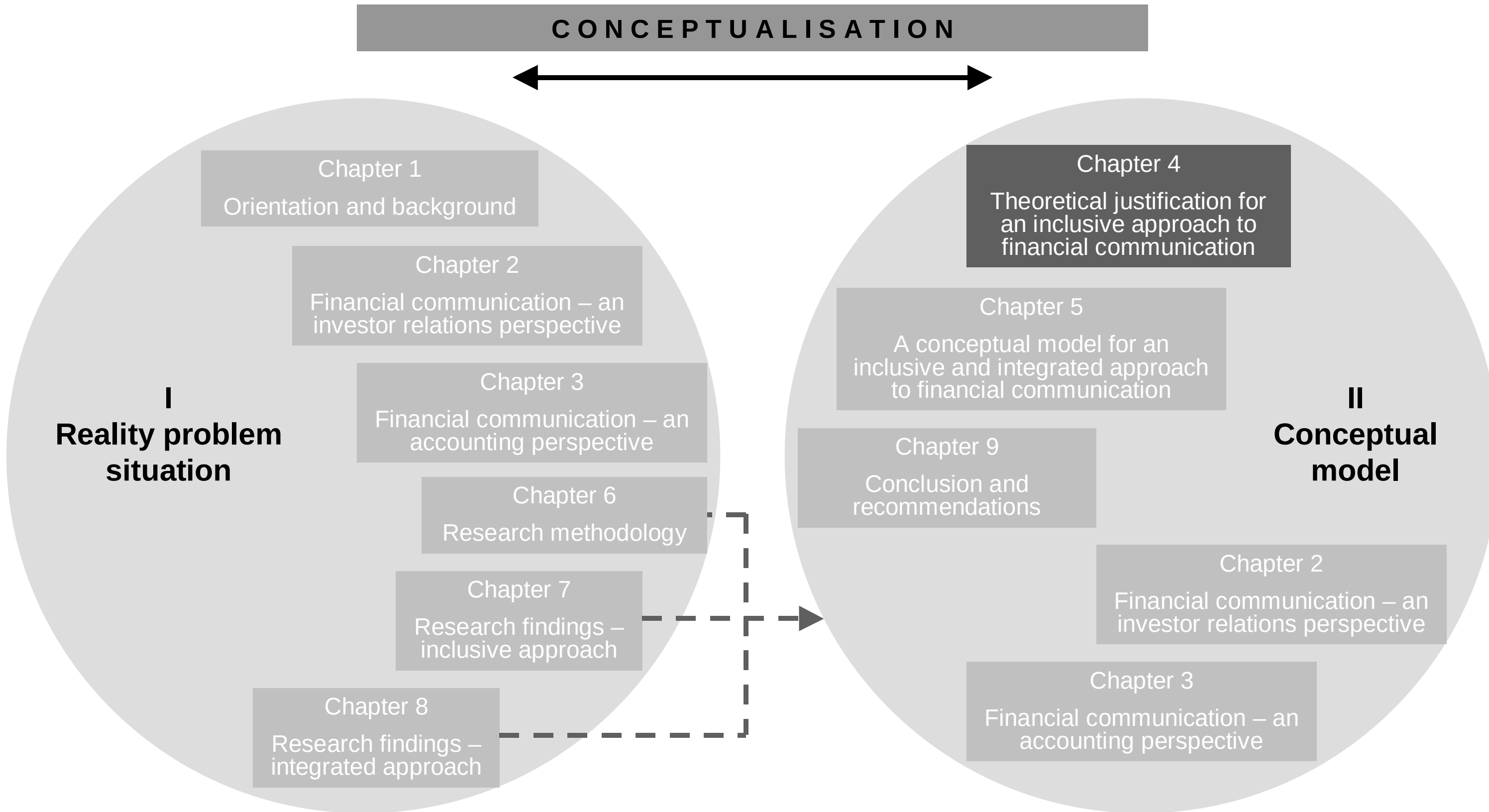


Research objective:

3. To provide a theoretical justification for an *inclusive* (stakeholder) approach to financial communication.

CHAPTER 4

Theoretical justification for an inclusive approach to financial communication

> *... the wealth-creating role of business arises directly out of integrating stakeholders into a productive whole - "a corporate community."*
>
> - Halal (2000:10)

4.1 Introduction

In Chapter 2 the current approach to financial communication was discussed from an investor relations perspective. The main conclusion was that the accounting profession has a stronghold on financial communication. In Chapter 3, the accounting approach to financial communication was investigated. Shortcomings of both these approaches were also identified. The main shortcoming of the investor relations approach is that there is a lack of integration and co-ordination in investor relations efforts. A second shortcoming is that these efforts are in most cases only directed at the financial community. The accounting approach to financial communication is also characterised by this narrow focus.

