that stakeholder changes from firm to firm, who count is the most closely connected with the company’s operations and goals.

In the real world of corporations the instrumental view is the principal one, indeed it is believed that the firms that accomplish to satisfy a broad number of stakeholders’ interests, in the end will outperform the competitors with a higher performance in a win-win fashion. Managing for stakeholders is definitely economically advantageous for the firm, so it deserves the right level of investments.

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103 *Ibidem.*
As a definition, several combinations of preferences can represent the utility function of stakeholders. The satisfaction of such stakeholders’ needs will depend on the outcomes resulting from the strategies implemented by the corporation.

In order to have a deeper understanding of the utility function of the stakeholders, that continuously update their preferences, it is important to examine in depth to levels of knowledge: the first one dealing with the factors that actually drive such function and the second one concerning the weighting of each factor.

From the opposite point of view, we cannot miss the importance of the firm’s utility function. Basically the interdependence of the utility functions of these actors tends to grow as much as they build trusting relationships, the key of value creation.

Usually the main drivers shaping the stakeholders’ behaviour are: a fair distribution of value by the firm and the possibility of voice in the decision-making of the firm strategies.

You could see the stakeholder as an exchange partner in a mere negotiation process, but you would destroy value in a wide sense. The stakeholder theory wants to reconsider the value creation proposition as a joint one in which the relationships should be seen as reciprocal, with the firm being at the center of a network of stakeholders.

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**Figure 14.** The value chain through the stakeholder perspective.

Firms that really have the capability to understand their stakeholder’s preferences and utility functions are considering the relationship as a concrete intangible asset of their portfolio. We said that the real stakeholder is the one that really counts, like the investor or a customer, and the right way to generate value is important for the key stakeholder. As a matter of fact, the stakeholder, according to the reciprocal perspective, will have higher utility in doing business with the company that has the higher knowledge about its preferences. In a certain sense, it would be the key for sustainability and efficiency because the business of the firm is based upon three main stakeholders that are investors, clients and the regulator. Once that you have built trusting relationships on the basis of knowledge of their utility functions, then you are able to allocate resources in a better way and you can shape your strategies and tactics efficiently.

If we consider the oil and gas industry the rigid regulations pushed the big corporations to comply with these new rules and it has forced them to invest billions of dollar in innovation.

Another important pillar of the value creation is exactly the innovation that can represent an opportunity for the firms to be one step ahead of the competitors.

An interesting example always dealing with the oil and gas industry is the corporation Statoil. It is able to produce two millions of oil barrels per day and it covers the 60% of the global demand of energy. These data are terrific but it is important to underline that this corporation has spent a lot in R&D and innovation and one of the reason that pushed them to find new smart way to do their business was the Norwegian tax on CO2 emissions, so the stakeholder identified as regulator. So, new needs of stakeholders push the corporations to invest in innovation and to get this path as a way of value creation.

Finally, value creation can be understood as the ability of the firm to be more flexible at changes in the environment and it is possible due to the fact that you have solid and strong partnerships with your stakeholders and you are able to adapt yourself to new needs. It is called strategic flexibility.

Managing for stakeholders is definitely expensive and it means communication and allocation of managerial time to better understand the drivers of key stakeholders. The real question that we should wonder at this point is if it really has a value or not. The main concern about managing for stakeholders is about the lack of measuring procedures, in fact we do not have accounting prove that this part of the strategy has a real impact or not. So, it would seem that the inability to measure the total value created
turns out to be a deterrent of managing for stakeholders but fortunately the empirical evidence shows us that it has an inner value.

The value created can be generally measured through growth, efficiency and as we said above innovation and according to the descriptive data firms that managed for stakeholders experienced higher financial performance. An example could be the one of the Japanese corporations characterized by a strong stakeholder-oriented strategy.

The empirical testing will be part of the following chapters in which we will try to identify effective feedback of value creation due to corporate stakeholder responsibility and CSR in general.
C.2 Corporate social performance and higher shareholder value

In the analysis of the value creation process we should take into consideration the implications that tie the three main pillars of corporations of the 21st century. The focal one is high financial performance and so shareholder value, then we have the stakeholder management for the sustainability of the business so the achievement of long term goals and finally the decision to respond to an increasing number of responsibilities that we could consider in the social issues sphere.

On one side it would seem that building stronger and better relationships with primary stakeholders permits to deliver higher value to shareholders and there is a considerable impact on the overall performance of the corporation. On the other side there are many concerns about the real impact on the performance of implementing social responsibilities strategies. It is peaceful that adopting environmental policies, charity projects and so on is something good and useful for the community, but what we would like to investigate is the business and its performance and furthermore if CSR is something that represent the advanced step in strategies of the company's framework or if it is just something superficial and useless for the real goal of the business, that is profit.

According to Graves and Waddock104 (1997) the corporate social performance, CSP, drives the improvements in the corporate financial performance, CFP, and consequently a better CFP has a deep positive impact on the social performance.

Since now we have seen very different perspectives about the CSR, in particular the stakeholder management one. Empirical research are needed in order to figure out with are the real financial implications arising from better relationships with stakeholders and active interests in social issues and after that if there is an evident improvement in the shareholder value.

The corporate social performance, like the CSR does, embraced a wide range of meanings and ideas, but it is useful to split the CSP concept in two main components:

- Stakeholder management
- Social Issues

The first concept can be translated in the ability of the firm in developing intangible and particularly valuable assets, which are identified as source of competitive advantage.

The same cannot be said about the social issue participation that as we will see, it would seem to be inversely correlated to shareholder value.

In order to have a more detailed knowledge of the CSP, let us go in depth in the analysis of what the CSP is, which are its divers and the different CSP models.

First of all we have to contextualise the role of the CSP, indeed in the last decades there has been the necessity to modify the performance concept at each corporate level.

The social performance responds to various unsatisfactory traditional models that did not take into consideration the instrumental role of managing for stakeholders.

The economic system always aims to the excellence selecting the best practices useful to improve the businesses. The social performance, meant as social collaboration and cooperation among stakeholders, is one of the main evolutions in the corporate perspective and all the players should consider it. Nevertheless, the real challenge of nowadays is the definition of performance itself and its measurability.

It is interesting to consider the CSP concept as the ability of the firm to satisfy (defined as responsiveness) the needs, the expectations and the demand of the stakeholders.

- **Figure 15.** The Corporate Social Performance dimensions. 
*Source: Primary Data*
According to Carroll (1979) the CSP is based on the main concept of responsibility, and here we underline the importance of CSR practices, but what we really want to stress is that the economic activity in general is made of responsibilities as well as risks.

Four main kinds of responsibilities are identified in the corporation framework: economic responsibility dealing with investors, legal responsibility in the interests of the government and finally ethical and discretionary responsibility addressing the community.

The open question is always if the CSP can be something that can be measured and if yes, in which extent does it affect the CFP?

In the research by A. J. Hillman and G. D. Keim they try to answer to this point using a sample of 308 companies in order to test empirically the relations between CSP, CFP and social issues\(^{105}\).

The focus of the study is trying to understand how a firm is able to outperform its competitors in terms of long-term value creation. Long-term value creation is synonym of a kind of sustainability built upon resources that are valuable, rare and inimitable.

It is exactly built on solid relationships that are not simple and common transactional relationships, but they found their real nature in the relational features.

In the test conducted by the two scholars, they chose three variables: the MVA, identifying the performance measure (dependent variable), and the others two measuring the CSR concepts (the stakeholder management – SM, and the social issue participation – SIP\(^ {106}\); the independent variables). CSR data are taken from KLD\(^ {107}\) index.

The discussion is articulated around the positive impact of SM on shareholder value and on the negative effect of the SIP on the value creation.

We identify an explicit division between the SM that is particularly valuable with respect to the SIP that seems not to be crucial in building the firm’s competitive advantage and falls apart from the company’s operations.

The main idea is that investing in relationships with primary stakeholders is something that is directly related to the business of the corporation and above all they are able to develop intangible competencies that will allow the company to gain and maintain competitive advantage. From the opposite viewpoint, the scholars argue that the SIP is


\(^{106}\) The SIP variable concerns with five main categories: employees, customers, community and suppliers.

\(^{107}\) See Annex IX for detailed explanation of KLM criteria.
not directly related to the core business and it implies just a moral/ethical choice, but nothing that could drive to the increase of the financial performance.

One of the interesting tips that emerge from this paper is the choice of the market value added (MVA) as performance variable with the aim to study the CSR impact on CFP. Indeed it is very useful according to the fact that it is able to capture the relative success of companies in maximising shareholder value through the efficient resource management and allocation of such resources. The MVA, defined as the difference between market value and the invested capital provided by both bondholders and shareholders, highlights two important components that are the valuation, so the value created for shareholders, and the overall performance that testify the quality of management. The great challenge that has always been subject of debates is the measurement of intangible assets, and it is very tough to identify in which measure do them impact the overall performance of the company. A higher MVA shows that the firm has been able to create significant positive results for the shareholders. While it is a different situation if you experience a negative MVA which testifies that the value produced by the management and all the investments is lower than the value of the capital contributed (both equity and debt).

In the building process of the equation explaining the model of Hillman and Keim, they basically have used the same approach of Fama, French and Carhart’s multifactor model. Indeed, they run a multiple regression model (eq.1 and eq.2) where Sales, Net Income, Risk and Industry are the control variables that have the aim to provide stability and validity to the model; more precisely they increase the explanatory power and the reliability of the test. The betas represent the coefficients of multiple regressions and the firm’s risk beta is identified according to Standard & Poor’s.

\[
\begin{align*}
\text{(Eq. 1)} & \quad MVA = \beta_0 + \beta_1 SM + \beta_2 Sales + \beta_3 Net\ Income + \beta_4 Risk + \beta_5 Industry \\
\text{(Eq. 2)} & \quad MVA = \beta_0 + \beta_1 SIP + \beta_2 Sales + \beta_3 Net\ Income + \beta_4 Risk + \beta_5 Industry
\end{align*}
\]

From the study of the correlation between the variables emerged that SM is positively correlated with shareholder value creation.

\[108\] See Annex X for detailed explanation of Fama, French and Carhart multifactor model.
(MVA). The opposite is true for the correlation describing SIP and MVA. Indeed, a negative correlation is recognized.

The most interesting part of such study is the regression result. In fact, running the regression once for the SM and once for the SIP, the two scholars obtained an incredible and reliable result showing the consistent impact that the independent variables (SM and SIP) have on the dependent one, MVA.

Firstly, there is a considerable impact on the MVA due to an increase of a unit of SM, and it is equal to 12.8%. Secondly, with an $R^2$ pretty high (0.42) a significant and powerful explanatory relevance is recognized (99% confidence interval). According to such data, SM definitely creates value for shareholders. The story is different in dealing with the SIP. The regression with SIP as independent variable simply demonstrates that, with a confidence interval of 95% and so just the 5% of error range, investing in SIP is destroying value for shareholders. Furthermore we can assert in a pretty confident way ($R^2 = 0.424$) that for an increase of SIP we have a negative impact on MVA, -0.127.

In conclusion, through the empirical test of Hillman and Kiem we are now accepting that CSR and SM are not just theory but if seen from the right perspective it can have a relevant impact on the CFP and be the playfield for new corporate strategies.
C.3 CSR as a risk management model and mechanism to preserve shareholders' value

In the previous section we have seen a particular case in which the CSR, through the stakeholder theory perspective, is able to generate value for the shareholders. Whereas if the CSR is intended as social issues participation, it is not recommended for the sustainability of your business; indeed, it actually destroys value for shareholders.

In this unit it is fascinating to analyse a different perspective introduced in 2009 by Godfrey, Merrill, and Hansen\(^{109}\), in order to provide a better and more complete background dealing with CSR and the value creation of the company.

The three scholars started always from the same question concerning if actually shareholders and the overall organization increase their wealth investing part of corporate resources in CSR activities. The solution is apparently associated to the connection that lies in between of CSR and CFP, or value.

The interesting link that they found is based on risk management activity, indeed they identified certain typologies of CSR activities, not all of them, that are able to offer insurance-like protection and benefit, when dealing with negative externalities.

So, in order to have a better understanding of this analysis let us go in depth trying to get familiar with the key findings.

The main idea that is presented in the research is that CSR actions, according to the risk management perspective, should be seen as a strategic way to preserve and immunize the value of the corporation rather than generate results translated in higher financial performance. Indeed, according to Godfrey\(^{110}\) the CSR policies can have the utility to generate moral capital or goodwill that diminishes punitive damages occurred by stakeholders (e.g. negative legal/regulatory actions) facing a negative event. And in this sense moral capital plays a considerable role in preserving the value for shareholders.

First of all, the two main characters are the CSR activities and the negative events that


may occur in the business environment, whereas the final goal is the maintenance of a certain CFP.

If we consider the risk management perspective it is important to recall the theoretical idea of perfect capital markets identified in the CAPM and developed by Markowitz in 1952. Indeed in a hypothetical world with perfect markets it would be useless and a waste of money investing in risk management, because it would mean spending more money to reduce idiosyncratic risk, so lower returns for shareholders.

The theory is useful as soon as a concept has to be developed, but in the real world things do change. In fact, the practicalities diverge with the theoretical assumptions and eventually firms invest in risk management, and in particular in the last decades more than ever. The unstable market environment makes the companies more vulnerable and the risk reduction plays a key role in business strategy and in a certain sense it adds value for shareholders.

As we have seen in the previous empirical test, the scholars make some assumptions and the most important are how to interpret the CSR concept. In this case, we find an essential commonality with the previous case that is abandoning the social issues field (e.g. charity) and taking the distance from ideas like CSR as driver to improve social conditions or CSR testifies the complete altruistic behaviour of the companies. In this case the scholars remind us that business is certainly profit making but there is the birth of a new sphere in business philosophy that is considering also the impact of the decision making on others.

According to the other-considering idea\textsuperscript{111}, the CSR should have two important characteristics that are:

- The activity involving CSR must be of public knowledge, so disclosure;
- CSR engagement must be credible and reasonable, so real commitment.

Basically when adverse conditions happen the firm suffers from punishment by stakeholders (e.g. governmental authorities) and the goal of this study is trying to find a way to reduce such impact according to the fact that recently lots of cases of “bad stories” about the firm happened. The CSR represents a tool to mitigate the negative stakeholder reactions in facing unfavourable situations, so the empirical test considers CSR as a way of managing stakeholders.

Godfrey, Merrill, and Hansen take into consideration CSR activities and the effect on shareholder value in a situation of a damaging event\textsuperscript{112}.

The paper considers the distinction between primary and secondary stakeholders, topic already discussed in the first chapter. With regard to this distinction the scholars add a particular feature to the secondary stakeholders. Indeed they are defined as those who can influence the company’s primary stakeholders. Furthermore, the CSR activities that involve primary stakeholders are identified as technical, TCSR. While CSR activities that take into account the secondary stakeholders are called institutional, ICSR.

The innovative idea introduced in the paper is the relation between risk management and shareholder value. In this case the risk management is identified through the CSR activities and furthermore by the stakeholder relationships. Indeed, such intangible asset plays a crucial role in defending shareholder value by adverse impacts.

According to the risk management perspective of the CSR, the concept of corporate size is an important variable because it can be synonym of higher or lower exposure to risks. The main idea is that larger companies can experience more and higher, in terms of magnitude, negative events. So, in the end it would be proper for larger firms to implement CSR actions more than the smaller ones.

CSR and risk management concerns also with the industry membership (e.g. tobacco, nuclear power, or gaming). And it is assumed that in the case of firms that have in their business negative social impacts, the CSR actions are perceived simply as either a way to improve self-reputation or it could be perceived as a “sweetest” way to implement other negative practices (e.g. tobacco companies that try to offset their negative product image through generous campaign)\textsuperscript{113}. This consideration could be very interesting in dealing with the British American Tobacco case study that will be analysed in the last chapter.

Finally, in order to sum up all the concepts that the three scholars have decided to comprehend in the CSR- risk management relation, if a firm invests in CSR actively, then it will benefit from it in terms of less exposure to negative event.

It is particularly interesting to highlight that consulting different perspectives and different scholars, the topic of CSR and stakeholder theory is recurrent and even if it is very wide, we are able to identify several points in common.

Basically all of them are stressing the concept that if you take care of such intangible

\textsuperscript{112} \textit{Ivi} p.429.

\textsuperscript{113} \textit{Ivi} p. 430.
assets then you will benefit and it will result in sustainability of the business and higher value for your shareholders.

The method that has been used is an event-based analysis and the aim of the research is exactly trying to investigate the impact of a variety of business events on the shareholder value, and above all trying to figure out how stock prices adjust due to new information.

The scholars focused on a deeper understanding of stock market reactions to events selecting 178 firms in the Socrates\textsuperscript{114} dataset and they developed this analysis through five main steps\textsuperscript{115}:

1. Identification of the event\textsuperscript{116} of interest such as lawsuit against the corporation, and its timing (reviewing the \textit{Wall Street Journal} articles from 1992 to 2003, and they identified up to 254 potential events of interest. Out of these events 99 firms experienced an event whereas 61 companies did not experience the negative event due to CSR participation);
2. Checking in the meanwhile for others events, different from the main one, that could drive movements in shareholders' value and valuation of the firm;
3. Prediction of the stock price pre-event (\textit{ex-ante});
4. Identification of the gap between the predicted share value and the actual one;
5. Regression model to test the hypotheses.

The dependent variable in the model is the shareholder value or better the stock price. More precisely such dependent value has the aim to identify the unexpected percentage change in the stock price due to a negative event. Stock prices change daily, due to

\footnote{\textsuperscript{114}The Socrates data contain 41 separate binary item measures of firm engagement along six CSR dimensions (community involvement, corporate governance, employee relations, environmental stewardship, diversity and product quality).}

\footnote{\textsuperscript{115}Ivi p. 435.}

\footnote{\textsuperscript{116}In the model are identified six categories of negative events that describe the features of such events. Those six are summarized into three main large sets of events that are: legal and regulatory, health and safety, and integrity.}
market conditions as well as firm specific events\textsuperscript{117}. So, in the paper is introduced the CAR, cumulative abnormal return that is basically the sum of the difference between actual return and expected return, on a daily basis. Whereas, in the case of independent variables the CSR participation concept is specifically divided into the two categories known as ICSR participation (concerning community and diversity dimensions) and TCSR participation (taking into account governance, employee relations, and product relations). As we will see it will imply some differences. Finally as control variables, firm size plays an important role as well as the market to book value.

