

Sustainability and Stakeholder Management: the Need for New Corporate Performance Evaluation and Reporting Systems

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ABSTRACT

Corporate sustainability, that is the capacity of a firm to continue operating over a long period of time, depends on the sustainability of its stakeholder relationships. This new stakeholder view of the firm goes beyond previous work on the triple bottom line and balanced scorecard. Companies need appropriate systems to measure and control their own behaviour in order to assess whether they are responding to stakeholder concerns in an effective way and to communicate the results achieved. These sustainability accounting systems should have the purpose of broadening and integrating the traditional financial approaches to corporate performance measurement, taking stakeholder needs into due account. This article presents the *sustainability evaluation and reporting system* (SERS), an integrated methodology aimed at monitoring and tracking from a qualitative and quantitative viewpoint the overall corporate performance according to a stakeholder framework, in line with small and medium-sized enterprises' managerial requirements. Copyright © 2006 John Wiley & Sons, Ltd and ERP Environment.

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Introduction

VALUE CREATION IS THE FINAL OBJECTIVE OF A COMPANY (RAPPAPORT, 1986; MILLS AND Weinstein, 2000; Jensen, 2001; Grant, 2002): in order to achieve this purpose, the firm cannot ignore the context in which it operates. In fact, a network of relationships connects the company to a great number of interrelated individuals and constituencies, called stakeholders (Freeman, 1984; Donaldson and Preston, 1995; Post *et al.*, 2002). These relationships influence the way a company is governed and, in turn, are influenced by the company's behaviour. In more depth, Post *et al.* (2002, pp. 9, 8) emphasize that 'the capacity of a firm to generate sustainable wealth over time, and hence its long-term value, is determined by its relationships with critical stakeholders' and 'any stakeholder relationship may be the most critical one at a particular time or on a particular issue'.

With regard to this point, convincing examples are provided by the protesting and boycotting campaigns carried out by NGOs against various companies operating in different industries and countries (Klein, 2000; Hertz, 2001; Bandura *et al.*, 2002; Bakan, 2004). Managers of these firms changed their strategic choices under the pressure of some specific stakeholder groups and the lack of an early recognition of their requirements brought in some cases harmful consequences for the company reputation and the business development.

If the entire set of stakeholder relationships becomes strategic for the long-term success and survival of a company, the measurement of corporate success cannot be limited to the creation of value for only one stakeholder group, i.e. the shareholders (Clarkson, 1995, p. 112). During the last 15 years many proposals were advanced to integrate and overcome the traditional methodologies, focusing on the financial dimension of corporate performance. Tools such as the balanced scorecard (Kaplan and Norton, 1992, 2004), the environmental and social reports (Bennett and James, 1999), the sustainability reports defined according to the triple bottom line (TBL) agenda (Elkington, 1994, 1997) and international standards such as the Sustainability Reporting Guidelines fostered by the Global Reporting Initiative and based on the TBL approach (GRI, 2002, 2006) are attempts to face the challenge represented by new information requirements for decision-making processes and communication policies (Wagner and Schaltegger, 2003; Schaltegger and Wagner, 2006).

However, at this time, how many companies have really changed their perspectives? How many companies measure and assess their own performance considering the impact of their own activities, for example, on human, social and natural capitals? Even if we consider only the listed companies worldwide, how many of these firms have really left the shareholder approach to adopt a more comprehensive stakeholder one? And if the largest companies are not so engaged, what about the small and medium-sized enterprises (SMEs), which are the majority of firms in the economic systems of every nation?

The purpose of this paper is exactly to address this need for change by presenting a relational view of the firm, based on the strategic value of the linkages with stakeholders, and its implication in terms of corporate performance evaluation and reporting systems. Therefore the focus of the paper is put on a new proposal in the field of sustainability accounting, defined according to this stakeholder framework in order to support companies and especially SMEs in their strategic and managerial efforts.