The objective of this chapter is to provide theoretical justification for a broader focus in financial communication efforts, in order to include stakeholders, other than members of the financial community. In other words, it will be argued that an inclusive approach is needed. The importance of an inclusive approach is one of the main themes in the 2002 King Report on Corporate Governance. The concept of corporate governance also encompasses the themes of corporate social responsibility and stakeholder relationships.

The corporate social responsibility literature emphasises accountability in terms of financial performance, as well as social and environmental performance: the so-called triple bottom line. There is also recognition that corporate social responsibility is a function of an organisation's external relationships. This establishes the link between corporate social responsibility and public relations.

The concept of stakeholder relationships is central to corporate governance, as well as corporate social responsibility. Although a large part of the stakeholder literature has been devoted to the debate around shareholder interests versus stakeholder interests, there is also a body of literature that suggests that these interests are not necessarily in conflict. The emphasis is rather on collaborative stakeholder relationships.

The emphasis on relationships is also evident in recent public relations literature. Most research efforts in this field have focused on defining the concept "relationship" in a meaningful and measurable way. The model of Broom, Casey and Ritchey (1997) and an adapted version by Grunig and Huang (2000) represent important progress in this regard.

The concepts of corporate governance, corporate social responsibility, stakeholder relationships and public relations as relationship management are interrelated. It is therefore impossible to discuss one, without referring to the other. However, good corporate governance lies at the bottom of social responsibility and positive relationships with stakeholders or publics. It is therefore a logical starting point for the discussions in this chapter.

4.2 Corporate governance

During the past ten to fifteen years the concept of corporate governance has received increased attention and is now a mainstream topic in financial and management literature. The Enron debacle, and other corporate scandals that followed, led to the questioning of "generally accepted" corporate conduct and elevated corporate governance to the top of the corporate agenda.

The growth of the corporate governance “movement” has been characterised by numerous committees and reports, of which the 1987 Treadway Commission Report in the USA was the first (Vinten, 2001:4; 7). The United Kingdom followed suit and the 1992 Cadbury Report is seen as one of the most influential in the field of corporate governance. Various “sons of Cadbury” followed (e.g. the Rutteman, Greenbury, Hampel and Turnbull reports). In South Africa, the King Report of Corporate Governance was published in 1994. A revised and expanded edition (King II) was published in 2002. The fact that much time and effort have been dedicated to compiling these reports is an indication of the importance of corporate governance. But what is meant by “corporate governance”?

4.2.1 Defining corporate governance

Cassidy (2003:33) defines corporate governance as “… the creation and implementation of processes adopted by a properly authorised and constituted board seeking to optimise the return to shareholders whilst satisfying the legitimate expectations of stakeholders ...”. He adds that communicating the company’s plans and actions to stakeholders (as far as commercial sensitivity allows), as well as creating opportunities for stakeholders to express their views, are part of the process.

Naidoo (2002:1) emphasises that corporate governance is essentially about responsible leadership and management of companies. Corporate governance therefore encompasses the creation and monitoring of systems within the company to ensure:

- a balanced exercise of power;
- compliance with legal and regulatory obligations;
- identification and management of risks to the sustainability of the company’s business; and
- accountability to the broader society in which it operates.

The needs and expectations of shareholders as well as other stakeholders, is a theme that underlies the definitions of corporate governance offered by both Cassidy (2002:33) and Naidoo (2002:2). The latter, for example, states that corporate governance seeks to align the social and economic goals of individuals, the company and broader society as closely as possible. According to Halal (2000:10), corporate governance has evolved from the traditional “profit-centred model” to the “social responsibility model”. Frankental (2001:18-19), on the other hand, contends that the current governance of companies reflects the interests of shareholders, but not of other stakeholders. He uses the example of company law in the United Kingdom, which offers legal protection for shareholders, but not for other stakeholder groups such as consumers, employees or communities. The shareholder-versus-stakeholder-debate is a contentious issue in stakeholder theory and is discussed in more depth in Section 4.3.3.

In South Africa, compliance with the terms of the 2002 King Report is a requirement for companies listed on the Johannesburg Stock Exchange (JSE). However, Naidoo (2002:157) notes that these terms are only a set of principles, and do not dictate a mandatory course of action. This might be seen as an inherent weakness of the corporate governance movement. Cassidy (2003:32) and Naidoo (2002:8) refer to the phenomenon of “box-ticking” to illustrate the over-emphasis on compliance with codes of corporate governance. Some companies see corporate governance as being too prescriptive and a source of irritation and anxiety. Therefore, corporate governance is reduced to a cosmetic exercise of compliance with principles, without bringing about an inherent change in the ethical practices of companies. What then, constitutes good corporate governance?