Among the key findings it is important to outline the positive correlation between CSR participation, ICSR participation and the abnormal return. While for the TCSR we cannot support a strong correlation with the CAR.

More specifically if we intend the CSR participation as a general concept embracing both ICSR and TCSR we have a relevant positive correlation with the abnormal return equal to 0.219 with a confidence interval of 99%. This approach allow us to have a first understanding about how these variables move and at first impact it would seem that they tend to move in the same direction.

Generally speaking companies implementing CSR actions are able to preserve value. But the relevant finding is that if the CSR participation is decomposed in its two main components, ICSR and TCSR, for ICSR we have statistically significant results whereas the opposite is not true for the TCSR. Finally the participation in CSR policies does provide companies with insurance-like protection from negative events.

In considering more in detail the CSR as the two components discussed above, we understand that ICSR, the one associated to secondary stakeholder, is the main component that drives this protection from negative externalities.

The analysis that has been run is based on the main open question related to the CSR that is about CSR as a driver of firm’s reputation and driver of firm specific resources. Furthermore if a solid reputation leads to a sustainable competitive advantage, does it worth to invest in CSR?

According to Godfrey, Merrill, and Hansen absolutely yes, but they specify that only certain resources related to CSR, like moral capital, are really valuable in order to

protect your firm. In addition they find an important correlation between these kinds of resources and the negative events such as those concerning uncertainty on firm’s reputation and honesty.

The interesting result that emerged from this research is the huge impact that companies can avoid through the implementation and participation in CSR practices. Indeed, considering the 178 companies sample, the data of average market capitalization pre-negative event was $32.6 billion and the firms that did not have a CSR engagement, in particular ICSR, experienced a huge loss in value up to $72.4 billion. While the companies with CSR active policies just suffered $22.8 billion dollar. The result is exactly a huge salvation of value equal to roughly 30%.

In the next chapters we will try to provide other evidences in order to strengthen this idea of CSR both creating and preserving value through some analysis of case studies that will be taken into consideration.
C.4 Stakeholder reporting as a strategic tool for value creation and system of insurance policy

Until now, in this chapter we have considered the value creation and its measurement but it is now fundamental try to get familiar with the tools and methodologies that enable firms to create such value.

Let us imagine a simple framework in which the firm is the main character, the CSR is the activity exercised by the firm and the corporate social performance, CSP, is the outcome of such process.

The stakeholder approach of CSR as we have seen can have an impact on the CFP both in terms of value creation for shareholders and in terms of existing value immunization from negative events.

The corporate stakeholder responsibility is therefore the main source of a certain CSP that is able to create a certain amount of intangible value, internal and external, which is vital in such turbulent market environment. The CSR is definitely an integrated in the strategic management of the firm and a report developed by the main consulting companies such as KPMG, PWC and E&Y is supporting this perspective\(^\text{118}\).

A balanced and sustainable external and internal value creation derives from dialogue and relationships with main stakeholders and such philosophy should be insert in the culture, mission, and vision of the firm.

Dealing with the internal value creation the stakeholder reporting plays a relevant role. In fact it is based on two main concepts such as dialogue and values that are shared between the stakeholder and the firm.

Stakeholder management should be assumed to be a leading asset of the company so it would seem to be proper to administrate not only the financial data but also the intangible resources because we have seen that they have an impact on performance.

The reports stress on the concept that in dealing with your business partners you are managing your best and most important relationships and what you have to achieve is the perfect process of corporate identity building. Dialogue means continuous feedback and succeeding in transmit the sense of belonging to all your key stakeholders.

This process is called the stakeholder reporting and it represents exactly the activity

\(^{118}\text{Ernst & Young, KPMG, PricewaterhouseCoopers, The Copenhagen Charter. A management guide to stakeholder reporting, House of Mandag Morgen, Copenhagen, Denmark, 1999.}\)
involving all the theoretical concepts analysed previously and they are translated into practicalities ready to be implemented in the firm daily operations. Furthermore the stakeholder reporting represents the instruction book to improve the corporate governance system investigating all the steps concerning the firm decision-making life.

![Figure 16. Stakeholder dialogue and reporting process for value creation. Source: Building stakeholder relations – auditor circle, 1999.](image)

The stakeholder reporting drove the attention of several consulting companies that perceived its strategic utility in running a company in terms of knowledge and source of information about opportunities and conflicts\textsuperscript{119}.

This approach shows a complete framework of the firms’ interests also considering the appealing one, the shareholder value. In fact the investors really appreciate this approach based on stakeholder management and analysis because year by year, with tougher investment decisions, they are always more demanding with information about human capital valuation, environmental and ethical issues. It testifies that the investor

\textsuperscript{119} Ibidem.
behaviour is shifting in qualitative factors to take into consideration. According to KPMG, PWC and E&Y the stakeholder reporting, and the stakeholder managing topic in general is becoming a real issue nowadays. Indeed it represents like a “licence to operate” able to minimize the risk of unexpected negative externalities. Basically the value creation related to this subject is translated in terms of reputation, stronger relationships, and ability to attract investor capital. In addition to that it is confirmed the insurance-like identity that we discussed in the previous section. Indeed, minimising the risk of potential relevant losses is perceived as adding value to the firm and its shareholders.

![Figure 17. Stakeholder reporting faster response time. Source: Building stakeholder relations – auditor circle, 1999.](image)

In Figure 22 it is shown the added value that the stakeholder reporting can deliver to the company. The smaller circle represents the early warning system in case of negative events or opportunities that may occur. Through such system a company can take advantage of not incurring into negative effects in profitability. In this sense you are able to avoid waiting for negative results that you will experience only checking your financial accounts, and so ex-post.

In the report some recommendations about how to manage effectively stakeholders are outlined. In particular three crucial pillars are identified in order to develop an effective

\[120\] Ibidem.
stakeholder reporting: laying the groundwork, embedding, and communicating.
The stakeholder reporting process requires different features to be effective, so let us list the main principles that make it work.
Dealing with the first category, the laying the groundwork, as a measurement of the importance of this issue, the decision concerning the stakeholder management needs to have robust and solid foundations coming from the top management. Its involvement is strongly recommended.
Secondly, as a matter of fact we have defined this activity as a real asset who needs to be invested and so it deserves all the resources and the attention that it does need. It requires a real budget activity and a structured resource allocation plan.
In order to complete the second feature, the CSR activity will need of a proper company department and team devoted to the well-functioning of the stakeholder reporting system. Finally, it is necessary to shape the internal organization in a flexible way in order to be able to exploit the early warning feature of the stakeholder reporting.
The second pillar, embedding, stresses on the communication message that is spread through mission, vision and culture of the corporation because they represent the corporate identity\textsuperscript{121}.
In addition to that, the dialogue activity needs the identification of key stakeholders and the understanding of who is the most important are essential\textsuperscript{122}. Above all, different dialogue strategies should be developed in order to engage the stakeholder in a win-win relationship. It is suggested to identify your primary stakeholders on the basis of interest and influence, a topic previously discussed in depth in chapter one.
Furthermore an individual analysis of the main stakeholders that have been identified should be run. It will deliver critical results in terms of resources that such stakeholder is able to provide me or to reject to me. The definition of a set of KPI’s is recommended.
In the end the communication pillar concerns with the report sharing the performance of management in the interaction with all the parties and it should be meaningful, clear, and well defined. The report communicates which are the values and the priorities of the firm and its key partners.
With regard to the truthfulness of the report, it is recommended the credibility of such report be proven by an independent verification.

\textsuperscript{121} Ibidem.

\textsuperscript{122} See Annex XI for the Corporate Stakeholder Responsibility value chain.
It is really important how you disclose such information and how you do present them to the market and in particular to your investors.

As we have seen until now, CSR and stakeholder management seem to be something that every company want to implement but according to the fact that it is mostly voluntary, all companies do it in different and not efficient ways.

The credibility of this reporting model for stakeholder management is the key success factor for its feasibility.

In the Copenhagen Charter\textsuperscript{123} the concept of credibility relies upon three main elements: accounting principles that shows the effective results reached, the relevance of information and so quality, and finally the verification that as already specified above should be done by an independent party.

\textsuperscript{123} http://www.copenhagencharter.com
C.5 CSR and CFP: prioritization of the stakeholder leads to value creation

This section is intended to strengthen the idea that CSR actually has an impact on the Corporate Financial Performance.

In a research conducted by Jong-Seo Choi, Young-Min Kwak, and Chongwoo Choe, they examined the relationship between the CSR and the CFP on a sample of Korean firms\(^\text{124}\). In particular they used a specific measure to recognize the degree of CSR implemented in such firms called KEJI index\(^\text{125}\). It is based on a multidimensional approach to CSR in which the ranking is based on seven categories that are: soundness, fairness, contribution to society, consumer protection, environmental issues, employees’ satisfaction and contribution to the economy.

The core finding of such study is the confirmation of what has been supported in this thesis and so that there is a positive and significant link between the CFP and the CSR. Even in this case we have to specify which kind of CSR is taken into consideration, and not surprisingly the scholars measured the CSR through the stakeholder theory perspective. Indeed the positive impact on CFP is given by the stakeholder-weighted index that reflects the degree according to which some stakeholders are managed in advance, so prioritized. The CFP variables selected for measuring the performance are, two accounting-based (short-term proxy) like the return on equity (ROE), and the return on assets (ROA), whereas one long-term market-based, the Tobin’s Q (market value/book value)\(^\text{126}\).

The interesting finding was not only that there is a positive relation between these variables, but furthermore they are able to influence one another activating like a cycle in which if you are doing good (stakeholder theory) you perform better and vice versa.

Finally, let us consider some information dealing with the sample under analysis. It is composed by a number of firms selected among the firms listed on the Korea stock exchange (KRX) in which, it is important to specify you have KEJI data available.

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\(^{125}\) Korea Economic Justice Institute developed by a Korean NGO called Citizens’ Coalition for Economic Justice. It is the first multidimensional measure of CSR in Korea. (www.ccej.or.kr/English).

\(^{126}\) Tobin’s Q = \((\text{market value of common stock + market value of preferred stock + current liability} – \text{current asset + long-term debt}) / \text{book value of total asset}\).
The sample is made by 1,222 firm-years and it considers a period of 7 years from 2002 to 2008. Basically the scholars run a multiple regression model in which the independent variable is the CFP and the independent variable is CSR\textsuperscript{127}. In order to give stability and reliability to the model some control variables (independent) have been chosen: size (number of employees), risk (in terms of leverage), industry (compare performance among companies that belong to the same industry), and sales growth.

\[ CFP_t = \beta_0 + \beta_1 \text{CSRindex}_t + \sum \gamma_i \text{CONTROL}_{it} + \epsilon_t \]

(Eq. 3)

The CSR index has been divided into two main proxies: the equal weighted (EW) and the stakeholder weighted (SW). The former considers the sum of all the seven categories of CSR described in the KEJI index with some controversies because it would mean that they have all equal importance. While the latter takes into consideration the relative degree of importance that is associated to each stakeholder group. The innovative perspective introduced by the scholars implies that with the EW, there is no difference between stakeholders and shareholders. The second differs for the differentiation among stakeholders (SW). Among the meaningful data that emerged from the analysis we have a significant positive correlation between SW and the performance variables. While for EW the correlation is still positive but less significant and with a lower impact. The result that emerges is that the CSR meant as SW (e.g. primary stakeholders), has a regression coefficient with Tobin’s Q statistically significant (0.54), not only for the 99% CI, but also for its big explanatory power ($R^2$ equal to almost 45%) testifying that the CSR can have high impact on CFP that is more likely to arise in the long run (T’s Q).

This study supports the thesis of stakeholder responsibility as a mean to value creation as well as the previous case in Section 2 by Hillman and Keim\textsuperscript{128}. We can appreciate even more the analysis of the Korean scholars because in the previous case, one of the control variables was the net income, not neutral with respect to the dependent variable (CFP). It implies a statistical phenomenon, in which two variables in a multiple regression are highly correlated (pretty high\textsuperscript{129}), the multicollinearity. Differently this study use delta sales that reflects a lower correlation with the performance (dependent) variable.

\textsuperscript{127} Also in this case the Fama-French-Carhart multifactor model has been adopted. See Annex X.


\textsuperscript{129} The correlation between the dependent variable and the independent variable, or better between Market value added and net income was considerably significant and equal to 0.623.
In order to have a better understanding about how the organizational moral development works, it has been considered useful the research conducted by J. M. Logsdon and K. Yuthas about the implications of corporate social performance\textsuperscript{130}. The study concerns with the parallelism between the Kohlberg’s categorization of the levels of individual moral development and the moral development of the organization. The interesting and core fact is that starting from the six individual moral stages advanced by Kohlberg, they have been applied to the structure of the organization and to its behaviour. The interesting outcome is that through this pattern is it possible to establish the different behaviours that a corporation could adopt in managing its CSP. According to the fact that the individual moral development could be assimilated to the organization, it is important to underpin that the organizational moral development is more complex and above all in the firm we have an important role that is played by the managers. Indeed, dealing with how managers and firms address such complex ethical and social issues is the actual challenge. The managers are supposed to define the level of responsibility about which the company should commit and furthermore they decide whether and how to make their corporation responsible. The CSP of an organization is perceived through the stakeholder theory perspective and so it implies how the firm addresses stakeholder relationships and issues. Starting with the assumptions made by Kohlberg, he asserts that in the individual moral development goes from childhood to adolescence in foreseeable phases and it concludes when you are adult and you are able of moral reasoning using abstract general principles. But at the same time, not all the people are able to reach the highest stage of moral reasoning.

The same is true for companies that can freely decide to adopt certain behaviours or to devote a certain amount of resources in dealing with moral development. In the model of Kohlberg, six phases of moral development are identified and they are divided two by two in three levels respectively called: pre-conventional, conventional and post-conventional.

The first level is basically built upon the concept that the moral development is imposed by external rules. The main idea here is to obey rules in order to avoid sanctions or punishments. Along with this level, the second stage is characterized by an instrumental purpose. Indeed according to Logsdon and Yuthas an individual takes into consideration the interests of others parties only and uniquely if that will eventually benefit oneself. This second stage is probably one of the main debated among the scholars; in fact we have had a focus on the instrumental stakeholder theory in the first chapter. The instrumental perspective would seem to be the predominant philosophy of many companies and in a certain sense it is understandable according to the fact that the business is just business and taking care of stakeholders and their relationships is simply the right and most effective way to do business. The social issues such as charity and development of the community is something that is not directly related to the business, it is more about the government and organizations that have in their nature this mission and vision, such as NGOs.

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131 Ibidem.
Finally the pre-conventional level focuses solely on three key points: compliance with rules, not incurring in sanctions, and exclusively self-interest.

We devoted particular attention to the second stage in which the company is able to benefit if it takes into account external forces (e.g. interests of the others) but the motivation is always pursuing the company’s interests and goals.

The conventional and third level differs from the first one in regarding a real moral development in the motivation of what you do and why you do that. Here the keyword is interests of peers (e.g. primary stakeholders), and above all there is a real interest from the company in understanding which are the needs and wants of the parties directly involved in the activity.

Generally speaking in these third and fourth stage there is an advanced moral attitude in the firm behaviour in which there is an explicit will to meet external expectations. The parallelism between individual and organization could be misleading in a certain sense due to the fact that the company approach implies a wider perspective and it is made of relationships and responsibilities.

As the level of moral development goes ahead, the level of acting just for self-interest is lower.

The last couple of stages are considered in the post-conventional level and they concerns with a hypothetical, and personally unreachable, consideration of social welfare as fundamental for achieving the company’s goals. It could be real just in case of a certain category of organization such an NGO.

According to this perspective the moral principles are vital for the viability of the business and above all the real goal of the organization should be like overcoming and exceeding peers expectations and regulatory issues. Indeed here the company is supposed to add something valuable without being forced to do it. In this case the organization should take into consideration all the parties involved, directly and indirectly (e.g. primary and secondary stakeholders).

After a brief explanation of the different level of moral development that an organization could decide to advance, it is important to stress on the role of managers.

The role of managers and in particular the role of top management represents the soul of the company because even if actually they are not the owners, they basically manage the company on daily basis shaping and spreading the culture and the identity of the firm.
Let us consider the behaviour of top management and more specifically how such managers should interpret their CSR at the different levels of moral development for their firm. If we reflect on the fact that the stakeholders basically experience the outcomes of the corporate behaviour, and so of the top managers, then the point should be how they consider relationships. In fact, the point of view adopted by the firm about goals and relationships is an important KPI of its moral and ethical development level.

In reality the basic practice is simply the instrumental view of stakeholders that are viewed as means in order to achieve the interests of shareholders, so increasing shareholder value.

Logsdon and Yuthas\textsuperscript{132} provide us with the three different perspectives that describe the relationships existing between the three levels of organizational moral developments analysed previously and the stakeholder theory/orientation.

<table>
<thead>
<tr>
<th>Level of Morai Development</th>
<th>Description</th>
<th>Stakeholder Theory and Orientation</th>
<th>Decision-Making Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-Conventional</td>
<td>Emphasis on self-aggrandizing without regard to others</td>
<td>Self only – others are only a means to one’s own benefit or pleasure. (Example: Managerial Prerogative Theory)</td>
<td>Pleasure/pain calculation</td>
</tr>
<tr>
<td>Conventional</td>
<td>Emphasis on negative duties to others, operating within external constraints</td>
<td>Narrow market-based stakeholder relationships, such as with owners, lenders, customers, and employees as required by law. (Example: Stockholder Theory)</td>
<td>Peer expectations and social controls</td>
</tr>
<tr>
<td>Post-Conventional</td>
<td>Emphasis on positive duties, internalizing respect for others and duty to promote their welfare</td>
<td>Broad range of stakeholders, including market-based relationships and non-market-based, such as to neighbors, communities, environmental groups, government agencies, etc. (Examples: Social Harmony Theory; Utilitarian Theory, Rawlsian Theory)</td>
<td>Universal ethical principles</td>
</tr>
</tbody>
</table>

\textbf{Figure 19. Stakeholder Theory and organizational moral development relationships.}

In the first level there is explicit self-interest dominance and it represents an extreme perspective because if you want to make your business viable in a certain sense you need to take into consideration the interests of the others, directly or indirectly.

