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On The Effectiveness of Social and Environmental Accounting

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Abstract

This paper presents the broad outline of an instrumental theory of social and environmental accounting (SEA) at two levels of analysis: organizational and societal. We argue that, given the impact of signaling and transaction costs as well as various other costs and benefits of SEA, the level of SEA should be set so that marginal costs of SEA equal marginal benefits (at the firm level) or marginal costs of SEA to society equal marginal benefits to society (in line with the tenets of social efficiency). In this context, we summarize the overall empirical evidence regarding the financial benefits of social and environmental disclosures for the reporting organization. Moreover, because all organizational decision making is embedded in political governance systems, we also highlight the importance of these systems for SEA and conclude with three suggestions for future research.

Keywords: *Corporate social performance; corporate social responsibility; environmental accounting; moral frameworks; political governance systems; social accounting; social efficiency; utilitarianism.*

THE EFFECTIVENESS OF SOCIAL AND ENVIRONMENTAL ACCOUNTING

The proportion of large multinational companies reporting on the social and environmental consequences of their business activities has dramatically increased during the last decade. In 1998, 35% of the Fortune Global 250 published social and environmental reports. This proportion has increased to 45% three years later and 64% in 2006 (Kolk, 2003; 2008; KPMG, 2002). European companies are more likely to disclose social and environmental data than U.S. companies and are generally seen as "best practice" trendsetters in social and

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environmental accounting (SEA) (Owen & O'Dwyer, 2008; Standard & Poor's, SustainAbility & UNEP, 2004). Nonetheless, some scholars have raised concerns about "greenwashing," the lack of verification or verifiability, and thus the lack of genuine accountability (Owen & O'Dwyer, 2008). As SEA touches on most dimensions of organizational performance and social efficiency as defined below, this commentary contextualizes SEA by focusing on the integral elements of effective SEA and its political governance contingencies.

For the purpose of this paper, we define *SEA* as the provision of information about business impact and performance with regard to social and environmental issues. Like standard financial accounting, SEA measures, monitors, and controls business activities and thus is helpful to both internal (e.g., managers) and external (e.g., investors) stakeholders. In line with this functional definition, *effectiveness* of SEA is defined as the extent to which SEA meets two equally important objectives, namely: the non-financial information requirements of organizational stakeholders in verifiable form and the contribution of SEA to business as a performance-enhancing tool (Epstein, 2008). Thus, to analyze the effectiveness of SEA requires a deeper understanding of outcomes at the societal and organizational levels of analysis.

At the societal level, that level of SEA is most effective that achieves greatest *social efficiency*, that is, maximum aggregate societal well-being (with both benefits and costs of SEA to all constituents being included in this utilitarian calculus) (Baron, 2006). At the organizational level, effectiveness is captured by the level of SEA that maximizes the firm-specific utility of SEA (again considering both costs and benefits of SEA, but only costs and benefits for the reporting organization). Keeping levels of analysis distinct is important because the two different objectives of effectiveness may not necessarily converge with respect to conclusions about the "right" level or type of SEA as they consider different costs and benefits at different levels of analysis for different actors (as we will show in this paper). The overall conclusion of our argument is that, given limited resources, both organizations and society as a whole should—in the interests of outcome effectiveness—only pursue those actions that maximize outcomes at minimal cost. Connecting SEA to organizational and societal net benefits, we introduce ideas that are primarily prescriptive in nature. According to Donaldson and Preston (1995) and Bazerman (2005), prescriptive theories connect actions A to outcomes B, i.e., evaluate the extent to which any action A is instrumental to achieve any outcome B. Although we do not provide a normative foundation for our chosen outcomes at organizational and societal level (there may be others), the sections on political governance systems, conceived as important contextual forces, do nevertheless allude to some of the normative underpinnings of our chosen outcomes.[1]

Our contribution to this issue of *Issues in Social and Environmental Accounting*

[1] Prescriptive, or instrumental, theorizing differs from normative theory in that the latter identifies moral or philosophical guidelines for the operation and management of business firms, while the former describes connections, or the lack thereof, between any action (e.g., SEA) and company objectives (e.g., profitability) or sociopolitical objectives (e.g., democracy) (Donaldson & Preston, 1995).

is structured as follows. First, we summarize potential benefits and costs of SEA to reporting organizations and the organizations' stakeholders. Second, in building off these general considerations, we derive some suggestions for best practice in SEA. Third, we present the current empirical evidence regarding the financial benefits of social and environmental disclosures for the reporting organization. Fourth, we point out how broader social and political governance systems may influence, constrain, or support SEA. Finally, we conclude with some suggestions for fruitful future research agendas in SEA.

Benefits and costs of SEA based on economic theory

Two seminal economic theories (signaling theory and transaction cost economics) can be used to analyze the costs and benefits of SEA. From a managerial perspective, economic theories are useful because they make explicit what other theories applied to SEA, such as legitimacy theory (Deegan, 2002), leave implicit. In other words, they make costs and benefits the central foci of the analysis of SEA. As shown in Figure 1, it is argued that these benefits and costs accrue to the reporting organization and society at large.

