

## CHAPTER 2

# THE META-THEORETICAL FOUNDATION: FROM SYSTEMS THEORY TO STAKEHOLDER THEORY

*“The whole is more than the sum of its parts”*  
– Aristotle

### 1 INTRODUCTION: TRUST A PREREQUISITE FOR SUSTAINABLE SYSTEMIC BEHAVIOUR

This study contends that corporate trust is an essential prerequisite for any for-profit organisation that wants to enable and safeguard its long-term economic and organisational performance sustainably in a competitive environment (Ingenhoff & Sommer, 2010:339). In essence, corporate trust is regarded as an outcome of the systemic behaviour of a for-profit organisation, as a result of the processes by which the organisation and its various components interact with, relate to and influence one another as well as the organisation’s environment (Kramer, 1999:570).

To this extent, the relevant elements of a for-profit organisation (i.e. its standing in society, identity and processes), the relationship between the organisation and all its stakeholders, the strategic alignment of the organisation’s actions with the expectations of all its stakeholders, and the impact that all of this has on how stakeholders perceive the organisation and on their decision to trust the organisation, are considered and examined in this study.

A key principle of King III is that the Board should safeguard their organisation’s sustainability by ensuring that the “... company is and is seen to be” a responsible corporate citizen by all its stakeholders (King, 2009:22). Since this study construes trust as being the outcome of consistent, trustworthy behaviour (i.e. how it *is*), which is aligned with the organisation’s self-presentation to its stakeholders (i.e. how it is *seen*), the social systems theory is located at the core of the assertions made in the study, and trust is posited as the outcome of consistent systemic organisational behaviour.

## 2 OUTLINE OF CHAPTER CONTENT

This chapter provides the meta-theoretical framework as the overall conceptual foundation of this study to position the corporate environment in which a for-profit organisation functions as a social environment, one in which corporate trust plays an essential role. Since this is quite a comprehensive chapter, an overview of the discussion of each theoretical framework is provided prior to the discussion itself.

First, the systems theory is positioned and explored as the macro-theory that underpins all the ancillary theories that are applied in this study, in order to position a for-profit organisation as a social system. This discussion includes an overview of the basis and key principles of systems theory, followed by an outline of the organisation as a complex and contrived social system. The delineation of the for-profit organisation as the system to be investigated in this study, one which is capable of acting purposefully, serves as a foundation to contextualise the ability of an organisation to build trust in itself.

Secondly, the theoretical foundation for the corporate construct is conceptualised by using the theory of organisations as basis. This discussion starts off with an overview of the early mid-twentieth century views, which had a broader social and political perspective on commercial organisations, in order to make the link with the conceptualisation of corporate trust and sustainability as posited in this study. Next, a very brief overview is given of the views of the theory of organisations that became more prominent in the latter part of the twentieth century, merely to highlight how the theory became disconnected from broader societal issues during this time. The revival of these issues from the 1990s onwards is then noted, with an introduction of the new model of structuralism, which focused prominently on the role of values, ethics, cultural processes and meaning systems that emerged in the theory of organisations from the 1990s.

Thirdly, the theoretical conceptual foundation for the trust construct is provided. Grounded in the systems and social systems theory, trust is conceptualised in this study as a sociological event. Following this introduction of trust as a social event, an overview to position trust and trustworthiness within the corporate environment is provided, by conceptualising a for-profit organisation as an independent, authoritative and purposeful

social actor in its own right, which can be held accountable for its actions on a legal and moral basis, as well as a social entity whose existence is dependent on its interactions with its environment. This locates the central role that internal and external stakeholders, as key actors who interact systemically with the for-profit organisation, play in the formation of corporate trust. The theory of action and decision theory as a specific approach to action theory is reviewed to contextualise the role of ethics in an organisation, and to make the link between the theory of organisations and trust.

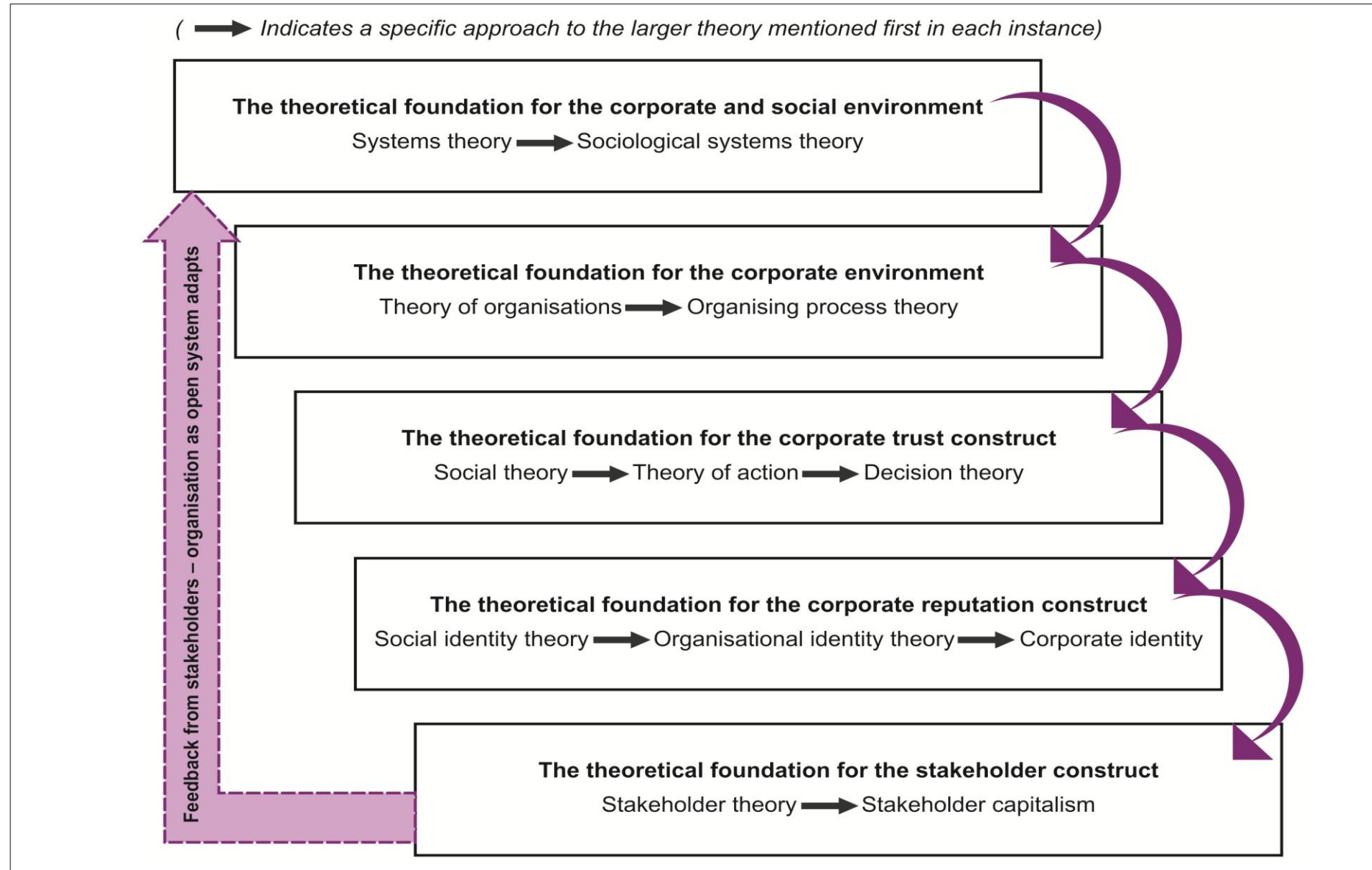
In the fourth place, an overview of identity theory is provided to serve as the theoretical conceptual basis of the reputation construct, since corporate identity is regarded as the foundation of corporate reputation (King & Whetten, 2008:193). Using the perspective of the organisation as social actor, the link between a for-profit organisation's legitimacy and reputation is explored to ground the reputation construct theoretically. The specific causal link between identity, reputation and trust is then briefly discussed, serving as preamble to a more detailed discussion of the reputation construct in Chapter 5.

Lastly, and to conclude this chapter on the theoretical conceptual foundation, stakeholder theory is reviewed. This provides a sound conceptual bridge between systems (specifically sociological systems) theory as macro-theory and the corporate trust construct in this study, and contextualises the key role that stakeholders play in influencing an organisation's long-term economic success and viability.

By meaningfully assimilating stakeholder theory into the concept of a for-profit organisation as a socially engineered system – one that is capable of purposive action and change – the argument that a for-profit organisation has to earn its stakeholders' trust by becoming a trustworthy, ethically responsible corporate citizen if it wants to ensure its own corporate sustainability, is brought full circle.

Figure 2 provides a summary outline of the meta-theoretical framework as the overall conceptual foundation of this study, indicating the flow from systems theory as the macro-theory to the ancillary theories.

**Figure 2:** A summary outline of the meta-theoretical framework as the overall conceptual foundation of this study – from systems theory to stakeholder theory



### **3 SYSTEMS THEORY AS MACRO-THEORETICAL FOUNDATION**

“The whole is more than the sum of its parts.” This dictum, which captured Aristotle’s world view with its holistic and teleological notions, forms the basis of the general systems theory that was developed by Ludwig von Bertalanffy in the 1930s (Von Bertalanffy, 1950:155; Von Bertalanffy, 1972:411). It means in brief that in order to understand an organised whole one must know both the parts and the relations between them (Von Bertalanffy, 1972:411).

#### **3.1 OVERVIEW OF THE SYSTEMS THEORY DISCUSSION**

As a macro-theory, systems theory, and particularly sociological systems theory, lays the foundation for the theoretical framework that is applied in this study to examine and conceptualise the corporate trust construct, and its relationship with reputation and stakeholder management in a for-profit organisation as a social system. The basis of systems theory is discussed first, followed by an overview of the key principles of systems theory and a description of the organisation as a social system, before the theoretical foundations for the corporate, trust and stakeholder constructs are discussed later in this chapter.

#### **3.2 BASIS OF THE GENERAL SYSTEMS THEORY**

The introduction of the concept of ‘system’ as a model of general nature represented the introduction of a new holistic paradigm, which was in contrast to the analytic, mechanistic, linear-causal paradigm of classical science and world view that was prevalent until then (Von Bertalanffy, 1950:165; Von Bertalanffy, 1972:421).

##### **3.2.1 Definition of a system in systems theory**

A system can be defined as “... a set of elements standing in interrelation among themselves and with the environment which together, through their interaction, form something more than the sum of the parts” (Littlejohn & Foss, 2005:40; Von Bertalanffy, 1972:417). Fundamentally, a system can therefore only be explained as a totality (Kast

& Rosenzweig, 1972:450). Von Bertalanffy (1972:422) concurs that an object (and in particular a system) "... is definable only by its cohesion in a broad sense, that is, the interactions of the component elements".

This means that a system is a whole that cannot be taken apart without the loss of its essential characteristics, and that the parts of the system should be studied and explained in terms of the whole, instead of explaining the whole in terms of its parts (Narayanan & Nath, 1993:56; Von Bertalanffy, 1972:415).

### **3.2.2 Classical versus functional systems theory**

Dynamic systems theory, which is concerned with changes of systems in time, uses two principal ways of description: internal and external (Von Bertalanffy, 1972:417). Internal description, or classical systems theory, is fundamentally structural and it aims to describe the system's behaviour in terms of its set of  $n$  measures (or state variables) and their interdependence.

External description is more functional and is used to describe the system's behaviour in terms of its interaction with its environment (Von Bertalanffy, 1972:417,420). The latter approach is applied in this study. The functional system that will be examined in this study is the organisation itself, in particular a for-profit organisation. Before discussing a for-profit organisation as a complex social system, a brief overview is given of some of the key concepts of general systems theory.

## **3.3 KEY CONCEPTS OF GENERAL SYSTEMS THEORY**

### **3.3.1 Open versus closed systems**

Systems can be considered as being either open or closed, although as Kast and Rosenzweig (1972:450) point out, it is never an absolute state but rather a relative one. An open system is in a dynamic relationship with its environment and as such it exchanges information, energy or material with its environment. To this extent, biological and social systems are then regarded as inherently open systems (Kast & Rosenzweig,

1972:450). As a social system, a for-profit organisation is therefore regarded as an open system, one that is capable of interacting actively and decisively with its environment.

### **3.3.2 Structure of a system**

Hierarchical relationships between systems form part of the basic concept of a system, and it simply means that any system consists of sub-systems of a lower order, and in turn it is also a part of a higher supra-system (Kast & Rosenzweig, 1972:450; Von Bertalanffy, 1950:158). In systems thinking, the structure of the system is realised in the pattern of interrelationships among key components of the system. These systemic structures are often invisible (Senge, 1990:90).

A for-profit organisation has many sub-systems, such as departments, processes and individual employees, and as a system it also forms part of society as a higher order system. The structure (i.e. the formation and development) of an organisation as a socially engineered system is therefore dependent on the establishment and nature of its interactions and relationships with its internal sub-systems and society as its external supra-system.

### **3.3.3 Permeable boundaries of an open system**

Even though a system may be regarded as open, it still has boundaries that separate it from its environment and broader supra-system. However, open systems have permeable boundaries, whereas closed systems characteristically have impenetrable and rigid boundaries. While boundaries are relatively easily defined in physical and biological systems, it is much more difficult to delineate clear boundaries in social systems, such as organisations (Kast & Rosenzweig, 1972:450).

As an open social system, a for-profit organisation's boundaries are penetrable. These boundaries range from physical to intellectual boundaries, i.e. from its physical buildings, which people can enter and exit, to its conceptual strategy and organisational goals, which can be influenced and changed by input received from its sub-systems and/or supra-system external to the organisation. It then also stands to reason that this

permeable characteristic of an organisation enables it to purposefully reach out beyond its own boundaries and interact meaningfully with its internal sub- and/or external supra-systems.

The permeable quality of an organisation therefore validates its capability to purposefully interact with its environment. This study regards effective and strategic two-way corporate communication as a critical and an indispensable mechanism that a for-profit organisation can use to interconnect with other systems beyond its own boundaries.

### **3.3.4 A social versus biological system as an open system**

Open systems appear to seek multiple goals or purposes. However, a social and a biological system are two different types of open systems (Kast & Rosenzweig, 1972:453). Social systems consist of elements that have and can exercise their own will and be purposeful in the multiple goals that they are seeking, which presupposes that a social system can change the outcome of its actions.

In contrast, a biological system (even though it is an open system with multiple goals) does not contain one element in its system which can purposefully decide to fulfil another role other than the one it is intended to fulfil (Kast & Rosenzweig, 1972:453; King *et al.*, 2010: 294). A biological system therefore has more in common with a mechanistic system, where the changes that take place as the initial system develops into its final state, are characterised by a direct relationship of cause and effect (Kast & Rosenzweig, 1972:450).

Von Bertalanffy (1950:160) notes that purposiveness, where the actual behaviour is influenced by the foresight of the goal, is the original Aristotelian concept. This presupposes that the future goal is already present in thought, which then directs the present action. “True purposiveness is characteristic of *human* [own emphasis] behaviour, and it is connected with the evolution of the symbolism of language and concepts.” (Von Bertalanffy, 1950:160). A system is regarded as an entity that can



maintain some organisation in the face of change from within or without (Narayanan & Nath, 1993:56).

This implies that a social system, such as a for-profit organisation, can purposefully plan and accomplish its goals and objectives using diverse inputs, and it can apply different internal activities or conversion processes to achieve its desired outcomes. Von Bertalanffy (1950:157) uses the term 'equifinality' to describe the fact that an open system can reach the same final outcome independent of the initial conditions or input and in different ways. A for-profit organisation as an open, social system is therefore seen as intentional, since it is specifically designed to carry out a particular point of view, and engineered to purposefully plan and adapt itself in its pursuance of its multiple goals (King *et al.*, 2010:294).

### **3.3.5 Transformative characteristics of an open, social system**

An open system can be viewed as a transformational model since it converts the various inputs it receives in some way and then exports outputs, representing a change in the component materials (Von Bertalanffy, 1950:155). This capability of an open system to transform itself is in contrast to a closed system (like a physical system), which is subject to the force of entropy or disorder which increases until the system eventually fails (Von Bertalanffy, 1950:161).

An open system then has the ability to arrest the entropy, and even to transform it into negative entropy and restore order in the system, because it can import resources from its environment. Fundamentally, an open system can attain and remain in a state of dynamic equilibrium through the continuous inflow of energy, materials and information (Kast & Rosenzweig, 1972:450; King *et al.*, 2010:291; Von Bertalanffy, 1950:162).

This is made possible in particular through the phenomenon of feedback. Since information concerning the outputs or processes of the system is fed back as input into the system, it can lead to changes in both the transformation process and future outputs (Kast & Rosenzweig, 1972:450).

A for-profit organisation as an open, social system is therefore not only able to interact purposefully and meaningfully with its environment, it is also able to adapt itself based on the feedback it receives. This concept validates the inference that an organisation as an open system can move towards greater differentiation, elaboration and a higher level of organisation, in contrast to a closed system which moves towards entropy and disorganisation (Kast & Rosenzweig, 1972:450; Von Bertalanffy, 1950:162).

This study contends that corporate trust, as a higher level of organisation, is formed as a result of the processes by which a for-profit organisation and its various components interact with, relate to and influence one another as well as its environment (Kramer, 1999:570). To this extent, the ability of the for-profit organisation to strategically align its actions with the expectations of all its stakeholders is deemed to have a significant impact on how stakeholders perceive the organisation and subsequently, on their decision to trust the organisation.

A brief overview of the implications that the systems theory offers for the corporate environment, particularly in terms of building internal and stakeholder trust, will be judicious at this stage in order to set the scene and provide the immediate link between systems theory as a macro-theory and the focus of this study. The ancillary theories are discussed in more detail in the rest of the chapter, to further elaborate on this connection, and provide the theoretical foundation for the corporate, trust and stakeholder constructs respectively.

### **3.4 AN ORGANISATION AS A COMPLEX SOCIAL SYSTEM**

It is prudent to commence the discussion of a for-profit organisation as a system by making a clear distinction between ‘organisation’ and ‘an organisation’. General systems theory maintains that all systems, which are composed of interdependent components in some relationship to each other, are organised. However, as Kast and Rosenzweig (1972:453) point out, while all systems (physical, biological and social) are by definition organised, not all systems are organisations.

### **3.4.1 Organisational theory versus a theory of organisations**

In line with this distinction between ‘organisation’ and ‘an organisation’, Kast and Rosenzweig (1972:453) also note a distinction between ‘organisation theory’, which deals with general and abstract organisational principles, and ‘theory of organisations’, which is a social science that “... puts real human organizations at the center of interest”. In view of the focus of this study, the latter term (theory of organisations) is then regarded as the more appropriate term to be used.

At the core of the argument lies the issue of purposefulness, the ability to exercise own will. Kast and Rosenzweig (1972:453) note that an organism, which is regarded as the foundation stone of general systems theory, does not have the ability to exercise its own will. Organisms adapt in response to environmentally generated inputs and feedback in order to maintain a steady state.

The purposeful elements within social organisations, however, make it possible for an organisation as a system to purposefully initiate activities and adaptations from within it, to respond to its environment in a predictable way (Kast & Rosenzweig, 1972:453; King *et al.*, 2010:294). An organisation is therefore a complex, social system, capable of self-reflection and also “... capable of responding to (or even creating) dramatic changes in the environment (or at least interpreting those changes as problematic for its survival)” (King *et al.*, 2010:294).

This point validates the proposition made in this study that a for-profit organisation has the capability to become and be seen to be a trustworthy organisation, in order to ensure and safeguard its long-term economic survival in a sustainable manner (King, 2009:22).

### **3.4.2 An organisation as a contrived, imperfect social system**

A for-profit organisation is a contrived, imperfect social system, one that is made of men and not one that occurs naturally in nature (Kast & Rosenzweig, 1972:450; King *et al.*, 2010:294). As such, social organisations can be established for an infinite variety of

purposes and their life cycle can either be extremely short or last for centuries, unlike biological systems which follow the same life-cycle patterns of birth, growth, maturity and death within a given period.

Furthermore, social systems are anchored in the attitudes, beliefs, perceptions, habits, motivations and expectations of human beings, so the glue that holds them together is essentially psychological and not biological (Kast & Rosenzweig, 1972:450; King *et al.*, 2010:292). Therefore this study contends that an organisation's continued economic success and survival is based on how well it manages the relationship it has with its stakeholders, which is determined by how effective that relationship is (i.e. is it doing the right things) (Narayanan and Nath, 1993) to evoke the *emotional* response required from its stakeholders that will ensure their cooperation and support for the organisation.

As a social system, a for-profit organisation consists of two things: on the one hand, a set of components and on the other, a process by which the components *purposefully* interact to achieve the objective for which it was designed (Littlejohn & Foss, 2005:40). In his influential work *Foundations of the theory of organization* (1948), Selznick defined an organisation as "... a system of consciously coordinated activities or forces of two or more persons". According to him, a formal organisation is "... a rationally ordered instrument for the achievement of a stated goal" (Selznick, 1948:25).

The for-profit organisation, posited as a social actor in its own right and as the central system to be examined in this study, is in constant interaction with itself (as a system) as well as with its environment (which includes stakeholders as actors) to achieve its goal, which is to become and remain economically viable and sustainable in its competitive environment in the longer term.

The core objective of any for-profit organisation is to ensure that it remains economically viable and successful in the longer term. In order to realise this, it constantly has to achieve its short-term goals – whether these are monthly, quarterly or annual profit margins, quality, service and production goals – in an effective, efficient, consistent and sustainable manner. All of this requires cooperation and coordinated efforts from people

who possess the human and material resources that the for-profit organisation needs to achieve its goals and objectives (Argandoña, 2008:441; Jones, 2007:4).

Goal attainment in a for-profit organisation is made more difficult because of the interdependence (and the related uncertainty and risks that this brings about) that defines the relationships among people within an organisational setting and with the stakeholders in their external environment (Mayer *et al.*, 1995:710; McEvily *et al.*, 2008:558, McKnight, Cummings & Chervany, 1998:474; McPhee & Zaug, 2001:581; Selznick, 1948:25, 26).