\textsuperscript{132} Ivi p.1217
If the top managers make the corporate decisions in their own interests it would mean mismanage the company and not considering the shareholders’ interests as well. The first level spreads a negative message that is basically the lack of moral identity. In the conventional phase, it is remarkably different according to the fact that there is an improvement in the behaviour of the firm. This second level asserts that you need to take into consideration at least the external forces exercised by the primary stakeholders. It stresses the marked-based stakeholder relationship as a key variable in the sustainability and success of the business. According to this perspective, that would seem to be the most true and real, the decision-making process should involve also the main parties affecting/affected in the activity and above all, in the end even if it is an instrumental perspective of stakeholders, the top managers will have to deal with stakeholders’ interests and needs. R. Edward Freeman and D. R. Gilbert particularly supported the instrumental stakeholder theory as most representative of conventional moral development, and in particular the focus on the stockholder perspective. The final level is the post-conventional that represents another extreme side of the moral development process. In this case there is a mature ethical approach indeed the firm actively promotes the welfare of stakeholders and it goes beyond the mere peers consideration. The main limit of this approach is that in reality it is unlikely to take into consideration such a broad range of stakeholders, market-based and non-market-based (e.g. poor and disadvantaged communities).

In this case the top management discusses about social issues and responsibilities that go well beyond the legal requirements. The post-conventional level embraces a too much theoretical approach and it is testified also by the kind of stakeholder theory that derives from that. In particular Logsdon and

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134 In India this post-conventional (extreme) level has been recently developed through the reestablishment of the Companies Act. It is incorporated in the more real conventional level because CSR is compulsory and the law requires it on a broad and wide stakeholder base. This is evidence that the real approach to adopt the CSR is something in between the post-conventional and the conventional.
Yuthas considered three stakeholder theory perspectives: social harmony, utilitarian theory and Rawlsian theory\textsuperscript{135}.

These theories could seem to be very attractive socially speaking, but it is important to underpin that they fall apart from the business perspective. Indeed it is impossible to consider firstly the well being of the community instead of your own survival in the market environment. From the firm perspective it is really unrealistic and firmly unrealistic to consider your business vital for making the community better off. It could have a positive impact on the community but it will happen only in the case in which you are profitable and you are a healthy company. The final goal realistically speaking is again profit and sustainability; it cannot exist for the benefit of the surrounding society even if it could be possible to make some considerations about NGO and others no-profit organizations.

This reasoning is simply real market environment in which many companies are wondering why should I invest in the community? Basically there is not a concrete answer to that, but probably all the scholars and people interested in this topic should ask themselves why some emerging countries like India make the CSR mandatory under the Companies Act in 2014. The response is pretty simple, because nobody was caring about real and effective CSR, because it is not related directly to the business and because it is expensive.

So, with the example of India we are able to identify that this social issues can be applied on the company structure but the main actor of that will be, as we said before, the government.

Another interesting example about social issues and in particular environmental issues is the CO\textsubscript{2} emission tax in Norway. Why did the government put that tax? Because nobody was taking care about the environmental impact, the consequences were not directly related to the business and it was expensive to invest in R&D and innovation to find new way to lower the production of that gas. Even in this case the intervention of the government generated significant results in fighting social issues, and it was not something inner in the company nature.

\textsuperscript{135} The Rawlsian theory focuses on the main idea of improving the welfare of the worst-off stakeholders is the goal of the company.
After this reflection about the different levels of moral development from the individual to the corporation, let us finally identify which are the forces shaping such moral development in the organization.

The main source that impacts the moral development of the company is the set of moral expectations held by the top management\textsuperscript{136}. As a matter of fact, such expectations are influenced through the relationships between individuals and the environmental factors surrounding these relationships.

Once such expectations have been defined and identified in a certain shape, they are enacted through well-thought organizational process in the firm operations. Finally you obtain a certain result that will identify the level of moral development of the organization.

The truth lies somewhere in between, around the conventional level and in my opinion there is a shift toward the post-conventional level through the action of the governments in the different countries. But if we have to say what is right or what is wrong we could just say that the social issues fall out from the business of a corporation, even if it could be useful for the world society to have more investments in all the different communities, and it is testified by the active governmental interventions that has intensified in the last decades.

D – Part 4  CSR and stock decision-making of investors

As long as the CSR discussion becomes more value oriented, is relevant to analyse the relation between CSR and value creation from another perspective. This chapter emphasises the impact that the CSR can have on capital markets and its implications for value creation.

Until now we have considered the CSR and the value of a firm in terms of CFP, the bottom line for instance. But if we would shift our attention to the resources that the company can attract in terms of capital due to the CSR, it is interesting to investigate which role the CSR plays from the investors’ perspective.

In the discussion of this theme, the non-financial nature of CSR information seems to be a positive driver in the investors’ decision-making, indeed what is emerged is that the investors’ confidence toward CSR-related investments is higher and the company can enjoy even more resources in terms of capital and create even more value with higher returns for shareholders.

Basically if you want to create high value for shareholders, you need to attract more capital and what appears is that CSR would seem to work in both directions.

The second section of the chapter provides an additional practical view of the CSR and of its double value creation perspective. It is made possible through the reporting of the key considerations made on this topic by two of the most powerful CEOs in the world that I had the chance to meet in Washington DC in May 2014, Sergio Marchionne (Chrysler Group LLC) and Helge Lund (Statoil Oil and Gas).
D.1 The power associated to non-financial information by investors

The weight of non-financial information is a key issue that cannot be ignored anymore when analysing the investors’ behaviour. The report of more and detailed non-financial information has increased due to the higher regulatory requirements (e.g. government) and also according to the new needs and interests of the main stakeholders. In the previous chapters we had the chance to analyse the missing balance between the party interested in the short-term results and the one concerning the long-term ones and it represented an issue. According to this point, it is important to make some considerations about the proper perspective to adopt in managing long-term versus short-term investors. Dealing with the CSR, also known as ESG (environmental, social, and governance), is definitely having a long-term viewpoint both in terms of results and in terms of investments. So it would appear meaningful to think about the behaviour of the most important long-term investors, such as the institutional investors, in dealing with the non-financial information, and if are or not taken into consideration in the decision-making process. It is important not to misunderstand the concept of ESG from the investors’ perspective just as a sustainable investing approach. Indeed, it represents an effective way to diversify your portfolio taking into consideration some additional factors like environment, social, and governance. An important shift in nowadays investor behaviour has taken place. In particular many investors are appreciating, now more than ever, the consideration of sustainability factors in their investments analysis and the advantages that may arise from those. The CSR, as we have seen before, is fast becoming the economic imperative of global business according to its risk management profile and its strategic role in delivering superior financial performance. From the CSR concept to the ESG one, we are able to focus the attention on the three main areas of interest that frame the sustainable business model of a company. Many companies devote their attention more on the “G” than on the “E” and “S” due to the fact that the governance concept is the one strictly related to the business and one of the main concerns of investors in the last decades, according to the recent cases of mismanagement.
The new way of thinking about the combination of financial data of companies and ESG analysis allows the portfolio managers to invest in a safe and sound manner. It is a smarter way to invest and to benefit from superior long-term investment performance. According to the ESG Mangers® Portfolio\textsuperscript{137} focusing on investments strictly related to the ESG factors can lead to higher financial results testifying the crucial impact of non-financial information. In particular they underpin the ability to minimize risks of such companies that have a strong environmental performance, a strong employee relations, and with a profound corporate governance culture.

The benefits that may arise from that are simply investing in companies in a better fashion, and so less affected by new legislations and mandatory requirements in terms of ESG factors. Somebody defines the CSR as philanthropy, but it is clear that it is something more that captured the attention of the main consulting companies and portfolio managers, according to the fact that “clients” so investors, are reshaping their decision-making process in terms of investments.

The target investment today is the one taking into consideration the leaders of the different industries, the better managed companies, the more forward-thinking companies, the companies that through a meticulous ESG analysis are able to mitigate the risk, and finally the companies that investing in the three main areas of the CSR are able to foster sustainability of the business and long-term goals.

“\textit{Companies that are considered leaders in ESG policies are also leading the pack in stock performance by an average of 25\%}” \textsuperscript{138}

\textit{Goldman Sachs, 2007}

\textit{“We were impressed by the quantity of reports that showed a strong link between ESG issues, profits, business activities and, ultimately, stock prices”} \textsuperscript{139}

\textit{United Nations Environment Programme Finance Initiative, 2006}

\textsuperscript{137}www.esgmanagers.com


<table>
<thead>
<tr>
<th>Area of focus</th>
<th>Activity</th>
<th>Impact on Financial Performance</th>
</tr>
</thead>
</table>
| **Environment** | • Resource management and pollution prevention.  
• Reduced emission and climate impact.  
• Environmental reporting/disclosure. | • Avoid or minimize environmental liabilities.  
• Lower costs/increase profitability through energy and other efficiencies.  
• Reduced regulatory, litigation and reputational risk.  
• Indicator of well-governed company. |
| **Social** | • Workplace  
- Health and safety  
- Diversity  
- Labour relations  
- Human rights  
• Product integrity  
- Safety  
- Quality  
- Technologies/innovation  
• Community impact  
- Relations  
- Responsible lending | • Workplace  
- Higher productivity and morale  
- Reduce turnover and absenteeism  
- Openness to innovation  
- Reduce reputational risk  
• Product integrity  
- Brand loyalty  
- Increase sales  
- Reduce litigations and reputational risk  
• Community impact  
- Brand loyalty and licence to operate |
| **Governance** | • Executive compensation  
• Board accountability  
• Shareholder rights  
• Reporting and disclosure/disclosure | • Interests of shareholders, stakeholders, and management in the same direction  
• Avoid negative financial "surprises"  
• Protection of the reputation |

*Figure 20. ESG activities and the potential impact on CFP.*  
*Source: www.ESGmanagers.com*
As introduced above the interesting link between the corporate social responsibility and the value that investors place on such non-financial information captured the attention of several players in the business environment. In particular the advisory and consulting sector identified such issue as an opportunity to enlarge the business. An interesting global survey has been recently conducted on this topic by Ernst & Young\textsuperscript{140}.

The analysis takes into consideration several large institutional investors involving portfolio managers, equity analysts, CIO (chief investment officers), and executive directors for a total sample of 163 investors. The selection of these institutional investors was not random, indeed specific powerful investors with at least US$ 10 billion of assets under management has been picked.

The main question that E&Y tried to address is a better understanding of investors needs and furthermore if those business people really appreciate the quality of such corporate non-financial information and which is the influence, if any, on their investments decision-making. This survey has been developed in order to respond to the future needs of investors and to show the shift in the trend of the investing world.

From a consulting company perspective the final goal is always and definitely to ensure the creation of a sustainable value for shareholders over the long run. So, we have an additional confirmation that in the business practice there is a predominance of the instrumental perspective of the stakeholder theory in which the shareholder value is the real final objective.

\begin{figure}[!h]
\centering
\includegraphics[width=\textwidth]{institutional-investors.png}
\caption{Type of institutional investors involved in the Global Survey of institutional investors. \textit{Source}: E&Y, Tomorrow's investment rules.}
\end{figure}

\textsuperscript{140}Ernst & Young, Tomorrow's investment rules – Global Survey of Institutional Investors on non-financial performance, EYG No. AU2277, ED 0316, 2014.
The survey was conducted globally and in particular there has been a focus on US, Canada, and Latin America investment environment up to a number of institutional investors interviewed close to 70%. The remaining 30% includes institutional investors spread among Continental Europe (11%), Middle East, Asia Pacific (11%), UK, and Africa.

The first point that has been analysed is which is the real value that is embedded in non-financial information and how such investors perceive it.

In the 21st century it would appear that the non-financial information are a subject of interest for investors, but the real issue is that they consider such data from different perspectives.

### Figure 22. How institutional investors evaluate the non-financial information related to ESG.
*Source: E&Y, Tomorrow’s investment rules.*

The graph above shows us that there is a consistent number, almost the 70% of institutional investors that conduct a kind of evaluation. From the opposite viewpoint there is still a meaningful portion of them that do not rely so much on these kind of information in the investment decision-making. Among those that consider the ESG factors as active part of the variables that should be taken under analysis, we can identify three categories. The first one (32%) simply associates to them a lower level of importance and such investors believe that an informal evaluation is at the same time necessary and sufficient. The second one (19%) adopts a meticulous and detailed approach because they perceive the ESG dynamics as fundamental in the life of a company. Indeed, they develop specific team dedicated to such analysis. Finally the third one (13%) represents something in between that does

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141 Ibidem.
not want to spend too much time and resources on this investigation and this category believes that relying on guidelines, such as the UNPRI\textsuperscript{142}, is enough to get investment-relevant info.

It is often highlighted that the inner value of this non-financial information can be either managing risk or opportunity and value creation. In some circumstances it might be both and it depends on the ability of the firm to disclose such information in a sound fashion able to instil in the investor the capacity to appreciate more that stock instead of another. So, an important finding could be that not everybody is addressing to this information the right level of importance due to the fact that it is not easy to make a comparison between companies. Furthermore, the voluntary nature of such disclosure for companies is not helpful for investors.

In the consideration of the best scenario we should have a combination of financial analysis and non-financial data assessment, both will provide the investor with the proper risk-return profile of the company considered. Unfortunately, this scenario is hardly followed because of the intangible aspect and the difficult measurability of non-financial info.

In the previous chapters we had the chance to go through a careful consideration of the South African perspective in dealing with CSR, in particular in dealing with governance requirements (King III Code of Conduct\textsuperscript{143}). According to the E\&Y global survey, when a member of a South African investment management company was interviewed it was interesting to underpin that in their opinion ESG risks are definitely linked to financial risks and the same is true for the returns. In addition, it was specified that all the multinationals listen on the Johannesburg Stock Exchange now are mandatorily required to present an integrated report including both financial and non-financial information, according to the King III code\textsuperscript{144}.

At the same time according to the survey we are able to identify dissimilarities between countries. Indeed, when an Asia-Pacific-based analyst for a bank was asked which was their idea about non-financial information he simply replied telling that no specific

\textsuperscript{142} Principles for Responsible Investments funded by the European Commission in partnership with the international Corporate Governance Network (ICGN) and the European Federation of Financial Analysts Societies (EFFAS).

\textsuperscript{143} See Chapter 2.

\textsuperscript{144} Ernst & Young, Tomorrow’s investment rules – Global Survey of Institutional Investors on non-financial performance, EYG No. AU2277, ED 0316, 2014.
methodology is adopted and that everything related to ESG is evaluated in an informal way such as expertise, experience, and so on.

The key finding is that there is a real interest in ESG assessment and the market needs it. Basically if we consider a standard portfolio manager we will expect him to diversify such portfolio on the basis of the risk profile of its client. According to that the real value associated to the ESG is that these three factors are perceived as risk factors, now more than ever, and a good portfolio manager should merge the most important and material financial information with the ESG ones.

There is an interesting theory developed by Erika Karp asserting that the real issue between ESG factors and investors behaviour is a problem of generational shift.

In order to speak more precisely about that, let us say that practically the old generation of investors is hardly concerning with environmental issues, mismanagement problems, and least of all with social issues. So the portion of this category of old-generation investors usually favours a different and more practical method of evaluation for stock picking based on financial performance.

The narration is completely different for that new generation of investors that has born in a recent century characterized by huge ESG phenomena. Indeed, for people who are into the business nowadays, they are simply more focused on this information because it is part of their life. Finally habits are hard to change and an old generation of investors that do not used to consider such issues thirty years ago hardly will change its mind.

According to Erika Karp the consideration of the ESG risk factors is essential in the investment analysis and figuring out how to allocate capital in order to push the economic growth is the key concept identifying the sustainable side of finance.

Actually always referring to the behavioural shift mentioned above, the role of investors taking care of ESG factors are causing a reshaping of the concept of corporate leadership.

The graph below provides us with an interesting finding testifying that the role of non-

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145 Erika Karp is the Founder and CEO of Cornerstone Capital Inc. The mission of the firm (launched in 2013) is to apply the principles of sustainable finance across the capital markets enhancing transparency and collaboration. In offering investment banking, investment management and strategic consulting services, Cornerstone works with both corporations and financial institutions, promoting new research in the field of ESG (Environmental, Social and Governance) analysis, and facilitating capital introductions for companies around the world engaged in sustainable business practices.

146 www.cornerstonecapinc.com
financial information on a last-12-month basis has played a crucial function in the decision-making of many investors.

### Crucial role of non-financial info in decision-making

- **Figure 23.** The crucial role of non-financial information in the last 12-month decision-making. 
  *Source: E&Y, Tomorrow's investment rules.*

According to that graph we are able to figure out a link with **Figure 29**; indeed the category associated to *occasionally* and *almost never* is the one that adopts an informal approach in dealing with ESG information assessment. Such a piece of information tells us that there is still a lot of room for improvements, and sooner or later, this is a trend that the market will require because it is starting to be appreciated by the investors.

An additional relevant result has been considered addressing the delivery capability, so can the company really do what it says and more specifically are all the information disclosed credible and reliable?

According to this issue the investors perceive the information that are taken directly from the company in a better way, whereas the information provided by rating agencies and third parties are less appreciated. This finding is justified by the fact that a direct release of certain information proves the sense of commitment of the company and as a matter of fact it is a positive element observed by investors for the decision-making.²⁴⁷

Once that has been clarified that the direct release of ESG information is able to increase the investor confidence, let us see which documents such investors mostly appreciate. It would appear that the annual report is particularly valued but basically the investors make their decisions principally on the basis of an integrated report exactly like the one required in South Africa by King III Code of conduct.

²⁴⁷ Ernst & Young, Tomorrow’s investment rules – Global Survey of Institutional Investors on non-financial performance, EYG No. AU2277, ED 0316, 2014.
According to the fact that investors have different preferences, the role of companies is the one to make a business sustainable and to provide a variety of information useful to cover the different investor's needs. And that is what an integrated reporting is supposed to do.

The role of portfolio managers is trying to manage the money of ignorant investors that have money and do not have time and knowledge to understand the data that is just so wide. So, with the additional variables related to ESG, an integrated reporting is what investors are looking for.

