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THE DURABLE CORPORATION IN A TIME OF FINANCIAL AND ECONOMIC CRISIS

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Abstract

In this paper we argue that the concept of sustainability is not fully understood by business managers. This paper extends our previous work (see for example Aras & Crowther 2007, 2008a 2008b 2009) to address the issue of sustainability in the context of financial crisis. In doing so we continue to develop new theory using a Kantian dialectical method based upon case analysis to develop a fuller understanding of corporate durability. We further argue that a company which understands and practices durability – a stronger form of sustainability – would be better equipped to withstand the economic crisis and would be less susceptible to succumbing to the problems of the financial crisis. An understanding of the complexities involved in the managing of durability enables the identification of the complexities of risk to which the company is exposed. We therefore explain the theory underpinning this assertion before going on to illustrate its veracity through the use of case studies of a variety of corporate contexts.

Keywords: Financial crisis; corporate social responsibility; sustainability; durability; sustainable development; governance; accountability.

Introduction

The 2008 financial and economic crisis has shown that there are failures in governance and problems with the market system. In the main these have been depicted as representative of systemic failures of the market system and the lax application of systems of governance and regulation. Thus many people are arguing for improved systems to combat this. Naturally many people have discussed these failures and the consequent problems and will continue to do so into the future. It is not of course the first such crisis and the market economy has been proceeding on a course of boom and bust for the last 20 years which is not dissimilar to that of the sixties and seventies which the neo-conservatives claimed to have stopped. The main differences are that recent cycles are driven by the financial markets and the era of globalisation means that no country is immune from the effects felt in other countries.

This globalisation should stifle one of the debates concerning the crisis, concerning the prevention of future occurrences through the introduction of an enhanced regulatory regime. Regulators are bounded by their terms and areas of reference whereas finance and trade is increasingly boundary-less. So the only form of regulation which would be effective would be a global system of regulation. This paper extends our previous work (see Aras & Crowther 2007, 2008a 2008b 2009) to address the issue of sustainability in the context of financial crisis. In doing so we continue to develop new theory using a dialectical method based upon case analysis to develop a fuller understanding of corporate durability. Of vital concern to all forms of business however, and also to leaders in governments, NGOs and financial institutions is the question of sustainability and the conditions under which sustainable development become possible. Although environmental effects are an important part of sustainability for businesses and for economic or financial activity mediated through the markets, sustainability is actually much more complex than this and requires the balancing of a variety of different factors. Nevertheless sustainable economic activity is dependent upon sustainable businesses while sustainable businesses are equally dependent upon stable and sustainable markets; equally the sustainability of national economies is dependent upon both, as is the global economy – a truly complex and symbiotic relationship! If regulatory control of these inter-relationships is problematic then this means that governance is also problematic – possibly one cause of the current crisis.

Most people understand sustainable development as being based upon the definition of the Brundtland Commission in stating that it must not impact upon the choices available to future generations. Moreover it is generally considered that issues concerning sustainable development are primarily concerned with environmental issues. It is our argument (see Aras & Crowther, 2008a) that this understanding is both incorrect and misleading and has hindered the development of sustainable corporate activity as well as the development of complete methodologies for strategic decision making.

Developing a full discourse of sustainability

One of the most used words relating to corporate activity at present is the word sustainability. Indeed it can be argued that it has been so heavily overused, and with so many different meanings applied, to it that it is effectively meaningless. It is therefore time to re-examine the legacy of Bruntland and to redefine what is meant by sustainable activity. Thus we argue that sustainable development has assumed such significance in the lexicon of corporate behaviour that it is in effect a strategic imperative, despite there being little understanding of the term and its implications (see Aras & Crowther, 2008b). It is part of our argument that the current fashionably ubiquitous use of the term has obfuscated any consideration of a real understanding of sustainability. This is unfortunate as we consider that sustainability must be an integral part of the strategic development of a company, but that a complete understanding of sustainability is necessary before sustainable development can be countenanced.

Sustainability is of course fundamental to a business and its continuing existence. It is equally fundamental to the continuing existence not just of current economic activity but also of the planet itself – at least in a way which we currently understand. It is a complex process, as we have discussed. Moreover it is a process which must recognise not just the decision being made in the operational activity of the organisation but also the distributional decisions which are made. Only then can an organisation be considered to be sustainable.