As a system, an organisation converts external inputs, such as resources, material and investments, into tangible outputs (i.e. products, services and profit) and less tangible outcomes (i.e. a corporate identity, culture, reputation and trust) via a throughput stage, which is comprised of the organisation's activities, operations and value-add (Gillespie & Dietz, 2009:130; Jones, 2007:2). This is done to achieve a particular goal.

Several system components can be found in the throughput stage, including leadership and management practices, policies and procedures, culture and climate, strategy and structure. In addition to these internal system components, external system components such as governance, stakeholders and the organisation's public reputation are also present (Jones, 2007:6). According to systems theory, these various components operate at multiple levels, and each component influences and is influenced in turn by activities in the other system components (Gillespie & Dietz, 2009:130). The process by which the different dimensions within the system influence each other is therefore indicative of systemic behaviour.

This process describes how corporate trust can be enabled and strengthened, how a for-profit organisation can *become* trustworthy and can be made to *be seen to be* (corporate reputation) a trustworthy, responsible corporate citizen by all its stakeholders (King, 2009:22) and how corporate trust is then an outcome of systemic behaviour.

This study argues that the presence of trust in a for-profit organisation presents a powerful mechanism that can help to manage and reduce the levels of complexity,

uncertainty and risk inherent in any social relationship. To this extent, trust is viewed as fulfilling a fundamentally functional role in social relationships within a corporate environment (Bachmann, 2006:394; Luhmann, 1979:8; Mishra, 1996:281; Nooteboom, 2002:5).

### **3.4.3 Benefits and limitations of the theory of an organisation as a system**

A study of organisational behaviour then entails a study of an organisation as a complex social system (Kramer, 1999:570; King *et al.*, 2010:294). Kast and Rosenzweig (1972:457) postulate that systems theory is vital to the study of social organisations since it presents a major new paradigm for this field of study, in that it provides a fundamentally different view of the reality of social organisations. However, these authors also note the current limitations of using systems theory in the study of social organisations, in particular the challenge to be precise in delineating system boundaries and system levels to avoid confusion about the actual 'system' that is being studied. For example, when referring to organisational behaviour, one needs to be clear whether the focus is on the behaviour of the organisation or on the behaviour of the individuals within the organisation (Kast & Rosenzweig, 1972:455).

Limitations aside, the significant contribution of general systems theory is that it provides a macro-paradigm for the study of social organisations. As Scott and others (in Kast & Rosenzweig, 1972:459) point out, the study of social organisations has also gone through a macro-micro-macro-cycle or sequence of emphasis, just like most sciences.

Traditional bureaucratic theory provided the first macro-view of organisations, where focus was placed on developing principles of management that could be applied to all organisations. This was followed by a period where more attention was paid to issues on the micro-level, with detailed analyses of the individual components or parts of the organisation. According to Kast and Rosenzweig (1972:459), the systems approach offers a return to the macro-level with a new paradigm, which emphasises a very high level of abstraction and allows scholars to focus on using this to move down a level of abstraction, to make their focus of study more concrete and enable them to concentrate on more explicit characteristics and relationships in social organisations.

### **3.5 CONCLUSION: SYSTEMS THEORY AS MACRO-THEORY**

Systems theory, particularly social systems theory, provides the macro-theoretical foundation for a study of organisational behaviour, and in particular for conceptualising trust in an organisational context. The various components of a system interact either in linear, functional or interdependent processes. While this study views an organisation and all its stakeholders as integral components of a social system, the key interaction process that is stressed involves more than just interdependency, and is extended to highlight the relationship perspective.

By looking at a for-profit organisation as a complex social system, a critically different view is offered of the reality that faces a commercial organisation. This view highlights that in order for the organisation to achieve its goal of sustaining its economic viability in the long term, it needs to acknowledge that it is totally dependent on other parts of the system (including its stakeholders), and needs to build and maintain positive relationships with its stakeholders to ensure that it remains a healthy, prosperous and sustainable system.

Since the organisation as a system can be positively or negatively influenced by its environment, it is held that the organisation should take careful note of how it interacts with its environment. As an open and socially designed system, the organisation is capable of interacting purposefully with its environment and as such it is also capable of adapting and transforming itself to manage how it interacts with, and therefore how it is influenced by, its environment. Thus the foundation is laid to conceptualise the importance of and need for trust and trustworthiness in a corporate environment.

## **4 THEORETICAL FOUNDATION FOR THE CORPORATE CONSTRUCT**

### **4.1 OVERVIEW OF THE CORPORATE CONSTRUCT DISCUSSION**

The second theoretical framework provided in this study is for the corporate construct, and this is presented by using the theory of organisations as basis for the discussion. This includes a brief overview of the bureaucratic organisation, as well as of one of the

early mid-twentieth century views regarding the theory of organisations. The views of these early organisational theorists are stressed, since they had a broader social and political perspective on commercial organisations, and therefore a clear link can be made between their views on organisations and the conceptualisation of corporate trust and sustainability as posited in this study.

This is followed by a brief overview of the theory of organisation's views that became prominent during the 1970s and 1980s, which had a more instrumental, resource-dependent focus on the organisation-environment tradition. This is done to draw attention to the shift that occurred during this time, where the theory of organisations became disconnected from broader societal issues. The subtle resurgence of these issues from the 1990s onwards (Lounsbury & Ventresca, 2003:458,459) is then noted, and this overview concludes with an introduction of the new structuralism model that emerged in the theory of organisations from the 1990s. Thought is given to the re-establishment of the attention that the early theorists paid to the influence of broader societal issues within a for-profit organisation's operations, and to the ensuing new economic sociological model which placed a strong focus on the role of values, ethics, cultural processes and meaning systems in reshaping the social structure.

The organising process theory, as a particular approach to the theory of organisations, is presented to position an organisation as being dynamic and capable of being changed by the actions of its members, which are driven by the values that underpin their decisions and sense-making. This in turn allows members to construct the reality facing the organisation as well as interpret and respond to that reality. With this, the link with corporate trust will be made.

## **4.2 INTRODUCTION: THEORY OF ORGANISATIONS**

Karl Emil Maximilian 'Max' Weber (1864-1920), a German sociologist and political economist, arguably the foremost social theorist of the twentieth century (Kim, 2008), is regarded as one of the founding fathers of the theory of organisations. With his insights into the functioning of bureaucracy as a dominant administrative system that emerged with capitalism, Weber contributed significantly albeit inadvertently to the origination and



development of the theory of organisations (Clegg, 1994:149; Lounsbury & Carberry, 2005:503; McPhee & Zaug, 2001:576; Perrow, 2000:470).

Weber maintained that rational capitalism can only exist on condition that enterprises are organised as dependable and predictable bureaucracies (Swedberg & Agevall, 2005:20). Although Weber's views on the origins of Western rationalism, capitalism and bureaucracy had been published since very early in the twentieth century, it was only when his works were translated into English in the late 1940s that "... interest in bureaucracy, bureaucratization, its sources, and consequences for behaviour in organizations" was revived and gave rise to a number of studies in the theory of organisations, such as that of Phillip Selznick (Lounsbury & Carberry, 2005:503). A brief overview is first given of Weber's theory and concepts of bureaucracy, before Selznick's contribution (1948) is discussed as link to the modern-day theory of organisations and the focus of this study.

### **4.3 THEORY OF BUREAUCRACY/ORGANISATION: EARLY THEORISTS**

#### **4.3.1 The bureaucratic organisation as a rational structure**

Two key Weberian concepts that helped to originate the theory of organisations are rationalisation and bureaucracy (Weber, 1946:155). Weber regarded the process of rationalisation as the central process in the development of bureaucracy (Gerth & Mills, 1946:50; Lounsbury & Carberry, 2005:503; McPhee & Zaug, 2001:576).

Weber's conceptualisation of rationalisation was based on a world view in which "... one can, in principle, master all things by calculation" (Kim, 2008). Weber portrayed bureaucracy as essentially being a rational structure of domination (Lounsbury & Carberry, 2005:504; McPhee & Zaug, 2001:576; Weber, 1946:198).

According to Weber (1946:196-198), an ideal type of bureaucracy is characterised by the following six features: it covers a fixed area of activity which is governed by formal rules; it is organised as a hierarchy with a clear chain of command; its actions are undertaken based on written documentation, which is preserved as files; it requires

some expert training; its officials need to devote their full activity to their work; and the management of the office (or 'bureau') follows general rules which can be learnt (Swedberg & Agevall, 2005:19). Weber's view of bureaucracy and capitalism can then best be depicted as a rational mode of economic life because it depends on a calculable process of production (Kim, 2008; Weber, 1946:214-215).

Weber's conceptualisation of a professional bureaucracy based on rational action highlighted the main benefit to the management of the organisation, namely the element of predictability due to increased knowledge and control (Swedberg & Agevall, 2005:20; Weber, 1946:214-215). To act rationally is to act on the basis of conscious reflection about the likely consequences of action. Rational action then presumes some knowledge of the ideational and physical circumstances in which the action is embedded. The knowledge that underpins a rational action is "... of a causal nature conceived in terms of means-ends relationships aspiring towards a systematic, logically interconnected whole" (Kim, 2008).

However, Weber also highlighted the detrimental result of bureaucracy. He observed that, since this process operated on the basis of systematic formal codes and the principle of *sine ira et studio*, that is, 'without regard to person' or 'without anger or bias', bureaucratic management increased impersonality and led to a dehumanising structure (Kim, 2008; Madsen, 2008; Swedberg & Agevall, 2005:20; Weber, 1946:215-216,334). DiMaggio and Powell (1983:147) also note that Weber warned in *The Protestant Ethic and the Spirit of Capitalism* that "... the rationalist order had become an iron cage in which humanity was, save for the possibility of prophetic revival, imprisoned 'perhaps until the last ton of fossilized coal is burnt'".

Weber's main contributions to the development of the theory of organisations include his conceptualisation of bureaucracy and his emphasis on authority, domination, power and conflict within the organisation. Based on his typology of administrative systems, he described three main types of legitimate domination or authority – rational-legal, traditional and charismatic authority (Weber, 1946:295-299). He held that rational-legal authority was rooted in a belief in legal codes that justified normative rule patterns and

the right of those in authority to issue commands under those rules (Lounsbury & Carberry, 2005:504; Weber, 1946:299).

Weber maintained that bureaucracy was an extremely efficient system of administration, particularly because it moved from the traditional to a rational-legal form of authority, thus enabling the reduction of organisational uncertainty (McPhee & Zaug, 2001:577; Oliver, 1991:147; Weber, 1946:214). The concept of organisational uncertainty rests on the dependency of the organisation on the individual worker, and the reduction of this dependency then relies on the ability of an organisation to make itself less dependent on the personal knowledge and skills of an individual, by for example displacing knowledge from the worker to the organisation (McPhee & Zaug, 2001:576; Selznick, 1948:25; Weber, 1946:215).

According to Weber (1946:215-216), this reduction of uncertainty is made possible partly because the activities of everyone in the organisation are oriented towards complying with a legal norm or system of abstract rules established by the leadership, and partly because of the division of labour principle, where each member has a position in the hierarchy of the organisation, as well as a specific task and sphere of legal competence within which he/she has to perform his/her tasks. This arrangement then allows for maximum predictability and the reduction of organisational uncertainty (McPhee & Zaug, 2001:577).

However, despite his focus on rational action and predictability, Weber also highlighted the complex connections that exist between an organisation and its environment, typified by social and political issues (Lounsbury & Carberry, 2005:502; Weber, 1946:228-235).

#### **4.3.2 Early foundations of the theory of organisations**

Phillip Selznick's work (1948) serves as an example of the developing views during the early stages of the theory of organisations, and many of the viewpoints raised in his work more than five decades ago still hold considerable appeal today, particularly for this study's conceptualisation of corporate trust.

With his definition of an organisation as “... *a system of consciously coordinated activities or forces of two or more persons*”, Selznick (1948:25) builds on Weber’s concept of rationalisation, by regarding a formal organisation as the structural expression of rational action. By this, he is referring to the systematic patterns of coordination of positions and duties, made feasible through defining the chain of command, establishing authority and constantly expanding formal mechanisms of coordination and control, in order to mobilise the technical and managerial skills required to achieve the agreed purpose of the organisation.

However, while he supports the conceptualisation of the commercial organisation as a rational structure, Selznick highlights the undeniable element of non-rational behaviour in an organisation. He argues that a formal organisation can never only be an almost mechanical arrangement and acceptance of organisational objectives, expectations and values, mainly for two key reasons. The first is because an organisation is made up of individuals who interact with one another and the organisation as ‘wholes’ – as emotional, non-rational individuals with their own sets of beliefs, values, habits, dreams, goals and commitments, and not merely in terms of their formal roles and functions in the system. The second reason is because the formal system itself, as well as the social structure within which it finds itself, are both subject to the pressure of an institutional environment to which some overall adjustment and modification must be made (Selznick, 1948:25,26; Scott, 1987:494).

Selznick distinguishes two views of a formal, concrete organisation, which are rationally distinct but empirically united in a context of shared consequences, namely to view it both as an economy and as an adaptive social structure at the same time (Selznick, 1948:25; Scott, 1987:494). As an economy, an organisation is conceptualised as a rational structure, as a system of relationships in which the availability of scarce resources is refined and manipulated in terms of efficiency and effectiveness.

However, Selznick reasons that an organisation is a social structure as well, one which is conditioned and influenced by the animated state of the real or actual structure, outside the systematics of delegation and control in the formal structure (Selznick, 1948:26). This means that, even in formal authoritarian organisations, control depends

on the extent to which the individuals in the system can be persuaded or encouraged to participate. It is this need for the consent of the workers which makes an organisation more than just a mechanical, rational structure that can be operated only on the basis of authority and control, but rather a social, adaptive structure that needs to react and adapt to influences from its external environment (Selznick, 1948:28).

With his conceptualisation of a formal organisation as a cooperative system, described as being “... *constituted of individuals interacting as wholes in relation to a formal system of coordination*”, Selznick widens the general frame of reference within which the manipulation of organisational resources could be examined.

According to Selznick (1948:28), this means that the ‘real’ structure of an organisation is a consequence of the mutual and reciprocal influences of the formal and informal relationships, and a result of the organisation’s reactions and adaptations to influences from its external environment. Selznick (1948:29) uses structural-functional analysis as a method of enquiry, defined as *a method that “... relates contemporary and variable behavior to a presumptively stable system of needs and mechanisms”*.

Selznick (1948:29) argues that the maintenance and continuity – the very *survival* – of a formal organisational system is dependent on the following: paying heed to social forces in the organisation’s environment, ensuring stable lines of authority and communication, acknowledging the power of informal relationships, ensuring continuity in policy and direction setting and cultivating a homogenous understanding of the organisation’s role and values.

Selznick’s description of the method of structural-functional analysis reflects the requirements and stable system generally characteristic of formal organisations. These imperatives, derived from the needs of the organisation, represent the conditions for survival or self-maintenance of cooperative systems of organised action (Selznick, 1948:30; Scott, 1987:494).

The concept of organisational need focuses analysis on “... the internal relevance of organizational behavior” (Selznick, 1948:30). Here reference is made in particular to the

discretionary action undertaken by employees in their pursuit of formal organisational goals, and their need to weigh specific actions in terms of their consequences for the stability and survival of the organisation. Selznick highlights that 'internal relevance' does not mean that the action needs to be only internally oriented, it should most likely also be externally oriented and inspected for its relevance to internal conditions.

Selznick (1948:31) introduces the concept of commitment or involvement as being fundamental to organisational analysis. He describes this concept as reflecting an inherent and profound "... dilemma in human behavior (represented) by an inescapable commitment which cannot be reconciled with the needs of the organism or the social system" (Selznick, 1948:31).

Applying this to organisations, Selznick (1948:32) notes that there is an observable tension in the split between the "... motion and the act", in that where there may be freedom of technical or ideal choice in the plan of action, the actual action is held captive by the individuals' own sense of involvement and commitment, which effectively tempers the initial plan. In the relationship between need and commitment, the "... latter not only qualifies the former but unites with it to produce a continuous state of tension" (Selznick, 1948:32). The concept of recalcitrance is used to describe the quality of the tools of social action, and to define the environment in which organised action takes place as *one that is marked by an ongoing battle between constraint, commitment and tension, rather than just one that is defined by the need to adjust.*

Selznick (1948:31) notes that "... an economic order committed to profit as its sustaining incentive may, in Marxist terms, sow the seed of its own destruction". The implication here is that a for-profit organisation that simply expects of its employees only to 'adjust', to remain singularly focused on increasing profits, without taking into account that this organisational need may create situations of conflict and tension for the employees when they are called on to act in a way that may achieve the profit objective, but conflicts with their own belief or value systems. In their review of Weber's influence on the theory of organisations, McPhee and Zaugg (2001:578) also note that, while the effects of the bureaucratic concept of rational action lead to narrowing organisational

goals and minimising ambivalence, it also leads to delegitimising alternative or incompatible goals.

A profit-making organisation, which monomaniacally pursues maximisation of monetary profit, will therefore ignore alternative organisational goals, such as considering and meeting stakeholders' expectations. The description of the inadvertent outcome of such a single-minded pursuit of profit at the expense of everything and everyone else is even more ominous today than the one Selznick described over five decades ago. McPhee and Zaugg (2001:578) note that analysts from a wide range of interest areas (e.g. political, economic, environmental, philosophical) "... argue forcefully that this dynamic is now threatening the entire planet", not only the future of an individual economic order.

#### **4.3.3 A connection with societal issues: early theorists**

Weber and Selznick as two early proponents of the theory of organisations premised their views of commercial organisations within a broader political and societal structure and incorporated the impact this had on both the organisation and society into their theoretical frameworks (Lounsbury & Ventresca, 2003:459; Selznick 1948:25,34). Weber situated his views of organisational processes within a broader framework of political economy, emphasising aspects of social structure such as power, domination, authority and legitimacy. However, while he emphasised the positive outcomes of bureaucracy, Weber was also disturbed by the power and the dehumanising nature of bureaucracies (Lounsbury & Carberry, 2005:459,505).

The importance of the societal context within which an organisation operates and the critical role that values play in an economic organisation were also key premises in the work of Selznick, who observed that it is imperative for an organisation to appreciate that it exists as a whole in relation to social forces in its environment, if it wants to maintain itself as a system and so ensure its survival (Selznick, 1948:29; Scott, 1987:494). Selznick defined social power as "... *subjective and objective factors which control the loyalties and potential manipulability of the community*", and noted that an organisation's "... continued existence is threatened" when it is disconnected from sources of social power (Selznick, 1948:35).

According to Selznick, social order is fundamentally based on a shared social reality, which in turn is a human construction, created in social interaction (Scott, 1987:494). Selznick (1948:30) held that one of the key mechanisms that a commercial organisation could employ to ensure its survival or self-maintenance as a cooperative system of organised actions, is the need to create a homogenous outlook – a shared reality – with respect to the character of the organisation; its meaning and role and the underlying values that drive and form the organisation’s character.

#### **4.3.4 Key implications of these early theorists for this study**

A brief overview of selected key implications that some of the concepts of Weber’s theory of bureaucracy and Selznick’s view of the theory of organisations proffer to the focus of this study is highlighted next, to contextualise the value of these views for the conceptualisation of corporate trust. This also serves to position the discussion that follows on the disconnection from the social element that took place in the study of organisational behaviour and performance in the latter part of the twentieth century.

- ***Creating an authentic mutually shared value system***

When Weber conceptualised domination in a bureaucracy as requiring a shared belief system between and among those in authority and their followers, he may have had in mind only the need for the leadership to institutionalise (i.e. to create a common or shared understanding of) the rules and norms that employees had to adhere to with the intent to structure the interactions and stabilise and govern the relationship (Lounsbury & Carberry, 2005:504). With his conceptualisation of the tension created between need and behaviour due to differences in levels of commitment and involvement, Selznick (1948:32) takes Weber’s conceptualisation further than just the level of rules and norms, and incorporates the role of the internal value and belief systems of employees – as emotional, non-rational individuals with their own sets of beliefs, values, habits, dreams, goals and commitments – in their organised action to meet the organisation’s needs.

This study expands Selznick’s concept further to highlight the need for organisations to create an *authentic* mutually shared value system, which unequivocally incorporates and accommodates employees’ individual values and beliefs. It is maintained that the



sustainability of a for-profit organisation is among others dependent on such a shared value system, one that will enable employees to uncompromisingly associate their own system of values and beliefs with that of the organisation, and will empower them to co-create the organisation's identity. It is posited here that this requirement is also of significance to the external environment. Stakeholders also need to fully understand the mandate, identity, character, meaning and intentions of an organisation, in order to be able to judge how effectively it is behaving in accordance with its promised behaviour.

- ***Co-creation of an organisation's character***

Another viewpoint that this researcher expands on from the early theory of organisations, is one that relates to Selznick's view that the leadership needs to ensure that the employees are made to understand what they are supposed to do and how they should behave while fulfilling their duties, to enable them not to violate the essential character of the organisation.

While the need for effective communication and the creation of a shared vision of the character and role of the for-profit organisation is undeniably supported, the expounded view of this study is that the employees are part of creating the character and meaning of the organisation through their everyday behaviour – they are not merely actors who only need to adhere to the character of the organisation as set by the leadership.

This presupposes that the principle of *sine ira et studio*, meaning 'without regard to person' (Kim, 2008; Swedberg & Agevall, 2005:20; Weber, 1946:215-216, 334), which characterised bureaucratic management and increased impersonality and dehumanised the employee as an individual, needs to be revised. The principle of regarding the employee in his totality as a social being and an individual within his role in a modern-day for-profit organisation then needs to be not only accepted, but embraced. This study also posits that the focus of the theory of organisations needs to be expanded to include the role that both the employees and the stakeholders play in co-creating an organisational character (Argandoña, 2008:441; McPhee & Zaug, 2001:585). The desired identity, character and culture, as set forth by the leadership, should therefore be one that employees and stakeholders can, and will want to, fully associate with, participating in its creation and maintenance.

- ***Reducing uncertainty by accepting complete dependency***

Weber and Selznick held that the way in which organisational uncertainty can be reduced, is for the organisation to make itself less dependent on the personal knowledge and skills of an individual (Selznick, 1948:25). Contrary to this, this researcher's view is that the reduction of uncertainty (Oliver, 1991:147) relies on the organisation's acknowledgement and acceptance of its *complete* dependency on its employees and stakeholders.