Figure 1
Taking Account of Social and Environmental Accounting

	Benefits	**Costs**
To Reporting Organization	• Legitimacy • Competitive advantage (through signaling/reputation)	• Signaling costs (e.g., monitoring, data collection)
To Other Stakeholders	• Decreasing transaction costs	• Opportunity costs • Information overload/ambiguity

Shift in emphasis from laissez-faire

to
liberal democratic state

Benefits and costs to the reporting organization

The conventional explanation for SEA, legitimacy theory (Deegan, 2002), relies on an institutional logic of conformity. According to legitimacy theory, organizations conform to stakeholder expectations of "good" behavior and to a broader "social contract" (Mathews, 1993). The idea that organizations continually strive to gain or maintain legitimacy is consistent with the notion of isomorphism in institutional theory (DiMaggio & Powell, 1983). To the extent that stakeholders claim a right to know details about organizations' social and environmental initiatives, organizations will try to live up to these expectations and, thus, close the legitimacy gap between stakeholder perceptions and organizational reality (Campbell, 2000). Seen in this light, SEA can be regarded as an explanation and justification of current organizational activities (Maurer, 1971) or an effort to garner social support (Suchman, 1995). In short, legitimacy theory can be considered an amalgam of institutional explanations and

stakeholder theory (Campbell, 2000).
Whilst legitimacy theory is of key importance, research has suggested that other theories can help provide further and arguably more nuanced explanations for the prevalence of SEA activities. For example, Campbell (2000) showed that chairman succession affected the level of the voluntary disclosures of Marks and Spencer, a British retailer. Campbell argued that because different corporate leaders may perceive organizational environments differently, we cannot understand organizations' investment in SEA technology without analyzing the cognitive filtering mechanisms inside managers' heads. Similarly, it is difficult for legitimacy theory to argue that business executives make resource allocations without reference to some type of cost-benefit analysis. This omission is redressed in this paper given its focus on economics and political governance, and its concern to offer practical solutions to managerial questions about the "right" level of voluntary SEA.

From an economic perspective, signaling theory adds explanatory power. Market signaling captures an economic view of organizational reputation because a signal is used to communicate information to, or change the beliefs of, other actors in the market (Spence, 1974; 2002). Thus, a signaling device such as SEA represents a differentiating (rather than mimetic or homogenizing) characteristic through which the reporting company may gain competitive advantage. In the same way as a degree of higher education may signal job applicants' intelligence, work motivation, or productivity, SEA can signal an organization's commitment to corporate citizenship. In turn, this can affect the organization's financial bottom line. For example, "good" corporate citizens may attract more talented employees (Greening & Turban, 2000; Turban & Cable, 2003; Turban & Greening, 1996) and address environmental challenges and opportunities more proactively (Berry & Rondinelli, 1998; Hart, 1995; 2007). Insofar as SEA is not imposed on all businesses and instead is voluntarily chosen, its adoption may lead to greater interorganizational trust and, in turn, higher economic performance and growth (Hosmer, 1995; Knack & Keefer, 1997). The overarching assumption in signaling theory is that managers will be incentivized to maximize these reputational returns of SEA net of its associated signaling costs. These signaling costs include financial and non-financial (e.g., time) expenditures associated with the collection and dissemination of SEA information.

However, not all organizations can expect to derive the same benefits from SEA signaling. The effectiveness of signaling depends on the extent to which stakeholders interpret SEA correctly as a signal of business responsibility and commercial reliability. This implies that an activity or characteristic that is relatively more costly for the lower-quality types in the market (i.e., irresponsible organizations) tends to be more effective as a signal because this makes it more expensive for irresponsible organizations to attain it and, thus, it is more likely to be used as a (valid) signal by responsible market actors. Conversely, insofar as managers know what types of signals are used by stakeholders under conditions of information uncertainty, they may be tempted to "fake" signals, so that the signals do not validly separate responsible and irresponsible organizations (Spence, 1974). For example, many outsiders mistook Enron's faking of social responsibility for genuine corporate responsibility. Likewise, many consumers seem to be misled by the marketing of "ethical food," which may have a number of ecologically harmful side-effects (Economist, 2006). When this kind of dishonesty or overstatement happens SEA's value as a signaling device will be weakened.

Benefits and costs of SEA to stakeholders

Any economic transaction incurs transaction costs, and all organizational actors are motivated to minimize these transaction costs (Coase, 1937; Williamson, 1975; 1985). Because of bounded rationality (Simon, 1997) and opportunism (Williamson, 1975), transaction costs are uncertain and often difficult to predict (Williamson, 1993). As mentioned above, SEA may signal that the reporting organization is behaving in a caring and responsible manner and, thus, provide evidence (hard data) summarizing, or at least illustrating, the organization's social and environmental activities. This will reduce transaction costs (borne by stakeholders): e.g. expenses associated with the monitoring and searching for signifiers of corporate responsibility and promise keeping. Stakeholders that claim a right to know about organizations' social and environmental activities would have to spend much more time searching for this information if SEA data were unavailable. For example, stakeholders would have to interview competitors and suppliers or spend money on undercover data collection. In other words, *because* SEA can serve as a market signal, it may also lower transaction costs for stakeholders. Insofar as the signal can be invalid, the reduction of transaction costs is, of course, not an automatic outcome of SEA.

Stakeholder costs as a consequence of SEA are more difficult to specify than the more obvious and tangible costs to the reporting organization. Stakeholders primarily incur opportunity costs. These opportunity costs arise from the fact that the reporting organization sacrifices some investments in stakeholder management activities that are *not* SEA. For example, instead of spending managerial time and organizational resources (such as paper) on the collection and compilation of data in glossy reports, organizations could devote more time to interactive stakeholder dialogues or address environmental risks. However, because SEA typically serves as a control device for past mistakes or failures in stakeholder management (Epstein, 2008), these opportunity costs are likely to be quite low. In addition to opportunity costs, accelerating provision of social and environmental reports may also lead to information overload and, therefore, more (rather than less) stakeholder uncertainty about the meaning of all this information—particularly when SEA tends to be based on non-standardized measures, which might be incommensurate in cross-firm and cross-industry comparisons.