Others have tended to assume that a sustainable company will exist merely by recognising environmental and social issues and incorporating them into its strategic planning. According to Marrewijk & Were (2003) there is no specific definition of corporate sustainability and each organisation needs to devise its own definition to suit its purpose and objectives, although they seem to assume that corporate sustainability and corporate social responsibility are synonymous and based upon voluntary activity which includes environmental and social concern.

Our argument – expounded elsewhere (see in particular Aras & Crowther 2007, 2009a) – concerning sustainability is that there are actually 4 components of sustainability:

- *Societal influence*, which we define as a measure of the impact that society makes upon the corporation in terms of the social contract and stakeholder influence;
- *Environmental Impact*, which we define as the effect of the actions of the corporation upon its geophysical environment;
- *Organisational culture*, which we define as the relationship between the corporation and its internal stakeholders, particularly employees, and all aspects of that relationship; and
- *Finance*, which we define in terms of an adequate return for the level of risk undertaken.

These are all necessary in order to ensure not just sustainability but to also enable sustainable development. Moreover it is the balance between them which is crucial. It will be observed that we have been added an extra component from the triple bottom line, concerned with culture. Moreover we have highlighted finance, on the basis that it is not possible to manage the other issues (social, environmental and organizational) without financial resources.

Although risk management, efficient management, regulation, ınternational standards and corporate governance are necessary all for sustainability and for sustainble business (Aras & Crowther, 2008c, 2009a), there are actually two discrete discourses concerning corporate sustainability which are operating in parallel with each other. One is predicated in the environmental sustainability discourse which is epitomised by such work as Jacobs (1991), Welford (1997) and Gray & Bebbington (2001). The second is predicated in the going concern principle of accounting as epitomised by the corporate reporting described earlier. Although seemingly incompatible, both are actually based on an acceptance of a conventional view of the transformational process of the organisation (Aras & Crowther, 2009a).

Traditional accounting theory and practice assumes that value is created in the business through the transformation process and that distribution is merely concerned with how much of the resultant profit is given to the investors in the business now and how much is retained in order to generate future profits and hence future returns to investors. This is of course overly simplistic for a number of reasons. Even in traditional accounting theory it is recognised that some of the retained profit is needed merely to replace worn out capital – and hence to ensure sustainability in its narrowest sense. Accounting of course only attempts to record actions taking place within this transformational process, and even in doing so regards all costs as things leading to profit for distribution. The traditional view of accounting therefore is that the only activities with which the

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organisation should be concerned are those which take place within the organisation;[1] consequently it is considered that these are the only activities for which a role for accounting exists. Here therefore is located the essential dialectic of accounting – that some results of actions taken are significant and need to be recorded while others are irrelevant and need to be ignored. This view of accounting places the organisation at the centre of its world and the only interfaces with the external world take place at the beginning and end of its value chain. It is apparent however that any actions which an organisation undertakes will have an effect not just upon itself but also upon the external environment within which that organisation resides. In considering the effect of the organisation upon its external environment it must be recognised that this environment includes both the business environment in which the firm is operating, the local societal environment in which the organisation is located and the wider global environment.

The transformational process revisited

In order to explain we need to go back to the transformational process which describes corporate activity. This model assumes that inputs (of capital labour and finance) are used to make goods and services through the employment of the operational factors of production (eg employees, suppliers etc) in order to make goods and services with a resultant profit. The implications of this conventional view of the transformational process are that the inputs can be freely acquired in the desired quantities and that the operational factors of production are commodified.

This model assumes that inputs (of capital labour and finance) are used to make goods and services through the employment of the operational factors of production (eg employees, suppliers etc) in order to make goods and services with a resultant profit. The implications of this conventional view of the transformational process are that the inputs can be freely acquired in the desired quantities and that the operational factors of production are commodified. This view of the process enables mediation through the market and is legitimated by the views of such as Spangenberg (2004) referred to earlier.