This implies that leadership should endeavour, and be able, to harness the personal knowledge and skills of the individual employees to co-create and endorse the culture and goals of the organisation, as well as to build a trust relationship with its key stakeholders in order to secure their support. This view is grounded in Selznick's argument that control depends on the extent to which the individuals in the system can be persuaded or encouraged to participate in organisational goals (Selznick, 1948:26).

Nurturing an authentic trust relationship to secure the support of stakeholders will in turn minimise constraints and maximise commitment from both employees and stakeholders, and so aid in securing the longer-term advancement and survival of the organisation.

- ***Creating a cooperative internal and external environment***

Another extended view asserted in this study is that a for-profit organisation that sets as its basic focus the need to behave in a transparent, ethical and trustworthy manner in its quest to attain sustainable economic growth, albeit in the longer term, will be able to create a cooperative internal and external environment – one that is characterised by fundamentally shared values, goals and expectations.

As a basis for this belief, Selznick's (1948:28) argument that the 'real' structure of an organisation is a consequence of the mutual and reciprocal influences of the formal and informal relationships and aspects of organisation, as well as a result of the organisation's reactions and adaptations to influences from its external environment, is used. This view from Selznick still has merit in today's organisational environment as well as for the focus of this study in particular, in that it provides the basis for examining

how the ‘real’ structure of a for-profit organisation (as a trustworthy and sustainable organisation) can be established, maintained and measured.

#### **4.3.5 Closing remarks on early organisational theorists**

These views of Weber and Selznick as early adherents of the theory of organisations offer a profound lens through which organisational analysis can be explored, one that is extremely pertinent to the focus of this study, since it contextualises the economy as being “... embedded in and shaped by society – that is, by social relations, culture, and history’s path-dependent processes” (Perrow, 2000:474).

Unfortunately, this early sociological framework, which more than adequately provided for the dynamism involved both within and between a commercial organisation and its social, political and cultural environment, was increasingly abandoned by the organisational theorists who followed, and who informed the views on the theory of organisations in the latter part of the twentieth century. However, the challenges facing for-profit organisations in the twenty-first century demand a reinstatement of a sociological organisational management framework that incorporates the role of contemporary social, political and cultural change and its impact on organisations (Lounsbury & Carberry, 2005:513,516).

Today’s post-modern society has to contend with contemporary transformative issues such as the social movements around globalisation, the rise of the stakeholder view, the crises of advanced capitalism and the impact of technology on social organisation (Lounsbury & Carberry, 2005:515; Wood, 2002:62). Any for-profit organisation that continues to act as if it is an entity that does not form an integral part of this society, and does not purposefully work at earning its place and right to operate in society by being a trustworthy corporate citizen, is risking its own economic survival.

#### **4.4 LATE TWENTIETH-CENTURY VIEWS ON THE THEORY OF ORGANISATIONS**

The purpose of this discussion is not to provide an in-depth overview of the development of this theory, but merely to highlight the shift that occurred in the theory of

organisations, from the early bureaucracy and organisation studies of the mid-twentieth century, which included a broader political and social perspective on organisations, to the operational and resource-dependent focus of the organisation-environment tradition in the latter part of the twentieth century. This shift shows the disconnection between the theory of organisations and broader societal issues which occurred from the 1970s, and the reemergence of these issues from the 1990s onwards (Dacin, Goodstein & Scott, 2002:45-47; De la luz Fernández-Alles & Valle-Cabrera, 2006:503-504; Lounsbury & Ventresca, 2003:458,459,501; Oliver, 1991:145; Scott, 2008:427-432; Selznick, 1996:270-273).

#### **4.4.1 A disconnection with societal issues: 1970s-1980s**

Following the connection that the early theorists of organisational analysis established with societal issues in the mid-twentieth century, a review of the development of theory in the latter part of the twentieth century indicates that this theoretical framework became increasingly disconnected from the role of organisations in society during this period (Lounsbury & Carberry, 2005:513; Lounsbury & Ventresca, 2003:458; Perrow, 2000:471).

During the 1970s and 1980s, organisational analysis became progressively fixated on the internal affairs of an organisation, particularly on productivity and efficiency, directed at assisting organisations to achieve their goals and objectives faster and better (Lounsbury & Carberry, 2005:514; Lounsbury & Ventresca, 2003:460; Narayanan & Nath, 1993:162; Perrow, 2000:470). This set of theoretical arguments triggered a return to conceptualising inter-organisational relations as highly rationalistic and instrumental (De la luz Fernández-Alles & Valle-Cabrera, 2006:504; Lounsbury & Ventresca, 2003:458).

From a systems perspective, it can be argued that an organisation was increasingly seen as a closed system during this period, since the focus was mainly related to the internal workings of an organisation, instead of acknowledging the openness of an organisation as a social system, which affects and is affected by the environment in which it exists (Narayanan & Nath, 1993:162). During this period less attention was

being paid, in both theoretical and empirical work, to wider societal patterns and the distribution of resources. The insight that the legitimate and sanctioned materials that are being provided by the environments "... comprise particular elements, ideologies and rationales [that are] contingent, time-dependent, and potentially in conflict one with another" was generally neglected (Lounsbury & Ventresca, 2003:463). Concurrently during this time "... attention to social structure became narrowly transformed into a more sterile conception of organizational environment as an abstract, exogenous force that constrained organizational behavior" (Lounsbury & Ventresca, 2003:461).

The focus during this time also shifted towards studying principally for-profit organisations. Organisational scholars started concentrating primarily on exploring and finding the most efficient organisational practices which would enable the achievement of an increasingly singular goal for these business organisations, namely more profits in a shorter time frame (Lounsbury & Ventresca, 2003:460-461; Perrow, 2000:470).

This change in focus brought about a disconnection, related to social issues and change, in organisational studies – a disconnection between the organisation and the social impact it had, its social consequences "... as the externalities born by workers and communities, the stratification system, and the concentration of wealth and power" (Lounsbury & Ventresca, 2003:458; Perrow, 2000:471). Organisational scholars lost touch with the position of organisations in society and the persistence of systems of power both within and outside organisations (Lounsbury & Carberry, 2005:514; Selznick, 1996:272). Instead, the power of capital markets and the shareholder view meant that "... the activities and meaning of organizations have been reduced to their financial statements" (Lounsbury & Carberry, 2005:516).

In the latter part of the twentieth century organisational theory, organisations and their environments were narrowly conceptualised, with very little consideration being given to cultural processes and meaning systems (Lounsbury & Ventresca, 2003:458). In 1996, Selznick (1996:272-273) referred to the then current view of organisational theory and its rational-actor models as 'shortsighted'. This intellectual shift that occurred in the development of organisational theory is also evidenced in the review of Lounsbury and Carberry (2005) of the development of the theory of organisations since the mid-

twentieth century. Based on their comprehensive citation analysis of Max Weber in scholarly articles in *Administrative Science Quarterly* (ASQ) from 1956 to 2002, Lounsbury and Carberry (2005:513) observe a steady decline in the percentage of articles citing Weber in ASQ since its peak (36.5%) in 1961 to its lowest point (6.8%) in 1991, followed by a modest increase up to 15% by 2002.

However, the more pertinent findings of these authors emanate from their in-depth content analysis of the text containing and relating to the citation of Weber, demonstrating that in the early years (1956-1970) articles related to intra-organisational and social organisation streams dominated, with the latter already reaching its peak during the early 1960s (Lounsbury & Carberry, 2005:511), but that articles during the period 1970-1989 became more disconnected from the Weberian theme of the interaction between an organisation and its social, political and cultural environment (Lounsbury & Carberry, 2005:513).

- ***A possible rationale for the disconnection from societal issues***

One probable rationale that can be offered to explain this shift is the rise of business schools in the late 1950s and 1960s, which decisively shaped the field and became the dominant site for the discourse and development of the theory of organisations (Lounsbury & Ventresca, 2003:461; Perrow, 2000:471). With foundation grants provided to study business organisations, scholars from the social sciences discipline migrated to professional business schools, and were initially responsible for directing these studies until the business schools were large enough to grow their own faculty.

Perrow (2000:471) observes that while these scholars would most probably have initially brought with them the larger social concerns and critical perspectives on organisations stemming from their discipline, their assignment to train future managers in the classroom significantly influenced their future research and writings to deal with the problems their charges were facing within their organisations. Lounsbury and Ventresca (2003:461) note that the study of how organisations in the 1970s related to broader social structures became a neglected topic, derided as archaic by mainstream organisational researchers who valued the development of knowledge about strategy and performance instead.

The emergent market of MBA students whose research needed to be judged in publications led to more specialised journals and publishers being established to meet the demand, which led to specialised fields being developed in business schools, particularly in the 1970s and 1980s. The research being done in the business schools then increasingly became “... narrowly oriented research in the idiom of normal science” (Lounsbury & Ventresca, 2003:462), in that the research was directed by middle managers in organisations, who would support the MBA students with their research financially or by granting them privileged access to data and personnel, based on an expectation to get research projects that dealt with their real-time needs and problems in their organisations in return (Perrow, 2000:472).

Consequently, the theory of organisations during this period materialised as a management sub-field, which conceptualised social structure and organisations progressively as being instrumental, driven by functional imperatives. This reinforced a conception of organisations as “... goal-driven unitary entities interlocked in concrete exchange relations” (Lounsbury & Ventresca, 2003:463). However, as Perrow (2000:473) points out, while this change in focus can partly be explained by the growth of business schools, it can also be explained by the lack of contribution to organisational theory from social scholars.

Since the 1950s, the social movements focused more on sentiment and solidarity, on ‘hearts and minds’, and displayed a gross insensitivity to the role of organisations (Perrow, 2000:472). This led to a view that social issues such as power, inequality and poverty had nothing to do with the free market system, since it did not meet the “... causal primacy of efficiency or narrow self-interest” that characterised the organisational scope at the time (Lounsbury & Ventresca, 2003:458). These social issues were regarded as falling outside the challenges that organisations had to contend with at the time (Perrow, 2000:473).

#### **4.4.2 A reconnection with societal issues: 1990 onwards**

From the 1990s onwards a gradual reconnection to societal issues in the study of organisations can be observed (Lounsbury & Carberry, 2005:513). In their citation

analysis of Weber in ASQ for the period 1956 to 2002, Lounsbury and Carberry (2005:513) found that there had been a moderate growth in articles that reconnected with the "... broad intellectual legacy left by Weber and his concerns with authority, domination, and situated socio-historical analysis" between 1993 and 2002.

In many of the organisational studies in the early twenty-first century intra-organisational and organisation-environment research has begun to shift towards the social organisation tradition, developing richer analyses of fields that consider culture and social organisations (Lounsbury & Carberry, 2005:513), and that consider the role of meaning systems as well as the everyday social practice that "... support and can contribute to the reshaping of social structure" (Lounsbury & Ventresca, 2003:458). This reconnection with broader societal issues can be seen as largely driven by the changes that have been, and continue to be, taking place in society at the start of the twenty-first century.

From a systems perspective, it is argued that this reconnection represented a return to the view of an organisation as an open social system, which holds that the primary goal of an organisation as a system, which both affects and is affected by the environment in which it exists, is the quality of its relationship with its stakeholders and its ability to adapt to its social environment to ensure its survival (Gioia, Schultz & Corley, 2000a:64; King & Whetten, 2008:192; King *et al.*, 2010:294).

In line with this reconnection with societal issues, organisational scholars increasingly started focusing on the concept of effectiveness (doing the relevant and appropriate things to ensure survival) rather than on efficiency. "Efficiency pertains to doing things right, whereas effectiveness pertains to doing the right things." (Narayanan & Nath, 1993:162).

This researcher agrees that the focus should be placed on effectiveness, rather than on efficiency. In a similar vein, this study concurs with Marsden and Andriof's (1998:338) contention that doing the profitable thing need not be separated from doing the right thing: "Understanding what is the right thing [read 'effective'] and having the integrity and moral courage to do it when it appears to conflict with other business objectives is



vitally important. It is simply so much easier to achieve when it can also be shown to support the *sustainable* [own emphasis] pursuit of profits which, it is argued, will increasingly depend on ecologically sound resource stewardship and a reputation for fair dealing with all stakeholders.”

The rise of the stakeholder view and concept of responsible corporate citizenship, the power of ordinary citizens to mobilise themselves *en masse*, using modern technology, and to act against organisations that they feel are contravening their powers and who are not doing the ‘right’ things, as well as the existent view that organisational action is fundamentally shaped by broader social and cultural processes (Lounsbury & Ventresca, 2003:458,515; Marsden & Andriof, 1998:332), are all significant contributors to driving the reconceptualisation of the role and responsibility of a for-profit organisation as a social system in today’s post-industrial society.

#### **4.5 NEW STRUCTURALISM, ECONOMIC SOCIOLOGY AND LINK TO TRUST**

The field of organisational theory started witnessing a dramatic change at the turn of the twentieth century, as its scholars started reconnecting organisational analysis with societal issues, thus bringing ‘society’ back to centre stage (De la Luz Fernández-Alles & Valle-Cabrera, 2006:503; Lounsbury & Ventresca, 2003:459). This led to a new form of structuralism, one that derives insight from the social structural tradition in sociology, and extends that tradition by conceptualising social structure as encompassing cultural rules, meaning systems and material resources (Lounsbury & Ventresca, 2003:457).

##### **4.5.1 Culture and institutional logics in new structuralism**

The new structuralism concept regards a cultural system as being structured as the summation of the various activities that individuals are obliged to engage with as they undertake and resolve the routine events and challenges they have to face on a daily basis. New structuralism theorists focus their attention on “... ontological problems having to do with how conceptions of reality are rooted in broader social and historical processes that operate beyond the direct consciousness of actors but are visibly instantiated in daily activities” (Lounsbury & Ventresca, 2003:464). This infers that focus

is now placed on exploring and examining the rules – the logics – which constitute the interests of actors and thus shape cognition and action.

Within the new structuralism framework, institutional logics then represent the patterns of sense-making and activity that develop within an organisation, patterns that are formed as a result of individuals' actions to make sense of and meaningfully organise their environment. Institutional logics comprises the rules or processes individuals use to guide their actions, rules that are based on what is meaningful to them within a broader social context, and not necessarily on a rational means-end basis (unless it is appropriate), and which therefore become the established, instinctive conditions of social action (Lounsbury & Ventresca, 2003:465).

Kramer (2010:87) refers to this as 'rule-based trust', described as "... *a set of formal and informal understandings that govern how individuals within the organization interact*", which "... becomes a potent form of an expectational asset that facilitates more spontaneous cooperation among organizational members" (Kramer, 2010:89). This is because trust becomes internalised at the micro-organisational level by institutionalising trust and trustworthiness through rule-based practices at the macro-organisational level, which results in a shared common knowledge in the ability of the role players in the organisation to reach cooperative outcomes.

#### **4.5.2 Institutionalised values, norms and beliefs direct organisational action**

Institutional logics is then equal to the concept of institutionalism, which can be defined as "... *the emergence of orderly, stable, socially integrating patterns out of unstable, loosely organized, or narrowly technical activities*" (Selznick, 1996:271). This definition therefore refers to the enduring and fixed character that beliefs, values, norms, behaviours or ways of thinking develop over time, when these social arrangements take on a rule-like quality and become institutionalised (Lammers & Barbour, 2006:358).

In the same vein, Hauriou (in Lammers & Barbour, 2006:358) regards shared and highly valued ideas as the underlying laws that direct actions in an organisation, ideas which in time become institutionalised. Commons (1950) views institutionalised ideas or values

as 'working rules' within an organisation (Lammers & Barbour, 2006:358). This view is reminiscent of Weber's distinction between formal rationality (a means-end calculation) and substantive rationality (a focus on how social action is shaped by ultimate values) (Lounsbury & Carberry, 2005:516-517). Institutional rules, such as who the actors are in the organisation, what interests and actions are regarded as appropriate and what means can be used to pursue those interests, are then products of socially constructed rules (Lounsbury & Ventresca, 2003:470; McPhee & Zaug, 2001:582).

It is therefore posited that it is the social structure of an organisation that shapes the behaviour of the organisation and its representatives and that also mediates the effects of its resources (Lounsbury & Ventresca, 2003:463; McPhee & Zaug, 2001:585).

#### **4.5.3 New economic sociology**

The new structuralism model that emerged in the theory of organisations from the 1990s then re-established the attention that early theorists had paid to the influence of broader societal issues within a commercial organisation's operations, and which placed a prominent focus on the role of cultural processes and meaning systems in reshaping the social structure (Lounsbury & Carberry, 2005:518; Lounsbury & Ventresca, 2003:457). With this, Weber's original concept of economic sociology (examining economic activities within a social context) is revived and further refined.

This brings about a new economic model, which emphatically recognises that the economy is embedded in and shaped by society (Perrow, 2000:474). This new sociological systems model enables a more insightful connection to be made between systems of authority inside of organisations, and broader structures of power and privilege within society, as well as the complex ways in which such systems and structures are legitimated (Lounsbury & Carberry, 2005:519).

The reconnection with social issues in the theory of organisations re-establishes the focus of examining the rational actor of economic theory and the socially constructed nature of reality (Lounsbury & Carberry, 2005:518). This then places a pertinent focus

on the role that values, ethics and trust fulfil in a for-profit organisation (Argandoña, 2008:439; Fukuyama, 1995:27; Hosmer, 1995:386; McPhee & Zaug, 2001:583).

#### **4.5.4 Organising process theory tradition**

Instead of viewing an organisation as a “... fixed and finished product handed down by a rational designer” (McPhee & Zaug, 2001:582), scholars from the organising process theory tradition then started looking at an organisation as being dynamic, constantly in flux and being changed by the actions of its members, actions that are informed by the manner in which they make sense of their environment and the values they adhere to when making their decisions (McPhee & Zaug, 2001:585).

One group of theorists in this tradition focused on “... the emergence of order, action, and meaning in processes of organizational interaction”. In this view, the organisation is seen as being shaped by the social-interactive routines used by its members to cope with the uncertainty that confronts the organisation, and in doing so they construct the reality facing the organisation as well as the interpretation of and a response to that reality (Lounsbury & Ventresca, 2003:463; McPhee & Zaug, 2001:582). The members of any organisation are constantly assailed with ambiguous demands and incomplete information, which makes it difficult for them to clearly know with absolute certainty what they need to do to perform their duties, and exactly how they need to do it (McPhee & Zaug, 2001:579). This is particularly true in today’s post-modern organisations, characterised by information overload, increasing pressures and stakeholder demands.

The organising process theory, as an approach to the theory of organisations, submits that more information and rules will not be an effective manner in which to assist these employees to reduce the uncertainty in their environment. Rather, the proposition is that employees need “... values, priorities, and preferences” that will help them clarify which tasks and projects matter, and guide them on how to behave. Sense-making is held to be grounded in identity construction, which means that when employees need to start making sense of an organisational problem or a task, they will start the sense-making process from the basis of what the organisation says it is (Fenton & Langley, 2011:

1171,1180) and use that as an “... extracted cue around which [they] assemble an interpretation” (Weick in McPhee & Zaug, 2001:584).

This view firmly places the need to institutionalise values and norms, defined here as a *generally agreed-upon standard for behaviour* (Jones, 2007:103), at the centre of a for-profit organisation’s strategy, if it wants to ensure its long-term economic success in a sustainable manner. Since an organisation’s institutional rules guide the behaviour of its representatives and employees, a system of value logics that has been institutionalised will enable the actors of the organisation to choose the most appropriate means to achieve an end – one that does not violate the values of the organisation.

#### **4.6 CONCLUSION: THEORETICAL BASIS FOR CORPORATE CONSTRUCT**

In providing an overview of the development of the theory of organisations, an attempt was made to conceptualise the corporate construct as it relates to the conceptualisation of trust within a corporate context by this study. The overview of the development of the theory of organisations, from its foundations in the bureaucracy school to the new economic sociological view that is pertinent today, has provided insight into the changing views of how a commercial organisation is seen to operate and what it needs to do to ensure its goal of sustaining its own economic viability.

This overview has highlighted that a commercial organisation is not a rational entity that is in total control of its destiny and can operate in a vacuum, but rather a complex social system that is totally dependent on its environment, on its internal and external stakeholders, and one that therefore needs to consider how it interacts with its environment. Secondly, it has shown that the initial understanding of a commercial organisation operating as part of a bigger social system, which had been replaced with more functional, inward-looking and short-term profit-seeking views of organisations in the latter part of the twentieth century, is becoming prevalent again in the twenty-first century. However, it has also emphasised that the social post-modern environment that the for-profit organisation finds itself in is at once more complex and more challenging than ever before, due to the greater emphasis being placed on values and moral behaviour, and the increased power that internal and external stakeholders have today.

Since it is held that the social structure shapes behaviour, it is posited that stakeholders construct the reality facing the organisation as well as the interpretation of and response to that reality. This view provides the definitive link between the renewed philosophy in the theory of organisations – one where values and ethics are accentuated as essential and beneficial *economic* attributes – and the pertinent focus on the role of trust and trustworthiness in an organisation (Argandoña, 2008:441; Cacioppe *et al.*, 2008:681; Fukuyama, 1995:27; Hosmer, 1995:386; McPhee & Zaug, 2001:583; Murphy, 2005:183).

## **5 THEORETICAL FOUNDATION FOR THE TRUST CONSTRUCT**

### **5.1 OVERVIEW OF THE TRUST CONSTRUCT DISCUSSION**

The theoretical foundation for the trust construct is now provided, using social theory as basis. According to social theory, trust is conceptualised as a sociological event, characterised and accompanied by a high level of relationships and their associated communication and engagement behaviours. After the role of trust in social relationships is explored, it is posited that trust can fulfil the self-same role in relationships within an organisational environment.

In order to conceptualise trust within the corporate environment, a for-profit organisation is then positioned as an independent, authoritative and purposeful social actor in its own right – as a legitimate entity that can therefore be held accountable for its actions on a legal and moral basis. As such, the organisation itself is positioned as the predominant system being explored in this study.

