Corporate social accounting as stakeholder risk management

Michelle Greenwood*
Monash University
Department of Management
Faculty of Business and Economics
PO Box 11E
Victoria 3800 AUSTRALIA
61.3.990.52362 telephone
61.3.990.55412 facsimile
michelle.greenwood@buseco.monash.edu.au

and

Harry J. Van Buren III
Anderson Schools of Management
University of New Mexico
1 University of New Mexico
Albuquerque, NM 87131 USA
1.505.277.7108 telephone
1.505.277.7108 facsimile
vanburen@mgt.unm.edu

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ABSTRACT

This paper investigates the potential of corporate social auditing and reporting (social accounting) to assist stakeholders to predict, manage and mitigate their risks in the firm. We commence with the precept that an important role of financial auditing and reporting (financial accounting) is to enable shareholders to manage investment risk, and propose to extend this idea to the role of social auditing and reporting with non-shareholder stakeholders. The term *stakeholder risk management* is often taken to mean the management by the firm of risk arising from stakeholders, yet *shareholder risk management* is understood as the risks taken by shareholders. We seek to establish the notion of stakeholder risk management in parallel with the latter: that is, the risk taken by stakeholders. Extant definitions of stakeholder risk management are highly-firm centric and thus undermine the import of stakeholder investment on both pragmatic and moral grounds. The importance and relevance of the reframed concept of stakeholder risk is demonstrated by the two exemplar cases of low wage workers and vulnerable communities.

INTRODUCTION

Social accounting is positioned as risk management for the firm rather than risk management for stakeholders. Royal Dutch Shell's response to stakeholder backlash from major social and environmental incidences by producing glossy stand-alone social and environmental reports provides a case in point (The Independent, 2000; Livesey, 2001). According to Gray (2000), social accounting is "the preparation and publication of an account about an organisation's social, environmental, employee, community, customer and other stakeholder interactions and activities, and, where possible, the consequences of those interactions and activities". Societal purposes of social accounting vary (Gray, Owen &

Adams, 1996) but are often depicted by a simple dichotomy; either a devise for strategic planning or impression management or a means for accountability to stakeholders (Owen, Swift, Humphrey & Bowerman, 2000). Owen et al. (2000) observe that the role for social accounting as a strategic mechanism often outweighs its role as accountability to stakeholders. This is in contrast with financial accounting, which is traditionally accepted as an account to shareholders, and as such, a method by which shareholders can manage their risk in the firm (Fama & Jensen, 1983).

The idea that stakeholders can and should manage their risk in the firm has rarely been addressed in the stakeholder literature but is a logical extrapolation of risk-based (Clarkson, 1994) and moral claimant stakeholder definitions (Kaler, 2002), and notions of fairness (Phillips, 1997), consent (Van Buren III, 2001) and trust (Greenwood, 2006) within organisational-stakeholder relationships. This contrasts with extant popular use of the term "stakeholder risk management" to mean the firm's management of stakeholders to mitigate its own risk and concomitant risk to shareholders (e.g. Edwards & Bowen, 2005; KPMG, 2008; Mitchell, 2009), which is in keeping with a strategic approach to social accounting (O'Dwyer, 2001). We turn the tables to define the term as stakeholders' management of their own risk or investment in the firm. Social accounting can then be considered for its role in stakeholder risk management.

Social accounting is a fairly recent phenomenon arising from accounting for non-financial activities or externalities. Whilst it draws certain characteristics from financial accounting such as the goal of objectivity and reliability, it differs in significant ways such as participation and metric types (Van Buren III & Greenwood, 2008). Financial accounting provides the base of risk management for shareholders as continued financial activities and information of the firm is essential for shareholders' risk management. Although not often identified, financial accounting also provides vital information to non-shareholder stakeholders. When seeking a new job potential employees may seek information to confirm the financial viability of their potential employer, for example, with regard to whether the employer will continue to provide benefits like pensions to employees (Brown & Holtz-Eakin, 2006). What may differ between some shareholders and non-shareholder stakeholders is that the latter may take a longer term perspective of their "investment". Investors seeking socially responsible investments (SRI) may differ from traditional investors in being particularly interested in non-financial activities over and above activities that have the primary goal of increasing financial returns (Logsdon & Van Buren III, 2008). They do not, however, hold the same position as non-shareholder stakeholders in that they do not take personal risk based on social reports as their primary stake (and stakeholder relationship to the firm) is still financial. Social accounting necessarily involves stakeholders as both the subject of the account (social performance measures involve collecting data from or about stakeholders) and the principal for whom the account is prepared. Social and environmental reporting (disclosure of non-financial activities) thus tends to relate to risks of non-owner stakeholders.