Best practice in SEA

These instrumental theories of SEA can add important insights to previous "SEA best practice" lists, which included, for example, Zadek *et al.*'s (1997) criteria of inclusivity, comparability, completeness, external verification, and continuous improvement. This and other best practice lists focus mainly on duty-based precepts. Deontological principles can obviously be praised from a moral perspective. Nevertheless, they can sometimes be accused of providing limited levels of managerial or political guidance regarding the practical limits imposed on SEA by resource scarcity and, thus, the "right" level of SEA. For example, the imperfect Kantian duty to treat others beneficiently – which is a duty that can be related to the duty that corporate managers might be considered as having in regard to accurate reporting – provides limited guidance as to how one should help others, how many one should try to help, how much time one should devote to helping others, and so on (e.g., Korsgaard, 1996: 20-21; White, 2004: 92-94).

In contrast to many duty-based precepts, which are often limited in their capacity to provide practical advice regarding the allocation of resources, the aforementioned theories can be used to derive the following prescriptive advice for best practice in SEA (see Endnote 1 on the distinction between prescriptive and normative dimensions of an issue).

First, at the *organizational* level of analysis, the preceding theories suggest that managers ought to initiate SEA so that the difference between total benefits of SEA for their firm and total SEA costs of their firm is maximized. Expressed differently, SEA should expand up to the point where firm-specific marginal benefits from SEA equal marginal costs. Only the firm-specific benefits and costs of SEA are included in the formal calculus of $\boldsymbol{MB_{SEA(firm)} = MC_{SEA\,(firm)}}$.

Second, and from the broader *societal* perspective, the preceding theories suggest that social efficiency—i.e., the difference between all societal benefits emerging from SEA and all societal costs emerging from SEA—should be maximized (see Baron, 2006 on social efficiency in general). This implies the following change in the utilitarian calculus: $\boldsymbol{MB_{SEA(all)} = MC_{SEA(all)}}$.

Undoubtedly, this cost-benefit analysis, whether at the organizational or societal level, is no easy task. The specification of all benefits and costs associated with SEA is difficult. However, our theorizing offers the following suggestions. First, SEA should be stakeholder-oriented rather than focused on society at large (Clarkson, 1995; Orlitzky, 2007; Orlitzky & Swanson, in press): for the simple reason that costs and benefits can only ever be related to specific constituents. What this means is that, stakeholder-centered reasoning requires that those who will reap the benefits related to SEA, and those who will bear the costs, be concretely specified. In contrast, reasoning based on some amorphous "common good" can be understood to present an obstacle to estimating the concrete costs and benefits associated with SEA.

At the same time, a stakeholder focus in SEA reiterates the importance of continuous improvement with (ever-changing) stakeholder needs in mind and as long as marginal benefits exceed marginal costs. An issue focus, on the other hand, might reify "issues" as stable entities to be addressed when reality would recommend a mindset that acknowledges stakeholder groups' (or individuals') evolving constructions of organizational reality. For example, what at one point in time was perceived as "business as usual" (e.g., disposal of oil rigs in the North Sea) might shift –almost overnight—to a deeply moral issue that oil companies must address. More broadly, flexibility allows for the innovations and strategic planning necessary to devise solutions in stakeholder and environmental management that are cost-effective *and* optimal for overall societal well-being (Husted & Salazar, 2006). Thus, reporting flexibility emerges as a key principle of effective SEA, a point to which we will return in the section on political governance systems.

In effective SEA, there is not only cross-temporal but also geographic flexibility. Stakeholders in different cultures may espouse different values (Donaldson, 1989; Donaldson & Dunfee, 1999), and SEA should reflect different cultures' differing preferences, norms, and priorities. This best practice of international flexibility even applies to "objective facts" such as pollution abatement or animal rights because different cultures espouse different views on the importance and substance of such practices.
Our instrumental theory of SEA effectiveness also explains why verifiability and verification of organizations' social and environmental disclosures are so important. Without verifiability and, in fact, actual credible verification, especially external stakeholders would experience no cost advantages when dealing with "responsible" versus "irresponsible" organizations because those SEA signals could not be trusted. Sooner or later, markets will collapse when there is information asymmetry (as in the case of SEA) and low trust between buyers and sellers of products and/or information (Akerlof, 1970). In this sense, market pressures exist for greater verifiability and accountability, and as shown by Akerlof and other economists, well-functioning markets tend not to reward the lack of transparency.

Empirical evidence on the effectiveness of SEA

As is obvious by now, we do not assume that more and more SEA is necessarily the optimal outcome for an organization (or society at large); nor do we assume that any particular type of SEA is necessarily optimal for either organizations or societies. Instead, we make the more realistic assumption that SEA, though *often* resulting in many benefits, is *never* a cost-free exercise and reaches an optimum level, beyond which net benefits (especially for business) will start to fall (see previous section on opportunity, signaling, transaction, and other costs). To understand the *net* effectiveness of SEA more fully, we can draw on empirical research to test this assumption—at least partially. Specifically, we can draw on past empirical studies that have examined the question to what extent SEA is linearly correlated with corporate financial performance across industries and study contexts. A large positive correlation would cast doubt on our theory of optimal—rather than maximal—SEA because such a correlation would imply a business case[2] for ever-increasing levels of SEA (for a similar discussion of corporate social responsibility more generally, see McWilliams & Siegel, 2001).