Generally speaking investment means risks and investors are obsessed with risk minimization. So, here we find the real rationale of why an investor should consider the ESG performance. It is not about investing in the community because the company wants to be a good citizen, basically it is trying to understand what is happening in the surrounding environment and be well equipped to face negative externalities, such as the impact of regulation (e.g. tax on CO₂ emission and so on).

From the survey conducted by E&Y around 80% of the sample answered that among the non-financial information the business impact of regulation is essential and important for decision-making. A clear example of the importance of such non-financial information is that according to the survey up to 77% of the investors usually adjust their evaluations when a risk is identified from the ESG performance analysis148. CSR, ESG, they are essential piece of information for investors but the main concern remain always the fact that less but more consistent information is required. Above all quantifying the ESG performance of companies is pretty hard, and this is an open question that we have underlined several times.

Basically we could see the ESG analysis and the risk management as the same thing, and the main rationale at the basis of that is simply that through the ESG factors the company is able to show to the investors who it is and not only what it does (e.g. financial performance).

Agreeing with the concern about the CSR measurability and the difficulty to prove its positive impact on investors’ decision-making, we could underpin the positive aspects that are appreciated by the supplier of capital: the quality and the utility of non-financial data.

This quality and the utility can be reached through a careful monitoring of “what the company has done (ESG) – what it is happening – which is the financial performance”. According to this approach the investors will be able to evaluate the quality of the non-financial information and consequently they will have the ability to use such piece of info in the better way they believe.

The 80% of companies disclosure in Europe has been defined disappointing by the investors and furthermore not in line with their expectations. This is a clear signal of lack of trust in a framework of companies that are already in an unfavourable economic environment and that must seek for improvements in disclosure and best practices if they want to attract new investors. This concept is strictly related to the CSR as a strategic tool to gain competitive advantage.

Investors perceive a high level of accountability for ESG in a company as a high level of responsibility and so the right place where to invest the money in a safe and sound manner. This represents what it should be and so the perfect picture of a company might be a structure able to provide investors with non-financial information linked to financial performance, but it hardly happens.

The issue is that the non-financial information are non-material and it is the main driver of the reason according to which ESG issues are not considered by institutional investors. The keywords that describe the non-financial info are: unclear, inconsistent, not verified, not able to be compared to other companies.

Considering the picture of an economic system that is changing rapidly, it is believed that the regulatory framework is slower than the change and it is causing a chaotic framework in which each company is adopting a different approach. At this point the investors are wondering which approach could be the best, but it is kind of subjective evaluation.

According to that, several international organizations, such as the Global Reporting Initiative (GRI), have developed some methods with the objective to simplify the recognition of the materiality-side of non-financial information: the sustainability-integrated reporting framework.

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149 Associations of Chartered Certified Accountants (ACCA) and European Sustainable Investment Forum (EUROSIF), What do investors expect from non-financial reporting?, 2013.
Another important contribution in terms of integrated reporting and in the determination of materiality\textsuperscript{150} of non-financial information derives from the SASB Materiality Map\textsuperscript{151}.

It is showed in the *Annex XII* and it considers different categories of sustainability issues on the basis of the specific industry. Indeed an initial set of ten sectors\textsuperscript{152} was outlined in such map with double aim to provide investors with a better understanding of companies’ profile and provide companies with a better knowledge of specific ESG risks.

The map is based upon the investors’ needs and the financial performance, and it takes into consideration more than forty ESG issues applied in more than eighty industries.

The smart approach implemented by the SABS is that in framing that map they broke up the ESG three-factor model into five more specific categories:

1. Environment capital
2. Social capital
3. Human capital
4. Business model & innovation
5. Leadership & governance

These five categories incorporate all the sustainability issues that could be of interest for a certain investor who focuses his attention on a certain industry. In this way the SASB Materiality Map is able to provide you with a transversal analysis from the perspective of the industry that concerns you the most.

The map works on the basis of tests conducted in order to prioritize the most material issues for investors. It relies on two categories of evidence that are the evidence of interests and the evidence of financial impact.

The former are based on gathering material from reports and financial newspapers in order to understand which are the main ESG concerns referring to a specific industry.

The second kind of evidence is kind of simpler according to the fact that is specifically

\textsuperscript{150} Materiality is a fundamental principle of financial reporting in the United States. The concept of materiality recognizes that some information is important to the fair presentation of an entity's financial condition and operational performance.

\textsuperscript{151} Sustainability Accounting Standards Board (SASB), Determining materiality, 2013 – www.sasb.org

\textsuperscript{152} The sectors included in the Materiality Map are: health-care, financials, technology & communication, non-renewable resources, transportation, services, resource transformation, consumption, renewable resources and alternative energy, and infrastructure.
material if you check balance sheet, profits, assets and so on. Finally, on the basis of the previous evidence some adjustments are made on the basis of three variables: magnitude, probability and externalities. This kind of map is intended to overcome the huge amount of immaterial information that is hardly considered by investors.

The SASB captured the attention of many investors and business people because they set standards for companies to disclose their material ESG impacts.

The keyword for investors is integrated report, and according to that in the US the Form 10-K represents a mandatory reporting mechanism that publicly listed companies use to disclose their performance to investors and to the public. The SABS is pushing for developing within the Form 10-K a more integrated view of the companies’ performance. At the moment there is a bias on financial reporting and non-financial information, but the law in the US requires that all the material information must be provided, so what SABS is trying to figure out is a way to make such non-financial information material. It is the moment to debunk the false myth that environmental and social factors are not material and the work of SASB is to develop such infrastructure so that the Form 10-K can be an integrated view of performance for investors about the trade-off risk-opportunity that they can face. If we do not consider the ESG performance of a company, we are basically missing a big part of the picture that represents my potential investment. It could be a source of differentiation from the others investments/companies.

The role of capital markets is fundamental for the economy because they direct resources to what matters and should build a sustainable business environment. The capital markets are made of hundreds of industries each made up of hundreds of companies. Central to each of these enterprises are investors whose confidence keeps markets moving, and the development of ESG performance in the integrated reporting can certainly lead to an increase in investors’ confidence.

The so-called reasonable investor should focus on rewarding companies that serve society’s needs and avoid the ones that do not. The investor confidence is the outcome of reliable disclosure of trustworthy information, a clear picture of the factors, which materially affect the company’s performance today and into the future. So good information create confidence, which directs investments and allows companies to build successful industries in capital markets that make the world go around.
The future of capital markets and their development along with the fast changing economic context is all about good information in the hands of investors. The issue is that quite often clear information is not always available.

Taking into consideration one of the most developed economy, the US has seen an important development of markets in 1930’s with the advent of the Securities and Exchange Commission153 (SEC) establishing rules for corporate disclosure to protect investors and the public. It happened again in the 1970’s with the Financial Accounting Standards Board154 (FASB) providing a true and fairly representation of companies’ assets and liabilities through rigorous financial accounting. It was exactly what the market was asking and the infrastructure of capital markets evolved in order to respond to such need.

Nowadays we are facing a world that has evolved since then, and it would appear that our global economy has grown larger than the planet ability to support it. It is exactly what the ESG performance is stressing, environmental and social constraints are now central to any industry and managing such issued has become a sources of leadership and competitiveness. With the evolution of the world there is a need for new, different, and more detailed information.

The old approach was based on the role of financials and analysts reporting a lot about the companies’ past and almost nothing about their future, and so the sustainability of the business. According to that it is interesting to underpin that only the 20% of value is based on tangible information available in the financial reports155.

Financial capital cannot represent anymore the solely source of decision making, so ESG capital is thought to be the future destination, and we are only just at the earliest stage. This is the perfect recipe for a true and fair representation to investors of how the value is created and if there is room for sustainability in the long run.

154 The SEC designed the FASB as the organization responsible for setting accounting standards for investors and public in the US.
155 Sustainability Accounting Standards Board (SASB), Determining materiality, 2013
According to this last concept the absence of a clear strategy and the poor governance\textsuperscript{156} are perceived by investors the two main drivers for ruling out or reconsider an investment\textsuperscript{157}.

The concerns reported by FASB for the US market are confirmed by the Global Survey conducted by E\&Y in which the majority of investors complain about the backward looking of the information provided by the corporations. Indeed, such piece of information focuses on reporting of past performance instead of plans for short and long term value creation. The low level of governance is something transversal to all the industries and adopting the best practices and disclosure in terms of governance is always well appreciated by the public and investors.

It is partially different for the “E” and “S” factors. Indeed, the environmental and social issues and the related policies are more specific for the different categories of industries. It has emerged that there are particular sectors in which the disclosure of non-financial information is particularly appreciated and relevant for investors’ decision-making.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure24.png}
\caption{In which sectors non-financial information are appreciated the most. \textit{Source}: E\&Y, Tomorrow’s investment rules.}
\end{figure}

\textsuperscript{156} In an interview conducted during the development of the E\&Y’s survey, a US asset manager considered the poor governance a crucial variable for the health of an investment. A clear example has been made about the need for disclosure of executive pay.

\textsuperscript{157} Ernst & Young, Tomorrow’s investment rules – Global Survey of Institutional Investors on non-financial performance, EYG No. AU2277, ED 0316, 2014.
It would appear that along with the ESG factors we should add one extra factor. The “R” factor representing the two main impacts that can emerge from the ESG: regulation impact and reputational impact. Indeed around the 70% of investors perceive the implementation of ESG practices by the companies just for anticipating/avoiding regulatory consequences or reputational damages158.

Above all it is important to say that the implementation of ESG efforts means expensive investments for the companies and it should be furthermore perceived by investors as an effort to testify the company’s sense of commitment in what it does and for the public, more specifically investors themselves.

Finally let us discuss the “S” factor, the social aspect linked to the company that can go from the labour force issues to the community development. Basically if you do not manage for stakeholders you put at risk your ability as company to deliver cash flow and to attract investors. The investors take care of this point of view and they simply identified that as the cost of doing business.

Going ahead with the survey another interesting discovery emerged. According to the previous focus on India and mandatory CSR, the interesting finding was that the emerging economies, such as India, are the one that are more interested in ESG than the most developed countries. It would seem that the geographical location plays a key role in this topic, and when the investors were divided on the basis of their home country159 what emerged was that investors in countries like Latin America and Asia are more careful to ESG policies.

The opposite is true for investors in US and Canada that answered for the 40% of times that non-financial information did not played a relevant role in their decision-making.

The only factor that really captures the attention of northern American investors is the “G” and it is not a case according to the recent cases of low level of governance.

Focusing a little bit more on Europe, it emerged that northern European investors are significantly interested in such kind of non-financial information, and in the next section we will have the interesting focus on the Norwegian oil and gas company Statoil.

This survey by E&Y revealed to be very useful to confirm all the theories that have been developed in the previous chapters. In particular the focus on emerging markets would seem to be appropriate according to the previous analysis of mandatory CSR in India.

158 Ibidem.
Even if the investors’ attention based in the emerging markets is a considerable signal of the new ESG wave into the life of business people, there is a critique that should be advanced. Indeed the method of assessment of this category of investors is typically informal and subjective and this is profound indicator that improvements in the infrastructure of investments are absolutely required.

The differences in the investors’ behaviours between emerging and developed countries require a deeper analysis of this duo, and it is provided by the graphs below.

### Figure 25: Differences concerning ESG between investors in Emerging and Developed countries.

Source: E&Y, Tomorrow's investment rules.

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159 On the basis of the 163 investor-sample: 48.5% US-Canada, 23.3% Latin America, 7.4% Continental Europe, 3.7% UK, 1.8% Middle East, 4.3% Africa, 11% Asia Pacific.
The observations above clearly testified a common approach to informal and subjective analysis of the ESG factors due to a substantial lack of harmonized sustainability frameworks among the companies and so, it is hard for investors to develop a structure decision-making based on these factors.

Dealing with the CSR factors seems to be crucial in the investment decisions. Indeed even if characterized by an imprecise valuation, it has been identified in the 70% of cases, in the last 12 months, definitely relevant for investors in emerging markets. It is significant as well in the developed ones for the 50% of investors.

Once more after a careful research into the CSR topic what emerges is that the global economy is moving the first steps into the right direction, but we are just at the beginning.

There is on one side the role played by the companies that are definitely obsessed with value creation for the shareholders and competitive advantage. On the other side the investors are looking for new safe investments in which they are able to minimize the risks. The key is ESG or CSR for both.

The real issue is still that for companies is hard to spend billions of dollars on CSR and not being able to provide relevant, consistent, comparable, balanced, financially linked, and reliable information to investors. But this is the new category of information that investors are seeking and as a matter of fact, it represents the future scenario of capital markets¹⁶⁰.

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D.2 Evidence of CSR and value creation. Conversation with the CEOs of Statoil and Chrysler Group LLC.

In this section we will introduce some evidence that emerged from the conversations that I had the pleasure to hold with the CEOs Mr Lund\(^1\) (Statoil) and Mr Sergio Marchionne\(^2\) (Chrysler Group LLC) during my period of research in Washington DC in May 2014. They will provide us with several important perspectives and considerations about the CSR and the impact that it has on their businesses in terms of value creation. Let us begin with the study of Statoil and the relationship CSR - oil and gas industry\(^3\).

As one of the world’s leading energy companies, Statoil has built a global oil and gas production portfolio and a reputation for responsible and technology-driven resource development in challenging environments.

Statoil is based in Norway, country that still represents the 60% of Statoil overall production, estimated to be around 2 million barrels per day. Statoil is the biggest offshore operator in the world and the second gas supplier to Europe. They have activities in 35 countries (US, Europe, Norway, Russia, Azerbaijan, UK, Algeria, Libya, Nigeria, recently huge discoveries in Tanzania, Brazil and so on).

Statoil is a company that is in the oil and gas business but lives in a context of normally high expectations for Corporate Social Responsibility. According to Statoil the CSR is meant, not just for how the company treats its employees and lives in the neighbourhood but in the way it serves as an engine for progressive value inside northern region society in Europe. It is very remarkable to see how well they have done.

\(^1\) Helge Lund has been the CEO of Statoil ASA since August 2004 and its President since October 2007. Mr Lund served as the CEO of Statoil from 2004 to 2007. He served as CEO of StatoilHydro from 2007 to 2009. He served as the Group President and Aker Maritime ASA. He served as the Chief Executive of Aker Kverner. He served as CEO and Group President of Aker Solutions ASA (formerly, Aker Kvaerner ASA) until March 2004. Mr Lund served as CEO of Aker Kvaerner ASA, Norway, from 2002 to 2004. Mr Lund has an MA in Economics from the Norwegian School of Economics & Business Administration (1987) and an MBA.

\(^2\) Sergio Marchionne is chairman and CEO of Chrysler Group LLC, CEO of FIAT S.p.A., as well as chairman of CNH Industrial N.V.

\(^3\) Conference at the Center for Strategic & International Studies (CSIS), Statoil’s strategy and ambitions, Washington DC, May 6th, 2014.
Statoil is a state-owned oil company but it operates with the efficiency of the private sector and brings to its enterprise a very deep commitment in doing the very best for the people of Norway.

The oil and gas industry is a very complex one with crosscutting pressure that CEOs like Helge Lund has to manage day by day.

According to Helge Lund there are two key themes that are crucial to secure the long-term legitimacy of the oil and gas industry:

1. Taking into consideration the changing energy landscape, in particular what is going on in the oil and gas industry and what Statoil does in order to remain competitive in all the changes.

2. How Statoil both as a company and also as an industry encourages the challenges that the world is facing nowadays. That includes the CSR issues with a particular focus on climate change and community engagement.

In the last decade the oil price has increased considerably from $30 to $110 but due to escalating investments, increase of costs, more complexity, and higher risks, the return on capital has actually been reduced by 1/3.

So the Statoil’s CEO underlined that currently the business model is not working properly and the competitiveness of oil and gas industry simply must improve. Improvements in terms of being more disciplined in the way they invest capital. The competitiveness of the industry in raising capital is fundamental for Statoil in order to deliver their mission of bringing light, heating, and transportation to the world\textsuperscript{164}. Statoil wants to be a reliable source for economic growth to the world.

The real challenge of the oil and gas industry is addressing the needs for energy and at the same time less CO\textsubscript{2} emission in energy production.

To succeed in this environment Statoil has put in place a very focused strategy for high value growth for increasing efficiency, both in terms of costs and capital, and also to improve capital discipline to be able to return value to shareholders.

Statoil has been the best oil and gas company in the world in terms of identifying new conventional oil and gas resources due to the huge investments in R&D and innovation.

\textsuperscript{164} Ibidem.
Working in an industry like this implies many risks and the CEO of Statoil finds crucial for their business the word: safety.

Safety on behalf of the community and employees because according to Mr Lund one of the worst things in doing business is arrogance. It does not allow you as a company to move forward. Trying to understand the surrounding environment and the stakeholders’ needs is crucial for the sustainability of the business.

This industry has a direct impact in what we have defined previously the “E” factor. Indeed, environmental issues such as the climate change is something global but a big player such as Statoil can do even more for the environment than for communities.

The real issue is that there is too much CO₂ and actually too little politics. So, the strategy of Statoil on addressing this issue is implementing local alternatives because the key success factor of Statoil is principally based on how they do what they do.

Statoil is committed to work with peers, governments and other stakeholders in order to develop robust and appropriate standards and best practices throughout their operations.

Statoil truly believes in working with governments, civil society, and with the scientific community to ensure that these resources are developed in a responsible and sustainable way.

This is what makes Statoil a different company in the business world because it does not develop just good principles but it puts them into practice and a real example could be useful to present how do they operate. The recent case of North Dakota (US) in which Statoil is working with the government and they have invested significantly in technology in order to reduce emissions and the impact of their operations.

This industry is entering new grounds and territories meeting new stakeholders and new needs, new expectations, and also new requirements.

People care about what Statoil, and more in general such industry, does because what they do matters. Basically their product matters and how it impacts society matters even more.

Statoil is a company that has been able to build trust through stakeholders’ engagement that according to Helge Lund is based on three key variables:

- **Transparency**, defined as the new currency for trust;
- **Dialogue**, the need to engage all stakeholders;
- **Responsibility**, which means continuously striving to improve the operating environment.