STAKEHOLDERS AND RISK

Stakeholder identification has been a quandary within stakeholder theory from the outset with competing notions of who is a stakeholder and what constitutes a stake (Greenwood, 2001a). We hold with the definition of stakeholders as moral claimants—as opposed to infuencers—in the firm (Kaler, 2002; Mitchell, Agle & Wood, 1997; Greenwood 2007; Van Buren III & Greenwood, 2008). If the contribution or investment by stakeholders is accepted by the firm, then the firm owes such stakeholders a duty to return benefit or protect from harm concomitant to the stakeholder's contribution (Greenwood, 2007; Van Buren III & Greenwood, 2008). This principle of fairness (Phillips, 1997) is based on the assumption that all parties are voluntary in the exchange (Van Buren III, 2001). Stakeholders, however, vary in their capacity to influence the firm irrespective of their moral claim. Some stakeholders are more powerful, press more urgent claims (Mitchell et al., 1997) and thus use different strategies to influence the firm (Frooman, 1999).

Stakeholders with urgent legitimate (moral) claims, but low power (capacity to influence), termed dependent stakeholders (Mitchell et al., 1997), are morally significant in that they have high investment but low capacity to pursue due benefits. The oft-cited classic example of a dependent stakeholder is that of the natural environment (Mitchell et al., 1997; Starik, 1995), which of course has no capacity to exercise voice on its own behalf. In order to assure their claims, "these stakeholders had to rely on the advocacy of other, powerful stakeholders or on the benevolence and voluntarism of the firm's management" (Mitchell et al., 1997: 822). Due to limited resources, dependent stakeholders may enter less than entirely voluntary exchanges or contracts of adhesion that they have no ability to change in ways that are beneficial to them (Van Buren III, 2001) and have to rely (often in vain) on either the trustworthiness of management or formal governance mechanisms to ensure equitable treatment (Greenwood, 2006).

Risk is defined as the potential of unwanted outcomes, often with an unknown probability of occurrence and, therefore, risk-taking is decision-making in conditions of uncertainty (Hansson, 2007). Clarkson famously identified the holding of risk in the firm as the definitive of a stakeholder in an oft-cited early explication of stakeholder theory (Clarkson, 1994; Phillips, 1999). He observed that a risk-based stake is not the same as a claim, and only the former creates a stakeholder (Phillips, 1999). Furthermore, he noted that risk takers can be either voluntary or involuntary (Phillips, 1999), with dependent stakeholders more likely to be the latter. Distinctions between voluntary and imposed risk, and intentionally and unintentionally exposing others to risk, lies at the heart of the ethics of risk (Hansson, 2007). Based on the differing characteristics of stakeholders, it is posited that risk will vary not only between stakeholder groups (e.g. employees compared with customers) but also between stakeholder types (e.g. dependent versus dominant stakeholders).

DEPENDENT STAKEHOLDERS AS UNCOMPENSATED OR INVOLUNTARY RISK BEARERS

The notion of stakeholders as under compensated or involuntary risk bearers is not a new concept, but derives from neo-classical economic theory. The likelihood that breakdowns in ideal market conditions produce externalities—social costs borne by those outside the market exchange—was established by Arrow (1973). Businesses benefit from risks imposed on stakeholders then they do not adequately provide compensations for those risks (Davis & Van Buren III, 2007). As noted, stakeholder theory incorporated risk bearing into its understanding of stakeholder identification in the early stages of its development. Not withstanding this early idea, stakeholder theory is yet to fully explicate the nature of the risks undertaken by stakeholders, particularly dependent stakeholders. Dependent stakeholders are more likely to involuntarily or unknowingly bear social costs not directly arising from their own market exchanges.

Dependent stakeholder may unwittingly bear risk for a number of reasons (Davis & Van Buren III, 2007). They may be unaware of risks to which they are exposed. This may be due to a lack of information about the company’s activities, or lack of specific information with regards to their stake (Fung, Graham & Weil, 2007). Knowledge about risk is knowledge about lack of knowledge (Hansson, 2007); thus stakeholders may be aware that they lack information but unaware as to the information they lack. The type of risk undertaken by stakeholders may be difficult to calculate, even if full information is available to that stakeholder. Alternatively it may be that such stakeholders lack capacity to interpret information or lack resources to act on information.

Some stakeholders may have information, and capacity to interpret it, but may have no real choice. For example, motor vehicle parts suppliers to Toyota in Australia expressed dissatisfaction with Toyota's supplier rating but believed their only choices were to accept it or lose their contract with the company (Langfield-Smith & Greenwood, 1998). Such contracts of adhesion ("take or leave it" arrangements) undermine voluntariness of stakeholders and thus the fairness principle (Van Buren III, 2001).

It is likely that dependent stakeholders are not adequately compensated for risks incurred. To what extent will disclosure assist dependent stakeholders to manage risk? We now turn to this question.

SOCIAL ACCOUNTING AS STAKEHOLDER RISK MANAGEMENT

Social accounting represents both a form of organisational communication and stakeholder participation (Greenwood, 2001b), both of which provide stakeholders an opportunity to protect their interests. The notion that social accounting provides stakeholders a governance mechanism to manage their risk is not without controversy.