There are however 2 fundamental flaws with this form of analysis, from a sustainability perspective:

1. The input referred to as capital actually represents environmental resources and these are quite definitely finite in quantity (Daly, 1996). Thus the market cannot mediate adequately as the ensuing competitive bidding will raise the price but will not bring more of the resource into the market because there is no more in existence. Substitution can compensate for shortages only to a limited extent: it is difficult, for example, to see the extent to which more finance or labour can compensate for the absence of oil or any other fuel.
2. The factors of production are not actually commodities: rather they are stakeholders of the organisation. It may aid analysis to commodify them but they require benefits from the organisational activity. In particular, when resources are recognised to be finite, market mediation in this way does not satisfactorily accommodate the requirements of all stakeholders to the organisation. Thus these stakeholder need to become a part of the output section of the transformational process.

As far as inputs to the transformational process are concerned then it is apparent that environmental resources are finite and effectively fixed. Currently all the resources of the planet are in use (some would say overuse) and the resources for one corporation can only be increased by taking them from another through the process of competition in the market place. This highlights 2 alternative routes to development. The first is through the substitution of environmental resources with other inputs – of labour or finance. The second is through making better use of the available environmental resources – effectively doing more with less. Both require technological development in order to bring into effect and so sustainable development essentially requires technological development – also known as research and development – in order to be tenable. This is the first point of intersection whereby sustainability comes into conflict with organisational accounting. Technological development for sustainability requires the more efficient use of environmental resources whereas accounting efficiency requires the more effective use of financial resources. Sustainable development therefore requires greater use of human resources, particularly highly skilled people, in order to develop that technology, and this of course will incur additional cost. Accounting efficiency requires the replacement of people – particularly skilled and therefore expensive people – with relatively low cost techniques such as programmed change initiatives – business process re-engineering etc – and computer

[1] Essentially the only purpose of traditional accounting is to record the effects of actions upon the organisation itself.

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based management systems. We therefore argue that the use of conventional accounting to a large extent is in direct opposition to the concept of sustainability.

Our model of sustainable corporate activity seeks to resolve this into on model which recognises both the transformational process within a corporation but also the distribution of the benefits as being equally significant to sustainability.

There are a number of problems with this economic view of corporate activity, encapsulated in the way that accounting for corporate activity has evolved.

- Firstly the economic view of corporate activity is that efficiency is all that matters – so economies of scale, deregulation of markets, globalisation etc
- Secondly efficiency is always equated as cost reduction – producing at a lower financial cost because finance is the scarce resource
- Thirdly cost reduction is sustainable – so business migrates around the world in search of ever lower costs of production – cheap labour and cheap raw materials
- And finally substitution is always possible – labour by technology, one source of energy by another. Etc.

These are all incorrect.

The other main problem with the traditional economic view of corporate activity is the assumption that stakeholders are a part of the factors of production – to be used to provide the surplus which is distributed to the owners and investors of the corporation. So employees and suppliers are merely a part of the production process; the effects of corporate activity can be externalised to society at large with impunity; the environment is a free resource to be used for financial gain. And the future – also a key stakeholder – can be neglected.

We accept that value is created through corporate activity but a crucial part of this is the distribution of the effects – positive and negative – to all stakeholders. Including society, the environment and the future. Our argument is that this does not actually lead to corporate sustainability without a consideration of the distributional impact of the corporate activity. Thus in our model none of the stakeholders are merely factors of production but are also affected by – and hence concerned with the results of corporate activity, as described through the transformational process. A reconsideration of sustainability shows that when resources are limited then the way to manage sustainable development is through the more efficient use of those resources. Thus all corporations are practicing cost management and efficient operational management as a matter of course but also as a means of achieving sustainability. Conventionally corporations grow by consuming more resources but redefining the problem shows us that natural resources are finite and are being fully committed at present – if not actually being over committed. So growth through the use of more natural resources is not possible. These are the scarce resource – not finance.

Consequently efficiency must be redefined away from financial efficiency and applied to the use of natural resources. Growth requires us to do more with less. So innovation, technology and R&D become more important. So we must redefine the transformational process to provide a more realistic description of the input resources used – and the potential for substitution and to highlight that growth must come through technological improvement rather than through the use of more resources A central tenet of our argument is that corporate activity, to be sustainable, must not simply utilise resources to give benefit to owners but must recognise all effects upon all stakeholders and distribute these in a manner which is acceptable to all of these – both in the present and in the future. This is in effect a radical reinterpretation of corporate activity.It is necessary to consider the operationalisation of this view of sustainability. Our argument has been that sustainability must involve greater efficiency in the use of resources and greater equity in the distribution of the effects of corporate activity. To be operationalised then of course the effects must be measurable and the combination must of course be manageable. This can be depicted as a model of sustainability.