For a CEO managing a global portfolio in particular in this very volatile industry is risky, even more if we consider the recent geopolitical challenges that we could classify as non-financial information. According to that the CEO of Statoil defined the oil and gas company as a risk management institution (technology, safety, regulatory environment, geopolitics and so on).

Such piece of non-financial information can have a real and huge impact on the business of the company and Statoil engages on daily basis with such kinds of risks.

Furthermore Mr Lund stressed on the concept of long run and sustainability of the business and what he believes is that the oil and gas industry is going nowadays more towards people lives than what it used to do in the past. Mr Lund considered crucial for a CEO and for a corporation to respond to the society needs and to take seriously the concerns of the community about the business that you run.

Generally speaking the perception is that Norway has achieved the ability to be competitive oil and gas producer but also a sort of aggressive proponent of doing something co-ordinately about reducing emissions. The main fact is that in Europe there was the ambition to have less CO₂, more security, and more efficient sort of energy but actually nowadays no one of those has been reached.

The key message that emerged from the conversation with Mr Lund is that is important and absolutely crucial having simple systems where politicians do not decide what technology should win but a system that is technology neutral and it can pushes for more developed technologies able to produce more with less pollution emission.

Statoil benefited from the introduction in the 1990’s of the CO₂ tax in Norway (almost $75 per tons), and it could seems kind of paradox. Actually the intervention of the government has been well thought and this tax is working because pushed Statoil to look for more efficient systems in order to save that money, and it ended in a win-win fashion both for the company and for the environment.

In addressing the topic concerning the degree of importance associated to CSR in Statoil’s business strategy Mr Lund focused on some main points.

Firstly he replied telling that this industry is about the long term and in order to create stability around the facilities that you are running regardless the place in which you are, you firmly need to create trust on your operations and on your companies, which is consequently translated into investors’ confidence.
Secondly he firmly believes that CSR is not something on the side or external to the business, differently the CSR is something that must be integrated transversally into the philosophy of the company and its business.

According to its CEO, Statoil considers the CSR a relevant part of its business that permits to deliver an added value to its shareholders.

Finally he concluded with an interesting consideration about the recent lack of trust in big institution like governments and he identifies his company and its peers the ones expected to address such global issues because politicians or governments hardly can figure out a way to do it. So, the role of big corporations as a vehicle for improvements in social issues. A clear example of what have been said is the case of Tanzania, in which Statoil has made important discoveries. In such rural environment the real issue for Statoil has been creating a situation that really gets benefits and the majority of the value goes to local community, so going ahead with the oil and gas project but in a sustainable fashion.

The graph below shows the Statoil’s stock price trend and even if we are dealing with an industry affected by many risks and certainly volatile, it demonstrates the healthy condition of the company. In particular in the last decade the investors are appreciating even more the efforts that Statoil is making in both business and sustainability policies.

- Figure 26. The Statoil Stock Price Trend.
  Source: www.finance.yahoo.com
The second conversation concerns an insight in the automotive industry with the CEO of Chrysler Group LLC (FIAT, Jeep, Dodge, Ram Truck) Mr Sergio Marchionne\textsuperscript{165}.

This opportunity to listen to a well-known leader like Mr Marchionne allows us to have a better understanding of how top managers behave, think, and take decisions. Basically what they see from inside the industry that people from the outside cannot see.

The example of the automobile sector in the US is strictly pertinent to the concept of investor confidence and CSR. Indeed, Mr Marchionne has been brilliant in acquiring through FIAT the North American automotive company, Chrysler, after the “controlled” default of that under the Obama administration in 2009 and to make it profitable.

Indeed in the Chrysler Group LLC report of May 2014, the US sales has increased by 17\%, and it represents the fiftieth consecutive month of sales gains for the Group.

The real question is how was it possible to make a defaulted company profitable in a little more than a couple of years? And furthermore how important has been reestablishment of investors’ confidence? Which the role of CSR?

First of all, Mr Marchionne decided to start from the rebuilding of the company culture and identity, which are vital for the sustainability of the business. Secondly starting from the bottom to build a new and strong reputation, because the brand matters. A Ferrari made in China is not a Ferrari, he said.

The “car guy”, that is the nickname that the Americans give to Mr Marchionne, spouses completely the instrumental approach of stakeholder theory. According to him what really matters is investors and so capital financing. The bottom-line for the CEO of Chrysler Group is delivering the higher value possible to shareholders; the means are vital but just instrumental to that.

As well as the oil and gas industry, in the case of the automobile industry the Mr Marchionne perceives that investments in technology, innovation, and R&D are fundamental to provide a proper working environment to employees. So we can identify a first crucial point stressing the “S” social factor.

The reasoning made by Mr Marchionne would seem to be superficial but actually it is not. Indeed, if the automotive Group is expected to deliver a high quality product, a high quality and innovative environment is necessary for the people and for engineers.

\textsuperscript{165} Conference at the Brookings Institute, \textit{A discussion with Chrysler Chairman and CEO Sergio Marchionne on the Auto Bailout}, Washington DC, May 21\textsuperscript{st}, 2014.
This point really sends us an important message that is basically concerning the efficiency on one side and on the other the sustainability and the social life of the working environment. Providing employees with a friendly environment for examples with lunchrooms is something that enhance the employee's performance and as a matter of fact, the overall performance.

Mr Marchionne drove the Group through a rigorous and disciplined with the aim to restore the brand and the credibility above all, in order to capture the investors’ attention.

The success of the Group is proven by the determined and solid commitment of the employees, and Mr Marchionne considers it one of the key success factors. It was something that he particularly pushed for indeed there has been a profound shift in the industrial relations’ management between the corporation and its employees.

We jumped from the environmental issue in oil and gas industry to the social issue concerning employees in the automotive industry and with a particular focus on the Chrysler Group standpoint.

According to Mr Marchionne all employees and stakeholders in general represent a unique source to reach the leadership of the industry and still represent a successful factor for the sustainability of the business. But when I asked him if investors have perceived such Corporate Stakeholder Responsibility in the reestablishment of the brand and which has been the impact, he replied negatively. Indeed the point of view as “industrial man” of Mr Marchionne was that these investments in CSR are really valuable for the firm but unfortunately never properly perceived by investors166.

The CSR, meant from the stakeholder perspective, is vital for the sustainability and high quality of standards in Chrysler Group operations but it is something that is emphasized exclusively internally as corporate choice. Whereas equity/capital markets are completely indifferent and not sensitive to such piece of non-financial information.

Personally I consider extremely valuable such insights in these industries and furthermore to see how is important CSR with the eyes of people who are more than experts in the field, is definitely an added value. They told us a story that is not probably the one we have been reading in newspapers.

In this section we have been able to go further the simple theory or the empirical data, in this case we had the chance to see exactly how and what a CEO thinks about

166 Ibidem.
sustainability, and how do they manage the hard matter of linking such non-financial information with the financial one.

Finally having a concrete analysis focus on both sides, investors’ perspectives and corporate/CEO perspective provide us with a solid basis of how the CSR is perceived inside and outside the company. Sometimes these two viewpoints have appeared to go in the same direction and sometimes the opposite, but generally speaking what has emerged is that there is a marked new trend in the business environment and its name is CSR.

CSR, as we have outlined in the previous chapters, is a matter of business strategy and the concept of responsibility emerges in the operations of the company. So, not responsibility in what the company does, but responsibility in terms of taking care about how the company succeed in reaching its goals.

The positive fact is that companies are open to talk about CSR; they are almost ready but still working on figuring out how to implement it in terms of practicalities and measurability, because basically investing in CSR is investing in the future.
D.3 Consequences on stock price of undervaluing the CSR

We have always thought about the benefits that an efficient CSR can provide and the different theories and perspectives according to which the ESG policies are seen as a strategic tool.

It is now the moment to make some considerations according to some empirical evidence about the real negative impact that a company can suffer with a superficial CSR policy or without having one at all.

In the previous chapter we have introduced the tragic event in 2010 in Gulf of Mexico related to the oil and energy company BP Global. Again the issue is not being sustainable in what you do, but how you do that and BP has been a clear example of a company that has not followed the same approach of Statoil in dealing with Corporate Social Responsibility. The graph below shows as the effects.

![Figure 27. The BP Global Stock Price Trend. Source: www.finance.yahoo.com](image)

When the disaster occurred in April 20th 2010 the reaction of the markets and of investors was terrible causing a lot of concerns about the future of the company.
A huge drop in the share price was immediately the effect of markets’ reaction but above all what really affected the company was the reputational effect. Once that you have lost your investors’ confidence it is a hard job trying to recover from big negative event and at the same time attract investors, because actually investors call investors and if your reputation in the capital market has collapsed, it is going to be a very long and tough period for you.

Companies in a situation like the one faced by BP Global in 2010 have to make a choice that basically is leave the business or trying to rebuild the brand of the firm with a huge amount of investments in CSR. This recovery strategy is about the long run and it is unbelievable how a company can destroy itself in a couple of days and then it takes you the very long run to recover from it; and the graph above clearly testifies the difficulties of BP to reach the pre-disaster level of stock price, indeed after a marginal recover the graph is pretty flat. As a matter of fact we could say that the reputation of a company cannot be built in one day, but actually it can be destroyed in a couple of hours.

Generally speaking the dilemma is always a choice between short-term results and long-term sustainability and health of the business and of the brand. And the mistake of BP Global has been not thinking about the sustainability of its business, because if you do not bear in mind the impact of your business on your stakeholders, the stakeholders are going to punish you, sooner or later.

The opposite is true for an extremely successful company, eBay. Such a huge company has always been focusing on meeting the expectations of multiple stakeholders and even though it has been an expensive investment in CSR, now eBay is experiencing amazing returns for its shareholders. A single number can summarize the successful business strategy of the company: stock price increase of around 400% between 1999 and 2006\(^\text{167}\).

The field concerning the CSR is very wide and not only about the topics that it can cover but also about the variety of way in can implemented into the business. We have seen with Mr Lund that an effective and efficient CSR is the one that is inner the corporate culture and identity, but sometimes the market is misled by fake practices concerning CSR and the investors being not properly informed make wrong decisions in terms of stocks to invest in.

A recent and well-known example is the Enron scandal. Indeed the kind of fun story is that paradoxically five days before the Enron scandal the CEO of Enron received an award to be the most socially responsible and admired company in America, but actually the real story emerged few days later.

This case is such an interesting one because it tells us, on one side the ability of the company in communicating what is more appreciated by the market and on the other side the difficulty of investors in having a real understanding of what is going on in the companies they want to invest in. If you disclose false information that are not in line with the corporate responsibility, basically you are focusing on the short term performance and as a matter of fact short term is not for ever.

It is important to stress on the fact that CSR is not an art of communication what is better on behalf of the company; CSR is not a mean to build a fake corporate culture or reputation. CSR is a way to have an integrated approach to your business that is not only made by the final output that the company produces but it is made of others factors that we identified in the three-factor ESG that are vital for the sustainability and competitive advantage of the business.

Since now we covered almost all the topics related to ESG providing case studies in line with the main environmental, social, and governance issues. But dealing with the “S” factor we have not analysed the impact on companies’ reputation and financial performance of social useful services in the community. Empirical evidence comes from the pharmaceutical industry.

Merck & Co Inc, a famous pharmaceutical company, decided to go for a social useful action in late 1980’s. They basically produced millions of doses of a drug able to defeat a terrible illness particularly widespread in Africa and Asia. The social aspect was identified in the free-of-charge nature of such action168.

Somebody could say that they did it for reputational aspects and others could say that they did it because they really wanted to invest money in the society, but it is still and will remain an open question. I would like to underline a particular aspect of this case study that is the capability of the firm to be in line with their mission169 and in this way

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168 Ibidem.

169 “Providing society with superior products and services by developing innovations and solutions that improve the quality of life and satisfy customer needs, and to provide employees with meaningful work and advancement opportunities, and investors with superior returns.”
they started to build a corporate social identity and as a matter of fact the reputation among investors increased as well as the stock price.

![Figure 28. The Merck & Co Inc. Stock Price Trend. Source: www.finance.yahoo.com](image)

If you are perceived as a “good guy” by the market, the investors will rely on you according to the company’s sense of commitment in what it does. This is the recipe that Merck & Co Inc. started adopting in early 1990’s and this is the way they built such an empire in the pharmaceutical industry.

Sometimes being just a player in the market field is not enough to catch the attention of the investors. They usually expect something from you that is going to freak them out in a positive way. A company cannot be in the market just for making money, in the current business environment you have to demonstrate that you want to be there and that it worth it investing on you.

Finally let us clarify that the ESG policies cannot be equal from company to company but they substantially differ one another, industry by industry. In the case of the pharmaceutical company investing in social responsible activities can be proper because it is linked to the core business. While companies like Chrysler Group LLC invest more in social-employees related aspects, because it is more in line with their business.
E – Part 5  British American Tobacco Case Study

The closing chapter represents the soul of the thesis partly because British American Tobacco (BAT) has been the starting point for the development of the thesis idea and partly because with the case study the reader will be able to explore the real value of the Corporate Stakeholder Responsibility into the business environment. Value creation and stakeholders responsibility could be a synonym of BAT and above all of an industry, that facing daily challenges due to its harmful products, underpins the key success factor of the business in the stakeholder management. Along with the idea of CSR, the BAT case study embodies the instrumental perspective of the stakeholder theory focusing on the Corporate Stakeholder Responsibility as a necessary condition for the value creation; the leitmotif of the thesis. The BAT case study has appeared to be relevant also for the substantial presence of the regulator in the tobacco industry that, as we saw in the previous chapters, can play a crucial role in the CSR dynamics. The chapter will introduce first of all BAT and why it is of interest in this thesis, secondly will be presented the industry and the business environment in which BAT operates, and finally the key success factors at the basis of the relationship BAT, stakeholders, and value creation. All the information reported in this chapter are the result of several meeting that I had the pleasure arrange with the Head of Corporate Affairs and Regulatory Affairs BAT Italy, Mr Gian Luca Petrillo.

Figure 29. British American Tobacco and its business.
Source: www.bat.com
## E.1 Why BAT

This chapter provides interesting insights from one of the tougher industry in the business environment, the tobacco industry.

The choice of British American Tobacco (BAT) is not random; in fact the thing that caught my attention the most was the real challenges that this company has to face day by day in order to sell its health-unfriendly product.

Going through such a complex business allows us to appreciate the real value creation for the company imbedded, not in its cigarettes, but in its CSR.

So, not exactly what they do but how they make themselves able to do what they do (e.g. careful stakeholder management, proactive dialogue, coalition building, management of regulations’ impact).

The CSR applied by BAT is more specifically stakeholder-oriented, so Corporate Stakeholder Responsibility, but we will have the chance to take into consideration also some examples of social responsibility recently implemented by the corporation (e.g. youth smoke prevention).

The message that this case study wants to send is that there is no business that can be sustainable over the long term if you do not invest in all the non-financial assets that allow you to sell your product or service.

The BAT case study is fascinating because shows us how the company is able to succeed in its industry even if selling a very dangerous product. Shaping the surrounding environment on behalf of your business is the key success factor for the competitive advantage of BAT and it is made possible through a careful stakeholder management and coalition building.

An additional strength point of BAT is its international features; indeed it is present in more than 180 countries in the world and according to Nicandro Durante, CEO of BAT, they have been able to become the second largest tobacco company in the world for their commitment in operating always in a responsible and sustainable way.

“ We behave in the right way and we always care about doing the right things”, he said.

BAT perceives the CSR as a crucial asset and a strategic tool to succeed constantly in the long run and it is core part of the company’s business strategy.

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Honesty, integrity, and transparency represent the BAT’s tripod and furthermore the company is aware of the fact that the compliance with regulation is one of the key issue of its business, so they push themselves to reach the highest legal standards possible along with the internal values of the company.

BAT has a responsible approach to business in term of ESG factors with a specific focus on anti-corruption behaviours and it is one of the leading companies that are fighting actively with local governments against illicit trade of cigarettes and other illegal and not responsible issues that have an impact on the regulated and accountable market of tobacco.

Finally BAT stresses the fundamental link between financial performance and non-financial performance for the sustainability of the business. The excellence in the bottom-line is vital year-by-year but not sufficient to survive in any industry. Along with that a deep commitment to stakeholder management and a profound identity in the corporate culture are the right formula to build a rock-solid reputation and to attract and increase the number of investors and their confidence.

BAT commercializes four leading brands that are Pall Mall, Kent, Dunhill, Lucky Strike, and two new brands Rothmans and GDBs, plus several local ones (e.g. Vogue and so on).

Finally let us consider the vision and mission of BAT according to which consumers are at the core of everything and the success of the company depends on addressing their evolving concerns, needs and behaviours.

Furthermore BAT wants to adopt a responsible approach creating shared value, and this is possible behaving with integrity throughout the supply chain. In addition wherever the tobacco products are sold, BAT wants that the consumer would be always well informed. The responsible attitude of BAT has been defined recently by the huge investments for research in harm reduction.
E.2 The Tobacco Industry and the challenges of the “sin” company BAT

Running a company when the most powerful stakeholders such as governments and big international bodies, like the European Commission, are continuously trying to limit your business is a hard job. Clear examples are the application of relevant taxes, in particular the one called “excise tax”, that make the purchase of a pack of cigarette pretty expensive in order to discourage the consumption. As a matter of fact it is a considerable obstacle in terms of revenues for companies like BAT. Furthermore being a tobacco company means continuously dealing with lawsuits\textsuperscript{171} and it is an additional cost for the company. Finally, if we just consider all the measures recently applied against cigarettes (e.g. prohibition to smoke inside public buildings, restaurants and so on) we can feel the difficulty in doing the business and be successful.

The interesting finding is that even if a lot of measures try to penalize the sale of tobacco products, actually the consumption is not reduced and it is substantially due to the fact that the company in such field as long as they know the rules of the game, they know how to “play” with such rules and how to developed high impact strategies; that is the fascinating thing of being part of “sin” companies team.