Most research reviews in SEA still conclude that, because of variable findings, the correlation between social disclosures and financial performance cannot be established empirically (Deegan, 2002; Ullmann, 1985). However, two award-winning meta-analyses concluded there is a small positive yet negligible correlation (Orlitzky & Benjamin, 2001; Orlitzky, Schmidt & Rynes, 2003).[2] The meta-analytic results shown in Table 1 suggest that we can, in fact, reach general conclusions about the business case for SEA. In general, the true score correlation ρ between social disclosures and all different measures of corporate financial performance (CFP) is .09, with over 98% of the cross-study variance by such artifacts as sampling error and measurement error. Whenever the cross-study variance explained reaches 75% in a meta-analysis (see sixth column in Table 1), we can conclude that there are no moderators and we have correctly identified the population parameter, or mean true score correlation ρ (Hunter & Schmidt, 2004). With market measures of CFP (such as share price appreciation), the true-score correlation was slightly larger (ρ = .11; σ^2_ρ = .01). Thus, the meta-analytic data suggest that financial markets reward social disclosures only to a minor extent. However, the meta-analytic data also show that social disclosures are not correlated, and may even be inversely correlated, with any internal, accounting measures of CFP (ρ = -.02; σ^2_ρ = .00; i.e., all of the cross-study variance is explained by study artifacts).

Hence, far from being inconclusive, the overall results show that voluntary disclosures have only small positive benefits for the valuation of firms in financial markets and may even be counterproductive in terms of internal accounting measures of CFP. Since these accounting measures can be conceptualized as measures of organization-level efficiency in the use of company resources, this finding reaffirms the aforementioned idea that increasing levels of SEA are not *necessarily* efficient from an organizational perspective. Alternatively, the negative correlation between accounting CFP and SEA might lead to the conclusion that poor financial performers are more likely to disclose social and environmental data (possibly to distract the readers of their annual reports, such as shareholders, from their poor financial performance as measured by return on assets or equity). This alternative interpretation, though, calls into question the interpretability of SEA as a valid signal of organizational social and financial sustainability (see also previous section on "faking").

The only area in which empirical results are inconclusive is the correlation between SEA and firm risk (Orlitzky & Benjamin, 2001). The true score correlation ρ of -.10 might suggest that SEA minimizes firm risk. However, this conclusion would be premature because study artifacts explained only 26% of the cross-study variance, and thus the true score standard deviation SD_ρ was a sizeable .23 (the square root of the true score variance estimate reported in Table 1, i.e., $\sqrt{\sigma^2_\rho}$). Furthermore, the file drawer analysis, which calculates the number of studies needed to change our conclusions substantially (i.e., a failsafe *N*), indicates that only one additional study would be needed to change conclusions in the case of SEA and firm risk. Therefore, more studies will have to be conducted on SEA and firm risk before we can reach any general conclu-

[2] By "business case of SEA," we mean SEA results in short- or long-term financial benefits for business.

Table 1
Meta-analytic Conclusions Regarding SEA

Relationship of Social Disclosures with…	k^a	Total sample size	Sample-size weighted mean observed r (r_{obs})	Observed variance	% Variance Explained[b]	Mean true-score r (meanρ)	Variance of r [$=\sigma^2(\rho)$]	File Drawer Analysis[c]
All measures of CFP	97	5,360	.0438	.0189	98.47%	.0871	.0011	NA
2.a.1. Market-based CFP	79	4,426	.0548	.0206	89.75%	.1090	.0081	8
2.a.2. Accounting CFP	18	934	-.0085	.0077	100.00%	-.0168	.0000	NA
Business risk	2	213	-.0741	.0381	25.85%	-.1041	.0543	1
Social audits and CFP	35	5,016	.1143	.0081	100.00%	.2272	.0000	45

Note: CFP = corporate financial performance.
[a] k: number of correlation coefficients meta-analyzed;
[b] refers to percentage of observed variance explained by sampling error and measurement error in CSP;
[c] Hunter & Schmidt's (1990) effect size file drawer analysis: Number of missing studies needed to bring r_{obs} up to -.05.

Source: Orlitzky & Benjamin (2001); Orlitzky, Schmidt, & Rynes (2003).

sions in this area.

Furthermore, these meta-analyses showed that, of all the different proxies of corporate social responsibility (CSR), SEA was correlated with CFP to the smallest extent (Orlitzky & Swanson, in press)[3]. These other CSR measures included CSR reputation, executive values, and such organizational processes as social audits, philanthropic donations, issues management, stakeholder management, and environmental assessment, forecasting, and management. For example, when SEA is verified in the form of social audits, we observe a much greater and generalizable true score correlation of .22 with CFP (see last row of Table 1). This suggests that stakeholders do not trust SEA as a signal of good corporate citizenship *unless* social disclosures are implemented in a comprehensive organizational audit system and objectively verified by independent auditors. Overall, our previous, theory-based intuition about the necessity of verification and auditing is supported by these meta-analytic findings.

[3] Orlitzky and Benjamin (2001) won the 2001 Best Article Award given by the International Association for Business and Society (IABS) in association with *California Management Review*. Orlitzky, Schmidt, and Rynes (2003) won the 2004 Moskowitz award for outstanding quantitative research relevant to the social investment field. The Moskowitz Prize is awarded annually to the research paper that best meets the following criteria: 1) practical significance to practitioners of socially responsible investing; 2) appropriateness and rigor of quantitative methods; and 3) novelty of results. This entire research program will be summarized (and updated with new findings) in a forthcoming book (Orlitzky & Swanson, 2008).