In more detail, the following section of the article starts from considering the ultimate goals of a company and proposes sustainability as a paradigm capable of ensuring the durable survival of firms. This model, which combines economic prosperity, social cohesion and environmental protection, is functional to and in keeping with the corporate objective of long-term value creation. A *sustainability-*

oriented company is fully aware of its responsibilities towards the different stakeholders and adopts methods and tools that allow it to improve its social and ecological performance. Thus, *new sustainability accounting systems* are needed.

With regard to this point, in the next section we advance our proposal, derived from theoretical analyses and empirical experiences and called SERS (sustainability evaluation and reporting system). This framework is coherent with the stakeholder view and can support all kinds of company to manage in an integrated way the relationships that are crucial for their long-term success.

The last section contains a discussion about the features of this approach and the further steps needed to improve the measurement of business success and go beyond the traditional financial and management accounting.

Stakeholder View, Corporate Sustainability and Performance Management

According to the stakeholder view of the firm (Donaldson and Preston, 1995; Clarkson, 1995; Post *et al.*, 2002), a company can last over time if it is able to build and maintain sustainable and durable relationships with all members of its stakeholder network. 'These relationships are the essential assets that managers must manage, and they are the ultimate sources of organizational wealth' (Post *et al.*, 2002, p. 8).

From this point of view, a company creates value when it adopts a managerial approach, which is sustainability oriented. In general, corporate sustainability can be considered as 'a broad approach that includes various characteristics, in particular relating to the *contextual integration* of economic, environmental and social aspects' (Schaltegger and Burritt, 2005, p. 189). In more detail, according to the definition given by AccountAbility (1999, p. 94), 'sustainability is the capability of an organization to continue its activities indefinitely, having taken due account of their impact on natural, social and human capitals'. A *sustainability-oriented company* is one that develops over time by taking into consideration the economic, social and environmental dimensions of its processes and performance. Therefore, financial and competitive success, social legitimacy and efficient use of natural resources are intertwined according to a synergetic and circular view of the company's aims. In this perspective, value creation processes are broad and shared and meet, in different ways, the stakeholder expectations. For this reason it is possible to make a shift in the generally adopted notion of value and introduce the concept of stakeholder value (Figge and Schaltegger, 2000).

Thus, the sustainability of a firm depends on the sustainability of its stakeholder relationships: a company must consider and engage not only shareholders, employees and clients, but also suppliers, public authorities, local (or national, according to a firm's size) community and civil society in general, financial partners etc. Nowadays and more and more in the future, the quality, that is the sustainability, of stakeholder relationships must be the guiding principle for the managerial decision-making process and the pillar of a more comprehensive corporate strategy.

Adopting this stakeholder view means rethinking nature and purposes of firms and the managerial tools adopted by companies themselves. In this relational view of the firm, the success of managerial efforts cannot be measured according to a shareholder perspective, but only by adopting a more holistic and comprehensive stakeholder framework. Companies need appropriate systems to measure and control their own behaviour in order to assess whether they are responding to stakeholder concerns in an effective way and in order to communicate and demonstrate the results achieved. These new evaluation and reporting systems should have the purpose of broadening, integrating and improving the

traditional financial/economic approaches to the corporate performance measurement, taking stakeholder needs and requirements into due account.

In over 15 years, more than a hundred standards and management solutions were developed to evaluate and report the economic, social, environmental and sustainability performance of companies (ISO Advisory Group on Corporate Social Responsibility, 2003). These tools provide information of a qualitative, quantitative and economic nature and influence the interactions between a firm and its stakeholders. Nevertheless, this multiplicity, complexity and the absence of a clear reference framework generate undesired effects among companies and their own stakeholders.

- Confusion for companies and lack of management and organizational innovation. The existence of several standards and acronyms, the development of different and at the same time similar proposals especially focused on big firms' expectations can complicate companies' attitude towards sustainability and CSR. This can bring a slowing down of the adoption and implementation of more advanced managerial models, especially in small and medium-sized enterprises, rather than supporting and promoting them.
- Confusion and lack of clarity for the companies' stakeholders. If firms do not use an effective and clear approach in order to manage, assess and report their own performance, the different stakeholder groups have difficulties in analyzing and appreciating the sustainability efforts of enterprises.