4.2.2 Characteristics of good corporate governance

The 2002 King Report lists seven characteristics of good corporate governance (King Committee on Corporate Governance, 2002:11-12), namely discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. Four of these characteristics have a direct bearing on this study.

Transparency is described as a measure of management's ability to make information available that is candid, accurate and timely, so that investors can make informed decisions (King Committee on Corporate Governance, 2002:11). This relates to the decision-usefulness objective of accounting, as discussed in Chapter 3. *Accountability*, which has also been discussed in Chapter 3, requires managers to account for their decisions and actions. Due to the separation of ownership and control in the modern corporation, principals need information systems, such as accounting, to monitor agents' behaviour.

The King II rejects the notion that companies are accountable to *all* stakeholder groups (King Committee on Corporate Governance, 2002:7), but nevertheless calls for an inclusive approach. Thus, *fairness* in corporate governance requires that the interests of stakeholder groups, *identified by the company as important and relevant to its business*, should be taken into account. Naidoo (2002:130) also considers defining a company's stakeholders and maintaining a balance between their interests and those of the company, integral to good corporate governance.

A fourth characteristic of good corporate governance is *social responsibility*. A company is considered as a good corporate citizen if it is non-discriminatory, non-exploitative and environmentally responsible (King Committee on Corporate Governance, 2002:12). Corporate social responsibility is discussed in more detail in Section 4.3.

4.2.3 Major themes in corporate governance

The 1994 King Report on Corporate Governance has been one of the first of its kind, worldwide, to advocate an integrated approach to corporate governance that goes beyond financial and regulatory aspects. An integrated approach to corporate governance is understood as considering the interests of a wide range of stakeholders, by adhering to principles of good financial, social and environmental practice - the "triple bottom line". This term is often used in the context of corporate social responsibility and receives even more attention in the 2002 King Report (King Committee on Corporate Governance, 2002:7; Naidoo, 2002:125).

The King II also acknowledges that corporate governance should reflect the value system of the society in which it operates (Naidoo, 2002:12-13). A hallmark of the African worldview is ubuntu, or humanity. Ubuntu emphasises, amongst other things, co-existence and co-operation. The individual is dependent on his or her relationships with others. It is argued in the King II that ubuntu can also be extended to the corporate world.

In conclusion, three main themes can be identified in the foregoing discussion of corporate governance. The first theme is corporate social responsibility. The second theme centres on an acknowledgement (although a qualified one) of the stakeholder concept. The third theme emphasises the importance of relationships with stakeholders. Although these themes are interrelated, each provides a particular angle to the justification of an inclusive approach to financial communication. In the section that follows, definitions of corporate social responsibility, as well as the rationale behind it, are investigated.

4.3 Corporate social responsibility

Corporate social responsibility is not a new concept. According to Clark (2000:366) the idea originated around the turn of the 20th century. However, researchers only really started to focus their efforts on the topic during the 1960s and 1970s. Today, the importance of corporate social responsibility is clear. What is not as clear, is what is understood by corporate social responsibility.

4.3.1 Defining corporate social responsibility

According to Havenga (1997:135), corporate social responsibility refers to "… behaviour which involves the voluntary sacrifice of profits in the belief that its consequences will be superior to the results of a policy of pure profit maximisation ...". One way this definition can be interpreted is that a trade-off must be made between profit and social responsibility. But Havenga also adds that the duty of the Board of Directors is to reconcile different interests, of which profit is the main, but not the only one.

Naidoo (2002:127) points out that the so-called trade-off between socially responsible investment and profit is a myth. The philosophy underlying corporate social responsibility does not require that companies totally abandon the profitability motive. It is an indisputable fact that companies are in business to generate profits. This sentiment is also expressed in the 2002 King Report on Corporate Governance. According to the report, entrepreneurship and enterprise are still important drivers of business (King Committee on Corporate Governance, 2002:8). It is therefore important to maintain satisfactory levels of profit. Otherwise investors, and even stakeholders, will look for alternative opportunities. Thus, corporate social responsibility requires that companies integrate social and environmental strategies into their core business, to ensure sustainability in more than financial terms. Naidoo (2002:126-127) states that nowadays, corporate reputation is as important to a company's share price and profitability as financial performance.