SEA and political governance systems

Organizations' social, political, and economic environments may also affect the effectiveness of SEA. Hitherto, this fact of organizational embeddedness has been understated within the SEA literature. This is unfortunate, for without work explicitly concerned to connect SEA with the broader domain of political governance systems, SEA scholarship remains incomplete (Deegan, 2002; Mathews, 1997), especially given our focus on SEA effectiveness. Amongst other things then, and as will be further emphasized in the concluding discussion, the present paper is concerned to suggest that scholars of SEA need to increasingly engage with, or at least more fully acknowledge, the ways in which the interrelated concerns of moral and political philosophy shape the political governance systems that impact upon, or contribute to the definition of, the effectiveness of SEA. More specifically, the present section of the paper refers to a number of perspectives that combine to inform, and often compete to inform, the (re)design and (re) construction of political governance systems within contemporary societies. With reference to the discussions already completed, what the present section of the paper suggests is that, ultimately, it is very difficult to conceive the effectiveness of SEA at the managerial and/or stakeholder level minus the sort of bird's eye view that the interrelated domains of moral and political philosophy enable one to take. It is for this reason that the following two systems of political governance are discussed next.

The laissez-faire, classically liberal, and/or libertarian perspective

The first political governance system can be termed the laissez-faire, classically liberal, and/or libertarian perspective. In this system, the importance of individual autonomy and freedom, especially negative liberty, is emphasized. In effect, the idea of negative liberty refers to those liberties associated with respecting private property, not being infringed upon, not being lied to, not being aggressed against, and/or, not being forcibly constrained (e.g., Berlin, 1969; Sen, 1988). For negative liberty to be respected then, it is generally required that other people refrain from actively harming others or from forcibly imposing their will on others in any way. Nevertheless, and as Shue (1996: Chapter 2) has argued, if the negative liberties of a certain person (e.g., Person A) are to be respected, other people or institutions (e.g., Police Force Z) will commonly be required to act so as to forcefully prevent another person (e.g., Person B) from infringing as such. Given this general concern – and whilst acknowledging that some thinkers aligned with the laissez-faire, classically liberal, or libertarian perspective argue that not even a minimal state can be justified given that taxation is money paid under threat of institutionalized violence, and hence, disrespectful of negative liberty (e.g., Hoppe, 1999; Rothbard, 1978) – most of those aligned with this broad line of thought side with Nozick (1974: ix) in thinking that something tending towards a "night-watchman" state limited "to the narrow functions of protection against force, theft, fraud, enforcement of contracts and so on" is justified.

The second thing that the laissez-faire, classically liberal, or libertarian perspective tends to suggest is that the sum of individual goods within a given society is likely to be maximized so long as negative liberty is respected. This utilitarian argument, whilst not always put forward by those associated with a laissez-faire, classically liberal, or libertarian perspective, is nevertheless commonly advanced. Mises (2002: 22-23), for example, makes the basic point well when he writes:

> …a system based on freedom for all workers warrants the greatest productivity of human labor and is therefore in the interest of all the inhabitants of the earth… free labor… is able to create more wealth for everyone….

Given these two beliefs – i.e., the belief in the importance of negative liberty and the belief that respect for negative liberty maximizes social welfare – those who can be associated with a laissez-faire perspective (e.g., Friedman, 1962; 1970; Mises, 1963; Mises, 1990; Nozick, 1974; Smith, 1776/1976) tend to (1) want the role of the nation-state to be limited to something *approaching* the "night-watchman" role[4] and (2) tend to champion the benefits that a society derives from the actions that business people (who are largely understood as being motivated by the desire to maximize their own financial profits) engage in to try to satisfy consumers.

Before proceeding to expand on the second of these two points, which is closely related to Smith's idea of the invisible hand (see below), it should be highlighted that the laissez-faire, classically liberal, or libertarian ideal of society has never been actualized on any large scale in recent history (it may, however, have been actualized on a large scale historically or on a smaller scale more recently). Indeed, not even nineteenth-century Britain, which is commonly considered the archetype of a classically liberal society, limited the role of the nation-state to that of the "night-watchman" (Taylor, 1972). Nevertheless, this general perspective has had a massive influence on the collective psyche of Western society and has thus influenced the design and construction of its political governance systems. Accordingly, it is here argued that a sophisticated understanding of the laissez-faire, classically liberal, or libertarian perspective is of vital importance to any discussion of the effectiveness of SEA. Three specific reasons will now be put forward for arguing thus.

First, an understanding of laissez-faire thinking is vital if one wishes to contextualize the fact that the managers of limited-liability and publicly traded corporations are legally obliged, and remuneratively encouraged, to try to maximize shareholder wealth (e.g., Beerworth, 2004/2005; Bostock, 2004/2005; Collison, 2003; Cragg, 2002; Owen, 2005a). This fact, which means that managers are *strongly encouraged* to measure the effectiveness of SEA in terms of maximum net *company* benefits, is often presented in a negative light within the SEA scholarly literature given that it tends to limit the extent and quality of SEA activities (Owen, 2005b). In short, those who present the "profit motive" in a negative light, do so for ethical reasons. Accordingly, and as the preceding discussion suggests, it is important that scholars of SEA recognize that this concern with profit maximization can be argued for on both deontological (and/or rights-based) and utilitarian grounds (McCloskey, 2006; Mises, 1963; Smith, 1776/1976).

[4] Neither Friedman nor Smith, for instance, championed the sort of "pure" laissez-faire perspective being here discussed. Nevertheless, both thinkers have definitely championed the benefits of limiting government involvement in various social and economic issues. Hence the emphasis placed on the word *approaching*.