Correspondingly, the for-profit organisation is also conceptualised as a social entity whose existence is dependent on its interactions with its environment in order to achieve its desired outcomes. This locates the central role that internal and external stakeholders, as key actors who interact systemically with the organisation, play in the formation of corporate trust. The extent to which this dependency leaves the achievement of specific goals outside the for-profit organisation's direct control represents a risk to be mitigated. Therefore corporate trust is positioned as an essential

strategy that a for-profit organisation needs to implement in its pursuit to ensure its own economic performance in a sustainable manner.

As a particular approach to social theory, the theory of action – which positions the organisation and its stakeholders as purposeful actors – is examined to locate the importance of trust within a corporate context. Decision theory, as a specific approach to action theory, is then used to position the role of ethics in consistent organisational decision-making and behaviour, thus making the link between ethics and corporate trust.

## **5.2 SOCIAL THEORY**

Social theory forms part of the theoretical framework of this study, particularly to expand on the theoretical foundation for the trust construct.

### **5.2.1 Trust as a social event**

Social theory conceptualises trust as a sociological event, as an inter-subjective, multi-dimensional and systemic social reality (Ingenhoff & Sommer, 2010:341; Lewis & Weigert, 2008:158; Wicks *et al.*, 1999:101).

#### **▪ *The role of trust in social relationships***

This study sees trust as a social event, a shared attribute, applicable to the relations among people, rather than an individual psychological state (Ingenhoff & Sommer, 2010:341; Lewis & Weigert, 2008:158). Today's modern society is complex and people have to manage many more significant relationships and social interactions on a daily basis than ever before. As there will always be an element of risk in any relationship, this study maintains that trust presents an efficient mechanism that can help to manage and reduce the levels of complexity, uncertainty and risk inherent in any social relationship, and to this extent trust is viewed as fulfilling a functional role in social relationships (Bachmann, 2006:394; Luhmann, 1979:8; Mishra, 1996:281; Nooteboom, 2002:5).

The presence of trust enables people to cope with risks and makes it possible for individuals to interact meaningfully with one another (Ingenhoff & Sommer, 2010:340; Lewis & Weigert, 2008:160; Wicks *et al.*, 1999:100). Trust can therefore be seen to exist in a social system when “... the members of that system act according to and are secure in the expected futures constituted by the presence of each other or their symbolic representations” (Lewis & Weigert, 2008:159).

- ***Trust as a functional alternative to rational prediction***

It is evidently possible for an individual to collect and rationally process information about a known causal relationship in order to predict a certain outcome, and to use such a ‘rational prediction’ strategy (Lewis & Weigert, 2008:160) as a coping mechanism instead of the trust mechanism. However, as Lewis and Weigert (2008:160) point out, rational prediction alone is not sufficient, since an individual simply does not have the time, resources or means to gain adequate information about every person or group he comes into contact with in order to be able to rationally predict a possible outcome. This is why Lewis and Weigert (2008:167) hold that “... trust begins where prediction ends”.

Trust, which is “... to live as if certain rationally possible futures will not occur”, can then be viewed as a functional alternative to rational prediction (Lewis & Weigert, 2008:160). It allows an individual to economise on his cognitive resources, information processing and safeguarding behaviours, since it represents an expectation that others will act in a way that will serve or at least not harm the individual’s interests (McEvily *et al.*, 2008:559).

The ability to trust people to act in a predictable manner, and then tailor his own actions accordingly, allows an individual in a social context to cope effectively with the uncertainty and potential risk inherent in his social relationships. The presence of trust in a social relationship therefore removes the possibility that an individual would be overwhelmed by the need to make provision for all possible outcomes of the actions of the other actors with whom he interacts (Lewis & Weigert, 2008:160). Uslaner (2010:111) argues that trust is “... the chicken soup of social life”, since trust is “... a central factor in shaping both social cohesion and institutions that function well”.



## 5.2.2 Trust in an organisational environment

This study posits that trust fulfils a similar functional role in a for-profit organisation, which has to manage a number of relationships and interactions with individuals in the organisation as well as key external stakeholders. Since all the actors in these organisational relationships are dependent on each other, the levels of complexity and uncertainty increase (Wicks *et al.*, 1999:104). This is because dependence is understood here as "... the extent to which outcomes are controlled by, or contingent upon, the action of another party" (Wicks *et al.*, 1999:104), and to the extent that this leaves the achievement of a specific goal outside an individual's direct control, it represents a risk to be mitigated.

Consequently, both the individual in a social environment and the for-profit organisation in a corporate environment can use trust as a strategy to manage their complex social and organisational relationships, particularly to reduce the risk brought about by their dependency on others to achieve their goals. The presence of trust then places these relationships and interactions on a simple and confident basis, whereas the absence of trust can pose such complexity of contingent outcomes that it could lead to paralysis (Bachmann, 2006:395; Lewis & Weigert, 2008:160).

This viewpoint also explains why Luhmann (1979:8) contends that the function of trust (as well as distrust) in a social environment is to reduce complexity (Bachmann, 2006:394; Mishra, 1996:281). Since an organisation is regarded as a complex *social* system (Kramer, 1999:570), these notions can also be extended to the role that corporate trust plays in a for-profit organisation.

Before discussing trust as an outcome of the systemic and consistently trustworthy behaviour of a for-profit organisation in more detail, it would be pragmatic first to define the actual system that is examined in this study. The conceptualisation of the organisation as a social actor, demarcating the for-profit organisation itself as the system, is therefore outlined first.

### 5.3 AN ORGANISATION AS A SOCIAL ACTOR

In an attempt to address the limitation that Kast and Rosenzweig (1972:455) identified in using systems theory to examine social organisations, namely the challenge to be precise in delineating system boundaries and system levels to avoid confusion about the actual ‘system’ that is being studied, the concept of the for-profit organisation as a social actor in its own right (King *et al.*, 2010:292; King & Whetten, 2008:193; Whetten & Mackey, 2002:393) will be used to explicitly demarcate the actual system being examined in this study.

This view also addresses the limitations identified in both systems theory and the theory of organisations. A too extensive focus on open systems theory may lead to a view where the organisation is increasingly perceived only as an “... instantiation of the environment in which it is embedded” (King *et al.*, 2010:292), instead of also carefully considering the principle that an organisation is not only moulded by its environment, but, more critically, that it can also mould itself as well as its environment at the same time that it is being influenced by its environment.

Conceptualising the for-profit organisation as a social actor clearly provides the ‘protagonist’ (King *et al.*, 2010:290) for the theory of organisations – the organisation itself. This is in contrast to many organisational scholarship studies, which typically portray an organisation as merely being a collection of individuals, who bring organisations into existence through a combination of individual transactions as well as inter-subjective and shared beliefs and experiences, or only as “... nodes in a social network, as instantiations of the environment” (King *et al.*, 2010:290; Whetten & Mackey, 2002:395).

This view of the organisation as an actor in its own right (King *et al.*, 2010:292; King & Whetten, 2008:193; Whetten & Mackey, 2002:393) differs substantially from the view of much of the existent literature. The concept of an organisation as a particular “... kind of social actor, capable of behaving in a purposeful, intentional manner” (King *et al.*, 2010:291), deviates from the usual view of an organisation as a social system that is structurally unique but still primarily embedded in the commercial market or in

communities of organising. In defining a for-profit organisation as a distinctive social entity and an actor on its own merits, King *et al.* (2010:292) acknowledge that an organisation can wield influence over individuals, that it can shape and form communities, and that it can transform their environments. This is why King *et al.* (2010:292) refer to organisations as “... bona fide mechanisms for societal change”.

Two theoretical assumptions underpin the organisational actor concept, namely the assumptions of external attribution and intentionality (King *et al.*, 2010:292). A more thorough overview of these assumptions will be useful to set the stage for positioning the necessity for and capability of an organisation to become a trustworthy concern.

### **5.3.1 The external attribution assumption**

In brief, external attribution means that other actors external to the for-profit organisation itself (such as the government, individual members of the organisation and stakeholders) credit the organisation as being capable of acting. By granting the organisation a legal and social status, these other actors have certain expectations of the organisation, and can therefore hold the organisation accountable and responsible for its actions on a legal and moral basis (Bakan, 2004:28; Greenwood & Van Buren, 2010: 429; King, 2009:11,12; King *et al.*, 2010:290,292; King & Whetten, 2008:198; Kramer, 2010:82; Moon *et al.*, 2003:9; Moon & Muthuri, 2008:4).

Based on this, the organisation is then simultaneously independent to act as well as dependent on and accountable to those actors (its stakeholders), who grant it the right to operate as an independent actor. This accentuates the necessity for an organisation to establish a good corporate reputation, so that its stakeholders can get to know it (who it is and what it stands for) so that they can trust and therefore support the organisation.

- ***The sovereign yet dependent nature of the organisation***

A for-profit organisation is a legitimate, autonomous and self-determining entity (King *et al.*, 2010: 292; Moon *et al.*, 2003:3; Whetten & Mackey, 2002:395), which can determine membership, hire and fire employees, enter into contracts, reward behaviours, impose sanctions and largely has supreme decision-making powers regarding its operations.

Organisations are externally defined as actors by other actors in society. For example, government grants an organisation legal status (Bakan, 2004:28; King *et al.*, 2010:298). Society also grants organisations their status to act – it gives an organisation the authority, the licence, to operate (King, 2009:21; Marsden & Andriof, 1998:331). Moon *et al.* (2003:3) note that organisations are “... created by society and derive their legitimacy from the societies in which they operate. They need to be able to articulate their role, scope and purpose as well as understand their full social and environmental impacts and responsibilities.”

King *et al.* (2010:292) hold that for-profit organisations “... are actors because society, not only legally but also practically and linguistically, grants them that status”. They cite comments such as “IBM has transformed itself” and “Nike acted irresponsibly” to show the linguistic reality of how society regards organisations as actors.

However, the authority that is bestowed on a for-profit organisation to establish and run a business, with a clear profit-seeking objective as a primary goal, is established on the back of certain expectations linked to it. These expectations are based on anticipated returns from the for-profit organisation, on what it will do to ‘reimburse’ government and society, for example by creating jobs, providing a quality product or service and paying taxes. It is on the basis of these expectations that the for-profit organisation can be held accountable to its stakeholders, despite its sovereign structure.

In the twenty-first century society is increasingly expecting for-profit organisations to make a long-term commitment to sustainable business practices and social participation, in line with triple-bottom-line thinking, which includes a commitment to economic development, social justice and environmental responsibility. Responsible corporate citizenship therefore entails a much greater focus on, and expectation of, fulfilling obligations to society rather than just government (Mackey, 2009:103; Marsden & Andriof, 1998:334-336; Moon *et al.*, 2003:14).

Internal and external stakeholders in turn monitor and supervise the actions and behaviour of the for-profit organisation (King *et al.*, 2010:292), either directly (via a regulatory function) or indirectly (via an article in the media or a complaint from a

customer). As such, stakeholders are regarded as key actors who interact systemically with the organisation and play an integral role in holding the organisation accountable. This forms the foundation for the importance of corporate trust and the need to develop such trust (Williamson, 1993:207).

Organisational sovereignty entitles the for-profit organisation to manage its operations and behaviour as it sees fit, as long as it remains within the parameters of its agreed mandate and does not violate the expectations of society. This means that an organisation can act without the consent of its members, "... even in cases where their actions might prove harmful to members, as long as they act within the perceived bounds of their authority" (King *et al.*, 2010:293).

This study posits that a for-profit organisation is capable of managing the actions of its members, since it has the power to control who its members are and what they do. It exercises its power in purposefully admitting and dismissing members of the organisation and controlling the behaviour of its members with rules, rewards and sanctions. When an employee joins an organisation, he submits some of his own natural rights to the sovereignty of the organisation and becomes subject to the constraints that define desired behaviour in the organisation as well as the role given to him (King *et al.*, 2010:293).

This means that the individual employee becomes a 'member agent' of the for-profit organisation, one who can speak and act on behalf of the organisation within the confines of his prescribed role (King & Whetten, 2008:195). The employee becomes "... an extension and representative of the organizational actor" (King *et al.*, 2010:293). In effect, employees enter into a joint commitment with the organisation, based on a shared understanding to uphold the obligations and principles as set by the organisation, "... even if they do so begrudgingly" (King *et al.*, 2010:293).

This supports the viewpoint that a for-profit organisation that sets out to become an authentic trustworthy organisation will be able to do so, since its employees are subject to the sovereignty of the organisation. However, as Gellerman (in Goodpaster, 2007:22) notes, while the leadership of a for-profit organisation has the right to expect loyalty from

employees against competitors, it does not have the right to expect or demand “... loyalty against the law, or against common morality, or against society itself”.

▪ ***Responsibility and self-governing capacity of the organisation***

In their conceptualisation of a for-profit organisation as a social actor in its own right, with legal status and in a unique position as a ‘societal powerholder’, King *et al.* (2010:294) highlight two points that are extremely pertinent to the focus of this study.

The first point is that a for-profit organisation is responsible and can be held accountable for its decisions and choices. On the one hand, a for-profit organisation can be deemed legally responsible for the contracts it enters into, as well as damages associated with its business operations. This presumes that an organisation can be held legally accountable for its actions (Bakan, 2004:28; King & Whetten, 2008:198). On the other hand, and outside the legal realm, concepts such as reputation, trust and image signify that stakeholders also judge for-profit organisations to be morally responsible and accountable for their actions (Whetten & Mackey, 2002:396).

The responsibility of a for-profit organisation is derived from its ability to direct its members and influence them to behave in ways they might not normally choose. “The mission of the organization, its routines and practices, and individual members’ roles within a hierarchy may elicit certain forms of behaviour and choices that are directly attributable to the organization rather than to the individual.” (King *et al.*, 2010:294).

The second point relates to a for-profit organisation’s capacity for self-governance. As an actor, it can establish strategy, develop and observe policies and procedures and make decisions to achieve its intended goal. It is because it possesses these ‘agency’ characteristics that an organisation can be judged to be legally and morally responsible and accountable for its actions (King *et al.*, 2010:294).

**5.3.2 The intentionality assumption**

In brief, the intentionality assumption is based on the supposition that a for-profit organisation, just like any other social actor, is “... capable of deliberation, self-reflection

and goal-directed action”, and that some form of intentionality underpins its decision-making and behaviour (King *et al.*, 2010:292).

As an independent actor, a for-profit organisation can therefore have intentions, motivated by its particular (self) view of the world, that are partly independent from the beliefs, values, preferences and goals of its constituents (King *et al.*, 2010:294). This allows the organisation’s member agents to make decisions and act in a reasonably reliable manner, since they will be oriented towards carrying out the organisation’s point of view, and not be focused on their self-interests and personal views.

Two internal concepts are fundamental to viewing an organisation as a social actor, namely identity and goals. These two features of the organisation cannot be ascribed to a single individual in the organisation, and in “... this sense, they are properties of the organization and not of some individual(s) within the organization” (King *et al.*, 2010:295). It is posited that by managing these two features effectively, a for-profit organisation can ensure that its employees, as members of the organisation, consistently act and perform within the ideal corporate identity and behavioural framework. Moreover, the organisation can ensure the support and approval of its stakeholders by building a corporate reputation on the basis of its identity as an ethical and trustworthy for-profit organisation.

The first of these two features – corporate identity – is discussed in detail in the next section, where an overview of identity theory is offered to provide the theoretical basis of the reputation construct, since identity is regarded as the foundation of corporate reputation (King & Whetten, 2008:193). However, the second feature – organisational goals – is briefly discussed here in order to contextualise the importance of identity and the role of the leadership of an organisation in this regard.

The study of organisational goals is typically linked to the rational view of organisations, “... which assumes organizations are goal-directed, purposive entities” (King *et al.*, 2010:296). Goals can be seen as the primary motivation behind organisational design, serve as a guide to employees’ behaviour and enable internal and external stakeholders to assess the performance of the organisation.

The significance of these points for the corporate trust construct is twofold. First, it is posited that the primary goals of a for-profit organisation essentially signify the identity, the character, of the organisation. In the light of this, it is crucial that any for-profit organisation that wants to earn the trust and support of its stakeholders needs to ensure that its strategic business goals are aligned with its core identity, which should reflect stakeholders' expectations of moral and ethical behaviour.

This study contends that only when there is congruence and consistency between the organisation's identity and its business objectives – and therefore between what it says it is and how its employees behave in fulfilling their daily duties – will it be able to earn its stakeholders' trust and support, provided the organisation's identity (and therefore its goals) is acceptable to its stakeholders in the first place.

Secondly, the ability of an organisation as an independent actor to be goal-directed accentuates the belief that an organisation can set itself the goal of becoming an authentic, ethical and trustworthy organisation, and that it will be able to achieve that due to its agency characteristics. However, even more relevant is the point that it *should* set out to become an ethical and trustworthy organisation, or it will risk losing approval to operate from its stakeholders, who hold the organisation responsible for its actions.

The relevance of this perspective for the focus of this study lies not only in delineating the system that will be examined as the for-profit organisation as a social actor, but also in clarifying the role of employees, as representatives of the organisation, in operationalising the role and behavioural principles prescribed by the organisation as a social system. Another relevant point is the role of stakeholders in holding an organisation accountable and responsible for its actions and behaviour.

The theory of action will now be examined to locate trust within a corporate context.

#### **5.4 THEORY OF ACTION: A SPECIFIC APPROACH TO SOCIAL THEORY**

In order to discuss trust as a subjective social reality within an organisational environment, the theory of action as an approach to social theory will be reviewed.



#### 5.4.1 The social versus the functional theory of action

The social theory of action sees individuals as being purposeful and goal directed; as being guided in the first place by a need to solve a particular problem in order to achieve a specific goal. However, individuals' actions are also seen to be influenced by their own interests and values as well as the rewards and constraints imposed by the social environment (Argandoña, 2008:436; Coleman, 1986:1310).

The primary issues here are the connection between the intentions or actions of individuals, the interaction between the individual (as 'actor' or 'active agent') and his environment and the consequences or outcome of their decisions and actions on the wider macro-social level (Argandoña, 2008:436).

Coleman (1986:1310) notes that "... the functioning of society as well as the engine of social change could be grounded in the purposive actions of individuals, taken in particular institutional and structural settings that shaped the incentives and thus the action". Based on this, a social system such as a for-profit organisation might be shaped by human will.

This is in contrast to the functional theory of action, which focuses on the functions of any institution or social configuration, but ignores the role that the individual plays within the institution (Coleman, 1986:1311). The criticism levelled against this theory was that it did not provide for any possibility of the normative evaluation of institutions or social configurations, since it "... never descended to the level of individuals, whose satisfaction (or dissatisfaction) provides our soundest basis for evaluating social configurations" (Coleman, 1986:1311).

In order to discuss the concept of corporate trust, which is where an individual makes a normative evaluation of the organisation, the *social* theory of action, rather than the functional theory, is used as point of departure in this study. Based on this theory the 'actor' (individual or organisation) is regarded as acting purposively (Coleman, 1986:1312; King *et al.*, 2010:291).

#### **5.4.2 Purposeful actions of individuals and organisations**

The social theory of action is particularly relevant to this study, since it substantiates the view that an organisation can and should foster and earn its stakeholders' trust. On the one hand, this is because the organisation, as an independent actor, is able to take firm and purposeful actions which, as discussed, can influence and guide the behaviour of its employees as members of the organisation. A manager (as a representative of the organisation) also takes purposeful action when he decides to create mutually trusting relationships as a matter of strategic choice (Wicks *et al.*, 1999:99).

On the other hand, a for-profit organisation needs to acknowledge that its internal and external stakeholders are also able to take purposeful actions – actions that can be either beneficial or detrimental to the sustainable economic performance of the organisation. The stakeholder as actor takes purposeful action by making a normative evaluation of the organisation, and by deciding on that basis how to behave towards it.

### **5.5 DECISION THEORY: A SPECIFIC APPROACH TO THE THEORY OF ACTION**

Decision theory, as a particular approach to the social theory of action, will now be briefly examined to establish the relevance of consistent organisational behaviour to trust, as a subjective social reality, within a corporate context and to position trust as the key link between the theory of organisations and ethics. This theory also further justifies the inference that an organisation, as a purposeful system, can deliberately construct and manage the level of trust that its stakeholders have in it.

#### **5.5.1 Introduction to decision theory**

The basic premise of decision theory is this: a decision-maker in an organisation, who is faced with a problem or an unsatisfactory situation, will resolve to perform an action that will hopefully resolve the problem (Jones, 1991:380). The difficulty that the decision-maker faces is on what basis he should make the decision, and how he should assess which action is the right one to satisfy the need and so resolve the problem (Argandoña, 2008:436).

Traditional decision theory has two inherent limitations: the first is the assumption that a decision-maker has to satisfy only one need at a time, and the second is the assumption that a decision can be made in isolation, which repudiates the fact that the results of solving one problem affect the probability of solving others. In explaining how these limitations have been addressed in decision theory, Argandoña (2008:436) cites the pioneering work of Juan Antonio Pérez López<sup>1</sup>, who added two elements to the basic premise of decision theory in his conceptualisation and extension of decision theory.

Pérez López (in Argandoña, 2008:436) theorises that the decision-maker (or 'active agent') is aware in the first place that the need will recur and, in the second place, that he has many other needs which he may not be aware of at the moment of making his decision, but which he knows he will have to satisfy, either now or in the future, once he becomes aware of it. By acknowledging this interrelationship between decisions, Pérez López repositions decision theory firmly as a social systems theory.

A brief overview of this extended understanding of Pérez López's decision theory will be expedient at this stage, particularly since it attributes a dominant role to ethics (Argandoña, 2006:2) in an organisational context. As such, it provides an extremely constructive basis from which to conceptualise corporate trust as a means to help ensure the long-term economic success of the organisation in a sustainable manner (Ingenhoff & Sommer, 2010:339), as well as being a result of the processes by which the various components of the organisation interact with one another and with their environment (Kramer, 1999:570).

### **5.5.2 Principles of decision theory and its relevance to organisational behaviour**

As a point of departure, Argandoña (2008:436) observes that a decision-maker needs to evaluate the proposed action from three points of view: how well the proposed action will satisfy the current need, what effects it will have on the decision-maker's ability to satisfy the same need when it recurs in the future and how the proposed action will affect the decision-maker's ability to satisfy this specific need as well as all his other needs, now and in the future.