The political nature of social accounting, both within the organisation and in its broader context, is manifest. Radical accounting scholars have long noted that construction of the account determines that which is counted (Morgan, 1988). The capacity of controlling parties and institutions to direct the social accounting processes in order to perpetuate existing power structures and relationships is similarly well noted (Adams & Evans, 2004; Belal, 2002). Referred to by Owen et al. (2000) as managerial capture, it has been suggested that not only are stakeholders and the social accounting project "captured" by power hegemonies (Ball, Owen & Gray, 2000; O'Dwyer, 2003) but also that managers are also captured in a manner that undermines their personal control and morals (Baker, 2008). Managerial capture can take many forms such as exclusion of key stakeholders (O'Dwyer, 2005), lack of independence of external auditors (Ball et al., 2000), and non-reporting range of highly material issues (Dey, 2003). Dependent stakeholders are particularly vulnerable to capture as the power relationship between the organisation and its stakeholders undermines genuine stakeholder engagement (O'Dwyer, 2005).

Measurement of complex social phenomena presents challenges at many levels. Outcome metrics used in social accounting (such as employee retention and turnover, attainment of environmental standards, and philanthropic donations) may have the advantage of being observable and verifiable but have the disadvantage of being retrospective and not necessarily true to the stated goal. Quality-of-relationship metrics (such as used in stakeholder perception surveys) may be better indicators of more complex phenomena but are more subjective and less measurable than outcome measures and, therefore, open to misrepresentation and biased reporting, and more difficult to verify. Key performance indicators (KPIs) vary in their ability to be true gauges of the phenomena they proxy. This may result in pursuit of meaningless targets undermining focus on real concerns. Desire to quantify “elusive intangible knowledge” has resulted in a design tension “between the demands for the reliability, for contractual purposes, and relevance for decision-making purposes” (Power, 2004: 777). The “objective standardization” of information that is quantifiable, uniform and comparable is given primacy over the “truth” or the accuracy of the information (Livesey & Kearins, 2002: 249). In the opinion of Power, (2004: 774) despite its democratic ideals, quantification of social phenomena is at best ambivalent and at worst dysfunctional, indeed a “fatal remedy”.

TWO CASES OF DEPENDENT STAKEHOLDER RISK AND SOCIAL ACCOUNTING

Low wage workers and local communities are two potential examples of dependent stakeholder groups in need of governance mechanisms to manage under-compensated risk.

The extent to which social accounting may provide such stakeholder groups assistance in this regard will be discussed herewith.

Low wage workers

We have noted previously the normative relevance of dependent stakeholders, stakeholders with legitimate and urgent claims, but no power (that is, capacity) to pursue them or defend their interests. Such workers thus are vulnerable to having the terms of exchange foisted on them as employers offer only contracts of adhesion that these workers cannot change (Van Buren III, 2001). The risks that such workers incur include inadequate disclosure of occupational risks (Lipscomb, McDonald, Dement & Epling, 2007; Mayhew & Quinlan, 1999), lower likelihood of pension coverage which would allow them to maintain income when past working age (Hacker, 2006; Mishel, Bernstein & Allegretto, 2007), and not being fairly compensated for their contributions to their organisations.

Social accounting for the benefit of low-wage workers thus should do several things. First, it should provide information to low-wage workers about the risks that they encounter in the workplace. Second, it should provide other stakeholders with assurance that the corporation is not exploiting low-wage workers. Third, it should facilitate the capacity of stakeholders—including low-wage workers—to seek fairer treatment.

Vulnerable local communities

Vulnerable local communities—communities with a high percentage of poor and or minority-race persons—suffer disproportionately high levels of exposure to environmental hazards (Agyeman, 2005; Davidson & Anderton, 2000; Shrader-Frechette, 2002), a phenomenon that is the focus of research and activism on environmental justice. Such communities are vulnerable because their lack of financial resources and political power means that they are less likely to be heard by corporations and political decision makers.

Although commonly identified with the United States context, concerns about environmental justice are applicable to poorer countries, especially in industries like oil (Gary & Karl, 2003) and electronics (Schroeder, Martin, Wilson & Sen, 2008).

Similarly to low-wage workers discussed previously, vulnerable local communities need social accounting to function in ways that provide information and allow them to exercise some sort of voice in their relations with corporations. However, the nature of this social accounting is quite different. Much extant social accounting occurs at the organisational level of analysis, aggregating elements of the corporation's performance. But if one lives in a vulnerable local community, what matters most is how the corporation is operating in the immediate geographic area—necessitating facility- and community level reporting for the benefit of each community in which the corporation operate. One example is the Facility Reporting Project (Ceres, 2005), an effort spearheaded by the U.S. non-governmental organization Ceres (Coalition for Environmentally Responsible Economies) to develop a framework for assessing and reporting on local-level environmental performance and community impact.

CONCLUSION

Stakeholder risk management should be understood as the management by legitimate stakeholders of risks related to their investment in the organisation. As a corollary to the provision of accurate and true financial information to shareholder risk management, the organisation should provide information that is specifically material to stakeholders. This does not preclude the use of financial information, but also necessitates the availability of social accounts that are relevant and accessible to all legitimate stakeholders, especially dependent stakeholders. Stakeholders with legitimate and urgent claims, but limited power to pursue their interests, are particularly vulnerable to under-compensated, involuntary contracts with the firm. Social accounting may provide one means by which such stakeholders can increase their capacities vis-à-vis the firm. In order to do this, however, much has to be addressed within the guiding principles and practice of social accounting.

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