Let us give some numbers to quantify the huge market of tobacco in the world:

- 6 trillion of cigarettes per year produced by the entire industry;
- > 40% of global consumption is based in China;
- The big four players are:
  - BAT;
  - Imperial Tobacco;
  - Japan Tobacco;
  - Philip Morris International;
- One of the biggest issues related to the tobacco industry is the illicit trade of tobacco products, the so-called black market;

\textsuperscript{171} An interesting recent (June 2014) example is the one concerning the tobacco companies that have been rejected by the High Court of Florida Suits. The Supreme Court rejected efforts by the tobacco industry to derail thousands of Florida smokers lawsuits, leaving intact 11 awards totalling more than US $ 70 million.
• The consumption of tobacco in developed countries is decreasing year by year, whereas the development of emerging countries (e.g. population growth and higher income pro capite) is pushing up the sales of tobacco industries.

• One of the main concerns for the “bad guys” of tobacco industry is the increasing tightness of regulations worldwide (e.g. plain packaging in Australia, pictorials\textsuperscript{172} etc.).

The effects of extreme regulations, such as higher excise taxes, can be unfavourable for the competitiveness among players in the tobacco industry and as a matter of fact it could lead consumers to buy another cheaper brand, or in the worst scenario they could take advantage from the black market. So, we will see that BAT is fighting along with the local governments for anti-illicit trade policies and at the same time is working in a sound manner with all the stakeholders of the value chain in order to have an active dialogue with the Regulator avoiding excessive regulations’ impact on the entire business and industry (e.g. farmers, retailers, and consumers).

The recent Tobacco Product Directive (TPD) is a clear example of dialogue between companies and regulator, and we will have the chance to talk about this in the following sections.

The tobacco industry, as we said before, is made of these big four players that make their business in a highly competitive marketplace. The factors on which they compete are: innovation, technology, R&D, responsibility, and sustainability.

Apart from that the real added value of these companies is their ability to dialogue and to see their business as a set of relationships with all the stakeholders in order to go all together in the same direction. It is exactly what we called Corporate Stakeholder Responsibility.

These highly regulated industries like tobacco, pharmaceutical, weapons, alcohol, and gambling are identified to be the tougher lobbies in the business environment.

It is important to introduce the lobbying concept because with lobby we consider a group of people, or companies, that share common interests, not only of economic nature, in order to pursue a specific goal in a win-win fashion.

The lobby activity is regulated in 16 countries\textsuperscript{173} and it is particularly famous in the USA in which 50 countries has regulated lobbying.

\textsuperscript{172} Pictures on packs of cigarettes representing illnesses caused by smoke, such as cancer.
In the tobacco industry the lobbying is fundamental to voice the interests of the company and of its stakeholders in front of the regulator (e.g. government). In this way the lobby activity should be meant, not as a corruptive method on behalf of the company, but as a concrete way according to which the company can show why a certain regulation could not work properly and have damaging effect on the community and on the whole economic system.

Through the lobby, you educate the lawmakers on what the issues are, what is important for your mutual constituents. The real and biggest issue that companies in this industry have to deal with is that the lawmakers most of the time are not experts in each industry. So they need people from the industry to educate them in which can be the effects of some regulations (e.g. higher excise taxes on packs of cigarettes, implies higher level of illicit trade for instance). Indeed, sometimes it can happen that people from the industry provide a draft of the law. The fundamental concept to bear in mind is that lobbying and transparency go hand by hand.

Along with the idea of social responsibility, the overall industry of tobacco is pushing to develop new cigarettes and alternatives to that, less harmful for the health of consumers. Furthermore a strong signal of the industry moving all together is youth smoking prevention policies.

Finally in order to have a complete picture of tobacco industry, let us consider its relation with capital markets. The tobacco companies are pretty well know to be among the most defensive stocks according to their meaningful financial performance (solid cash flow, particularly high profit margins) and the skilled and smart people working in such companies.

Phillip Morris is the company that generates more cash in the world, whereas BAT ranked 4th and Imperial at the 9th place174.

After all the considerations made about the corporate social responsibility, ESG factors, and the new generation of investors and how they structure their decision-making, the interesting point is if investors still perceive investing in companies like BAT, a sustainable, responsible, and profitable investment.

At first, it would seem that the sustainability of the business is almost at risk according to the diminishing number of smokers (even if as we said above emerging markets are a

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173 USA, Canada, Cost Arica, Argentina, Chile, Peru, EU Parliament and Commission, Scotland, Germany, Hungary, Poland, Lithuania, Georgia, Taiwan, Australia.
golden resource). Then the responsibility of the business is definitely a paradoxical situation because cigarettes and tobacco products will be always harmful for people’s health.

The perspective about such companies completely changes if we accept the idea “CSR is not what the company does, but how the company does it”. Indeed, companies like BAT work in a legal market and are even excessively regulated, and their responsibility is embedded in finding new and less damaging products and sponsoring/applying several social and environmental policies throughout the company.

The biggest issue recently faced by tobacco companies is the really high excise tax also called “sin tax”, and more in general the tax event of these companies is the biggest issue affecting their bottom line. Some empirical data from tobacco companies can give an idea of such effect:


The players in the tobacco industry still seem to be profitable and in order to invest in the long run and in the sustainability of the business, the future is diversification in reduced-risk tobacco products (e.g. electronic cigarettes). BAT and Imperial have recently invested around US $500 million in reduced-risk products development and they have produced their own e-cig. The BAT’s one is called Vype e-cig and was launched in 2013.

According to the fact that, European lawmakers have amplified the magnitude of health and warnings on cigarette packs and forbidden flavoured tobacco, investing in diversification would seem to be the future focus of the leading tobacco companies.

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174 R. HARGRAVES, *These three factors are pushing Philip Morris’ profits higher*, Motley Fool, April 4th, 2014.

175 BAT is particularly interested in Lorillard Inc. for its Blue Electronic Cigarettes. Lorillard stocks’ performance skyrocket recently and the biggest BAT’s shareholder Reynolds American Inc. (maker of Camel cigarettes) will make a bid for it.

E.3 BAT’s instrumental perspective of Corporate Stakeholder Responsibility as a strategic tool for value creation

The tobacco industry is kind of controversial if we consider the CSR, but it underpins the core concept that differentiates business and socially well-accepted initiatives. BAT is a company that commercializes health-damaging products but at the same time, according to the definition of Corporate Stakeholder Responsibility, it is able to deliver higher value to both its shareholders and to all stakeholders involved in the business. And the CEO of BAT, Nicandro Durante, confirms it:

“It’s about creating shared value and making sure that what we do as a business doesn’t just benefit our shareholders, but can also have a much wider, positive impact for society.”

In BAT we recognize the main idea of stakeholder theory that basically is doing business in a better way because it is creating lots of value for shareholders and creating lots of value for the other stakeholders, and these interests have to go in the same direction. This is what happens in BAT.

The power of companies like BAT is imbedded in the relationships building. It is about the culture of the company that wants to take the needs of customers into consideration providing them with the higher quality possible and, paradoxically, with the “healthiest” or better, less harmful product such as e-cig. Being innovative and continuously figuring out alternatives into a profitable enterprise is the lifeblood of BAT.

BAT put itself in the middle as the hub of all the relationships with stakeholders and wonders itself what is its purpose. The answer is still the one developed by Friedman in late 90’s: maximising shareholder value. This is still and always will be the daily goal. So what about the stakeholders? Are they just a mean to reach the final aim? It depends. Exactly it depends on the perspective that is adopted.

Basically this is the business and as a definition it is made of different actors each of them is crucial in dealing with a specific task. It is the instrumental perspective of stakeholder theory and according to the fact that the value is delivered to all

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177 Five-year Dividend growth 11.21%
stakeholders on behalf of the final goal “higher value creation for shareholders” it would seem to be commonly accepted. It represents a system of interconnections that work interdependently in which everybody is a piece of a puzzle called, company. It is what makes the difference between great and good.

The value creation works because BAT is able to link all the stakeholders in the value chain finding the key intersections of all the interests and needs. As a matter of fact, is vital for sorting out conflicts among stakeholders, as well.

In the next section we will focus on the relationship BAT – stakeholders because it is the key success factor that allows the company to make business sustainable in the long run. In the four pillars of the company we can recognize the real goal-oriented nature of BAT: Growth, Productivity, Responsibility, and Leadership.

It is made possible through the management of best relations in the production and supply chain that pushes the company to do deliver always higher performance.

The tools useful to pursue such optimal performance are innovation, efficiency, commitment, and quality. Then there are some more technical and specific tools such as the SQP (Supplier Quality Partnership) and the SRTP programme (Social Responsibility in Tobacco Production).

In BAT a supplier is more than an economic contract between two parties. Here you have high standards of collaboration and actually you have a real partnership according to which it makes it easier to manage critical situations. Then you are able to exploit opportunities of mutual advantage in a win-win fashion.

The partnership philosophy developed in the corporate principles is based on good behaviour inside and outside the corporation (the “G” factor of the ESG model), responsible management of the product according to its high impact on people, and mutual advantage.

The latter principle is of fundamental value because it is the rationale at the basis of the instrumental perspective of stakeholders. Indeed, in BAT is firmly believed that all the stakeholders and business partners of the supply chain should have the opportunity to take advantage on the business activities shared with the company.

It is made possible through open and transparent communication that allows both parties to be informed and work with high standards of quality on behalf of each other. Good relationships permits to share benefits as well as risks, and sharing responsibilities in the problem-solving issues means minimization of risk and
improvement of operations. In this case we recognize the already discussed risk management approach associated to CSR.

Working in the tobacco industry requires a lot of competences because it is a business made of several businesses in which both technical skills and relational skills are vital for the success and for gaining the competitive advantage in the playfield.

The stakeholder responsibility of BAT is made of all these features and it is about synergic commitment of all the parties involved with a very unique long-term goal, the value creation for shareholders.

The path to the success is pretty hard and the team-logic of the multinational company wants to underline the role of BAT in supporting all its stakeholders in adopting all the best practices that can impact positively the business of both, stakeholders included.

This is measurable in huge investments in what the investors should perceive as non-financial information, and this aspect is core part of the business strategy of BAT that is particularly careful in being as much responsible as it can according to the fact that it operates in a very controversial industry179.

In a certain sense, such companies are forced to behave in the best way and with the best practices they can because they are in the limelight and the regulator has a particular and more rigid devotion to them.

BAT identifies its social responsibility in developing high quality products along with the duty of considering the expectations of all the stakeholders. Above all it is a system of stakeholders and its CSR and the responsible approach is spread throughout its supply chain. Generally speaking BAT has been pushing itself as main influencer prompting the adoption of best practices in all its stakeholders’ operations. So with BAT we are referring to an integrated responsibility framework embracing all the different players involved in the operative stages of BAT’s business.

The profound commitment of BAT is proven by the fact that even if the business partners are a separate entity from the company, the BAT culture is based upon some principles that impose a minimum set of requirements in order to be a suitable partner. For example: policies against child labour, policies against tobacco use among youth, policies against illegal and not transparent practices, policies on healthy job environment condition, and safety180.

BAT is also dedicated in reaching higher standards in terms of environmental sustainability (the “E” factor). The business of tobacco is strictly related and dependent on the environment through the agriculture activity. BAT, according to its culture believes that working all the supply chain (business partners and suppliers) together toward a common goal is the key to have a sustainable attitude to the environmental performance. The company is putting efforts into R&D (ranked in the top 25% EU companies for R&D investments) in order to develop new variety of tobacco that are more sustainable in the future. The support that BAT gives to farmers with the discovery of new technologies and more sustainable techniques for the agriculture is a clear example of working together and going in the same direction.

As we have said above the CSR in BAT is integrated not only in the company’s operations but it is spread through a waterfall approach along the entire value chain and it is the integrated result of all the partners’ responsibilities and commitment. BAT believes that the high standards of behavior support a sustainable shareholder value and adopting a long-term view, investing in non-financial performance will be appreciated by capital markets.

The point of strength of BAT is that the business of tobacco is a legal and regulated market and being associated to the consumption sector, BAT has the obligation to preserve the interests and the right to consume of its customers.

The Tobacco industry, and BAT as one of the main players, is actively adopting the best practices and it is encouraging its partners to do so. According to that I had the chance to be in touch with Trent Boorman a Systems Analyst from Sustainability Accounting Standards Board (SASB) who has explained me that SASB is currently still developing standards and releasing them on a rolling/quarterly basis. The Tobacco industry is indeed classified under the Sustainability Industry Classification System (SICS™) and the SASB has actually just begun development for the Consumption sector, the Sector that houses the Tobacco industry, and in 6-8 months a draft for this industry will be released. So for the future of this industry, it would be interesting to compare what BAT has been doing until now, and what the SASB will be requiring for the “sin” companies in the future.
E.4 The multi-stakeholder dialogue: a chess game with more complex rules

The process to implement an efficient and sound CSR is complicated and absorbs a huge quantity of resources. Let us see how it works in BAT.

One of the key steps to put in practice the stakeholder management is the map of the decision-makers, or stakeholders. It represents the point of view according to which the company perceives the wide theme of stakeholders. Confirming what said in the first chapter, Mr Petrillo defines the stakeholders as those who have the power to influence your business; stakeholder is who is relevant for your activity.

The crucial aspect is how to take part in the dialogue with these stakeholders; indeed BAT has a very special approach that is different and proper to each different actor of the supply chain. The right formula to succeed in stakeholder engagement is to be aware of the interests of the counterpart and trying to find a point of common agreement to start a negotiation.

I can remember something that really impressed me during one of the conversations hold with Mr Petrillo, in which he described the business of tobacco as a game of chess but with more complex rules. The key to move into such business is one and only one, not be alone and investing as much as possible in coalition building.

It is so important to have real partners in this industry because when you need something you have to be able to figure out to whom you could go to come over a potential issue. This concept has to be considered as lobbying activity, a crucial part of stakeholder management.

![Horizontal relationships](image)

- **Figure 30.** British American Tobacco’s map of decision-makers, or stakeholders.
  *Source:* Primary Data.
In the table above is showed the supply chain (e.g. farmer, transformer, carrier, tobacconist, and consumer) of BAT and its three big competitors. The tobacco industry is unique for its double way to behave. Indeed on one side the level of competitiveness is very high but on the other side the collaboration in certain circumstances, even among competitors, is vital.

The real added value of the tobacco industry is its ability to involve all its actors in what is called *trade association* when a particular regulatory issue is perceived to have damaging factors for the business. And as matter of fact, it happens frequently.

A clear and significant recent example is the European Tobacco Product Directive\(^{181}\) (TPD) that is still under analysis but its content interested all the four big players that activated a strong communication channel among each other in order to defend their business.

Building solid and sound relationships in both directions, vertical and horizontal (see Figure 30), is the recipe that allows BAT to reach its final goal, higher financial performance (e.g. profit and revenues).

Nothing new from the business world, companies exist to create wealth that is consequently delivered to those that have bet on such companies, shareholders. Stakeholders are the business, managing through stakeholders implies managing for stakeholders and in the end they will benefit as well. In this chapter the message that is sent is “business involves stakeholders and produces wealth indirectly for them and directly for shareholders”.

The horizontal chain does not move always together in the same direction because as a matter of fact, different competitors have conflicting interests. An example could be the case according to which in the industry each company is not free to operate but as we repeated several times this market is highly regulated, and the price for instance is fixed by the law in a specific Code called in Italy *Testo Unico delle Accise* (Legge 504/95 and subsequent modifications). In this case the competitors do not cooperate and they implement different strategies.

In other cases like the TPD, the industry works together. In particular we have collaboration among the horizontal players in the case in which there is not competition on the product.

\(^{181}\) One of the provisions subjects of discussion between the trade association and the lawmaker was the abolition of the package of ten cigarettes, for instance.
BAT plays in a very dynamic environment in which your worst enemy today could be your best ally tomorrow. The players of the tobacco compete in several areas of interest but when they behave like a trade association they are seen from a different point of view.

The rationale at the basis of the coalition building with stakeholders finds its ground in the problem-solving task. It means that BAT, according to its vision of the industry or of a specific topic, builds its coalition on the basis of the issue that is dealing with. For example in analyzing the issue of anti-illicit Trade (AIT), BAT focuses more on coalition building with the tobacco shops, because is one of the component of the supply chain that would be affected negatively. The opposite is true for the farmers that do not have a real interest in fighting the AIT, so it does not make sense for BAT to engage them in this situation. Basically when coping with a problem BAT moves vertically throughout the supply chain trying to figure out who has a specific interest in common dealing with this specific issue. Once that the partners have been discovered, the ability of BAT is in finding the right way to engage them, because the better way to come up with a solution is to take action as a coalition. The theory of the coalition building allows the company to be more powerful in presenting its interests to the lawmaker. Basically, it is a specific law or an issue that permits to the company and its stakeholders to align themselves at the same level and go together in the same direction.

As well as the stakeholder theory developed by Freeman, here we recognize the concept of the company's ability in considering all the interests of its primary stakeholders, aligning them at the same level, and drive all of them in the same unique direction that is value creation.

In this case the value creation for BAT can be both lower impact of negative externalities (e.g. provisions from the lawmaker) and higher financial performance due to good trade relationships that allow you to deliver high quality products worldwide. Furthermore a business with strong trade relationships is viable and concretely sustainable. The sustainability of this kind of business is even strengthened through the huge pull of investors that perceive the tobacco companies as a safe and evergreen investment.

The tobacco industry in Italy contributed in 2013 with roughly € 15 billion, 10.4 from the excise taxes and 3.1 from IVA so it represents a real source of financing for the country (1% of the Italian GDP) and this is a key finding in terms of negotiation power of tobacco corporations. This last consideration is really valuable because in a certain
sense gives a strong message of sustainability of this business and it is an additional factor driving the capital markets' behaviors.

The long-term goals of BAT are sustainability and gaining market share from competitors. The success of this company has to be found in something that goes beyond the simple pack of cigarettes, in fact between the production and the sale of the final product, BAT is involved in a number of turbulent dynamics in which only the most cunning guys, called “the bad guys of tobacco lobbies”, are able to shape the business environment and the existing regulations in order to make their business profitable.

The graph below provide us with the trend of BAT stock price of the last twenty years and it would seem that the stock of BAT has experienced a successful period in the last decades confirming that the company has implemented the right approach to value creation and the Corporate Stakeholder Responsibility is one of these key success factor.