<sup>1</sup> *Professor Juan Antonio Perez Lopez (1934-1996): His work is little known, because it is mainly written in Spanish (Argandoña, 2008:435).*

An action that consists of an interaction between the decision-maker (the ‘active agent’) and his environment or another person (the ‘reactive agent’) is then chosen based on three criteria: effectiveness, efficiency and consistency. In explaining these key concepts, Pérez López (in Argandoña, 2008:436,437) defines effectiveness of an action as “... *the extent to which the action contributes to achieving the specific purpose of the action*”; efficiency of an action as “... *the value of the learning brought about by the decision*”, which presupposes that a skill has been learnt which will make it easier to satisfy the same need when it recurs in the future; and consistency of an action as “... *the value for the active agent of the learning that takes place in the reactive agent as a result of the experience of the interaction*”, and which will make future interactions either easier or more difficult (Argandoña, 2008:436,437).

While it is accepted that consistency in decisions affects the longer-term effectiveness and efficiency of actions in the organisation (Argandoña, 2008:438), the argument is extended to include the view that this consistent decision-making should be based on normative rules, or as Hosmer (1995:395) observes, on the classical ethical assertion that a ‘good’ decision is one that is not only focused on the short-term self-interest of the decision-maker, but also takes the valid self-interests of others into account.

Hosmer (1995:398) also refers to Kant’s description of goodwill, and notes that he had logically shown “... that the only will that could be called ‘good’ without qualification was the will that followed the universal law that if it was right for one person to take a given action then it must be right for all others to be encouraged to take that same action”. Essentially, it is then held that ethics should be guiding organisational behaviour.

This is similar to what Goodpaster (2007:28) proposes. In analysing two national scandals in the USA, namely the fraud perpetrated by Wall Street investment banker Martin Siegel and the explosion of the space shuttle Challenger on 28 January 1986 (2007:16), Goodpaster identifies the underlying patterns that formed part of the decisions made in both these situations, which led to disastrous results and ended careers. Based on his analysis of what fundamentally led to these scandals, Goodpaster (2007:28) coins the term ‘teleopathy’ to refer to the unbalanced pursuit of purpose in either individuals or organisations, which is “... a habit of character that values certain

limited objectives as supremely action-guiding, to the relative exclusion not only of larger ends, but also of moral considerations about means, obligations, and duties”.

Goodpaster (2007:28) observes that, in its most extreme form, “... teleopathy involves a suspension of ethical awareness as a practical force in the decision-making process. It substitutes for the call of conscience the call of very different decision criteria: winning the game, achieving the objective, following the rules laid down by some goal-oriented framework independent of ethical reflection.” According to Goodpaster (2007:30), the indications of teleopathy, such as goal fixation, rationalisation and detachment, should warn the leadership of a decision-making pattern that has lost perspective and balance. He argues that the only practical response to this hazard and risky mindset is to accept ethics as the underlying framework to guide decision-making (Goodpaster, 2007:15).

### **5.5.3 Ethics as a guide to consistent organisational decisions and behaviour**

Argandoña (2008:435) notes that Pérez López used ethics as his recourse to define the characteristic behaviour of human beings, both as individuals and as members of organisations. Since human decisions cannot be scientifically predicted, Pérez López argued that only the “... most profound of all sciences (ethics) can predict the consequences of decisions for the improvement of the actual decision-maker”. Argandoña (2008:435) also comments that Pérez López’s views represented a break with the mainstream scholarly thinking of the time, which regarded economics “... as a science free of value judgments that excludes any role for ethics, which, it is assumed, is limited to subjective, unscientific judgments”.

In line with this, Moss Kanter (2011:68) emphasises that corporate leaders of great organisations in the twenty-first century are those who, in developing an institutional perspective, “... internalize what economists have usually regarded as externalities and define a firm around its purpose and values”. As such, these leaders create frameworks that use societal and human values as decision-making criteria, instead of viewing organisational processes merely as ways of extracting more money.

In building his theory of action and in particular his position on decision-making theory, Pérez López endeavoured to incorporate all the facets of reality that are relevant to a decision, which included an appreciation for the role that ethics plays. According to Argandoña (2008:443), this was because Pérez López maintained that a disregard of ethics would leave any action theory dreadfully incomplete, based on his argument that “... the realities included on the ethical plane are realities that condition what happens on other more superficial levels that are more apparent”.

Jones (1991:367) defines an ethical decision as *a decision that is both legal and morally acceptable to the larger community, whereas an unethical decision is either illegal or morally unacceptable to society.*

#### **5.5.4 Trust as the connecting link between theory of organisations and ethics**

The for-profit organisation as a social system, composed of several actors, is then an emerging consequence of the interdependent actions of all the actors who make up the system (Coleman, 1986:1311). This has three implications for the concept of corporate trust.

First, trust forms an integral part of the formulation of strategy in an organisation and therefore the actions of managers as key decision-makers of the organisation have a direct impact on the levels of trust that are created with stakeholder groups (Wicks *et al.*, 1999:99). Secondly, a for-profit organisation has to earn the trust of its individual stakeholders – it cannot merely command trust in itself (McEvily *et al.*, 2008:559; Swift, 2001:22). Lastly, if any of the stakeholders lose their trust in the organisation, they could take action, and through their individual actions and behaviour, put pressure on the organisation to change (Gillespie & Dietz, 2009:127).

“Trust is therefore a result of ‘proper’ decisions and actions, and proper decisions and actions are those that follow the ethical principles of analysis.” (Hosmer, 1995:399). By using the principles of decision theory, which positions ethics as the main criterion that can ensure consistent decision-making and behaviour in a for-profit organisation, ethical behaviour is then posited to be a key strategy that an organisation can employ to earn

its stakeholders' trust, which accentuates the need for it to become an ethical, trustworthy organisation.

To understand trust from the perspective of the trusted is to understand that trust is more than just a device for reducing transactions' costs or for easing business operations. "To understand the importance of being trusted is to understand the way in which the responsibility for trust reposed can affect character. It can create virtue where little had previously existed." (Mitchell, 2001:110).

## **5.6 CONCLUSION: THEORETICAL BASIS FOR THE TRUST CONSTRUCT**

Trust, as a social and systemic reality, fulfils a functional role in both interpersonal and corporate relationships, since it helps to enable meaningful interactions between people as well as a for-profit organisation and its internal and external stakeholders. Since the organisation is dependent on its stakeholders to achieve its goals, its relationships with these stakeholders are characterised by complexity and uncertainty, which poses a risk to the organisation that needs to be managed. The presence of trust, as an outcome of the systemic way in which the organisation interacts with its environment, is regarded as a key strategy that can be used to manage and reduce this risk (Bachmann, 2006:395).

Positioned as an independent social actor in its own right, a for-profit organisation has the authority to act as it sees fit, since its stakeholders have granted it the legal and moral status to do so. This in turn highlights its very dependency on its stakeholders, who can act purposefully and decide to either assist or hinder the organisation in achieving its goals. Since stakeholders hold the organisation accountable for its actions, they can revoke the status and authority they have bestowed on the organisation, should the organisation not meet their expectations.

A for-profit organisation can mitigate this risk, since it also has the ability to act purposefully. As both an open, social system and a social actor, it can purposefully initiate activities and adaptations from within and use the information it receives from its stakeholders concerning its outputs to transform itself and its future outputs in order to achieve its objectives.

This study posits that by establishing its identity and goals as an ethical and trustworthy for-profit organisation, it can direct and guide the behaviour of employees as its representatives to act in accordance with what it stands for. It can also use its corporate communication activities to showcase its identity, character, values and activities, so that its stakeholders can get to know the organisation, and based on their positive assessment of its past and current behaviour (its reputation), stakeholders can then come to trust the future actions of the organisation.

Corporate trust is therefore conceptualised as a multi-dimensional (Kramer, 1996:221) and systemic sociological reality that exists in an organisational context – a consequential reality which emerges based on the purposeful actions and outcomes of the interdependent relationship between the for-profit organisation as an independent actor and its internal and external stakeholders. Trust is regarded as a critical mechanism for reducing risk (Bachmann, 2006:395) and enabling an organisation to achieve its goal of sustainable economic performance (Einwiller & Will, 2001:6).

However, since this study contends that trust is an outcome of a good corporate reputation – only if that reputation is built on the back of an organisation's single, authentic identity as an ethical and trustworthy corporate citizen – the reputation construct will be discussed next.

## **6 THEORETICAL FOUNDATION FOR THE REPUTATION CONSTRUCT**

### **6.1 OVERVIEW OF THE REPUTATION CONSTRUCT DISCUSSION**

Since corporate identity is regarded as the foundation of corporate reputation (King & Whetten, 2008:193), an overview of social identity theory and its link to organisational identity theory is provided here to serve as the theoretical basis of the reputation construct. Using the perspective of the organisation as social actor, the link between an organisation's legitimacy, identity and reputation is explored to ground the reputation construct theoretically, serving as preamble to a more detailed discussion of the specific causal link between identity, reputation and trust which follows in Chapter 5.



### **6.1.1 Legitimacy and identity of the organisation as social actor**

Based on the perspective of the organisation as social actor that is applied in this study, as discussed, an organisation is understood to be a legitimate and purposeful social actor in its own right, one that is capable of behaving in an intentional manner (King *et al.*, 2010:291), and one that is granted its legitimacy by society – by its stakeholders.

King and Whetten (2008:192) observe that legitimacy and reputation are perceptions of approval of an organisation's actions based on stakeholders' evaluations, and as such both of these can be regarded as intangible assets that organisations rely on "... to enhance their performance and chances of survival". Contrary to conventional thinking, this study supports King and Whetten's (2008:192-193) view of reputation as an extension of legitimacy, since both legitimacy and reputation are regarded as being connected through an organisation's adoption of a particular social identity.

In the literature on organisational identity, emphasis is placed on the realisation that identity is not only an internal concept, which is defined by the leaders of an organisation, but also a concept that is constructed via interaction with internal and external stakeholders (Gioia, Schultz & Corley, 2000b:146). Brickson (2000:148) observes that organisational identification processes possess both static and dynamic aspects driven by the needs of stakeholders at all levels of analysis. This implies that, although the leaders of an organisation need to take the lead in adopting and defining the organisation's identity, they cannot and should not do this in isolation.

It is suggested that when leaders develop a corporate identity that categorically incorporates and accommodates values and beliefs shared by their stakeholders, they ensure that their stakeholders can, and will want to, fully associate and identify with it, and that they will therefore support and participate in the maintenance of the new identity. By taking their internal and external stakeholders' needs and expectations into account, the leaders then basically enable the organisation's stakeholders to help co-create its desired identity (Argandoña, 2008:441; Gao & Zhang, 2006:729; McPhee & Zaug, 2001:585). This is reminiscent of Selznick's view (1948:32) of an authentic and mutually shared value system, which will enable the stakeholders to associate the

organisation's values with their own system of values and beliefs in an enduring manner and use those values to guide their decisions and actions to do the right thing (Cartwright & Craig, 2006:748; Marsden & Andriof, 1998:338).

Grunig (2003:219) highlights the significance of shared values and consistent behaviour when he endorses Pfeffer's definition of organisational legitimacy as "... *the congruence between social values and organizational actions*". In addition, Grunig (2003:219) regards legitimacy as a key attribute of an organisation's relationship with its stakeholders, which he describes as a relationship in which both parties recognise the importance of the other. A for-profit organisation that wants to build a strong corporate reputation, which will enable it to earn its stakeholders' approval and trust based on their evaluations of the organisation, will do well to keep this in mind when (re)defining its identity.

This assertion is based on Selznick's (1948:28) proposal that the actual structure of an organisation is a consequence of the mutual and reciprocal influences of and reactions and adaptations to the interactions between the organisation and its external environment. This view still has merit for the focus of this study, in that it provides the basis for examining how the 'real' structure of an organisation can be established, maintained and measured.

This study asserts that a for-profit organisation that includes as part of its inherent character and basic focus the need to behave in a transparent, ethical and trustworthy manner in its quest for sustainable economic growth, albeit in the longer term, will be able to create an institutionalised culture to guide the behaviour of its employees (Pirson & Malhotra, 2008:10; Pirson, 2009:8; Vanneste *et al.*, 2011:23) and a cooperative external environment. A for-profit organisation's identity, characterised by fundamentally shared values, goals and expectations, can then help to earn stakeholders' trust if the organisation builds its corporate reputation on this basis.

It is understood that the reference to the organisation as social actor does not literally imply that organisations are indeed human, but rather "... that their substance or their actions can be understood as being in some meaningful way *similar* to that of a citizen"

(Moon *et al.*, 2003:3). An organisation is then regarded to have a personal and social identity, similar to the personal and social identity of any individual (Cooren, Kuhn, Cornelissen & Clark, 2011:1159). As these issues have already been discussed earlier in this chapter, these points are merely reiterated to serve as backdrop for further discussion of identity theory.

### **6.1.2 Social identity theory and its link to corporate identity**

Research on organisational identity has been influenced by various disciplinary perspectives, particularly by social and cognitive psychology. Social psychological research has mainly focused on how individuals categorise themselves and others into various social categories, such as organisational, gender or age groups (Ashforth & Mael, 1989:20; Hogg & Terry, 2000a:121). The concept of social identity, as first introduced by Tajfel, is defined as “... *the individual's knowledge that he belongs to certain social groups together with some emotional and value significance to him of this group membership*” (Hogg & Terry, 2000a:122).

Social classification serves two functions. In the first place, it cognitively segments and orders the social environment, providing the individual with a systematic means of defining others. Secondly, social classification enables the individual to locate or define himself in the social environment (Ashforth & Mael, 1989:20-21; Hogg & Terry, 2000a:122).

Within the framework of identity theory, the self-concept is comprised of a personal identity as well as a social identity (Pratt & Foreman, 2000:142). An individual's personal identity (which largely features in interpersonal situations) encompasses distinctive individual characteristics, such as bodily attributes, particular abilities, psychological traits and unique interests; whereas his social identity (which largely features in group situations) involves relevant and significant group classifications.

Social identity theory is concerned with the latter and starts from the assumption that identity is derived primarily from group memberships (Ashforth & Mael, 1989:21; Brown, 2000:746-747; Olins, 2003:57).

- ***Social identity theory***

Social identity theory is a social psychological analysis of the role of self-conception in group membership, group processes and intergroup relations. In this context, a group is regarded as existing psychologically if three or more people construct and evaluate themselves in terms of shared attributes that distinguish them collectively from other people or groups (Hogg, 2006:111).

Self-categorisation theory specifies the operation of the social categorisation process as the cognitive basis of group behaviour, where the social categorisation of self and others into ingroup and outgroup accentuates the perceived similarity to the relevant ingroup prototype – as a cognitive representation of features that describe and prescribe attributes of the group (Hogg & Terry, 2000a:123). Social identity rests on intergroup social comparisons that seek to confirm or establish “... ingroup-favoring evaluative distinctiveness between ingroup and outgroup, motivated by an underlying need for self-esteem” (Hogg & Terry, 2000a:122). Social identification is then the perception of oneness or identification with some human aggregate or group, and in this regard, it provides a partial answer to the question: “Who am I?” (Ashforth & Mael, 1989:21).

A dyad is not regarded as a group, since it is not possible to infer group norms from the behaviour of just one other person (Hogg, 2006:116). A social group then consists of more than two people who share the same social identity, and who identify and evaluate themselves in the same way – individuals who have the same definition of who they are, what attributes they have and how they relate to and differ from people who are not in their group or who are in a specific outgroup. Group membership is then a matter of collective self-construal; of ‘we’ and ‘us’ versus ‘them’ (Hogg, 2006:115). Social identity theory proposes that people strive to achieve or maintain a positive social identity in order to boost their self-esteem, and that this positive identity derives from favourable comparisons that can be made with similar groups (Brown, 2000:747).

In terms of how they categorise themselves, individuals then seek to increase or sustain their positive self-esteem by positively differentiating their ingroup from a comparison outgroup on a certain valued dimension (Hogg & Terry, 2000a:122). This quest for positive distinctiveness means that when a person’s sense of self is defined in terms of

'we' (i.e. social or group identity) rather than 'I' (personal identity), they strive to see 'us' as different from, and preferably better than, 'them' in order to feel good about who they are and what they do (Cooren *et al.*, 2011:1159). The definition of others and the self are then largely relational and comparative, since an individual defines himself relative to individuals in other groups. Positive and negative intergroup comparisons have been found to affect a member's self-esteem accordingly (Ashforth & Mael, 1989:21-22; Brown, 2000:755).

An individual will define himself in terms of the group(s) that he perceives himself to be an actual or symbolic member of, and as such he will perceive the fate of those group(s) with which he classifies himself as his own. Social identification is then seen as personally experiencing the successes and failures of the group. As such, identification is often maintained in situations involving great loss or suffering, missed potential benefits, failure, and even expected task failure (Ashforth & Mael, 1989:21). Extensive research has shown that groups perceiving themselves to hold similar norms and attitudes have been found to show more intergroup attraction and less bias than dissimilar groups (Brown, 2000:757).

Since social identification then appears to derive from the concept of group identification, both terms can be used interchangeably (Ashforth & Mael, 1989:21). In line with social science literature, group identity is viewed as an important component of most individuals' psychological makeup, and it is believed that in situations where group identity is brought into play, individuals appear to consider the group's welfare as well as their own.

Stout and Blair (2001:47-48) observe that this argument is amply supported by the social dilemma evidence. Players who perceive their fellow players as members of their own ingroup are more likely to cooperate than those who see themselves as playing against members of an outgroup. Based on their survey of the extensive experimental evidence produced over the past four decades on human behaviour in 'social dilemmas' (as prepared by David Sally), Stout and Blair (2001:48) note that "... evidence of the importance of group identity can be seen in the consistent finding that allowing the players to communicate with each other in a social dilemma significantly increases the

incidence of cooperation. Sally's meta-analysis, for example, found that allowing communication raised base cooperation rates in repeated games by 40 percentage points." A rationale offered for this increased cooperation, is the possibility that communication promotes feelings of group identity (Stout & Blair, 2001:48).

This is relevant to an organisation, since it shows that a sense of group identity can be fostered through stakeholder communication, which in turn is important to build a strong corporate reputation in order to earn stakeholders' trust and support.

- ***Organisational identity theory***

While organisational identity is by nature more removed, varied and diverse than personal identity (Gioia *et al.*, 2000b:145), organisational identification can be regarded as a specific form of social identification (Ashforth & Mael, 1989:22). Consequently, an extended perspective of social identity theory is used to inform an understanding of organisations and organisational behaviour (Hogg & Terry, 2000b:150). While somewhat dated, the formative work done by Ashforth and Mael (1989) is included in this overview of social identity theory in an organisational context, since their work represented the first systematic introduction of social identity theory to organisational psychology (Hogg & Terry, 2000a:122).

Based on the literature on organisational identity, several factors that will most likely increase the tendency of individuals to identify with the organisation as a group – and therefore commit to and support the organisation – can be identified. The first factor is the *distinctiveness* of the for-profit organisation's values and practices in relation to those of comparable organisations, which serves to separate that which is characteristic of the organisation and can be used to differentiate it from other organisations, providing it with a unique identity (Ashforth & Mael, 1989:24). This underscores the suggestion of adopting a single, value-based corporate identity as the foundation of a corporate reputation that will earn stakeholders' trust.

The other factors include the *prestige* of the organisation, which is based on the argument that, through intergroup comparison, social identification affects self-esteem and that individuals often cognitively identify themselves with a winner; the *prominence*

and awareness of comparable organisations as outgroups, which reinforces an individual's awareness of his ingroup; and the effects of intergroup *competition*, which leads to group lines being drawn more sharply, values and norms being underscored, and the we/they differences being accentuated (Ashforth & Mael, 1989:24-25). This underscores the suggestion of building a corporate reputation (i.e. to make sure that it is 'being seen') on the back of the organisation's single, value-based identity to earn stakeholders' trust.

According to the literature on organisational identity, there are at least three consequences that make social identification relevant to organisations. The first is that individuals tend to choose activities that are congruent with prominent aspects of their own identities, and they support the institutions that embody those identities (Ashforth & Mael, 1989:25; Hogg & Terry, 2000a:123). Therefore it is likely that identification with a for-profit organisation will enhance internal and external stakeholders' support and commitment.

A second and related consequence is that social identification affects the outcomes that are usually associated with group formation, including intragroup cohesion, cooperation, altruism and positive evaluations of the group. Therefore it is likely that identification with an organisation may engender the internalisation of, and adherence to, the organisation's values and norms and homogeneity in attitudes and behaviour and that it would be associated with internal and external stakeholders' loyalty to, and pride in, the organisation and its activities (Ashforth & Mael, 1989: 26; Hogg & Terry, 2000a:123).

In the third place, social identification reinforces the very antecedents of identification, including the distinctiveness of the group's values and practices, group prestige and the salience of and competition with outgroups. Therefore it is likely that identification with an organisation will let the values and practices of the ingroup become more salient and be perceived as unique and distinctive by the organisation's internal and external stakeholders (Ashforth & Mael, 1989:26; Hogg & Terry, 2000a:127).

It is suggested that the greatest contribution of social identity theory to the literature on organisational behaviour is perhaps the recognition that a psychological group is far

more than an extension of interpersonal relationships. Identification with a collectivity can arise even in the absence of interpersonal cohesion, similarity or interaction and yet have a powerful impact on affect and behaviour (Ashforth & Mael, 1989:26). In crediting a collectivity with a psychological reality beyond its membership, social identification then enables the individual to conceive of, and feel committed to, an organisation or corporate culture, which in turn makes group commitment and behaviour possible.

This is possible because social interaction involves the motivated manipulation of symbols through speech, appearance and behaviour by people who are strategically competing with one another to influence the frame of reference within which accessibility and fit interact (Hogg & Terry, 2000a:125). The critical point here is that the manipulation of symbols should not be intended to deceive, but rather to ensure and enable the alignment of speech, appearance and behaviour.

As observed by Olins (2003:56): “Corporate identity – real corporate identity that is – is about behaviour as much as appearance, and certainly about reality, as much as symbolism. Whenever behaviour and appearance are linked, real corporate identity emerges.” This dynamic perspective on identity and self-conceptual prominence has clear implications for an organisational context.