Furthermore, this absence of shared, sound and recognized processes and methods might reward free riders that adopt fraudulent behaviour and communicate unfair and untrue results.

Moreover, even if we consider the most advanced methodologies in the sustainability field (Figge *et al.*, 2002), they are not designed to take into account in an explicit, clear and complete way the different relationships that companies develop with their stakeholders. The concept of extended enterprise, based on a relational view of the firm focused on stakeholder linkages (Post *et al.*, 2002, p. 25), goes beyond 'previous work on the "triple bottom line" and "balanced scorecard": "The key to solving the core strategic problem is to understand the firm's entire set of stakeholder relationships' (Post *et al.*, 2002, p. 8).

Furthermore, the traditional environmental, social and sustainability reports are defined more as public relations products than as effective methodologies to control and manage the corporate performance (Cerin, 2002a, 2002b).

Finally, the balanced scorecard, the GRI Sustainability Reporting Guidelines and the Sustainability Integrated Guidelines for Management (SIGMA Project, 2003) are instruments not suitable for SMEs because of their complexity, the limited flexibility and the need for formal procedures. Until now, for example, only some hundred companies all over the world have adopted the Sustainability Reporting Guidelines, but this result is very far from a broad firms' involvement. During the last years approaches and guidelines have been developed in order to support SMEs in their managerial efforts (e.g. Rayner and Raven, 2002; CSR Europe, 2002; United Nations Industrial Development Organization, 2002; Deloitte Touche Tohmatsu Emerging Markets, 2004; GRI, 2004). They can be considered as important steps towards a greater engagement of small and medium companies, but they did not provide solutions that have become reference points in the management of sustainability.

In conclusion, in order to face the strategic challenge related to the management of stakeholder relationships and meet the managerial needs especially coming from SMEs, we believe that there is a strong need for a clear and modular methodology for a sustainability accounting system. In the following section, we present and describe our framework, defined to monitor and track from a qualitative and quantitative viewpoint the overall corporate performance according to a stakeholder view and based on a flexible structure that makes it suitable for companies of different industries, sizes and countries.

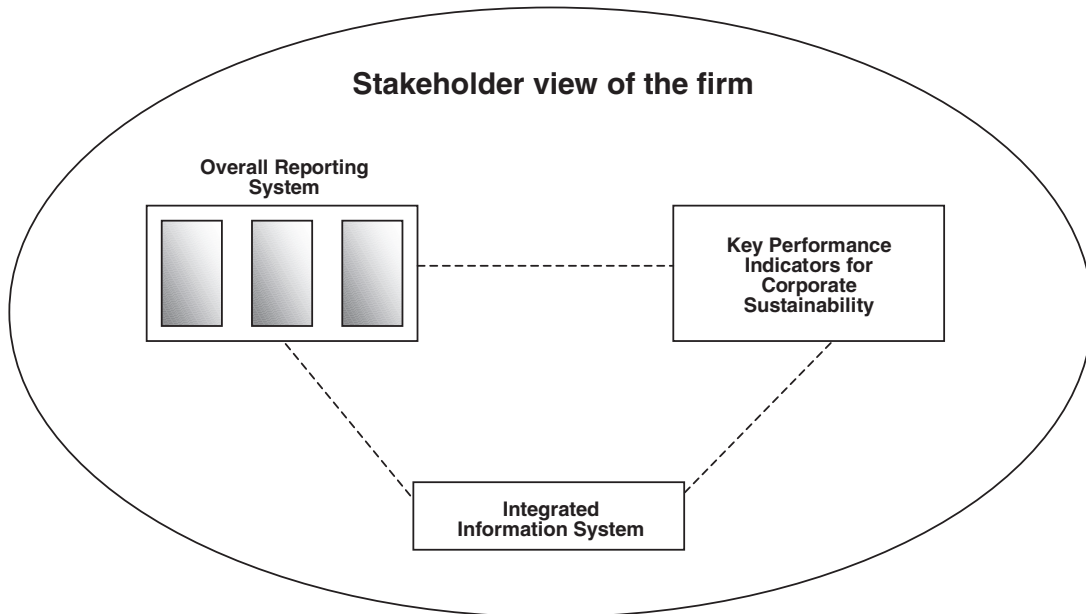


Figure 1. The sustainability evaluation and reporting system (SERS)