BAT has been a reliable company with solid earnings growth from 2009 to 2014. But the effect of increasing health concerns about smoking and black market slowed the earnings rate of expansion indeed the growth of last year 5% is hard to compare to the +19% of 2009. The forecasts for the next year are positive and BAT is expected to experience +9% in 2015. Finally in order to perceive the flavor of the impact of the CSR on the CFP, BAT has a market to book ratio equal to 10.7. This pretty high ratio is explained by the high profitability of the business and by the high growth rates of earnings mentioned before.

- **Figure 31.** British American Tobacco stock price trend.  
  Source: Primary Data.
Conclusion

The Corporate Stakeholder Responsibility has emerged to be a necessary condition for the companies operating in the current business environment. Stronger business relationships and better knowledge of the stakeholders’ interests is the intangible part of the business strategy that cannot be ignored in the 21st century. This thesis wants to stress the importance of sustainability of the business even more than profitability, and it is made possible not only by the production of a high quality good for instance but with a deep investment in stakeholder responsibility. This condition of attention on behalf of the stakeholders should not be perceived as a kind of social responsibility because managing for stakeholders is a crucial step in the value creation for shareholders and it is adopted in an attempt to improve financial performance and to reach long term goals. This is what we called the instrumental perspective of the stakeholder responsibility.

The BAT case study is a clear example that provides us with meaningful findings determining the strategic, and not social, feature of the CSR. It is all about short-term costs for long term benefits that can go from value creation to a kind of risk management perspective that are extremely valuable in a context of exposure at too many risks and uncertainty of profits.

In the elaboration of the thesis we had the chance to connect the dots between the theoretical studies and the empirical evidence, and what emerged to be the key driver of value creation was always the stakeholder management or stakeholder prioritization.

The following important consideration was if the market was sensitive to such kind of non-financial information and actually the answer is it depends. We could assert that always more investors are taking into consideration such kind of information but it is definitely not accepted the hypothesis that an investor will be attracted just by huge investments of the company X in CSR. Actually the investor will be interested in the past about looking the stock price trend, in the present about the bottom line and the financial solidity of the company.

From the perspective of CSR as a crucial aspect of the business strategy and as driver (instrumental) for shareholder value creation, we can definitely accept it as fascinating competitive factor on which companies should invest more in the future. But from the perspective of the communication requirements we come up with some concerns. Indeed the CSR, according to its voluntary nature, is not required with a mandatory
Disclosure so the main issues arise in the moment in which there is a substantial gap between the CSR as real responsibility of the investment conducted by the company (e.g. how the company does what it does) and the CSR as communication. So the question is if the market reacts to the information that are disclosed or to the real things that are/are not done by the company in terms of investment. The answer is that the market reacts to the communication.

According to this perspective the market should trust the disclosure of the companies without taking care of the social performance. In the discussion of the thesis emerged an interesting finding that basically concerns the measurability in terms of investment of companies in CSR. As we well know we cannot find an account in the balance sheet with the name expense in CSR, it is not mandatory. But what emerged is that the CSR activities is strictly related with the investments in R&D and innovation and in a certain sense it could provide a slightly perception of how many resources are devoted to the CSR. Finally CSR is communication and each company is free to disclose what is better on the behalf of itself (e.g. reputational effect). The voluntary nature of the CSR makes it a potential key success factor for competitive advantage, but it could be interesting to see in the next years that for those companies that decide to disclose some non-financial information some formal rules should be applied.

According to the fact that the market is sensitive to the communication and to the information, the main assumption is that if the company decides to go for disclosure, these information should be certificated by binding laws, that at the moment do not exist.

We could conclude with an optimistic message about the fact that during the period of elaboration of the thesis it emerged that lots of companies really perceive the value the of stakeholder responsibility, from Statoil Oil & Gas, to BAT, to Chrysler Group LLC, but only some of them identify in the disclosure of these information an added value.

According to the non-transparent behaviours adopted in the latest years in many business situations, it would seem that showing the internal practices such as “this is how we operate and this is what allows us to be profitable and sustainable over the long run” is becoming more common. Not exactly because it is meaningful for the business viability but in particular way because it is the market that requires new and more detailed information and as J. Welch, ex CEO of GE said: “If the rate of change on the outside exceeds the rate of change on the inside, the end is near” – “change or die” – “change before you have to”.

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## Annex I – Stakeholder Definition

<table>
<thead>
<tr>
<th>Date</th>
<th>Author</th>
<th>Stakeholder definition</th>
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<tbody>
<tr>
<td>1963</td>
<td>1. Stanford Research Institute</td>
<td>Those groups without whose support the organization would cease to exist</td>
</tr>
<tr>
<td>1964</td>
<td>2. Rhenman adopted by:</td>
<td>Are depending on the firm in order to achieve their personal goals and on whom the firm is depending for its existence</td>
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<tr>
<td>1965</td>
<td>4. Ansoff (1965a: 34)</td>
<td>The objectives of the firm should be derived balancing the conflicting claims of the various ‘stakeholders’ in the firm. The firm has a responsibility to all of these and must configure its objectives so as to give each a measure of satisfaction</td>
</tr>
<tr>
<td>1971</td>
<td>5. Ahlstedt and Jahnkaineden</td>
<td>Driven by their own interests and goals are participants in a firm, and thus depending on it and for whose sake the firm is depending</td>
</tr>
<tr>
<td>1983</td>
<td>6. Freeman and Reed (1983: 91)</td>
<td>Wide: can affect the achievements of an organization’s objectives to who is affected by the achievement of an organization’s objectives Narrow: on which the organization is dependent for its continual survival</td>
</tr>
<tr>
<td>1984</td>
<td>7. Freeman (1984: 46) adopted by:</td>
<td>Can affect or is affected by the achievements of the organization’s objectives</td>
</tr>
<tr>
<td></td>
<td>8. Berman et al. (1999)</td>
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<td></td>
<td>15. Jawahar and McLaughlin (2001)</td>
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<td></td>
<td>16. Jones and Wicks (1999a)</td>
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<td></td>
<td>17. Kujala (2001)</td>
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<tr>
<td></td>
<td>20. Roberts (1992)</td>
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</tr>
<tr>
<td></td>
<td>22. Rowley (1997)</td>
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<tr>
<td></td>
<td>24. Wood and Jones (1995)</td>
<td></td>
</tr>
<tr>
<td>1987</td>
<td>25. Cornell and Shapiro (1987: 5)</td>
<td>‘Claimants’ who have ‘contracts’ Can affect or is affected by business</td>
</tr>
<tr>
<td></td>
<td>26. Freeman and Gilbert</td>
<td></td>
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<tr>
<td>1988</td>
<td>27. Bowie (1988: 112)</td>
<td>Without whose support the organization would cease to exist Have a stake or claim in the firm Benefit from or are harmed by, and whose rights are violated or respected by, corporate actions</td>
</tr>
<tr>
<td></td>
<td>28. Evan and Freeman</td>
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<tr>
<td>Date</td>
<td>Author</td>
<td>Stakeholder definition</td>
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<tr>
<td>1989</td>
<td>29. Alkhafaji (1989: 36)</td>
<td>Groups to whom the corporation is responsible. Asserts to have one or more of these kinds of stakes, which range from an interest to a right (legal or moral) to ownership or legal title to the company’s assets or property.</td>
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<tr>
<td></td>
<td>30. Carroll</td>
<td></td>
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<tr>
<td>1991</td>
<td>32. Low (1991: 336)</td>
<td>All those who have an interest in the firm’s survival. Stakeholders are people who can help or hurt the corporation.</td>
</tr>
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<td></td>
<td>33. Miller and Lewis (1991: 55)</td>
<td></td>
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<td></td>
<td>34. Savage et al. (1991: 61)</td>
<td>Have an interest in the actions of an organization and have the ability to influence it.</td>
</tr>
<tr>
<td>1992</td>
<td>36. Hill and Jones (1992: 133)</td>
<td>Constituents who have a legitimate claim on the firm . . . established through the existence of an exchange relationship. They supply ‘the firm with critical resources (contributions) and in exchange each expects its interests to be satisfied (by inducements)’ Those whose welfare is tied with a company.</td>
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<td></td>
<td>37. Palgrave et al. (1992)</td>
<td></td>
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<tr>
<td>1993</td>
<td>38. Brenner (1993: 205)</td>
<td>Having some legitimate, non-trivial relationship with an organization (such as) exchange transactions, action impacts, and moral responsibilities.</td>
</tr>
<tr>
<td></td>
<td>39. Carroll (1993: 22)</td>
<td>Individuals or groups with which business interacts who have a stake or vested interest in the firm. Asserts to have or may have more of the kinds of stakes in business . . . may be affected or affect. Power and legitimacy.</td>
</tr>
<tr>
<td></td>
<td>40. Stairik (1993: 22)</td>
<td>Any naturally occurring entity that affects or is affected by organizational performance.</td>
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<tr>
<td>1994</td>
<td>41. Clarkson (1994: 5)</td>
<td>Bear some form of risk as a result of having invested some sort of capital, human or financial, something of value, in a firm . . . [or] . . . are placed at risk as a result of a firm’s activities.</td>
</tr>
<tr>
<td></td>
<td>42. Freeman (1994a: 415)</td>
<td>Participants in ‘the human process of joint value creation’.</td>
</tr>
<tr>
<td></td>
<td>43. Langtry (1994: 433)</td>
<td>The firm is significantly responsible for their well-being or they hold a moral or legal claim on the firm.</td>
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<tr>
<td></td>
<td>44. Mahoney</td>
<td>Passive stakeholders who have a moral claim on the company not to infringe liberties or inflict harm and active stakeholders whose claims are more in the nature of welfare rights.</td>
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<tr>
<td></td>
<td>45. Schlossberger</td>
<td>Investors who provide specific capital or opportunity capital to a business.</td>
</tr>
<tr>
<td></td>
<td>46. Stairik (1994: 90)</td>
<td>Can and are making their actual stakes known . . . or might be influenced by, or are potentially influencers of, some organization whether or not this influence is perceived or known.</td>
</tr>
<tr>
<td></td>
<td>47. Wicks, Gilbert, and Freeman (1994: 483)</td>
<td>Interact with and give meaning and definition to the corporation.</td>
</tr>
<tr>
<td>Date</td>
<td>Author</td>
<td>Stakeholder definition</td>
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<tr>
<td>1995</td>
<td>48. Blair</td>
<td>All parties who have contributed inputs to the enterprise and who, as a result, have at risk investments that are highly specialized to the enterprise</td>
</tr>
<tr>
<td></td>
<td>49. Brenner (1995: 76)</td>
<td>Are or which could impact or be impacted by the firm/organization</td>
</tr>
<tr>
<td></td>
<td>50. Calton and Lad</td>
<td>Legitimate claims</td>
</tr>
<tr>
<td></td>
<td>51. Clarkson (1995: 106)</td>
<td>Have, or claim, ownership rights, or interests in a corporation and its activities</td>
</tr>
<tr>
<td></td>
<td>52. Donaldson and Preston (1995: 85)</td>
<td>Those individuals with explicit or implicit contracts with the firm. Identified through the actual or potential harms and benefits that they experience or anticipate experiencing as a result of the firm’s actions or inactions</td>
</tr>
<tr>
<td></td>
<td>53. Jones (1995: 407)</td>
<td>Groups and individuals with (a) the power to affect the firm’s performance and/or (b) a stake in the firm’s performance</td>
</tr>
<tr>
<td></td>
<td>54. Nasi (1995: 19)</td>
<td>Interact with the firm and thus make its operation possible</td>
</tr>
<tr>
<td>1996</td>
<td>55. Gray, Owen, and Adams (1996: 45)</td>
<td>Any human agency that can be influenced by, or can itself influence, the activities of the organization in question</td>
</tr>
<tr>
<td>1997</td>
<td>56. Carroll and Nasi (1997: 46)</td>
<td>Any individual or group who affects or is affected by the organization and its processes, activities, and functioning</td>
</tr>
<tr>
<td></td>
<td>57. Mitchell, Agle, and Wood adopted by:</td>
<td>Legitimate or urgent claim on the corporation or the power to influence the corporation</td>
</tr>
<tr>
<td></td>
<td>58. Agle, Mitchell, and Sonnenfeld (1999)</td>
<td>Voluntary members of a cooperative scheme for mutual benefit...partners for the achievement of mutual advantage. A claim (norm) can only be justifiable in the case that it can be approved of by all those affected by the norm</td>
</tr>
<tr>
<td>1998</td>
<td>60. Argandoña (1998: 1099)</td>
<td>Those who have an interest in the company (so that the firm, in turn, may have an interest in satisfying their demands)</td>
</tr>
<tr>
<td></td>
<td>61. Frederick (1998: 361)</td>
<td>Everyone in the community who has a stake in what the company does</td>
</tr>
<tr>
<td>1999</td>
<td>62. Clarkson Centre for Business Ethics (1999: 257)</td>
<td>Parties that have a stake in the corporation: something at risk, and therefore something to gain or lose, as a result of corporate activity</td>
</tr>
<tr>
<td></td>
<td>Adopted by:</td>
<td>Have rights that are internally linked to the constitution of the company, which gives them constitutional powers</td>
</tr>
<tr>
<td></td>
<td>63. Whysall (2000)</td>
<td>Those with ‘an interest for which a valid normative claim can be advanced’</td>
</tr>
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<td></td>
<td>64. Leader</td>
<td></td>
</tr>
<tr>
<td></td>
<td>65. Reed</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>66. Gibson (2000: 245)</td>
<td>Those groups or individuals with whom the organization interacts or has interdependencies and any individual or group who can affect or is affected by the actions, decisions, policies, practices, or goals of the organization</td>
</tr>
<tr>
<td>Date</td>
<td>Author</td>
<td>Stakeholder definition</td>
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<tr>
<td>67</td>
<td>Kochan and Rubinstein</td>
<td>Contribute valued resources . . . which are put at risk and would experience costs if the firm fails or their relationship with the firm terminates and . . . have power over an organization</td>
</tr>
<tr>
<td></td>
<td>Scott and Lane (2000: 53)</td>
<td>A direct influence on organizational performance and survival</td>
</tr>
<tr>
<td>2001</td>
<td>Hendry</td>
<td>Moral actors . . . relationships cannot be reduced to contractual or economic relations. Include social characteristics such as interdependence</td>
</tr>
<tr>
<td></td>
<td>Lampe (2001: 166)</td>
<td>Parties affected by an organization</td>
</tr>
<tr>
<td></td>
<td>Ruf et al. (2001: 145)</td>
<td>Constituencies who have explicit or implicit contracts with the firm</td>
</tr>
<tr>
<td>2002</td>
<td>Cragg</td>
<td>The corporation impacts . . . individuals and collectivities whose interests are thereby affected both negatively and positively</td>
</tr>
<tr>
<td></td>
<td>Orts and Strudler (2002: 218)</td>
<td>Participants in a business (who) have some kind of economic stake directly at risk</td>
</tr>
<tr>
<td></td>
<td>Reed</td>
<td>Basic stake, whereby stakes can be that of fair economic opportunity, a stake of authenticity, or one of political equality</td>
</tr>
<tr>
<td>2003</td>
<td>Phillips (2003a: 30–1)</td>
<td>Normative stakeholders: for whose benefit should the firm be managed. Derivative stakeholders: potential to affect organization and its normative stakeholders</td>
</tr>
</tbody>
</table>

Annex II – Principles of stakeholder management

<table>
<thead>
<tr>
<th>Principle</th>
<th>Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Managers should <strong>acknowledge</strong> and actively <strong>monitor</strong> the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.</td>
</tr>
<tr>
<td>2</td>
<td>Managers should <strong>listen</strong> to and openly <strong>communicate</strong> with stakeholders about their respective concerns and contributions, and about the risks that they assume because of the involvement with the corporation.</td>
</tr>
<tr>
<td>3</td>
<td>Managers should <strong>adopt</strong> processes and modes of behaviour that are sensitive to the concerns and capabilities of each stakeholder constituency.</td>
</tr>
<tr>
<td>4</td>
<td>Managers should <strong>recognize the interdependence</strong> of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.</td>
</tr>
<tr>
<td>5</td>
<td>Managers should <strong>work cooperatively</strong> with other entities, both public and private, to ensure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.</td>
</tr>
<tr>
<td>6</td>
<td>Managers should <strong>avoid altogether</strong> activities that might jeopardize inalienable human rights (e.g. the right to life) or give rise to risks that, if clearly understood, would be patently unacceptable to relevant stakeholders.</td>
</tr>
<tr>
<td>7</td>
<td>Managers should <strong>acknowledge the potential conflicts</strong> between (a) their own role as corporate stakeholders; and (b) their legal and moral responsibilities for the interests of stakeholders, and should address such conflicts through open communication, appropriate reporting, and incentive systems, and, where necessary, third party review.</td>
</tr>
</tbody>
</table>

Annex III – Convergent stakeholder theory principles

1. The following boundary conditions are met:
   • The firm is publicly held and operates in a competitive market economy;
   • Important corporate decisions are made by professional managers, and
   • The behavioural contingency (the normative core) is adopted - the value of the supporting instrumental theory is contingent on the prescribed behaviour.

2. It does not depend on any specific behavioural assumptions; it assumes only that:
   • Human behaviour is both varied (e.g., self-interested, trusting, and cooperative) and variable (e.g., sometimes self-interested, sometimes "other regarding") and that
   • Human behaviour is malleable - it often depends on context and circumstances. (Organizational structures and cultures affect the way that people behave; we can, at least partially, enact the environments in which we operate.

3. It is a theory of relationships (a broader term than contracts or transactions).
4. It is simultaneously normative and instrumental, offering both normative standards of behaviour and arguments that adherence to those standards will lead to outcomes that are both normatively and practically acceptable.

5. Its normative foundation ("core") is explicitly and unabashedly moral and has to be explicitly defended in moral terms; instrumental means are not either (a) applied to immoral behavioural standards or (b) used to pursue immoral ends.

6. Its instrumental means-ends chain is persuasively argued and demonstrates the practicality of the behaviour called for in the normative core.

7. It is managerial in focus, instructing managers with respect to:
   • The way in which relationships with corporate stakeholders should be structured (the means to corporate ends),
• The moral foundation for structuring these relationships in the specified way,
• The outcomes expected from structuring relationships in the specified way (corporate ends) and why these outcomes are expected to obtain (means-ends chain), and
• If the specified ends are unconventional, the moral defence of those ends.