Corporate identity is then primarily concerned with the way the organisation collectively demonstrates and presents its character to its stakeholders – in behaviour and appearance – in order to provide the basis on which stakeholders can make their assessments of the organisation (Balmer & Greyser, 2003a:54; Barnett *et al*, 2006:36; Chun, 2005:105; Fombrun & Van Riel, 1997:10; Fombrun & Van Riel, 2003:230; Gotsi & Wilson, 2001:29). This makes the definitive link between corporate identity and reputation (King & Whetten, 2008:193).

### **6.1.3 Corporate identity as the backbone of corporate reputation**

The groundwork for the concept of organisational identity was laid by Albert and Whetten in 1985 (Barnett *et al.*, 2006:33; Brickson, 2000:147), but it was Fombrun and Van Riel (2004:165-166) who developed this concept in the field of reputation studies



when they described a corporate identity as consisting of “... (a) features that employees consider *central* to the company, (b) features that make the organisation *distinctive* from other companies ... and (c) features that are *enduring* or continuing, linking the present and the past to the future”.

This researcher defines organisational or corporate identity as *an organisation's inherent character; that which it is, what it stands for and can be held accountable for and it encompasses the vision and values of the organisation which effectively make it unique and distinctive from other organisations* (Balmer & Gray, 2001:979; Barnett *et al.*, 2006:28,33; King & Whetten, 2008:195).

An organisation's unique identity originates from its vision, values, culture and behaviour, as well as its use of symbols and physical designs to present itself collectively to its stakeholders (Grunig, 2003:212). This collective presentation becomes institutionalised over time (King *et al.*, 2010:295; King & Whetten, 2008:195) and as such that which is core to the organisation, that which is labelled and perceived as presumably most central, enduring and distinctive about the organisation's character, contributes to institutionalise the personality of the organisation (Albert & Whetten, 2003:78; Brickson, 2000:147; Cooren *et al.*, 2011:1159; Gioia *et al.*, 2000a:63; Hatch & Schultz, 2008:50; King *et al.*, 2010:295; King & Whetten, 2008:195; Olins, 2003:56,64; Scott & Lane, 2000b:144).

This in turn allows for the identity of the organisation to create a social context and a set of expectations about appropriate behaviour. On the one hand, this helps to guide employees with a common understanding of the organisation, which influences their decisions and behaviour, without having to rely on the personal judgement of every employee (King *et al.*, 2010:295-296). On the other hand, it is held that this also guides external stakeholders to have a common understanding and expectation of the organisation.

Essentially, stakeholders come to know and form an opinion of the for-profit organisation based on its collective, institutionalised presentation of its identity (reputation), which makes it at once recognisable and distinguishable from other organisations (Balmer &

Gray, 2001:979; Barnett *et al.*, 2006:28,33; Gioia *et al.*, 2000a:64; King *et al.*, 2008:295). As such, the stakeholders will then either identify with the organisation ‘in order to feel good about who they are and what they do’ (Cooren *et al.*, 2011:1159), or they will distance themselves from the organisation if they do not agree with what it does; with its ‘social’ identity. As Brown (2000:747) points out, individual members may – in the event of an ‘unsatisfactory’ social identity – seek to leave their group (the organisation) or find ways of achieving more positive distinctiveness for it (Brown, 2000:747).

This is in line with one of the key tenets of social and organisational identity theory, namely that people tend to identify with, support and commit to an organisation whose identity increases or contributes to their own positive self-esteem, self-consistency and self-distinctiveness, since the organisation’s identity is compatible with salient aspects of their own identities (Ashforth & Mael, 1989:25; Brown, 2000:747; Scott & Lane, 2000a:47). Hogg and Terry (2000b:151) also suggest that people tend to identify with an organisation because they seek to reduce and/or avoid self-conceptual uncertainty.

Social identities “... constitute an organization’s reference group and provide stakeholders with standards by which assessments of the organization are made” (King & Whetten, 2008:192). Corporate reputation then arises from common social comparison processes, whereby internal and external stakeholders use institutionalised standards to assess and compare organisations (King & Whetten, 2008:193). Through social identity selection, an organisation becomes linked to the critical social and cognitive mechanisms through which assessments of legitimacy and reputation emerge (King & Whetten, 2008:194).

In order to aid stakeholders’ assessments of the organisation, an organisation as a social actor has to meet a key condition of successful social interaction, which is that it has to have identifying features – rendering it recognisable as a particular type of actor, as well as distinguishing it from all similar organisations (King & Whetten, 2008:195). A for-profit organisation that wants to build a strong corporate reputation and earn the trust and commitment of its internal and external stakeholders therefore needs to ensure that its identity is one that will enhance stakeholders’ positive group identification to improve cooperation and support between it and its stakeholders. This study contends that the

likelihood of this will be enhanced with the adoption of a single, value-based identity or character.

In accepting the view of a single corporate identity, the idea is also extended to a view of a single corporate reputation. A single corporate identity and reputation can also be referred to as a general or overall identity and reputation, as compared to coexisting stakeholder-specific identities and reputations for an organisation (Helm, 2007:243).

It needs to be highlighted that this concept of a single corporate reputation differs from the concept of a single reputation proposed by some authors, where a single reputation score is arrived at by weighing and combining the separate reputation scores from an organisation's different stakeholders (Bromley, 2002:41; Caruana, 1997:109). This study contends that a for-profit organisation should focus on building a single identity as an ethical and trustworthy organisation, and then use the same measurement to survey all its stakeholders in order to understand how they assess the organisation in terms of that single identity.

#### **6.1.4 Manner in which messages and symbols are processed**

Having discussed how the institutionalised identity of an organisation creates the social context and expectations about its behaviour, and the opportunity for stakeholders to identify with the organisation, it will be prudent to provide a brief overview of how people process messages and sensory inputs, and highlight the significance of this for the development of corporate reputation and trust.

Based on general theories of cognitive psychology, the manner in which messages are processed is conceptualised at three levels, namely sensory processes, perception and cognition (Grunig, 2003:213). These theories hold that message consumption starts with the sensory processes of sight, sound, taste, touch and hearing. However, since an individual cannot necessarily recognise, 'see' or pay attention to all the sensory stimuli in his environment, cognitive theories require a second stage of message consumption, namely perception. In this sense, perception means that in order for an individual to pay attention to objects in or messages from his environment, he should be able to perceive

them, that is, "... to recognize objects or see patterns in sensory stimuli" (Grunig, 2003:214).

However, before the individual can remember or think about the objects or symbolic messages he receives, he must be able to construct mental representations or concepts of the objects or messages. This third stage of the process is referred to as cognition – as "... the process through which people develop beliefs about what is real or come to understand – from their perspective, of course – what they perceive" (Grunig, 2003:214).

Social psychology adds a fourth level to this process of message consumption, namely the concept of attitude, which is essentially "... evaluations of the objects and attributes in cognitions or the possible behaviors that are implied in cognitions" (Grunig, 2003:215). Petty and Cacioppo (in Grunig, 2003:215) define attitudes as "... *general evaluations people hold in regard to themselves, other people, objects, and issues*". In addition, attitude can be regarded as a behavioural intent.

Perception, cognition and evaluation are then the major processes that take place in the mind, but there is a definite link between these processes and actual behaviour. Grunig (2003:215) cites research by social psychologists that show that attitude, particularly in situations that are open to change, can predict behaviour. In noting the important link that cognitive theorists are making between cognition and attitude, Grunig (2003:215) observes that these theorists hold that "... people who construct new cognitive units – that is who *think* about – persuasive messages are most likely to change their attitudes, especially when they are highly involved in a situation to which the attitude applies".

The relevance of this is that any organisation that wants to establish a strong corporate reputation, one that will lead to the desired behaviour where its stakeholders will trust and support the organisation, needs to keep these processes in mind, not only when it plans and executes its communication, but more particularly also when it (re)defines its identity. The following explanation will serve to clarify this statement: People, over the long term "... organize their cognitions and attitudes into complex units of knowledge called schemas or schemata", which are broader sets of cognitive units, as well as

evaluative and behavioural intentions (Grunig, 2003:216). This is what constitutes an individual's subjective knowledge about the organisation, and it is this knowledge that largely governs his behaviour. Psychologists have learned that people can organise their schemas in different ways, but most often "... the mind groups cognitions and attitudes because they have a 'family resemblance' ... [that is] people remember and associate cognitive units that seem relevant and similar to them – i.e. cognitive units that resemble each other in the same inexact way that family members do" (Grunig, 2003:217).

This accentuates two key factors: on the one hand, it underlines the need for and the importance of a corporate identity that stakeholders can identify with, since it is in their identification with the organisation that stakeholders' commitment to and positive support of the organisation originate. On the other hand, this also highlights the need for the organisation to make itself known to its stakeholders by establishing its corporate reputation through its corporate communication and relationship-building activities.

These factors are discussed in greater detail in Chapter 5, where the link between identity and reputation and the key elements that are required to build a sustainable reputation will be outlined, in order to substantiate its relationship with trust.

## **6.2 CONCLUSION: THEORETICAL BASIS FOR THE REPUTATION CONSTRUCT**

Corporate identity is regarded as the core foundation of corporate reputation. Just as an individual is responsible for shaping and presenting his own identity in order to improve interaction and cooperation with those around him, an organisation as an independent social actor in its own right is, and is held, responsible for managing its own character. It also has the responsibility to ensure that its stakeholders get to know who it is and what it stands for through its communication and reputation-building activities. Research has shown that communication promotes feelings of group identity (Stout & Blair, 2001:48).

However, it is held that stakeholders' commitment and support is largely dependent on who the organisation is, on the very identity that it adopts, demonstrates and presents. This study posits that by establishing its identity as an ethical and trustworthy for-profit

organisation, it ensures that its core values will resonate on an emotional level with its stakeholders, and so increase the opportunity that its stakeholders will positively identify with it and its values. Since its stakeholders grant an organisation its legitimacy, they can justifiably expect and demand congruence between social values and the organisation's actions.

Corporate reputation is regarded as the assessment that stakeholders make of the organisation, based on that which it defines itself to be, its identity, which originates from its vision and its values. Since a for-profit organisation is dependent on the approval of its stakeholders to continue operating, its corporate reputation is an intangible asset that it relies on to enhance its own long-term sustainability (King & Whetten, 2008:192).

The reputation construct is theoretically grounded in social identity theory, which is extended to organisational identity theory. Social identity theory proposes that people categorise themselves and others into social groups, which is related to how they seek to achieve or maintain a positive social identity, which derives from favourable comparisons that can be made with similar groups (Brown, 2000:747), in order to boost their own self-esteem. By positively differentiating the group they belong to on some valued dimension, people's individual sense of self is then defined in terms of their social identity. This has significant consequences for an organisation.

Organisational identification can be regarded as a specific form of social identification (Ashforth & Mael, 1989:22). As such, it is held that just as an individual will derive his social identity from the relevant and significant groups that he identifies with and classifies himself as a part of (Ashforth & Mael, 1989:21; Brown, 2000:746-747; Olins, 2003:57), stakeholders of an organisation will tend to identify with, commit to and support an organisation whose identity increases or contributes to their own positive self-esteem and self-distinctiveness, since the organisation's identity is compatible with salient aspects of their own identities (Ashforth & Mael, 1989:25; Brown, 2000:747; Scott & Lane, 2000a:47).

While stakeholders' perception, cognition and evaluation of an organisation take place in the mind, there is a definite link between these processes and actual behaviour, since it

is through their identification with the organisation that stakeholders' commitment and positive support originate. When stakeholders feel good about who the organisation is and what it does, it will make them feel good about who they are. This in turn will lead to their commitment to and supportive behaviour for the organisation. When stakeholders do not agree with what the organisation does, when they cannot identify with its 'social' identity, they will distance themselves from it and withdraw their support.

Based on the literature on organisational identity, several factors that will most likely increase the tendency of individuals to identify with and therefore commit to and support the organisation are identified: the distinctiveness of the organisation's values and practices, which provides it with a unique identity; the prestige of the organisation; the prominence and awareness of comparable organisations as outgroups; and the effects of intergroup competition, which lead to group lines being drawn more sharply and to values, norms and the we/they differences being emphasised (Ashforth & Mael, 1989:24-25).

At least three consequences that make social identification relevant to organisations are identified. The first is that since individuals tend to choose activities that are congruent with prominent aspects of their own identities (Ashforth & Mael, 1989:25; Hogg & Terry, 2000a:123), it is likely that identification with an organisation will enhance internal and external stakeholders' support and commitment.

A second consequence is that social identification affects the outcomes that are usually associated with group formation, such as cooperation and altruism, making it likely that stakeholders' identification may engender the internalisation of, and adherence to, the organisation's values and norms; homogeneity in attitudes and behaviour; and stakeholders' loyalty to, and pride in, the organisation and its activities (Ashforth & Mael, 1989: 26; Hogg & Terry, 2000a:123).

In the third place, social identification reinforces the very antecedents of identification, including the distinctiveness, and therefore stakeholders' positive perception, of the organisation's values and practices (Ashforth & Mael, 1989:26; Hogg & Terry, 2000a:127).

This underscores the suggestion of adopting a single, value-based corporate identity as the foundation of a corporate reputation that will earn stakeholders' trust as well as the suggestion of building a corporate reputation (i.e. to make sure that it is 'being seen') on the back of the organisation's single, value-based identity in order to earn stakeholders' trust.

In crediting a collectivity with a psychological reality beyond its membership, social identification then enables the individual to conceive of, and feel loyal to, an organisation or corporate culture, which in turn makes group commitment and behaviour possible. This is possible because social interaction involves the motivated manipulation (to ensure alignment, not to deceive) of symbols through speech, appearance and behaviour by an organisation that is strategically competing with others to influence the frame of reference within which accessibility and fit interact (Hogg & Terry, 2000a:125).

Real corporate identity is then about behaviour as much as appearance, and certainly about reality, as much as symbolism. "Whenever behaviour and appearance are linked, real corporate identity emerges." (Olins, 2003:56). This dynamic perspective on identity and self-conceptual prominence has clear implications for an organisational context. Based on its own selection of a social identity and the articulation of this desired identity, an organisation provides stakeholders with a promise; a standard by which they can make an assessment of the organisation, also in comparison to other similar organisations (King & Whetten, 2008:192).

It is against this promise that stakeholders can assess how well the organisation is fulfilling its promise to them, based on what they experience from its culture and actual behaviour, as well as what they hear about the organisation and learn from its use of communication, symbols and physical designs to present itself to its stakeholders. The organisation's reputation then emerges based on those collective social comparison processes, whereby stakeholders use institutionalised standards to assess and compare organisations (King & Whetten, 2008:193).

Corporate identity is then primarily concerned with the way the organisation collectively presents its character to its stakeholders – in behaviour and appearance – in order to



provide the basis on which stakeholders can make their assessments of the organisation (Balmer & Greyser, 2003a:54; Barnett *et al*, 2006:36; Chun, 2005:105; Fombrun & Van Riel, 1997:10; Fombrun & Van Riel, 2003:230; Gotsi & Wilson, 2001:29). This makes the definitive link between corporate identity and reputation (King & Whetten, 2008:193).

## **7 THEORETICAL FOUNDATION FOR THE STAKEHOLDER CONSTRUCT**

The last construct to be discussed in this theoretical chapter is the stakeholder construct. Stakeholder theory is very pertinent to the focus of this study since it provides a comprehensive connection between systems theory, social systems theory and the corporate trust concept, and it contextualises the key role that stakeholders play in influencing a for-profit organisation's long-term economic success and viability.

This serves as background to the assertion of this study that it is imperative for a for-profit organisation to pay close attention to how its stakeholders perceive it – to deliberately work at fostering an authentic relationship with its stakeholders, to earn its stakeholders' trust by being trustworthy in all it does and by building a concomitant corporate reputation.

It is then held in this study that a for-profit organisation, as a socially engineered system, is capable of purposive action and change – it can effectively integrate the concepts of stakeholder theory into its own corporate sustainability strategy and it can change and become a trustworthy, ethically responsible corporate citizen in order to earn its stakeholders' trust.

### **7.1 OVERVIEW OF THE STAKEHOLDER THEORY DISCUSSION**

First, a brief background on stakeholder theory is provided, and the increased need for ethical decision-making at the start of the twenty-first century is highlighted. The key tenet of stakeholder theory is then briefly outlined, before the key approaches to

stakeholder theory and the concept of stakeholder capitalism are discussed. The concept and role of stakeholders are then defined.

Next, stakeholder theory is discussed from an organisational perspective, within the context of the nature of a for-profit organisation, before the relevance of stakeholder theory to organisational performance is outlined. This is followed with an overview of stakeholder theory from a stakeholder perspective. In particular, stakeholders' sources of power and support are discussed.

The importance of ethics and values is then discussed, by outlining the principle of fairness, the role of ethics and values, and the link to trustworthiness and trust. This section on the theoretical foundation of the stakeholder construct is concluded with a brief summary, prior to providing the overall conclusion for this chapter.

## **7.2 OVERVIEW OF STAKEHOLDER THEORY**

### **7.2.1 Background on stakeholder theory**

Originating in the work of R. Edward Freeman (1984), the concept of stakeholders, referring to the groups or individuals that have a stake – a role and impact – in the success or failure of the for-profit organisation, has been developed (Freeman *et al.*, 2010:xv). Consequently, Freeman is often described as the father of stakeholder theory (Friedman & Miles, 2006:19; Hatch & Schultz, 2008:151; Laplume *et al.*, 2008:1152).

While the stakeholder concept is implied in the works of the Stanford Research Institute (1963); Rhenman and Stymne (1965) in Sweden and Ansoff (1965) in the United States, Freeman was the first author to fully articulate the stakeholder framework in his seminal book *Stakeholder Management: A Stakeholder Approach* in 1984 (Friedman & Miles, 2006:19; Laplume *et al.*, 2008:1156-1157).

Freeman's point of departure was that the existing management theories of the 1980s were "... inconsistent with both the quantity and kinds of change which [were] occurring in the business environment", since these theories emphasised the static nature of

organisations and the predictable and relatively consistent nature of an organisation's external environment (Freeman, 1984:5).

In contrast to the simplicity of owner-entrepreneur organisations in the past, where 'doing business' consisted of buying raw materials from suppliers, converting it to products and selling it to customers and where the owner/manager/employee only needed to worry about satisfying customers and suppliers to make the business successful, organisations in the late twentieth century were larger, and much more complex (Freeman, 1984:5-6; Mackey, 2009:74). This meant that in order to be successful, the managers of an organisation needed to simultaneously satisfy the diverse needs and demands of multiple stakeholders, including owners, shareholders, employees, unions, customers, suppliers, government, consumer advocates, environmentalists, special interest groups, media and even competitors (Freeman, 1984:8-22; Friedman & Miles, 2006:1).

Freeman (1984:5) therefore held that a new conceptual framework was needed, one that would enable managers to turn the external changes – the emergence of new groups, events and issues which could not be readily understood within the framework of an existing model or theory – into internal change, by reassessing current objectives and policies in the light of new demands from the groups the organisation was dealing with, in order to reduce the uncertainty that the external changes brought about (Freeman, 1984:5,8,11,13).

Freeman's initial intent in 1984 was then to offer a pragmatic approach to strategy that urged organisations to be cognisant of their stakeholders in order to achieve superior performance (Laplume *et al.*, 2008:1153), and he regards his work in 1984 as a framework for management, which aimed at developing "... a generalizable and testable approach to managerial strategic decision-making" (Freeman, 1984:4).

According to Laplume *et al.* (2008:1158), Freeman's overall stakeholder approach was "... unabashedly strategic in content because consideration of stakeholder interests was seen as playing an instrumental role in enhancing firm performance".

While the stakeholder concept had developed in a number of disciplines over the course of its history, Freeman (1984:48-49) drew on various literatures on strategic planning, systems theory, corporate social responsibility and organisational theory to develop an approach to strategic management, essentially focusing on showing how the stakeholder view would reconceptualise the concept of strategic management (Freeman, 1984:43; Freeman & Phillips, 2002:333; Freeman *et al.*, 2010:xvi).

In their review of the literature on academic stakeholder theory as it developed between 1984 and 2007, Laplume *et al.* (2008:1152) analysed the content of 179 articles that directly addressed Freeman's work on stakeholder theory. These authors noted a substantial rise in stakeholder theory's prominence since 1995 and documented that the theory has detractors insofar as it questions the maximisation of shareholders' wealth as the most fundamental objective of business. These authors also noted that, "... [h]aving written several dozen articles, books, and book chapters on the subject, over the course of more than two decades, Freeman continues to act as stakeholder theory's senior trustee" (Laplume *et al.*, 2008:1158).

While interest in stakeholder theory took root in the field of strategic management and then grew into organisational theory and business ethics, the theory's social responsibility element allowed it to blend into social issues in management. More recently, it has begun to enter the conversation about sustainable development (Laplume *et al.*, 2008:1156; Mackey, 2009:76).

It is held that now in 2012, even more than before, there is a need to think differently about the strategic management of a for-profit organisation, particularly in terms of ensuring its own long-term economic sustainability (Mackey, 2009:103). This is particularly due to the dramatic changes that characterise the twenty-first century, such as the rise of globalisation, the dominance of information technology and the increased societal awareness of the impact of business on communities and society in general (Freeman *et al.*, 2010:3).

These changes have brought about major challenges for private sector organisations, in that they can no longer rely on managing their organisations based on the dominant

view of understanding business and management theory that was developed during less turbulent times, such as Weber's ideas about bureaucracy (Freeman *et al.*, 2010:3).

### **7.2.2 Key tenet of stakeholder theory**

The stakeholder view represents a departure from the standard and predominant understanding of business, namely that a for-profit organisation is merely a vehicle to maximise returns to the owners of capital. However, while the stakeholder view is often put forward simply as an alternative to this mainstream view of shareholder capitalism, Freeman instead holds that there is little direct conflict between the shareholder view and the stakeholder view (Freeman, 2008:166).

Essentially, stakeholder theory is held to be about business and capitalism, business being "... that human institution that is about value creation and trade" (Freeman & Phillips, 2002:340). As Freeman (2008:166) posits: "Stakeholder theory offers a different set of metaphors and ideas, with hope that we can make capitalism work better for us." As such, stakeholder theory is a more useful way to understand modern capitalism (Freeman *et al.*, 2010:xv).