Describing the Framework: Sustainability Evaluation and Reporting System (SERS)

The proposal – developed by SPACE (the Research Centre of Bocconi University on Risk, Security, Occupational Health and Safety, Environment and Crisis Management) and called the *sustainability evaluation and reporting system* (SERS) – aims to aggregate different management tools (e.g. social reporting, environmental reporting and key performance indicators) into a comprehensive model. This integrated approach derives from theoretical analyses and empirical experiences carried on in almost 15 years of research activities in the fields of management of sustainability and social, environmental and sustainability performance evaluation and reporting and thanks to the collaboration with companies and institutions (SPACE, 1993; Pogutz and Tencati, 1997; De Silvio and Tencati, 2002; Tencati, 2002; Perrini and Tencati, 2003). The goal is to build an efficient and effective methodology for an overall assessment of the corporate sustainability in order to foster and support new accounting and reporting efforts in companies (with a particular focus on SMEs), contribute to the integration between financial and non-financial performance measures, improve the quality of decision-making processes and of the overall business management and strengthen the corporate accountability and responsiveness towards the different stakeholder groups.

SERS is composed of three modules (see Figure 1):

- the *overall reporting system* (or the *sustainability reporting system*), which comprises
 - the annual report;
 - the social report;
 - the environmental report;
 - a set of integrated performance indicators;
- the integrated information system;
- the key performance indicators for corporate sustainability.

-
1. *Corporate identity*
 - Brief description of the company
 - Ethical policy
 - Charter of values and principles (ethical code)
 - Mission
 - Charter of commitments towards stakeholders
 - Employees
 - Members/shareholders, financial community
 - Clients/customers
 - Suppliers
 - Financial partners (banks, insurance companies and financial services)
 - State, local authorities and public administration
 - Community
 2. *Economic wealth created and distributed by the company:*
The value added
 3. *Relationships with stakeholders*
-

Table 1. The social report according to the SERS scheme

The Overall Reporting System

The Annual Report

The *annual report* includes the profit and loss account, the balance sheet and the statement of cash flows. Ratios and indicators should be included in order to check the corporate competitiveness in the finance, marketing, operations, technology and quality fields. Furthermore, significant information from a social and environmental point of view is already presented in annual reports with regard to issues related to risk management, potential liabilities, research and development policies and so on. In any case, every country has a specific regulation on this topic. The last financial downfalls brought policy-makers to strengthen the rules regarding the financial accounting in order to ensure higher levels of transparency and fairness in financial accounting and reporting activities. However, if we adopt a stakeholder view of the firm, this tool is not sufficient to cover all aspects of corporate performance, including social and environmental ones.

The Social Report

The *social report* measures the impact of the company and its activities on the different stakeholder groups. Therefore, it is a methodology capable of supporting the management decision-making process and the corporate communication/engagement policies. According to the SERS approach, it is composed of the ethical policy, the value-added statement and the analysis of stakeholder relationships (see Table 1).

The ethical policy contains specific corporate commitments toward the stakeholder groups in line with the relational view of the firm. On the basis of these commitments the corporate social performance is assessed through the other two elements.