The deontological (and/or rights-based) argument in favor of profit maximization states that as long as profits are generated in a manner that does not infringe on the negative liberty of other people – e.g., so long as there is no coercion or deception involved – then they are justified. This argument is directly related to the idea that a truly commercial interaction is mutually beneficial, and hence, non-coercive. Furthermore, this idea is related to the belief that, so long as one is entitled to, or rightly owns, the resources utilized in the production of goods and services, then they are also entitled to, or deserving of, any profits that the sale of these goods and services generate (Kirzner, 1989; Nozick, 1974). In contrast to the deontological (and/or rights-based) argument, the utilitarian argument justifies the right of individuals to earn private profits on the basis that this right has positive consequences for social welfare. Mises neatly encapsulated one element of the utilitarian defense of private profits by stating that:

> The behavior of the consumers makes profits and losses appear and thereby shifts ownership of the means of production from the hands of the less efficient into those of the more efficient […] In the absence of profit and loss the entrepreneurs would not know what the most urgent needs of the consumers are. (Mises, 1963: 299)

And, more famously, Adam Smith has provided a utilitarian argument defending private profits when he wrote:

> The uniform, constant, and uninterrupted effort of every man to better his condition, the principle from which public and national, as well as private opulence is originally derived, is frequently powerful enough to maintain the natural progress of things towards improvement, in spite both of the extravagance of government, and of the greatest errors of administration. Like the unknown principle of animal life, it frequently restores health and vigour to the constitution, in spite, not only of the disease, but of the absurd prescriptions of the doctor. (Smith, 1776/1976: 443)

Both the deontological and utilitarian arguments made above help justify institutional frameworks that strongly encourage managers to judge the effectiveness of SEA initiatives in terms of firm-specific net returns from SEA. Accordingly, it can be argued that those who wish managers to primarily judge the effectiveness of SEA initiatives in other ways – such as in terms of accountability to stakeholders (Owen, 2005b) – need to directly engage these normative arguments if they are to alter systems of political, economic, and corporate governance that encourage managers to be primarily concerned with profit maximization.

The second point to be made, in relation to SEA and the laissez-faire, classically liberal, and/or libertarian perspective, is that the deontological argument aligned with this worldview can be used to argue for the necessity of honest and comprehensive disclosure when it comes to SEA. Indeed, given the laissez-faire concern with truly commercial interactions and, given the presupposition that many consumers are concerned with the social and environmental impact that companies can have, it can be argued that companies are morally obliged – on laissez-faire, classically liberal, or libertarian grounds – to honestly and comprehensively disclose the impact that the production and sale of company goods and services have in regard to social and environmental matters. The reason why this can be argued is that the mutual benefit upon which any commercial transaction is based implies the need to disclose information that could potentially prevent a sale. For example, at least some people would, all other things being equal, prefer to purchase products from companies determined to reduce their carbon footprint than those not so concerned. Thus, if a company decided to give the false impression that their carbon footprint was less than that of their competitors via their SEA, then they could be ethically criticized on laissez-faire, classically liberal, or libertarian grounds: for lying (whether actively or by omission) is to disrespect the negative liberty and personal autonomy of others. Furthermore, the failure of organizations to provide honest accounts of such issues will likely increase transaction costs incurred by customers and other stakeholders in the future because deception lowers trust, which in turn necessitates more future monitoring. Obviously, such an outcome will also lead to undesirable outcomes at the level of aggregate social welfare.

The third reason that an understanding of the laissez-faire perspective is vital to understanding the current state of, and current debates surrounding, SEA, is due to the utilitarian argument associated with the classically liberal perspective suggesting that it would be a mistake for governments to over-regulate this area. This general argument, most closely associated with various thinkers aligned with the Austrian school of economics (Kirzner, 1985; 1989; Mises, 1963; 1990), suggests, amongst other things, that if governments set and enforce baseline standards that must be met with regard to SEA reporting, then companies will be likely to do no more than try to achieve this baseline standard. One reason why this might occur is that, whenever governments set a baseline standard, they can, whether intentionally or not, give off the impression that any effort to improve upon this level would result in resources being misallocated. Furthermore, whenever governments provide hard and fast rules for the completion of a task, managers and business people will obviously decide not to try to create a better way to accomplish the same task on the grounds that government regulations will not allow such an improvement to be implemented. In short, it can be said that government regulation, in these and other matters, discourages innovation and results in a suboptimal compliance rather than a more desirable integrity mindset on the part of business executives (Paine, 1994). Furthermore, whenever such baseline standards are implemented, firms will be in a position to deflect criticism that they might receive from various stakeholders for not doing more by responding: "Company X has achieved the government's standards and hence Company X has met society's expectations." Such a managerial compliance mindset can translate into a stance of "as bad as the law allows" (to borrow the words of Interface CEO Ray Anderson).

In building off this same argument, it can also be suggested that, whenever governments regulate and monopolize reporting and accounting processes, they decrease the sphere available to social and environmental entrepreneurship and innovation. What this suggests, in specific regard to the contemporary lack of governmentally enforced SEA activities, is that such a lack is far from being a bad thing. To briefly elaborate, this lack of governmental presence leaves a vacuum that market-driven innovations from several competitors can fill. Thus, we have organizations, such as AccountAbility in the UK, the Global Reporting Initiative (GRI), KPI in Europe, and other similarly oriented organizations, all developing systems and institutions that encourage SEA innovations. Such diversity and competition, according to the laissez-faire perspective, is beneficial. And, when it comes to a young and developing field like SEA, it might be suggested that this lack of hard regulation is a very good thing indeed.

The liberal democratic perspective

The second political governance system can be termed the liberal democratic perspective. It is arguably more important than the laissez-faire, the classically liberal, or libertarian perspective in that it is actualized to a greater extent within the world today. The reason then for the laissez-faire perspective having been discussed first is that, in a number of important regards, the liberal democratic perspective can be considered a moderated version of it. With this stated, the first thing to note is that, whilst being far from disrespectful of negative liberty, the liberal democratic perspective nevertheless suggests that people have a right to other goods as well; and, that liberal democratic nation-states have a duty to provide these goods to its citizens. These goods, which are commonly thought to include things such as basic levels of education and welfare, can be considered examples of positive liberty (Sen, 1988) in that such goods positively enable people to achieve certain ends that mere negative liberty cannot ensure (e.g. without a basic level of education, individuals are unlikely to be capable of holding down a decent job, even though their negative liberty is respected and protected).