Manageable (strategic)	Measurable (financial)
Equitable (distributional)	Efficient (technological)

Figure 1. The Facets of Sustainability

This acts as a form of balanced scorecard to provide a form of evaluation for the operation of sustainability within an organisation. It concentrates upon the 4 key aspects, namely:

- Strategy
- Finance
- Distribution
- Technological development

Moreover it recognises that it is the balance between these factors which is the most significant aspect of sustainability. From this a plan of action is possible for an organisation which will recognise priorities and provide a basis for performance evaluation. To summarise, sustainability requires a radical rethink and a move aware from the cosy security of the Brundtland definition. We therefore reject the accepted terms of sustainability and sustainable development, preferring instead to use the term durability to emphasise the change in focus. The essential features of durability can be described as follows:

- Efficiency is concerned with the best use of scarce resources. This requires a redefinition of inputs to the transformational process and a focus upon environmental resources as the scarce resource
- Efficiency is concerned with optimising the use of the scarce resources (ie environmental resources) rather than with cost reduction
- Value is added through technology and innovation rather than through expropriation
- Outputs are redefined to include distributional effects to all stakeholders

Agency and economic activity

The basic assumption of economic activity is that it should be organised into profit seeking firms, each acting in isolation and concerned solely with profit maximisation, and justified according to classical liberalism and the Utilitarian philosophy of John Stuart Mill. This inevitably results in management which is organisation-centric, seeking merely to measure and report upon the activities of the firm insofar as they affected the firm. Any actions of the firm which had consequences external to the firm were held not to be the concern of the firm (Aras & Crowther, 2009b, 2009c). Indeed enshrined within classical liberalism, alongside the sanctity of the individual to pursue his own course of action, was the notion that the operation of the free market mechanism would mediate between these individuals to allow for an equilibrium based upon the interaction of these freely acting individuals and that this equilibrium was an inevitable consequence of this interaction.[2] As a consequence any concern by the firm with the effect of its actions upon externalities was irrelevant and not therefore a proper concern for its management.

One issue of relevance to all organisations is the governance problem caused by the agency problem (Becker & Westbrook, 1998); for financial organisations however this problem is particularly profound. The general agency problem can be characterized as a situation in which a principal (or group of principals) seeks to establish incentives for an agent (or group of agents) who takes decisions that affect the principal to act in ways that contribute maximally to the principal's own objectives. In business this means the relationship between the owner of the business and other investors – as principal – and the managers of the business – as agents. The difficulties in establishing such an incentive structure arise from either divergence of the objectives of principals and agents or the asymmetric information between principals and agents (Vickers and Yarrow, 1988), and very often from both of these factors.

When financial companies are considered then there are significant implications from the agency problem. The first of these is that there are considerably more stakeholders than for an ordinary company. Every borrower and lender is a stakeholder with a continuing relationship with the company. This relationship is much stronger than that with customers are suppliers of an ordinary company due to the ongoing financial commitment by both parties. The second implication is concerned with information asymmetry because the level of risk taken in financial transactions is often much higher but more importantly cannot be assessed by the stakeholders to the financial company even though the managers have sophisticated methodologies for doing so. Thus stakeholders need to rely upon rating agencies to eliminate – or significantly reduce – this information asymmetry. It is significant to note however that the current crisis

[2] This assumption of course ignores the imbalances in power between the various parties seeking to enact transaction through the market.

has shown that the methodologies of financial organisations have been shown to be inadequate[3] and rating agencies have failed to demonstrate any ability to compensate for the information asymmetry.

Advent of the Financial Crisis

Thus risk has been largely ignored[4] and information asymmetry has simply been accepted. At the same time these financial companies have been making large[5] profits: for example HSBC made profits of 114% from borrowing and lending and adding fees into the process during the first half of 2008 and of 102% for 2007, and this is typical of all similar institutions. With (abnormal) returns at this level coupled with low levels of risk it is perhaps unsurprising that investors in financial organisations have been happy to leave the management of the business to their agents and to pay them very large sums of money as remuneration. No-one wished to question this performance and risk killing the golden goose. Even governments have been complicit in this by gradually relaxing the regulatory regime, *in the interests of competing in the global market*. It is only when the crisis unfolds and these financial transactions unravel that anyone has started to question the behaviour of these financial organisations and their managers (Spence, 2008).