The value-added statement is a traditional tool in social reporting: for example, it was adopted in the 1970s by the group of German companies called Sozialbilanz-Praxis (Rusconi, 1988, pp. 84–88), and it is the link between the traditional financial accounting and the social reporting. It measures the (financial) value added generated and distributed by the company to the different stakeholder groups (employees, financial partners, state and local authorities, community, shareholders) or invested into

Types of environmental information Object of analysis	Energy and material flows	Financial items
Processes	Ecobalance or input–output analysis	Cost–benefit accounting related to environmental management of processes
Products	Product ecobalance or life-cycle assessment (LCA)	Cost–benefit accounting related to environmental management of products

Table 2. Environmental accounting: main methodologies

the firm. It is a first picture of the (stakeholder) value created and distributed (Figge and Schaltegger, 2000).

The analysis of stakeholder relationships aims to assess the sustainability of the interactions between a company and its stakeholders through qualitative and quantitative information. This analysis also comprises forms of social accounting in order to understand the economic costs and benefits related to social activities and policies (e.g. internal costs and benefits related to the occupational health and safety management).

The Environmental Report

In general, the corporate *environmental report* is a tool a company uses to manage and control corporate activities and support communication with stakeholders, especially those interested in environmental issues (Azzone *et al.*, 1997). Although a single, definitive model of environmental report does not yet exist because of the special features of the tool (still prevailing voluntary approach, focus on the national, industrial, corporate specificities etc.), we can attempt to define the boundaries that should characterize a comprehensive environmental information system. According to the nature of the environmental information (physical data or financial items) and the object that these measurements refer to (processes or products), it is possible to classify the principal methodologies developed up to now to monitor the relationships between corporate activities and natural capital as follows (see Table 2).

The environmental reporting framework within SERS aims to include all the methodologies identified and combine an accounting system collecting physical data with the measurement of (internal) costs and benefits related to the environmental management choices made as regards processes and products (Burritt *et al.*, 2002). According to this approach, the environmental report comprises input–output analysis, LCA and cost–benefit account related to environmental management of products/processes. Therefore, two important kinds of information flow are the object of the environmental reporting system: flows related to physical data – energy and materials accounting; flows related to financial items – monetary environmental accounting (see Figure 2).

Energy and materials accounting (Hallay, 1990; Beck, 1993) collects information regarding the environmental impact of company activities. Input–output analyses gather and organize the information on energy and material consumptions and the related emissions caused by the operations. Ecobalances (LCA) measure the environmental impact of the main products of the firm in terms of resources consumption and pollution along their entire life cycle (from-cradle-to-cradle approach).

Monetary environmental accounting (Bundesumweltministerium and Umweltbundesamt, 1995; US EPA, 1995) is a method designed to determine the financial costs/benefits borne by the company and associated with the environmental management activities carried out by the firm itself and represents the second important dimension in developing a corporate environmental report. It is a matter of build-