## Annex IV – CSR definitions

<table>
<thead>
<tr>
<th>Author(s)</th>
<th>Construct proposed</th>
<th>Definition provided</th>
<th>Focus/Perspective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bowen (1953)</td>
<td>Businessmen</td>
<td>“It refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of actions which are desirable in terms of the objectives and values of our society” (p. 6)</td>
<td>Businessmen / Normative / Institutional</td>
</tr>
<tr>
<td>Davis (1960)</td>
<td>Corporate social responsibility</td>
<td>“businessmen’s decisions and actions taken for reasons at least partially beyond the firm’s direct economic or technical interest” (p. 70)</td>
<td>Businessmen / Normative / Beyond expectations</td>
</tr>
<tr>
<td>McGuire (1950)</td>
<td>Corporate social responsibility</td>
<td>“The idea of social responsibilities supposes that the corporation has not only economic and legal obligations but also certain responsibilities to society which extend beyond these obligations” (p. 144)</td>
<td>Corporation / Normative / Beyond expectations</td>
</tr>
<tr>
<td>Walton (1967)</td>
<td>Corporate social responsibility</td>
<td>“In short, the new concept of social responsibility recognizes the intimacy of the relationships between the corporation and society and realizes that such relationships must be kept in mind by top managers as the corporation and the related groups pursue their respective goals” (p. 18)</td>
<td>Top managers / Normative / Institutional</td>
</tr>
<tr>
<td>Friedman (1970)</td>
<td>Business social responsibility</td>
<td>“There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.” (p. 247)</td>
<td>Profit focus / Normative / Critical</td>
</tr>
<tr>
<td>Eells and Walton (1974)</td>
<td>Corporate social responsibility</td>
<td>“In its broadest sense, corporate social responsibility represents a concern with the needs and goals of society which goes beyond the merely economic. Insofar as the business system as it exists today can only survive in an effectively functioning free society, the corporate social responsibility movement represents a broad concern with business’s role in supporting and improving social welfare” (p. 247)</td>
<td>Normative / Institutional / Ecological / Welfare focused</td>
</tr>
<tr>
<td>Frederick (1978 [1994])</td>
<td>Corporate social responsiveness</td>
<td>“Corporate social responsiveness refers to the capacity of a corporation to respond to social pressures” ([1994, p. 247])</td>
<td>Corporation / Business / Integrative</td>
</tr>
<tr>
<td>Carroll (1991)</td>
<td>Corporate social responsibility</td>
<td>“The social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time” (p. 500)</td>
<td>Institutional / Business / Integrative</td>
</tr>
<tr>
<td>Author(s)</td>
<td>Construct proposed</td>
<td>Definition provided</td>
<td>Focus / Perspective</td>
</tr>
<tr>
<td>--------------</td>
<td>--------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>---------------------------</td>
</tr>
<tr>
<td>Carroll (1979)</td>
<td>Corporate social performance</td>
<td>&quot;...for managers to engage in CSR they needed to have (a) a basic definition of CSR, (b) an understanding/ enumeration of the issues for which a social responsibility existed (or, in modern terms, stakeholders to whom the firm had a responsibility, relationship or dependency), and (c) a specification of the philosophy of responsiveness to the issues&quot; (as reported in Carroll, 1999, p. 283-289)</td>
<td>Managers / Integrative</td>
</tr>
<tr>
<td>Epstein 1987</td>
<td>Corporate social responsibility</td>
<td>&quot;Corporate social responsibility related primarily to achieving outcomes from organizational decisions concerning specific issues or problems which (by some normative standard) have beneficial rather adverse effects on pertinent corporate stakeholders. The normative correctness of the products of corporate action have been the main focus of corporate social responsibility&quot; (p. 104)</td>
<td>Corporations / Integrative / Normative</td>
</tr>
<tr>
<td>Frederick (1986)</td>
<td>Corporate social rectitude</td>
<td>&quot;Corporate social rectitude embodies the notion of moral correctness in actions taken and policies formulated. Its general value referent is that the body of sometimes dimly or poorly expressed but deeply held moral convictions that comprise the culture of ethics.&quot; (p. 135)</td>
<td>Corporation / Normative</td>
</tr>
<tr>
<td>Wood (1999)</td>
<td>Corporate social performance</td>
<td>&quot;A business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programmes, and observable outcomes as they relate to the firm's societal relationships&quot; (p. 693)</td>
<td>Organization / Integrative</td>
</tr>
<tr>
<td>Maignan and Ferrell 2000</td>
<td>Corporate citizenship</td>
<td>&quot;The extent to which businesses meet the economic, legal, ethical and discretionary responsibilities imposed on them by their stakeholders&quot; (p. 284)</td>
<td>Corporation / Stakeholder / Integrative</td>
</tr>
<tr>
<td>McWilliams and Siegel 2001</td>
<td>Corporate social responsibility</td>
<td>&quot;Here, we define CSR as actions that appear to further some social good, beyond the interest of the firm and that which is required by law&quot; (p. 117)</td>
<td>Corporation / Social good / Beyond requirements</td>
</tr>
<tr>
<td>Matten and Crane 2005</td>
<td>Corporate citizenship</td>
<td>&quot;Corporate citizenship describes the role of the corporation in administering citizenship rights for individuals&quot; (p. 173)</td>
<td>Corporation / Political / Institutional</td>
</tr>
<tr>
<td>Author(s)</td>
<td>Construct proposed</td>
<td>Definition provided</td>
<td>Focus / Perspective</td>
</tr>
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</tr>
<tr>
<td>Campbell 2006</td>
<td>Corporate social responsibility</td>
<td>“I view corporations as acting in socially responsible ways if they do two things. First, they must not knowingly do anything that could harm their stakeholders. Second, if they do harm to stakeholders, then they must rectify it whenever it is discovered and brought to their attention” (p. 928)</td>
<td>Corporation / Stakeholder / Institutional / Minimalist</td>
</tr>
<tr>
<td>Crouch (2006)</td>
<td>Corporate social responsibility</td>
<td>“...behaviour by firms that voluntarily takes account of the externalities produced by their market behaviour, externalities being defined as results of market transactions that are not themselves embodied in such transactions. CSR is essentially ‘corporate externality recognition’.” (p. 1534)</td>
<td>Corporation / Transactional / Externality focused</td>
</tr>
<tr>
<td>Basu and Palazzo (2008)</td>
<td>Corporate social responsibility</td>
<td>“...we can define CSR as the process by which managers within an organization think about and discuss relationships with stakeholders as well as their roles in relation to the common good, along with their behavioral disposition with respect to the fulfilment and achievement of these roles and relationships.” (p. 124)</td>
<td>Stakeholders / Common good / Integrative</td>
</tr>
</tbody>
</table>

Annex V – Table of Principles for CSR

<table>
<thead>
<tr>
<th>Principle</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Bring stakeholder interests together over time.</td>
</tr>
<tr>
<td>2. Recognize that stakeholders are real and complex people with names, faces and values.</td>
</tr>
<tr>
<td>3. Seek solutions to issues that satisfy multiple stakeholders simultaneously.</td>
</tr>
<tr>
<td>4. Engage in intensive communication and dialogue with stakeholders not just those who are “friendly”.</td>
</tr>
<tr>
<td>5. Commit to a philosophy of voluntarism—manage stakeholder relationships yourself, rather than leaving it to government.</td>
</tr>
<tr>
<td>6. Generalize the marketing approach.</td>
</tr>
<tr>
<td>7. Never trade off the interests of one stakeholder versus another continuously over time.</td>
</tr>
<tr>
<td>8. Negotiate with primary and secondary stakeholders.</td>
</tr>
<tr>
<td>9. Constantly monitor and redesign processes to better serve stakeholders.</td>
</tr>
<tr>
<td>10. Act with purpose that fulfills commitments to stakeholders. Act with aspiration toward your dreams and theirs.</td>
</tr>
</tbody>
</table>

## Annex VI – CSR: American perspective vs. European perspective

<table>
<thead>
<tr>
<th>American perspective</th>
<th>European perspective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Avoid any effects that may be damaging to shareholder value and to the firm’s reputation</td>
<td>Integral part of managerial ‘philosophy’ given a particular organizational culture and a management based on references to values</td>
</tr>
<tr>
<td>‘External’ demands leading to ethical codes</td>
<td>Management cannot ignore democracy in the workplace</td>
</tr>
<tr>
<td>Tradition of civic-mindedness (especially the civic virtue of honesty)</td>
<td>‘Ethical’ perspectives emanating from one’s social partners</td>
</tr>
<tr>
<td>Importance granted to formal training in values</td>
<td>Importance granted to understanding value</td>
</tr>
<tr>
<td>Common law legal tradition leaving room for conflict and interpretation</td>
<td>Napoleonic code legal tradition, replete with employment rights</td>
</tr>
<tr>
<td>Importance of anti-corruption laws</td>
<td>Voluntary (non-legal) aspects</td>
</tr>
<tr>
<td>Ethical codes are quasi-laws</td>
<td>Ethical codes are non-compulsory guides</td>
</tr>
<tr>
<td>Federal sentencing guidelines</td>
<td>Partnership between employers and employees (including labour unions)</td>
</tr>
<tr>
<td>Business ethics modules in management curricula</td>
<td>Modules on economic implications of business life, in the light of ethical considerations</td>
</tr>
<tr>
<td>Aspect incorporated into accreditation processes like AACSB in management education</td>
<td>Aspect not necessarily taken into account in accreditations and curricula</td>
</tr>
<tr>
<td>Teachers from other departments (philosophy, theology, political science)</td>
<td>Specific and optional modules taught by management lecturers</td>
</tr>
</tbody>
</table>

Annex VII – Global Compact Principles of the UN

The Global Compact principles of United Nations are intended to take into consideration different areas of interests that are commonly associated with the corporation environment and are: human rights, labour, the environment and anti-corruption, and all of them enjoy universal consensus. The UN Global Compact asks companies to embrace, support and enact, voluntarily, within their domain of interest, a set of key principles:

1. Businesses should support and respect the protection of internationally proclaimed human rights; and
2. Make sure that they are not complicit in human rights abuses.
3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
4. The elimination of all forms of forced and compulsory labour;
5. The effective abolition of child labour; and
6. The elimination of discrimination in respect of employment and occupation.
7. Businesses should support a precautionary approach to environmental challenges;
8. Undertake initiatives to promote greater environmental responsibility; and
10. Businesses should work against corruption in all its forms, including extortion and bribery.

135. (1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

(2) The Board’s report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

(3) The Corporate Social Responsibility Committee shall—

(a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;

(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and

(c) monitor the Corporate Social Responsibility Policy of the company from time to time.

(4) The Board of every company referred to in sub-section (1) shall—

(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company’s website, if any, in such manner as may be prescribed; and

(b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

(5) The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:

Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities:

Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (a) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation. — For the purposes of this section “average net profit” shall be calculated in accordance with the provisions of section 198.
SCHEDULE VII
(See sections 135)

Activities which may be included by companies in their Corporate Social Responsibility Policies

Activities relating to:—

(i) eradication of extreme hunger and poverty;
(ii) promotion of education;
(iii) promoting gender equality and empowering women;
(iv) reducing child mortality and improving maternal health;
(v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
(vi) ensuring environmental sustainability;
(vii) enhancing vocational skills;
(viii) social business projects;
(ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
(x) such other matters as may be prescribed.

P.K. MALHOTRA,
Secretary to the Govt. of India.
Annex IX – KLM index (Kinder – Lydenburg – Domini)

The KLM index\textsuperscript{182} is a commonly used measure of Corporate Social Performance compiled by an independent rating service that focuses exclusively on ranking approximately 800 firms (included the S&P 500) on a range of several social performance activities. Each of them is made of different strength-criteria and concern-criteria that enable to rank the different companies. The KLD categories are rated on a scale ranging from -2 (major concerns) -1 (concerns) 0 (neutral) 1 (strength) 2 (major strength). The absence of ratings, signified by a “0” indicates that a company did not meet the criteria for the strength or concern.

The sources of KLD are a broad range of surveys, reports and articles in the general business press and agencies.

\textit{Qualitative screens (strength and concerns):}

1. \textbf{Community relations:} how/what kind of impact has the business on the community;

2. \textbf{Corporate Governance:} it concerns with high/low compensation of CEO and directors\textsuperscript{183};

3. \textbf{Employee relations:} the role of union relations, health and safety, employees’ involvement and so on;

4. \textbf{Environmental performance:} pollution prevention, recycling and green power;

5. \textbf{Product characteristics:} quality, R&D, innovation investments, antitrust and so on;

6. \textbf{Diversity:} it deals with treatment of women and minorities;

7. \textbf{Human rights controversies:} indigenous people relations in the area of current business operations, labour rights and so on.

\textit{Exclusionary screens (no strength ratings but only concerns):}

8. \textbf{Military contracting;}

9. \textbf{Firearms;}

10. \textbf{Production of alcohol;}

\textsuperscript{182}Kellogg School of Management - http://www.kellogg.northwestern.edu.

\textsuperscript{183}The limit for a rating is total compensation of less than $500,000 per year for a CEO or $30,000 per year for outside directors.
11. *Tobacco*\textsuperscript{184}

12. Gambling industry

13. Nuclear energy

The KLD chart has been found to be one of the most complete measures of CSP available. Each screen focuses on a particular social indicator and is part of an overall evaluation of corporate social performance.

The KLD index, classifies firms along a scale from -2 to +2, based on their social performance, and provides data on CFP of socially screened portfolios\textsuperscript{185}.

\textsuperscript{184} (TOB-con-A). The company derives substantial revenues from the production of tobacco products. (TOB-con-X). The company derives substantial revenues from the activities closely associated with the production of tobacco products. KLD assigned concerns in this category through 2002.

\textsuperscript{185} http://www.kld.com/indexes/index.html.
Annex X – Multifactor model (Fama, French and Carhart)

\[ E(Rs) = Rf + \beta_{mrp}*[E(Rm)-Rf] + \beta_{smb}*E(Rsmb)+ \beta_{hml}*E(Rhml)+ \beta_{pr1yr}*E(Rpr1yr) \]

With this expression we identify the multifactor model of risk in response to the inefficiencies of CAPM. This model is an extension of the CAPM.

First of all to make this model consistent with the CAPM we must consider the concept of self-financing portfolios. According to the CAPM an investor should invest either in market portfolio or in risk free assets (you cannot invest your money in other portfolios). But in this case we add the self-financing portfolios, those which do not require any additional investment by the investors, you buy without paying anything (short-selling procedure).

Market portfolio, it is consistent with the CAPM because it is the example of one single factor model, that is the **market risk premium**.

**SMB**, (small minus big dealing with capitalization) each year you divide stocks on the basis of stock market cap, you take the median and you buy (long position) all stocks below the median (characterized by smallest cap) and you take short position of all the stocks above the median (larger cap).

**HML** (high minus low dealing with B/M ratio), here the same is true for B/M ratio. Indeed you'll take long position with stocks with high B/M (you have a higher return) and short position with lower B/M. In this case we’re referring, not to the median, but to the upper or lower percentile. Until here we have the so called Fama&French 3 factor model MRP - SMB (Capitalization) - HML (B/M) **PR1YR**, (prior 1 year) it is based on the momentum strategy in which we take long position on stocks that performed better in the previous period and we take short position for those that performed worse.

Each one is characterized by its own sensitivity; indeed we have 4 different betas. F&amp;F and Carhart 4-factor model is saying that there is a strong relationship between alpha and factors of different type.

**Source:** Advanced Corporate Finance lectures by Prof. Raffaele Oriani at LUISS Guido Carli University, 2013.
Annex XI – The Corporate Stakeholder Responsibility value chain

Annex XII – SASB Materiality Map

1. Environment
- Climate change risks
- Environmental accidents and remediation
- Water use and management
- Energy management
- Fuel management and transportation
- GHG emissions and air pollution
- Waste management and effluents
- Biodiversity impacts

2. Leadership & Governance
- Communications and engagement
- Community development
- Impact from facilities
- Customer satisfaction
- Customer health and safety
- Disclosure and transparency
- Marketing and ethical advertising
- Access to services
- Customer privacy
- New markets

3. Human Capital
- Diversity and equal opportunity
- Training and development
- Recruitment and retention
- Compensation and benefits
- Labor relations and union practices
- Employee health, safety and wellness
- Child and forced labor

4. Social Capital
- Long-term stability of core business
- Accounting for externalities
- Research, development and innovation
- Product societal value
- Product life cycle use impact
- Packaging
- Product pricing
- Product quality and safety

5. Business Model & Innovation
- Regulatory and legal challenges
- Policies, standards, codes of conduct
- Business ethics and competitive behavior
- Shareholder engagement
- Board structure and independence
- Executive compensation
- Lobbying and political contributions
- Raw material demand
- Supply chain standards and selection
- Supply chain engagement & transparency

UNIVERSE OF SUSTAINABILITY ISSUES
Environmental Capital | Social Capital | Human Capital | Business Model & Innovation | Leadership & Governance

Evidence of Interest
- Issue frequency in 5 data-driven tests:
  - Financial risks
  - Legal drivers
  - Industry norms
  - Stakeholder concerns
  - Innovation opportunity

Evidence of Financial Impact
- Issue impact on 4 business value drivers:
  - Revenue impact
  - Return on capital
  - Risk management
  - Management quality

Forward-looking Adjustment
- Issue relation to 3 sustainability principles:
  - Magnitude
  - Probability
  - Externalities

PRIORITIZED SUSTAINABILITY ISSUES
<table>
<thead>
<tr>
<th>88</th>
<th>Industry Profiles</th>
</tr>
</thead>
<tbody>
<tr>
<td>43</td>
<td>ESG issues tested</td>
</tr>
<tr>
<td>6</td>
<td>Types of source documents used for data collection (10Ks, legal news, CSR reports, general media articles, innovation news)</td>
</tr>
<tr>
<td>86</td>
<td>Sets of keywords with literally thousands of possible keyword combinations describing the ESG issues</td>
</tr>
<tr>
<td>12,500</td>
<td>U.S. publicly traded companies from which source documents are available</td>
</tr>
<tr>
<td>+45,000</td>
<td>“Evidence of interest” data points</td>
</tr>
</tbody>
</table>

Source: Sustainability Accounting Standards Board (SASB), Determining materiality, 2013.


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