Increasingly, the relationship between capitalism and society is being questioned, particularly since the global financial crisis in 2008/2009 (Freeman *et al.*, 2010:5; IISD, 2009; Mackey, 2009:73; Uslaner, 2010:111).

Freeman *et al.* (2010:xv) observe that the changes in the business environment in the twenty-first century "... necessitate a rethinking of the dominant conceptual models used to understand business", particularly in order to deal with the increased interest in understanding how capitalism, ethics, sustainability and social responsibility can be forged into new ways of thinking about business (Freeman *et al.*, 2010:5). These authors suggest that stakeholder theory can contribute to solving some of the problems, particularly with regard to addressing the problems of value creation and trade, the ethics of capitalism and the prevailing managerial mindset that separates business and ethics in their decision-making (Freeman *et al.*, 2010:4,5).

In particular, it is held that the problem of the ethics of capitalism originates from the fact that most theories of business rely on separating 'business' decisions from 'ethical' decisions (Freeman *et al.*, 2010:6; Mackey, 2009:76). Stakeholder theory suggests that the adoption of the relationship between a for-profit organisation and its stakeholders as a unit of analysis provides a more effective way to conceptualise and deal with combining these issues (Freeman *et al.*, 2010:5-6; Mackey, 2009:104). Stakeholder theory views organisations as systems that are dependent on their internal and external stakeholders for survival (Freeman *et al.*, 2010:86).

Today's for-profit organisations can no longer assume the dominance of capitalism as the main means of organising value creation and trade, especially not if their concept of capitalism is based on an understanding of a kind of economics that assumes "... the questions of values and ethics [are] at best 'extra-theoretic' if not downright irrelevant" (Freeman *et al.*, 2010:4). In an environment where people are increasingly aware of the effect of capitalism on society, it has become clear that an organisation that restricts its attention only to the economic effects of its business is putting its longer-term economic performance and survival at risk.

An organisation that is engaged in value creation and trade is held to be responsible to its stakeholders, those groups and individuals who can affect or who are affected by the organisation's actions. It is held that an organisation that recognises the joint interests of all of its stakeholders (not just its shareholders), and then works towards creating value for all of them, will be managing its business ethically and will therefore make its business work at its best (Freeman *et al.*, 2010:9; Friedman & Miles, 2006:160).

Perhaps the most significant criticisms of stakeholder theory are that it violates the shareholder-manager relationship (Friedman & Miles, 2006:119) and the claim by some economists that stakeholder management promotes mismanagement because it gives managers too much power to distribute shareholder wealth in questionable ways (Friedman & Miles, 2006:122). For example, Jensen (in Laplume *et al.*, 2008:1159) characterised stakeholder theory "... as an affront to 200 years of economic theory and research" and argued that "... stakeholder theory plays into the hands of special interests who wish to use the resources of firms for their own ends".

Jensen (2008:167) also observes that the danger of stakeholder theory, as he has seen it expressed in most cases, is that those who advocate it simply assume that managers would do the right thing so as to benefit society as a whole. He regards this position as naive for at least two reasons, in that managers would have no way of knowing how to best benefit society, and furthermore there would be widespread disagreement on how and what to do. “Moreover”, Jensen (2008:167) writes, “if adopted, stakeholder theory would do further damage. It would literally leave managers unmonitored and unaccountable in any principled way for their actions with the vast resources under their control. Now that’s a disaster.”

Conversely, Freeman believes that the key insight of stakeholder theory is that capitalism works because there is a jointness to the interests of at least customers, suppliers, employees, communities and financiers. “The role of the manager or entrepreneur is to capture the nature of that joint interest and create value for each and all. Where there is conflict, innovation kicks in and *more* [own emphasis] value gets created.” (Personal communication from Freeman, March 12, 2008, in Laplume *et al.*, 2008:1179).

As Donaldson (2008:173) rightly notes, the assumption of the economy as a zero-sum game (that is, assuming that there is only a fixed amount of wealth available) was thrown out by a ‘young moral philosopher’ by the name of Adam Smith (widely cited as the father of modern economics and capitalism) in 1776, and replaced with a new understanding about how vast wealth and value could be created, especially through labour and voluntary exchange.

While economists such as Milton Friedman then hold that a successful business is characterised only by its ability to maximise profits for its shareholders, stakeholder theory holds a more extended view, namely that *in order to* maximise profits a for-profit organisation needs great products and services that customers want, solid relationships with suppliers that keep operations on the cutting edge, inspired and committed employees who stand for the company mission and push the company to get better, and supportive communities that allow businesses to flourish (Freeman *et al.*, 2010:11; Mackey, 2009:83).

Mackey (2009:82-85) explains this profit paradox, by outlining that the best way to maximise profits over the long term is *not* to make profit the primary goal of the business. Rather, it is held that management should focus on fulfilling its role to optimise the health and value of the organisation as an interdependent system as well as the well-being of all its stakeholders instead, to achieve an end result which will also be the highest long-term profits for its shareholders.

Similarly, Freeman (2008:166) argues: “If a business tries to maximize profits, in fact, profits don’t get maximized, at least in the real world. The reason may be clear: tradeoffs are made in favor of financiers, and the tradeoffs are false ones due to complexity, uncertainty and bounded rationality.” He notes that Friedman and his followers may be focusing on a theory about the way markets work under certain kinds of conditions, and while he holds that this theory is useful for certain purposes, stakeholder theory, in his view, is not about markets and how they work. Stakeholder theory, according to Freeman (2008:166) is “... not a theory of the firm. Rather it is a very simple idea about how people create value for each other. It’s a theory about what good management is.”

Consequently, Freeman (2008:166) and Mackey (2009:83) suggest that the primary responsibility of an organisation’s leadership is to create as much value as possible for their stakeholders, because that is how they create as much value as possible for their shareholders. In the case of conflict between stakeholders and shareholders, executives have to rethink the problem so the interests go together, since no stakeholder interest stands alone. Freeman also acknowledges that sometimes interests will conflict and executives will have to make tradeoffs. “When that happens, the executive has to figure out how to make the tradeoffs and figure out how to improve the tradeoffs for both sides. Managing the stakeholders is about creating as much value as possible for stakeholders without resorting to tradeoffs, or fraud and deception.” (Freeman, 2008:166).

Essentially, stakeholder engagement, which denotes the allocation of resources to stakeholders, matters for the creation and distribution of economic value (Crilly, 2011:519). As such, stakeholder theory is about value creation and how to manage a business effectively, which is to create as much value as possible for all stakeholders, including its shareholders (Freeman *et al.*, 2010:9; Friedman & Miles, 2006:150).



Stakeholder theory then unequivocally rejects the 'separation thesis', which holds that ethics and economics can be separated (Freeman, 2008:163; Freeman, Wicks & Parmar, 2004:364; Friedman & Miles, 2006:124). As Freeman *et al.* (2004:364-365) observe, "... dividing the world into 'shareholder concerns' [economics] and 'stakeholder concerns' [ethics] is roughly the logical equivalent of contrasting 'apples' with 'fruit'".

### **7.2.3 Key approaches to stakeholder theory**

According to Freeman *et al.* (2010:212), Donaldson and Preston (1995) were the first to explicitly acknowledge the notion that the overall body of stakeholder theory can basically be categorised into three distinct parts. The three distinguishing parts or approaches to stakeholder theory are the descriptive approach, which refers to research that focuses on making factual claims about what managers and organisations actually do in terms of stakeholder relationships; the instrumental approach, which refers to research that focuses on the outcomes of specific managerial behaviour; and the normative element, which refers to research that focuses on what managers and organisations should do (Friedman & Miles, 2006:29).

The first two elements of stakeholder theory are unequivocally part of the social sciences and involve matters of fact. The normative element, however, is explicitly moral and situated in the ethical domain (Freeman *et al.*, 2010:212; Friedman & Miles, 2006:36-37; Mackey, 2009:76). Each of these elements has its own specific role and methodology, and each plays an important role in stakeholder theory. Scholars differ, however, in terms of the nature of the relationship between these elements. Donaldson and Preston regard these as not being equal, in that they view the normative element as forming the central core of stakeholder theory, while the other two elements are held to fulfil a subordinate role (Freeman & Phillips, 2002:339). In contrast, Jones and Wicks claim that while there is an important connection between the three different elements, the differences between these are not sharp and clear-cut as suggested (Freeman *et al.*, 2010:212).

Stakeholder theory is then seen as a theory of organisational management and ethics, as indeed all theories of strategic management have some moral, though often implicit,

content (Freeman & Phillips, 2002:333; Phillips *et al.*, 2003:480; Friedman & Miles, 2006:37; Mackey, 2009:76).

Stakeholder theory is distinct from other organisational management theories, because it addresses morals and values explicitly as a central feature of managing organisations. Since the ends of cooperative activity and the means of achieving these ends are critically examined in stakeholder theory in a way that they are not in many theories of strategic management, stakeholder theory is conceived in terms that are "... explicitly and unabashedly moral" (Phillips *et al.*, 2003:481). However, while stakeholder theory is first and fundamentally a moral theory that specifies the obligations of a for-profit organisation to their stakeholders, Freeman also holds that it is not always possible to draw a sharp and clear distinction between these different elements of stakeholder theory (Freeman *et al.*, 2010:212-213).

Based on Freeman's suggestion that "... all these forms of enquiry are forms of storytelling, and that, conceptually, all three branches have elements of the others embedded within them", Freeman *et al.* (2010:213) posit that the creation of compelling stories involves all three elements of stakeholder theory, and they support the additional element, as originally proposed by Donaldson and Preston in 1995, namely that stakeholder theory is also managerial, since it helps managers to create value for stakeholders and enables them "... to live better lives in the real world, not in some imaginary fantasy of philosophers".

Stakeholder theory is widely regarded among academic business ethicists as the most significant theoretical construct in their discipline. Normative ethical stakeholder theory articulates the view that a for-profit organisation ought to be managed in a way that achieves a balance among the interests of all its stakeholders (Friedman & Miles, 2006:182-183; Laplume *et al.*, 2008:1179; Mackey, 2009:83; Marcoux, 2008).

#### **7.2.4 The concept of stakeholder capitalism**

As a possible answer to the question of whether there can be a systematic way to understand business activity that is both libertarian in spirit and attends to the

managerial interests inherent in the stakeholder approach, Freeman and Phillips (2002:339) propose the concept of stakeholder capitalism, as part of their ‘libertarian’ defence of stakeholder theory. With this concept, they argue that “... strong notions of ‘freedom’ and ‘voluntary action’ are the best possible underpinnings for stakeholder theory, and in doing so, [they] seek to return ‘stakeholder theory’ to its managerial and libertarian roots found in Freeman (1984)” (Freeman & Phillips, 2002:331).

This concept is similar in sentiment to the concepts of moral, ethical and conscious capitalism that will be discussed in Chapter 3, but is discussed in greater detail here as part of the larger stakeholder theory discussion.

▪ ***Concept of freedom as a foundation for stakeholder theory***

The hallmark of libertarian theory is one of consent and agreement, where free people have the right to make agreements with others, even if some of those agreements limit their own freedom (Freeman & Phillips, 2002:341; Mackey, 2009:75). Based on three criteria for a libertarian theory, namely freedom, rights and the creation of positive obligations by consent, Freeman and Phillips posit that the reason “... why capitalism works is ultimately due to these three ideas and how they interact”.

Business is founded and created on the idea that people are free to enter into agreements with one another, and that others are not permitted to interfere unless they are substantially affected by those agreements (Mackey, 2009:75). “Entrepreneurs see the possibility of creating value where others do not. They contract with suppliers, employees, suppliers of finance, and customers, as well as others, to start and build firms. In other words they create a set of positive obligations among those parties.” (Freeman & Phillips, 2002:341).

Freeman and Phillips (2002:344) hold that “... the principle of continuous creation claims that the creative force of humans is the real engine of capitalism. One creation doesn’t have to destroy another; rather there is a continuous cycle of value creation which raises the well-being of everyone. People come together to create something, be it a new computer program, a new level of service ... or simply to work together. It is the creative spirit that results from freedom-loving people that makes capitalism work.”

- ***Concept of voluntary action as a foundation for ethical stakeholder theory***

Voluntary action is the well-spring of capitalism. All the stakeholders of a business, such as customers, suppliers, employees, financiers and communities voluntarily exchange with the business to create value for themselves and for others. The voluntary support of each group is vital to the success of the endeavour and the outcomes are synergistic. This is the cooperative common-sense part of business that every executive knows (Mackey, 2009:75-76). “When stakeholders pool their resources to create something; no one has the right to prevent their actions, provided they do not impose substantial harms on innocent third parties.” (Freeman & Phillips, 2002:341).

Value creation and trade is not a zero-sum game (Freeman & Phillips, 2002:341). This implies that there is a concomitant responsibility for both parties to the voluntary agreement that comes with exercising their freedom. “This voluntary exchange for mutual benefit is the ethical foundation of business and capitalism.” (Mackey, 2009:75). The alternative to the two principles of individuals’ freedom to voluntarily enter into agreements, and accept the associated responsibility that comes with exercising such freedom, is “... a view that capitalism rests on the idea that ‘anything goes’ and ‘let the buyer beware’”. (Freeman & Phillips, 2002:342).

Stakeholder capitalism then requires that freedom-loving human beings be at the centre of any process of value creation and trade, and it underscores the responsibility thesis that common decency and fairness are not to be set aside in the name of playing the game of business. “It suggests that we should demand the best behavior of business, and that we should enact a story about business that celebrates its triumphs, admonishes its failures, and fully partakes of the moral discourse in society as a routine matter.” (Freeman & Phillips, 2002:345). This is in line with Wood’s observations, when she suggests that an organisation built upon business ethics (versus the reverse) can be the repository of economic responsibility (Agle & Mitchell, 2008:181).

- ***Contribution of the concept of stakeholder capitalism***

While Freeman and Phillips do not propose the concept of stakeholder capitalism as the ultimate solution, they do highlight that it simply allows the possibility that business

becomes a fully human institution. “Stakeholder capitalism bases our understanding and expectations of business not on the worst that we can do, but on the best. It sets a high standard, recognizes the common sense practical world of global business today, and asks managers to get on with the task of creating value for all stakeholders.” (Freeman & Phillips, 2002:345).

According to Freeman and Phillips (2002:345), stakeholder capitalism then invokes a focus at the level of *how* value is created “... rather than at the societal level of value distribution, or the accrual of large amounts of capital and control over it”. These authors suggest that, by focusing on these principles, capitalism can be reoriented toward an ethics of freedom and responsibility, ultimately to an approach that inherently marries business and ethics.

### 7.3 DEFINITION AND RELEVANCE OF STAKEHOLDERS

Freeman’s classical definition of a stakeholder is “... *any group or individual who can affect or is affected by the achievement of the organization’s objectives*” (Freeman, 1984:46; Friedman & Miles, 2006:1). It would seem that, while Freeman held that an organisation needs to deal with those groups that it can affect in order to be effective, he was mostly interested in the ‘is affected’ category to the extent that these stakeholder groups could potentially affect the performance and sustainability of an organisation (Laplume *et al.*,2008:1160-1161).

“To be an effective strategist,” Freeman wrote, “you must deal with those groups that can affect you, while to be responsive (and effective in the long run) you must deal with those groups that you can affect” (Freeman, 1984:46).

An example of stakeholders who can affect an organisation are those active stakeholders or stakeholder groups (also called special interest groups or ‘brand communities’) who may not be as directly involved in an organisation as employees, customers or shareholders are, but who do take a specific interest in it. These stakeholders can affect an organisation, in that they can either add huge value to the organisation if they support or endorse it, or exert influence to change or even stop the

organisation's intended actions if they don't agree with them (Hatch & Schultz, 2008:192).

There are different views in the literature on who should be regarded as stakeholders, ranging from a narrow or restrictive view of stakeholders, that is, only those that yield power over organisations or take on risk; to an expansive or broad view of stakeholders that includes the powerless and even nonhuman entities such as trees and deities (Friedman & Miles, 2006:9; Laplume *et al.*, 2008:1161).

However, in this study, where a strong emphasis is placed on the importance of stakeholders' identification with and support for an organisation to ensure its long-term economic sustainability, the outcome of work done by Mitchell, Agle and Wood in 1997 is supported. These authors, who synthesised approximately 20 different studies on stakeholder identification, concluded that managers pay attention to those stakeholders who have power in relation to the organisation, in that they possess valued resources; are deemed legitimate, in that they are socially accepted and expected; and can muster urgency, in that they have time-sensitive or critical claims (Laplume *et al.*, 2008:1161).

A stakeholder is then defined in this study as *any person or group who has a direct interest, involvement or investment in an organisation, who can affect the organisation and its operations, or who can be affected by the organisation, its decisions and operations* (Hatch & Schultz, 2008:192-193; King, 2009:100; Steyn & Puth, 2000:5). A stakeholder is therefore regarded not just as a person or group of people "... who may benefit from or be harmed by the actions of the organisation" (Davies *et al.*, 2003:58-59), but as someone who can *also* either hinder or assist the organisation in its endeavours.

An organisation will therefore have multiple stakeholders, depending on the business of the organisation. Stakeholders can typically be grouped as internal stakeholders, such as employees, managers and unions, and external stakeholders, such as customers, shareholders, media, suppliers, special interest and activist groups and the public (Chun, 2005:93; Jones, 2007:28-31). Each stakeholder group will have different needs and expectations of and perspectives on the organisation (Hatch & Schultz, 2008:193), and each stakeholder or group has the power to affect the organisation, its operations,

and therefore its performance and success in some way (Davies *et al.*, 2003:60; Friedman & Miles, 2006:11).

Crilly's (2011:519) categorisation of primary stakeholders, such as employees, investors, and suppliers who are involved in the production process, as well as secondary stakeholders, such as communities and regulators "... that grant legitimacy to corporate activity" is therefore not supported, since it is held that *all* stakeholders are involved in granting a for-profit organisation its legitimacy, its 'licence to operate', and in ensuring its performance and sustainability.

However, another categorisation of stakeholders which is supported in this study is to separate stakeholders into normative and derivative stakeholders. Normative stakeholders are those for whose benefit the organisation ought to be managed, and as such the organisation has a direct moral obligation to attend to their well-being. Typical normative stakeholders are those most frequently cited in stakeholder discussions such as financiers, employees, customers, suppliers and local communities. Normative legitimacy is created by the principle of stakeholder fairness and the obligations that arise from that (Phillips, 2003:10).

Conversely, derivative legitimacy is derived from these prior moral obligations and gets its force from the ability of certain groups to affect the well-being of the organisation and its normative stakeholders (Phillips, 2003:10). Derivative stakeholders are then those groups or individuals who can either harm or benefit the organisation, but to whom the organisation has no direct moral obligation as stakeholders. While the organisation is not managed for the benefit of derivative stakeholders, managers are obliged to account for them in their decision-making to the extent that they may influence the organisation or its normative stakeholders. This latter group might include such groups as competitors, activists, terrorists and the media (Phillips *et al.*, 2003:489).

The view held in this study, based on stakeholder theory as originated in the work of Edward Freeman in 1984, is that an organisation has to manage its business in such a way that it achieves a balance among the interests of all its stakeholders (Friedman &

Miles, 2006:162). “In Freeman’s account, the very purpose of the firm is coordination of and joint service to its stakeholders.” (Marcoux, 2008).

## 7.4 ORGANISATIONAL ACTIONS AND RESPONSES

### 7.4.1 Nature of for-profit organisations

Formal business organisations are among the most powerful and dominant modern-day social entities, which control vast resources, cross national borders, and affect every human life (Laplume *et al.*, 2008:1153; Mackey, 2009:73; Phillips, 2003:1). As such, it is held that any economic system or institution, especially the most important modern economic institution, the for-profit organisation, stands in need of normative justification. In this light, Donaldson (2008:175) argues: “We must eventually abandon justifying such institutions entirely in terms of back-to-front, patched-up theories, such as voluntary transactions and free market systems. We must face up to the questions, as we are beginning to, of ‘Why does the corporation exist?’ and ‘What are these institutions for?’ Corporations, larger and richer than most of us, are, if nothing else, artefacts. We made them; we created them; and we will make them differently in the future.”

This view is shared by Wood (2008:160), who states that institutions do not exist to serve their own purposes, but rather to serve the needs of societies and their peoples. “Business, like all other societal institutions (including the family, religion, education, government, etc.), serves vital functions but is never completely free to act as an independent entity.”

Wood (2008:160-161) also refers to the fact that all societies use social control mechanisms, including laws, regulations, economic sanctions, moral persuasion, interpersonal behaviours and the individual internalisation of rules and norms, to govern people, institutions and business organisations: “A company’s right to pollute a commons or mislabel goods or mislead shareholders ends short of causing harm to the relevant stakeholders. Society’s social control mechanisms help to ensure that such rights are not violated and, when they are, that fair compensation and retribution are forthcoming. Social control mechanisms help to ensure that institutions function



effectively, and that common areas are preserved for the benefit of all. They are a necessary antidote to the toxic effects of the pursuit of economic self-interest.”

#### **7.4.2 Stakeholder theory from an organisational perspective**

The long-term survival and success of a for-profit organisation is determined by its ability to establish and maintain relationships with its entire network of stakeholders (Freeman *et al.*, 2010:96; Friedman & Miles, 2006:163; Mackey, 2009:82-85). Responsible stakeholder treatment can help an organisation to avoid value-destroying outcomes associated with stakeholder dissatisfaction and actions, such as legal suits, adverse regulation, consumer boycotts, strikes, walkouts and bad press; and reduce expenses and strategic risks related to negative stakeholder-related outcomes (Freeman *et al.*, 2010:95-96; Friedman & Miles, 2006:234).

Excellent stakeholder relationships can also provide numerous positive opportunities and benefits to an organisation, as is discussed in greater detail in this study. In brief, this includes enhanced organisational flexibility, the formation of alliances, long-term contracts, joint ventures and increased economic value (Friedman & Miles, 2006:234). “A trustworthy reputation becomes a source of competitive advantage as the firm is presented with a larger number of better business opportunities from which to select.” (Freeman *et al.*, 2010:96-97).

In line with Freeman’s view of stakeholders as being either cooperative (providing opportunities) or competitive (posing threats), the question is what an organisation needs to do to gain its stakeholders’ support. There are many different views in the literature on stakeholder theory, including that organisations can gain stakeholder support through charitable contributions, employee stock option programmes, organisational communication and reputation management (Laplume *et al.*, 2008:1164).