In addition to such positive liberties, which are commonly argued for on deontological grounds and/or on the basis of human rights (e.g., Donnelly, 2003: Chapters 1-3), supporters of the liberal democratic perspective consider equal political participation essential to living a good and full human life. Indeed, and once again, those of a liberal democratic bent regard participation in the democratic election of politicians as a human right (e.g., Gewirth, 1996: Chapter 8). On this particular point, it must be mentioned that advocates of a laissez-faire, classically liberal, or libertarian political governance system also commonly champion the importance of political participation. The difference between the two perspectives in this specific regard is that, whilst advocates of laissez-faire political governance systems try to convince the voting public that it is important to keep the role of governments to a minimum, advocates of liberal democracy argue that democratic governments need to play a much more active role.

Those aligned with the liberal democratic perspective will argue as such because they believe it important that all the people within a given society have their positive and participative rights respected and, in contrast to advocates of laissez-faire, that governments need to play a more than minimal role to ensure that the "social good" is maximized. In regard to the "social good", which is here conceived in utilitarian terms, those aligned with the liberal democratic perspective commonly put forward two reasons as to why simply respecting negative liberty will not ensure an increase in social welfare (see Baumol, 1965, for example). First, they commonly reason that, without government direction and/or control of resources, certain public goods will often go unproduced on the grounds that private providers are unable to capture any income from their production. Second, they commonly reason that, minus government regulation of commerce and industry, negative externalities will proliferate given the costs associated with self-regulation. Whenever either of these things occurs – i.e., whenever markets do not produce certain public goods or whenever they produce negative externalities – the market can be said to have failed.

As the preceding discussions state, those aligned with the liberal democratic perspective believe – in contrast to those aligned with the laissez-faire, classically liberal, or libertarian perspective – that a more than minimal government directing society in the name *of* the people, and indeed, *for* the people, is justified. More specifically, those aligned with the liberal democratic perspective commonly want governments to impose hard regulations that require business people and managers to act one way or the other. To reiterate, the basic reason why is that those aligned with the liberal democratic perspective do not believe that social welfare will be maximized if business people and managers are left to pursue profits in a regulatory environment that is simply and solely concerned to protect negative liberty. Thus, and whilst the liberal democratic perspective is far from disparaging of the utilitarian arguments that those aligned with the laissez-faire perspective make, it nevertheless suggests that governments need to establish various rules, regulations, incentives, and so on to ensure that the energies of profit-motivated actors contribute to, and do not undermine, the "social good."

One of the key decisions facing public policy makers then, according to the liberal democratic perspective, is whether or not they should "devise mechanisms," or "allow mechanisms to evolve, that channel the pursuit of profits in a socially productive direction" (McMillan, 2002: 228). In specific regard to SEA, what this means is that public policy must decide whether governments should, or should not, impose hard regulation on business and corporate activities. As the preceding sub-section has indicated, there are potential costs associated with hard regulation, i.e., diminished innovation and the potential for a reduction in activities towards the lowest common denominator. However, and as the discussion of this sub-section has indicated, there are similarly potential negatives associated with leaving such institutional creation to the invisible hand.

One potential negative is that, without government coercion, various other stakeholders will be unable to enforce honest and comprehensive reporting and social disclosures. Thus, if a society considers it important that people have access to information established via SEA activities, it can be argued that governments need to ensure, via ultimately coercive means, that businesses and corporations disclose such information. Importantly, this specific concern is related to the more general notion that, "a workable market design keeps in check transaction costs… These costs include the time, effort, and money spent in the process of doing business – both those incurred by the buyer in addition to the actual price paid…Transaction costs can arise before any business is done" (McMillan, 2002: 9).

This idea of transaction costs is central to understanding the fact that various non-governmental organizations (NGOs) – such as the CORE coalition, for example (Zerk, 2007) – continue to lobby liberal democratic governments for increasingly stringent and comprehensive SEA practices. One of the reasons they desire such regulation is so that they can then use this information to suggest to their own members, and to the public more generally, that if they hold certain values regarding any number of social and/or environmental concerns, then they should choose Company A over Company B, C, and D. In short, they wish the government to impose increasingly comprehensive regulations so that they can reduce the transaction cost for those who wish to make purchasing decisions on more than narrowly instrumental grounds.[5]

A second reason why various NGOs wish to see increasingly stringent and comprehensive SEA practices enforced by governments is so that they can use this information to suggest the need for other policy initiatives. For example, if environmental NGOs have increased access to information regarding deforestation, desalination, groundwater usage, hazardous chemical usage, and so on, then they can use this information to try to encourage governments to engage in new policy initiatives whose aim is to ensure that corporate practices improve in such regards. Clearly, if one accepts that corporations can both positively and negatively impact upon social and environmental concerns, and if one similarly accepts – as do those aligned with the liberal democratic perspective – that government action is commonly required to ensure that corporations positively impact upon social and environmental concerns, then it is clear as to why governmentally enforced SEA standards may be required. Indeed, it can be argued that governments themselves will be unable to establish the relative success or failure of various policy initiatives unless they have access to information garnered from SEA practices. In short, the liberal democratic perspective suggests that governments will commonly be required to regulate various elements of SEA if the activities of profit-motivated actors are to contribute to, and not undermine, social welfare.