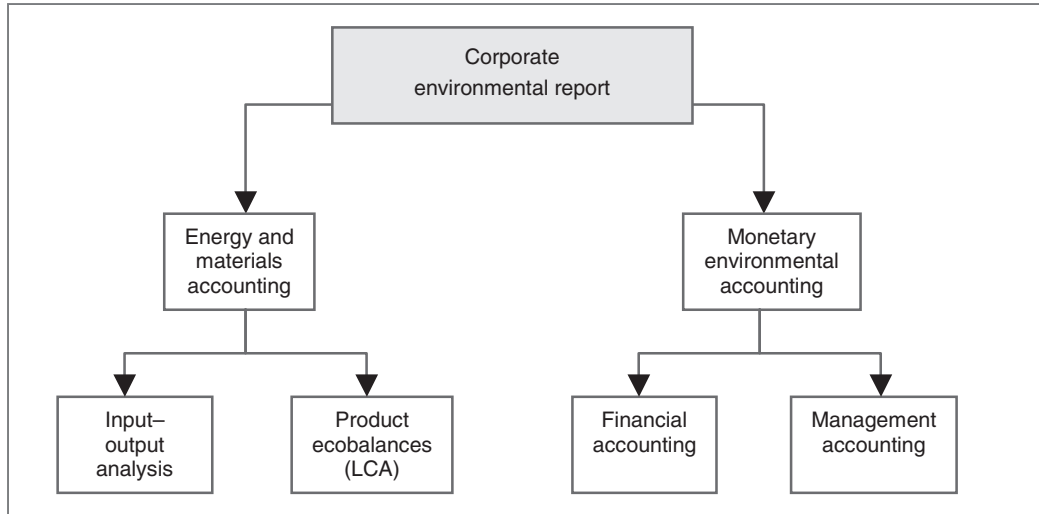


Figure 2. The environmental report: the SERS model

ing a tool to measure the economic quantities related to environmental management to improve decision-making. This monetary environmental accounting has to be well integrated with the existing financial and management accounting systems (Burritt, 1997). Therefore, defining this kind of environmental accounting is very complex and few companies in the world have introduced an advanced system of measuring environmental costs and benefits.

A Set of Integrated Performance Indicators

The Sustainability Reporting System allows a company to check and report the annual overall corporate performance. Its goal is to build a true and fair view of the business situation in order to strengthen, improve and manage in a sustainable way the stakeholder relationships. It is a fundamental tool in meeting the information needs coming from different stakeholder groups and affecting the concept of corporate accountability. Thus, in order to achieve a more complete view of the business behaviour, a company should also define and present a *set of integrated performance indicators*, i.e. *cross-cutting indicators* (GRI, 2002, pp. 45, 82–84). In general, cross-cutting indicators relate physical and technical quantities to financial ones (e.g. an indicator could relate the total amount of waste generated during the year to the value added). In this way, a firm goes beyond a triple bottom line approach in order to adopt a more comprehensive and integrated perspective, capable of defining a more reliable and material picture of the corporate activities and related implications.

The Integrated Information System

This is the core of performance evaluation and reporting processes. Based on the new ICT – information and communication technologies – solutions such as the enterprise resource planning (ERP) systems, this element enables an organization to collect, process and share physical/technical and financial data. Programmes to introduce environmental and social accounting systems for the purpose of integrating and improving the existing financial and cost accounting methodologies have to start from this level.

The goal is to build a satellite accounting system (United Nations, 1993; United Nations *et al.*, 2003) focused on social and environmental performance, capable of collecting and organizing all the relevant data (including financial ones) and connected with the other specific accounting/information systems. Through the integration of the different databases it is possible to extract and provide to operators and decision-makers the necessary information to assess the overall performance of the company and its sustainability.

The Key Performance Indicators for Corporate Sustainability

They are specific indicators developed in relationship with the corporate information requirements. The aim is to provide a tool to continually monitor an organization's performance trends. Number and types of measures should be defined on the basis of real corporate needs. In this way the *key performance indicators* (KPIs) represent a *dashboard of sustainability* (International Institute for Sustainable Development, 2001) supporting management decision-making processes. Sets of indicators proposed by many organizations, such as GRI (2002, 2006), the World Business Council for Sustainable Development (WBCSD, 2000, 2003), Eurostat (2005) and the European Environment Agency (EEA, 2002, 2003), can be used in drawing up an organization's specific measurements, but they cannot limit the corporate choice. Indicators can focus on the financial, operating, marketing, environmental, social, cross-cutting (e.g. with regard to the eco-efficiency and the socio-efficiency of the organization: Schaltegger *et al.*, 2002, p. 9; Schaltegger and Burritt, 2005, pp. 188–192) aspects of business management. KPIs are also used in the overall reporting system and in order to define them the company should carry on stakeholder engagement activities (Stakeholder Research Associates Canada *et al.*, 2005; AccountAbility, 2005).

KPIs are the crucial element of the SERS methodology. A small or medium company could not have sufficient time and resources to define a long and complicated sustainability reporting system, but this kind of firm certainly needs a map for an ongoing assessment of its performance and of the related quality (i.e. degree of sustainability) of the relationships with its stakeholders. This map is really provided by a set of KPIs, and this consistent and clear dashboard of sustainability could also be used as a fundamental tool to communicate the information required by the different stakeholder groups. Therefore, in line with the adopted stakeholder view of the firm and the sustainability concept, KPIs should be organized according to a framework based on stakeholder categories.