This study, however, posits that one of the key strategies that an organisation can use to build an enduring relationship with its stakeholders, which in turn will produce their support, is to build trust and avoid treating its stakeholders opportunistically (Friedman & Miles, 2006:92). This is in line with the view of several scholars, such as Calton and

Lad; Heugens, Van den Bosch and Van Riel; Hosmer and Kiewitz; Husted; and Jones (Laplume *et al.*, 2008:1165).

This study also contends that the manner in which an organisation can do this is to manage its identity accordingly (Friedland & Miles, 2009:52-53). Brickson (in Laplume *et al.*, 2008:1165) proposes that an organisation's identity orientation (i.e. individualist, relational, or collectivist) determines the nature of its stakeholder relationships and she notes: "Although individualistic firms tend to maintain weak (instrumental) ties, relational firms tend to maintain strong (trust-based) ties, and collectivist firms tend to have cliquish (ideological) ties."

Based on the sociological systems theory that underpins this study's theoretical framework, this researcher supports the relational identity orientation. Consequently it is held that organisational identification is a mechanism that aligns individual stakeholders' interests and behaviours with interests and behaviours that benefit the organisation. Since stakeholders are more likely to identify with an organisation when their values converge with those of the organisation, an organisation's actions toward its stakeholders are likely to affect their perceptions of value congruence. "For instance, opportunistic behavior toward marginalized groups could compromise member identification if it is perceived as unjust or callous." (Laplume *et al.*, 2008:1178).

According to Friedman and Miles (2006:149), stakeholder management "... is essentially stakeholder *relationship* [own emphasis] management as it is the relationship and not the actual stakeholder groups that are managed". Freeman *et al.* (2010:29) refer to this as a "... 'managing for stakeholders' approach".

This view is supported in this study, as this researcher contends that instead of trying to manage the diverse needs and demands of its different stakeholders, i.e. of managing multiple relationships (Owen, Swift, Humphrey & Bowerman, 2000:89), a for-profit organisation will be better served if it focuses first and foremost on managing itself, its own identity and character, to be able to deliver that which it promises its stakeholders to be. This suggests that it needs to focus on managing its authentic relationship with its stakeholders.

Corporate identity is regarded as the core of an organisation's corporate reputation. Since corporate reputation is seen as the assessment by stakeholders of how well the organisation manages its identity – that which it defines itself to be, its inherent character, which originates from its vision and its values (Friedman & Miles, 2006:52-53) – this study contends that an organisation should rather focus on managing *its accountability* to its stakeholders; on managing *its* relationship with its stakeholders, rather than trying to manage its stakeholders or multiple relationships (Owen *et al.*, 2000:89).

It is then suggested that changing its strategic focus to manage its own accountability and demonstrate its trustworthiness to all its stakeholders, rather than trying to manage its different stakeholder relationships (Friedman & Miles, 2006:52-53; Owen *et al.*, 2000:89), will best enable a for-profit organisation to meet stakeholders' diverse expectations and resolve any possible conflicting interests (Bañon Gomis *et al.*, 2011:185), whilst building a strong corporate reputation, one that will help it to earn the trust and support of its stakeholders (King, 2009:22) and so ensure its own sustainability.

Freeman *et al.* (2010:29) note that "... matters of ethics are routine when one takes a 'managing for stakeholders' approach'. In the words of one CEO: 'The only assets I manage go up and down the elevators every day'".

#### **7.4.3 Relevance of stakeholder theory to organisational performance**

The fundamental reality at the core of stakeholder theory is that economic value is created by people who voluntarily come together and cooperate in order to improve everyone's circumstances. Therefore profit should be regarded as the result of a well-managed organisation (and stakeholder theory as an idea about what it means to be well-managed), rather than the driver in the process of value creation or the purpose of the organisation (Freeman, 2008:165).

This implies that the leaders of a for-profit organisation should understand that the moral presuppositions of managing are about purpose and human relationships and they

should see the importance of values and a relationship with their stakeholders as a critical part of their organisation's ongoing and long-term success and sustainability (Freeman *et al.*, 2004:364; Mackey, 2009:80-82). "Profits and purpose are two different ideas, and collapsing them is like concluding from the fact that I need red blood cells to live, that the purpose of my life is to make red blood cells. There are lots of purposes for a business, and any resemblance among all of them is just what Wittgenstein called a 'family resemblance'." (Freeman, 2008:166).

Freeman (1984:33) proposes that the central issue of stakeholder management is "... pure and simple: survival", when he notes that without the support of its stakeholders a for-profit organisation cannot survive. He proposes using stakeholder analysis techniques to improve an organisation's prospects for survival by helping anticipate and/or prevent unforeseen problems and also improve access to vital resources (Laplume *et al.*, 2008:1166).

Crilly (2011:519) holds that stakeholder management's greatest contribution may not lie with efficiency but with effectiveness through enhanced legitimacy; where legitimacy is known to produce stakeholder support and create environmental stability, which benefits organisations in the long term (Laplume *et al.*, 2008:1168). "Stakeholder orientation, which denotes the stakeholder groups of concern to managers, is fundamental to strategy, since stakeholders are strategically significant actors who control resources essential for organisational survival and performance."

Furthermore, Crilly (2011:526) posits that stakeholder orientation is also important to corporate reputation, by noting that how managers and organisations allocate resources among the demands of competing stakeholders influences competitiveness and societal well-being. Crilly (2011:526) holds that, in contrast to prior studies suggesting that stakeholders do not distinguish between organisations' substantive and symbolic actions, stakeholders differ in their motivations and capacities to penetrate beyond organisations' symbolic actions – suggesting a mechanism linking organisations' allocation of resources to social stakeholders to their reputation and, conceivably, their long-term financial performance.

Stakeholder theory is held to be a managerial theory, since it directs how managers of a for-profit organisation should operate (Freeman *et al.*, 2004:364). This is because stakeholder theory is expressed in two key questions relating to the core purpose of the organisation and the responsibility of the leaders of an organisation to stakeholders, respectively. The first question encourages leaders to articulate the shared sense of the *value* the organisation creates; that which brings its core stakeholders together. The second question directs leaders to articulate *how* they want to do business, specifically the kinds of relationships they want and need with their stakeholders to deliver on their organisation's purpose (Freeman *et al.*, 2004:364).

Freeman (2008:164) holds that businesses and executives are responsible for the effects of their actions, that they are responsible precisely to those groups and individuals that they can affect or be affected by, such as customers, employees, suppliers, communities and financiers at a minimum, and other groups in so far as they affect these definitional stakeholders.

In the light of this Freeman (2008:164) proposes that business and ethics are integrated. "If business is on one side and ethics is on the other, then we'll have a gap that may come to be known as 'corporate social responsibility'. I want to suggest that we avoid this gap by having some integrated way to think about business and ethics, and the idea of responsibility seems to be a good way to start." (Freeman, 2008:164).

Freeman suggests that stakeholder theory makes the idea of corporate social responsibility superfluous, because stakeholders are defined widely and their concerns are integrated in the business processes (Freeman *et al.*, 2010:60; Laplume *et al.*, 2008:1168; Mackey, 2009:103). He also notes that the most troubling issue is the very nature of corporate social *responsibility*, as if the concept were needed to augment the study of business policy, and instead prefers the concept of corporate social *responsiveness*, which enables the link between social issues and the traditional areas of strategy and organisation (Freeman, 1984:39-40; Freeman *et al.*, 2010:41).

Several other researchers support and build on this idea by suggesting that stakeholder theory could help bring the abstract idea of 'society' closer to home for managers and

scholars and provide a good starting point from which scholars can better understand how society grants or takes away corporate legitimacy (Bakan, 2004:140; Fombrun & Van Riel, 2003:20; Friedman & Miles, 2006:184; Mackey, 2009:76; Laplume *et al.*, 2008:1168).

## 7.5 STAKEHOLDERS' ACTIONS, RESPONSES AND THEORY

### 7.5.1 Sources of stakeholders' power

Stakeholders differ with regard to their capacity to influence an organisation in an effort to change its behaviour. Greenwood and Van Buren III (2010:432) consider three sources of power potentially available to organisational stakeholders, namely voting, political and economic power. According to Greenwood and Van Buren III (2010:433), economic power is perhaps most significant with regard to a stakeholder's ability to influence a corporation.

This is in line with Frooman's resource dependence theory as a typology of stakeholder influence strategies. Stakeholders use direct strategies when the organisation depends on them for resources, and indirect strategies, such as working through an ally, when it does not. Moreover, stakeholders withhold resources when they are not dependent on the organisation and make the use of organisational resources conditional when they are. Since stakeholder influence is determined by the power and legitimacy of the stakeholders, indirect strategies, such as coalitions formed between stakeholder groups, may allow stakeholders to combine their power and legitimacy in a way that enhances their bargaining position (Friedman & Miles, 2006:191; Laplume *et al.*, 2008:1162,1163).

In addition to economic, political and voting power, Freeman (1984:92-93) also emphasises stakeholders' social power, in that they can alter the position of the organisation in society, change the opinion of the public about the organisation, or allow or constrain what the organisation is able to do, with 'society's permission'.

Di Maria and Iwata (2007:22) observe that today's organisations no longer only have to contend with traditional stakeholders, but also with "... a billion global 'publishers' with

the means to be heard by mass audiences and to organise quickly”. In this study, this fourth source of power, namely social power, is held to be very relevant. The pervasive availability and use of modern-day communication technology and social media allow stakeholders an unprecedented ability to communicate with and mobilise others *en masse* to take action against a for-profit organisation whose behaviour is being viewed by its stakeholders as unethical or irresponsible, in order to put pressure on that organisation to change (Pharoah, 2003:48).

The literature provides a number of reasons to explain when stakeholders are most likely to mobilise and collaborate – either for or against an organisation – including goal commonality, shared economic interests, a common threat or enemy, common legal concerns or mandates, a history of having acted collectively in the past and greater internal network density (i.e. the group members communicate effectively). However, in line with the focus of this study, the proposal by Rowley and Moldoveanu (in Friedman & Miles, 2006:112) that a particular stakeholder group is more likely to mobilise, act as part of a collective and support if its members value the common identity conferred through their association with the organisation, is strongly supported.

### **7.5.2 Sources of stakeholders' support**

In an attempt to illuminate the antecedents of stakeholder support for organisations, to examine when stakeholders would be most likely to support an organisation, Laplume *et al.* (2008:1164) highlight the following: that stakeholders are more likely to support firms that they perceive as older, more cognitively legitimate, well liked, reliable, accountable and strategically flexible. In particular, the proposal by Hosmer and Kiewitz that stakeholder support is most likely when stakeholders believe they have been fairly considered, fairly treated and fairly rewarded is supported in this study. The suggestion made by Laplume *et al.* (2008:1164), namely that organisations need to employ stakeholder management strategies with caution so as not to erode their credibility or, worse, alienate stakeholders, is also fully endorsed.

The literature on stakeholder theory provides anecdotal evidence of the role that emotional resonance plays, with previous research suggesting that positive emotions

build individuals' personal resources and expand their cognitive thought processes. Therefore it is held that when stakeholders feel that they can trust an organisation, they are more willing to take risks in their relationships with the organisation (Friedman & Miles, 2006:92).

Laplume *et al.* (2008:1178) elucidate: "For instance, it appears reasonable to argue that employees may be more energized working for firms that have a purpose that goes beyond maximizing shareholder wealth. Likewise, it might be particularly useful to create win-win situations with marginalized stakeholders that permit and encourage positive deviance; that is, 'intentional behaviors that depart from the norms of a referent group in honorable ways'." While some possible outcomes of positive deviance include subjective well-being, long-term effectiveness and the evolution of organisational and common business norms, this study supports the suggestion by Laplume *et al.* (2008:1178) to see this linkage potentially extending to organisational sustainability.

## **7.6 THE IMPORTANCE OF ETHICS, VALUES AND TRUST**

### **7.6.1 Power and the principle of fairness**

The power that has been transferred to modern-day business institutions and other private organisations requires a close, explicit and reflective consideration of the morality of economic interactions and the organisations where these transactions take place (Phillips, 2003:2).

Differences in power between organisations and different stakeholders account for differences in outcomes experienced by stakeholders, and therefore Greenwood and Van Buren III (2010:431) hold that "... stakeholder theory ought to identify power imbalances, trace through their effects, and offer proposals for their amelioration". Since stakeholders are potentially vulnerable and dependent on the organisation, stakeholder theory critically needs to address and account for issues of power, and explore and extend the developments within stakeholder theory in the areas of fairness, consent, and trust, for it to be explicitly and effectively normative in nature (Friedman & Miles, 2006:36; Greenwood & Van Buren III, 2010:431).



Phillips (2003:9) holds that, beyond the financial reasons (and the moral rationale that underlies profitability), there are other moral obligations that arise in organisational contexts. He argues the principle of stakeholder fairness, which states that when stakeholders are engaged in a cooperative effort and the benefits of this cooperative scheme are accepted, obligations are created on the part of the organisation accepting the benefit. He also observes that these obligations are elaborated, defended and compared with other forms of obligation generation such as actual and implied consent.

“The principle of stakeholder fairness only provides for the existence of obligations among stakeholders; the content of the obligations must be filled out within the particular contexts of organizational interaction. In other words, that there are obligations and who the parties to these obligations are is determined using the principle of stakeholder fairness. The content of these obligations (i.e. what the parties are obligated to do or refrain from doing) is established by the norms of the particular organization and its stakeholders.” (Phillips, 2003:9).

#### **7.6.2 Ethics and values form the core of stakeholder theory**

In addition to Donaldson and Preston’s view that the normative element forms the core of stakeholder theory, Laplume *et al.* (2008:1169) – based on their extensive review of the literature on stakeholder theory – note that many normative frameworks have been used for stakeholder theory, ranging from two of the most frequently applied normative frameworks, namely feminist ethics and principles of fair play, to many other normative frameworks, including the common good framework as posited by such as Argandoña, critical theory, deontology, Aristotelian ethics, Kantian ethics, organisational justice and libertarianism, as posited by Freeman and Phillips. These authors also note that the deluge of articles emphasising an ethical rationale for stakeholder theory has been generally well received (Laplume *et al.*, 2008:1169).

According to Laplume *et al.* (2008:1180), their review of stakeholder theory points to its growing acceptance in the light of the lack of discourse on issues related to ethics and morality in the field of organisational studies. These authors also observe that the concomitant increase in corporate scandals, reports on unethical organisational

behaviour and demands for socially responsible organisations have made scholars and practitioners alike rethink whether current frames of reference are sufficient to address substantive ethical and moral problems in the world of business.

Stakeholder theory's rise in prominence is evidenced by the growing acceptance of the theory across functional disciplines and explained by its relevance in addressing practical concerns of unethical and irresponsible behaviour by some organisations. Laplume *et al.* (2008:1180) note that they have found "... an emerging consensus on the need to be cognizant of stakeholders, for both strategic and moral reasons". These authors also notice the social construction of ethics and a normative core in the theory, something that transcends Freeman's seminal work.

According to Freeman, Wicks and Parmar (2004:364), stakeholder theory "... begins with the assumption that values are necessary and explicitly a part of doing business. It asks managers to articulate the shared sense of the value they create, and what brings its core stakeholders together. It also pushes managers to be clear about how they want to do business, specifically what kinds of relationships they want and need to create with their stakeholders to deliver on their purpose."

Freeman (1984:96) notes that while ethics is a necessary ingredient of the analysis of 'what the organisation stands for', it is not sufficient in itself. Consequently, he also highlights the importance of an organisation's intrinsic values (values that are good in and of themselves and that should be pursued for their own account and worth) and instrumental values (which are means to intrinsic values). While Freeman (1984:97) notes the importance of leaders' role to be able to articulate the most important values of the organisation, he emphasises that it is critical that there should be a high degree of congruence between their personal values and the values of the organisation.

If ethics is to become an integral part of business conduct, it must be knit into the very fabric of organisational life (Phillips, 2003:2). According to Freeman *et al.* (2010:28), creating as much value as possible for stakeholders, without resorting to tradeoffs, is more easily accomplished when an organisation has a sense of purpose that speaks to the hearts and minds of its stakeholders.

### **7.6.3 The link with trustworthiness and trust**

Trust-based cooperative relationships are distinguished by their moral component. Based on the earlier espousal of the principle of fairness, it is apparent that cooperative relationships between organisations and legitimate stakeholders are morally based. This study contends that being trustworthy as an organisation is the most direct way of discharging that obligation to its stakeholders.

An organisation displays its trustworthiness by consistently and ethically managing its accountability to its stakeholders – by being and delivering what it has promised to them. Based on this, its stakeholders will in turn extend their trust – their support – to the organisation, which will assist the organisation to perform and assure its own economic sustainability in the longer term. Although there is empirical support for the contention that improving stakeholder relations creates organisational performance (Laplume *et al.*, 2008:1176), these authors hold that there is also a need to examine when and how trust spills over from one stakeholder relationship to another, particularly with regard to interest and identity as key variables for stakeholder mobilisation, and how these variables interact to affect attitudes, intentions and actions.

It is posited that this study, with its focus on how an organisation as a system can ensure its own long-term economic sustainability by building an enduring corporate reputation on the foundation of its own trustworthy, ethical identity in order to enhance its stakeholders' trust and support, makes a contribution to the literature in this regard.

## **7.7 CONCLUSION: FOUNDATION OF THE STAKEHOLDER CONSTRUCT**

This discussion of stakeholder theory provides a pertinent link between systems theory and the concept of corporate trust. Based on the key tenet of stakeholder theory, the key role that stakeholders play in influencing a for-profit organisation's long-term economic success and viability is contextualised.

Modern-day for-profit organisations need to consider and implement stakeholder theory, because the positive and negative impact that stakeholders have (or can have) on an

organisation's performance and sustainability makes it an undeniably critical management theory. The growing importance of values and ethics in this regard highlights the key tenet of this study – that stakeholders' trust in an organisation is a prerequisite for its continued success and sustainability, and that an organisation can only earn that trust if it becomes a trustworthy, ethical organisation.

This presents a departure from the traditional view that an organisation needs to manage its stakeholders or multiple relationships with stakeholders, towards a view that primarily focuses rather on managing itself – its accountability to its stakeholders – and therefore on managing its own relationship with its stakeholders.

## **8 CONCLUSION: TRUST A PREREQUISITE FOR SUSTAINABLE SYSTEMIC BEHAVIOUR**

Systems theory, and particularly sociological systems theory, emphasises the importance of maintaining the relationships between the various elements of the system. A for-profit organisation is a social entity that is dependent on its social environment – its stakeholders – to continue to operate and grow its economic performance. Trust, as a sociological event, fulfils an important function in any relationship, namely to reduce complexity (Bachmann, 2006:394; Luhmann, 1979:8). As with personal trust in a dyadic relationship, the presence of trust allows the interaction between the two actors to be simpler and more effective. However, while the likelihood of possibilities for beneficial action increases when trust is present, trust by itself does not constitute anything, and it is rather the trustworthiness of the person who is trusted that allows for the reduction of complexity. “That is to say, again, the focal problem is trustworthiness, not trust.” (Hardin, 2002:30).

Since a for-profit organisation is regarded as a complex social system (Kramer, 1999:570), these notions can be extended to the role that corporate trust plays in the organisation. The presence of trust in a for-profit organisation allows for relationships and interactions on a simple and confident basis, whereas the absence of trust can pose such complexity of contingent outcomes that it could lead to paralysis (Lewis & Weigert, 2008:160).

The use of trust is regarded as a key strategy that can reduce the complexity and uncertainty brought about by the interaction and interdependence in the relationships within a for-profit organisation and with its environment (Luhmann, 1979:8). Trust can also be used to help the leadership create and instil a homogenous identity in the organisation, one that is based on ethics and trustworthy behaviour, as well as values that guide the decisions and actions of everyone in the for-profit organisation to do the right thing (Cartwright & Craig, 2006:748; Marsden & Andriof, 1998:338), and which will then lead to a corporate identity and culture of sustainability and trustworthiness (Pirson & Malhotra, 2008:10; Pirson, 2009:8; Vanneste *et al.*, 2011:23).

This study holds that a for-profit organisation's reputation for trustworthiness is formed as a result of the interactions between the organisation, its representatives and its external stakeholders (Williamson, 1993:207), as well as its reaction to the feedback from its environment. It is posited that the interdependent actions of the internal and external actors who form part of the system and enact the various activities within the for-profit organisation, as well as the activities and behaviour of actors or stakeholders outside the organisation (system), lead to a constant development of the system or for-profit organisation itself (Coleman, 1986:1312). This infers that the goal-oriented actions of the various internal and external actors combine to bring about system-level behaviour. Concomitantly, these goal-oriented actions are also shaped by constraints that result from the behaviour of the system (Coleman, 1986:1312; Selznick, 1948:25).

Through the interrelationships among the various components, certain actions are facilitated and reinforced, and if these are repeated regularly over time, institutionalised patterns of thinking and behaviour are established. This in turn changes the for-profit organisation itself (Argandoña, 2008:441; Gillespie & Dietz, 2009:130; Scott, 2008:442). The process by which the different dimensions influence the degree of overall trust in a for-profit organisation is therefore indicative of systemic behaviour.

This process describes how corporate trust can be created and strengthened, how a for-profit organisation can become trustworthy by grounding its corporate identity on core values that are congruent with the values of its stakeholders (Pirson & Malhotra,

2008:10; Vanneste *et al.*, 2011:23), and can be shown to be a trustworthy, responsible corporate citizen to all its stakeholders (King, 2009:22).

This study contends that a deliberate and focused approach to manage this process will ensure greater consistency and predictability in the trustworthy behaviour of a for-profit organisation, which will lead to increased integrity in how the organisation presents its identity to its stakeholders (Pirson & Malhotra, 2008:23) and therefore to an improved corporate reputation, and subsequently to increased stakeholder trust in the for-profit organisation.

It is further posited that the reputation for being trustworthy and the increased trust will lead to more supportive stakeholder behaviour, and that this sustainable systemic behaviour will in turn enable and safeguard the for-profit organisation's long-term economic viability and success in a sustainable manner.