In liberal democratic governance systems, then, the emphasis shifts from firm-level effectiveness of SEA ($\boldsymbol{MB_{SEA(firm)} = MC_{SEA(firm)}}$) to social efficiency ($\boldsymbol{MB_{SEA(all)} = MC_{SEA(all)}}$). This shift in emphasis is shown as an arrow in Figure 1. As argued before, the arrow does not imply that laissez-faire capitalism cannot maximize social efficiency. Rather, in the absence of government intervention (in laissez-faire systems), managers have

[5] Of course, costs are not reduced at the aggregate level because more regulation means a larger governmental bureaucracy is needed to enforce these regulations, which in turn needs to be funded with greater taxation. Strictly speaking, we are not dealing with a society-level reduction in (transaction) costs but with a transfer of costs from one set of stakeholders to another.

cognitive leeway to focus on employer interest in their cost-benefit analyses of any given corporate action. Arguments can be provided that these ultimately self -interested actions result in the greatest public benefit, or maximum social efficiency (Bragues, 2006; Mises, 1963; Smith, 1776/1976). So, "shift in emphasis" refers to a shift in managerial thinking, which is forced (either directly or indirectly) through government intervention in liberal democratic societies, to transcend, in all managerial decision making, the organization-level calculus of $\boldsymbol{MB_{SEA(firm)} = MC_{SEA(firm)}}$ and consider the broader stakeholder benefits of organizational practices and policies.

Suggestions for future research

This paper, like a great deal of the existing scholarly literature on SEA, concentrates on Western countries and Western institutional forms. Accordingly, we suggest that future research on SEA needs to broaden its horizons, and increasingly engage with hitherto under-represented geographic regions, and the varying institutional frameworks that prevail within them. For example, Aguilera & Jackson (2003: 453), Sternberg (1998), and Yafeh (2000) have all highlighted that corporate governance systems within East-Asia are commonly characterized by a system of cross-shareholdings. Furthermore, Hansmann & Kraakman (2004: 40), Robins (2002), and Whelan (2007) have all emphasized that the political governance systems of East-Asia have historically tended to emphasize a stronger role for governments in the direction of industrial policy. Arguably, the moral and political philosophies that support such different political governance systems need to be articulated, if one is to fully understand the current state of SEA within these different countries. Whelan's (2007) work in particular, which engages with Confucian thought to make further sense of the Asian financial crisis and just what corporate social responsibility might mean in this part of the world, provides an example of how moral and political philosophies can be used to shine a light on matters of institutional concern.

Another area that requires further research is empirical work relating to the moral frameworks through which managers view the world. Tetlock (2000), for example, has highlighted that the way in which managers view a particular situation will be informed by the ethical and political theories they align themselves with. To briefly extrapolate, such work suggests – along with Whelan's (2002) work on Pierre Bourdieu's failure to change the institutionalized patterns of the French media – that if managers are to be convinced of the merits of adopting various SEA activities, then it would be sensible for those trying to convince managers to present their arguments in a manner that is not inconsistent with the ethical and political beliefs that managers have. Thus, if one presupposes that the managers of business corporations are largely in favor of commercial enterprise, arguments aimed at convincing managers to adopt various SEA practices should not, in addition to other things, rankly criticize commerce. Or, if one presupposes that managers and students of business tend to be utilitarian in ethical orientation, as has been suggested in at least some of the literature (Orlitzky, 1997), then those wishing to convince managers of the merits of SEA, should do so in utilitarian terms.

Rather obviously, just what the ethical and political beliefs of managers are, and the way in which these beliefs impact on managerial perceptions of SEA, is a question that requires further empirical research.

The field of SEA, like most of the academic business literature (Pfeffer, 1993; Van Maanen, 1995b), is characterized by high paradigmatic diversity (Mathews, 1997; Owen & O'Dwyer, 2008). Paradigmatic diversity implies that different perspectives and findings are incommensurate (Burrell & Morgan, 1979). To clarify the current state of affairs, researchers could, at a minimum, investigate *why* paradigmatic diversity is so prevalent in the SEA research arena (see also McKinley, Mone & Moon, 1999). Pfeffer (1993) and others (e.g., Wilson, 1998) argued that science would progress most rapidly when researchers agree on a common set of ontological and epistemological assumptions. On these grounds, it might be worthwhile to strive towards greater theoretical agreement. From the vantage point of scientific progress and influence, the best type of SEA theory would not only be unified but also prescriptive (Bazerman, 2005). On the other hand, it must be acknowledged that, given the relative youth of the field, a diversity of approaches would arguably allow for maximum innovation (Van Maanen, 1995a; b).

Conclusion

In this paper we took a few preliminary steps toward the development of a prescriptive theory of the effectiveness of SEA at two levels of analysis (organizational and societal). We concluded that, given the impact of signaling and transaction costs and various benefits of SEA, the level of SEA should be set so that marginal costs of SEA equal marginal benefits (at the firm level) or marginal costs of SEA to society equal marginal benefits to society (in line with the tenets of social efficiency). However, because all organizational decision making is embedded in moral and political governance systems, we also highlighted the importance of these systems for SEA. In doing so, and amongst other points made, we drew on laissez-faire or classically liberal thinking to argue that honest and comprehensive disclosure is needed if the relationship between consumers and corporations is to be a truly commercial one, and, in drawing on liberal democratic ideas, we suggested that governments will commonly try to impose standards for disclosure on corporations whenever suitable levels of disclosure do not voluntarily arise. In doing so, these “macro” discussions provide an overview of certain normative beliefs which can be understood to justify the roles governments currently do (or do not) play in setting standards for SEA; and, a further understanding of why Anglo-American corporations are positively encouraged to try to maximize profits. The paper concluded with three suggestions for future research.

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