For example, the indicators could be organized according to a three-level framework (WBCSD, 2000, p. 8; GRI, 2002, pp. 36–37):

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

The stakeholder categories adopted could be as follows (Tencati *et al.*, 2004):

- (1) employees;
- (2) members/shareholders, financial community;
- (3) clients/customers;
- (4) suppliers;
- (5) financial partners;

- (6) state, local authorities and public administration;
- (7) community;
- (8) environment.

In particular, the small and medium-sized enterprises could use this proposal as a starting point to build their own shared map, through a specific stakeholder engagement process, in order to assess and communicate the corporate performance.

Conclusions

One of the keys for a successful strategic management is the availability of sustainability accounting tools capable of monitoring and tracking from a qualitative and quantitative viewpoint the overall corporate performance and, in particular, the state, i.e. the sustainability, of the different stakeholder relationships. Thus, there is an urgent call for new systems of measuring the corporate outcomes according to a stakeholder framework in line with a more suitable and correct strategic approach.

In this article we have presented SERS, a sustainability evaluation and reporting system, based on a stakeholder view of the firm and therefore really aimed at balancing and integrating financial and non-financial performance indicators, supporting planning, implementation and control activities of a sustainability-oriented and responsive organization.

Our proposal provides a reliable tool in order to help companies to understand stakeholder requirements and assess their own performance. This framework, through an integrated perspective, aims:

- (1) to aggregate different management tools (e.g. social reporting, environmental reporting and KPIs) into a comprehensive model – methodological integration;
- (2) to map and monitor the entire set of a company's stakeholder relationships – integration of different perspectives into the sustainability accounting system towards a *multiple bottom line* approach – and
- (3) to supply information, which can be qualitative, quantitative (physical and technical) and economic–monetary, through the performance measurements – integration of data/information. These indicators build a sort of dashboard of sustainability, that is an effective *Tableau de Bord*, which goes beyond the traditional financial data. Moreover, the availability of this broad range of measures allows a company to build integrated performance indicators by relating physical and technical quantities to financial ones. The environmental intensity ratio presented in the previous section is only an example of a methodology which can be applied by every firm. Companies could develop many other measures according to their specific information needs: e.g., in the occupational health and safety management field, an indicator could relate the trend of the injury rate during the last three years to the costs connected with the projects implemented to improve the work conditions; with regard to R&D policies, another indicator could relate the achieved results in terms of new patents, launch of new products, introduction of new labelling schemes etc. to the investments in this area borne during a specific period of time identified on the basis of the industry competitive dynamics. These comparisons help management to assess the effectiveness of their choices and to review their strategies and define next steps by using a suitable informational support.

In this way, according to a relational view of the firm, the SERS methodology enables a company and its management to manage the stakeholder relationships and address the information needs and the economic, social and environmental concerns of various stakeholder groups. This point is crucial for every kind of firm and especially for SMEs, whose success is deeply rooted in stakeholder networks (Lipparini, 2002).

Moreover, the SERS structure, composed of different modules (the overall reporting system, the integrated information system and the key performance indicators) is flexible enough to be used by businesses of different sizes operating in different sectors and countries.

However, further steps in the field of sustainability accounting are expected: if stakeholder relationships are the essential assets to create sustainable wealth, not only the company-centred, but also the stakeholder-centred performance should be measured. This means that, for example, the degree of stakeholder trust and the stakeholder satisfaction generated by the corporate strategy and behaviour should be carefully evaluated (Ghoshal and Bartlett, 1999; Lev, 2001; Castaldo, 2002). This calls for the development of further methodologies that could broaden the available set of measures, but also make more difficult the use of specific performance indicators.

Therefore, if we adopt a stakeholder view of the firm in order to design sustainability accounting systems, we should also understand how the stakeholder relationships and the related engagement processes could impact the quantity and quality of performance indicators aimed at monitoring the corporate sustainability. This perspective could dramatically change the way managers and stakeholders assess firms, their success and their role in the society.

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