This can be contrasted with the behaviour of companies which regard themselves as sustainable and have adopted policies accordingly. For example in their 2006 report[6] BP provide a good illustration of addressing sustainability by stating: *That is why we care about the sustainability of our activities and why, throughout the company, we work to ensure that the things we do and the way we do them are genuinely sustainable.* In their latest reported figures they report a reduction in profit of 15% and issue a cautionary note concerning *the continuing risk of slowing global economies, exacerbated by the global credit freeze, to our marketing and supply businesses* while claiming that they can manage the economic crisis and continue to develop their activities. In doing so they giver every indication of having understood the implications of sustainability and built these into both their risk analysis and strategic planning.

Most people consider that the financial crisis was caused by unsustainable activity in the US housing finance market – commonly known as sub-prime lending. It quickly became apparent however that the banking sector around the world had been engaged in what can only be described as gambling. Supposed assets had been packaged together into parcels for which even the most sophisticated models available could not calculate the risk; consequently risk was ignored in the naïve assumption that these packages were safe investments. When it was discovered that they were actually worthless then they were quickly relabelled as toxic assets and governments were persuaded to buy them from the banks. Surprisingly even the US government complied. For some – such as Madoff with his hedge fund – even this gambling was insufficient; outright theft was required.

The only barriers to financial transactions are national regulations (Tobin 2000). However, it can be seen that regulation is not enough to regulate and control for international transactions and capital flows in developing countries and transitional economies – or to effectively regulate global financial companies. Risk has been effectively ignored and corporate governance principles (see Aras & Crowther, 2008c, 2009d) flouted. The principles of governance and the principles of sustainability are inextricable inter-related and the ignoring of governance principles shows that such firms have scant regard for sustainability; indeed the behaviour of financial institutions still continues to show no regard for sustainability – for themselves, for national economies and for the global economic system. It seems that they have learned nothing from previous crises, which have been a regular occurrence in the Western economic system. The only difference this time is the global nature of the effects from the local American cause. The financial crisis has of course expanded into an economic crisis and many sound businesses are perishing in this climate. Others are however prospering and it is out argument that a large part of the difference between survival and failure in the current climate of economic downturn is a proper understanding and assessment of risk, based upon an understanding of the principles of sustainability (see Aras & Crowther, 2008a). The evidence to support this assertion is still accumulating as the crisis continues to unfold.

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[3] Or possibly ignored in the search for greater profits.
[4] Perhaps this demonstrates prescience (or arrogance) as the failed financial organisations have just been supported by individual citizens (via government loans) thereby demonstrating that the risk to the agents at least is non-existent! Indeed the US bank managers are so self-congratulatory about this that they paid themselves large bonuses, much to the disgust of new president Obama!
[5] Many would describe these profits as exorbitant and unjustifiably large – exploiting their oligopolistic positions.
[6] www.bp.com

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Conclusions

It is our argument therefore that the lack of a full understanding of what is meant by sustainability (or as we prefer to term it *durability*), and particularly by sustainable development, means that the issue is confused in corporate planning and reporting (see Aras & Crowther, 2009a). This allows for the kind of misunderstanding and obfuscation which is taking place. We suggest that a full evaluation requires an understanding of the complex factors which need to be balanced to enable a corporation to engage in sustainable development and one part of this paper explains the complexity of this. We further argue that a company which understands and practices durability – a stronger form of sustainability – would be better equipped to withstand the economic crisis and would be less susceptible to succumbing to the problems of the financial crisis. This is because an understanding of durability enables an accurate assessment of risk through an understanding of the factors involved rather than a reliance on the discredited practises of the rating agencies coupled with immature optimism. These do not compensate for actual analysis based upon an understanding of the principles involved.

An understanding of the complexities involved in the managing of durability enables the identification of the complexities of risk to which the company is exposed, as the two are inevitably interlinked in any consideration of the longer term strategic planning of corporate activity. We therefore explain the theory underpinning this assertion before going on to illustrate its veracity through the use of case studies of a variety of corporate contexts. Finally we acknowledge the current financial and economic crisis by using our theory to illustrate what might have happened if a different understanding of sustainable development, and its related methodologies, had been adopted by some of the companies involved.

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