A potential danger of the emphasis on corporate social responsibility is that it can be interpreted as merely making paternalistic, charitable contributions (Clark, 2000:366). Furthermore, companies realise that there is "mileage" in linking their name to a good cause. Frankental (2001:23) warns that this is not what corporate social responsibility is about. Havenga (1997:136) and Moir (2001:17) state that corporate social responsibility covers a wide range of issues pertaining to employee relations, human rights, corporate ethics, community relations and the environment. These issues include the health and safety of employees, the removal of gender and racial discrimination, product safety, fair treatment of suppliers and environmental protection. The question that arises is: what motivates companies to pay attention to these issues?

4.3.2 The rationale behind socially responsible corporate conduct

Moir (2001:19;20) asserts that companies engage in socially responsible endeavours because society implicitly expects them to do so, based on the social contract between them. Another way to explain this is in terms of a company's "licence to operate". Historically, regulators issued licences for companies to be formed and operated, but this scenario has changed (King Committee on Corporate Governance, 2002:8). Although regulators still grant the initial "licence to operate", companies must now continue to "deserve and retain", it by operating within the norms set by society. According to Overton-De Klerk (1994:175), organisations exist only because society allows them to.

Frankental (2001:20) maintains that companies are motivated to engage in corporate social responsibility by their desire for a return in some form. Moir (2001:17) refers to the enlightened self-interest of business in this regard. The King Committee on Corporate Governance (2002:12) declares that a socially responsible company is likely to experience indirect economic benefits such as improved productivity and reputation. Moir (2001:17) adds higher levels of employee loyalty and retention and public support to the list of possible benefits.

4.3.3 Corporate social responsibility and the financial markets

The 2002 King Report (King Committee on Corporate Governance, 2002:12) refers to *indirect* economic benefits that companies can derive from socially responsible behaviour. However, according to Frankental (2001:19), there is no substantial evidence that any *direct* economic benefits follow from corporate social responsibility. The reason is that financial markets judge companies mainly according to financial indicators such as profits and earnings per share. This fixation with financial indicators of company performance has been alluded to in Chapter 2.

Frankental (2001:19) also refers to the reality that companies are driven by market forces and competitiveness pressures. If financial markets do not reward socially responsible behaviour (or conversely, penalise socially irresponsible behaviour), are the *indirect* economic benefits referred to previously, really enough to motivate companies to be socially responsible? Even if companies listed on the JSE have to comply with the 2002 King Report's guidelines, these are only guidelines and not laws.

There is a way to ensure that markets reward socially responsible companies. Instead of only auditing a company's financial performance, accounting systems should be changed in order for the company's social and environmental performance to be audited as well (Frankental, 2001:19). In other words, companies should be audited according to the "triple bottom line", encompassing financial, social and environmental performance.

The social component of the triple bottom line refers to values, ethics and reciprocal relationships with stakeholders (King Committee on Corporate Governance, 2002:11). The management of relationships is currently one of the major themes in public relations research, and is also one of the fundamental concepts in this study. It is also interesting to note that the King II considers financial aspects as well as non-financial ones as part of the economic component of the triple bottom line. However, reporting on non-financial aspects remains a challenge, as traditional accounting standards and rules do not make provision for it. The same applies to the environmental component of the triple bottom line, although it has received some attention from corporate social accounting scholars (see Chapter 3). According to the King II (King Committee on Corporate Governance, 2002:11), what is known as The Global Reporting Initiative, is an attempt to lay down guidelines for reporting on the triple bottom line.

If companies are formally audited according to the triple bottom line, the principles of corporate social responsibility will take root in financial markets. In fact, there is already evidence of this. Naidoo (2002:127) mentions three major indexes that track the performance of socially responsible companies: the Dow Jones Sustainable Group Index, the FTSE4Good, and the Dow Jones Stoxx Sustainability Index listed on the European Stock Exchange. There are also a number of companies that publish annual social reports. Frankental (2001:20) remarks that, although these companies have been accused of "window dressing" or using the reports as a "PR exercise", the fact that they have accepted a wider sense of accountability is significant.

4.3.4 The link between corporate social responsibility and public relations

Frankental (2001:22) reports that corporate social responsibility is often seen as an add-on to public relations and not something that should be embedded across the organisation. Seitel (2001:87), however, reports the opposite, namely that most firms view corporate social responsibility as a way of life. What is important is that Frankental (2001:22) recognises that corporate social responsibility is a function of a company's external relationships. Clark (2000:376) points out that one of the similarities between public relations and corporate social responsibility is that it is the goal of both disciplines to enhance the quality of the organisation's relationships with key stakeholder groups.

Grunig (1992b:240) identifies social responsibility as one of 12 characteristics of excellent organisations and postulates that it is the purpose of excellent public relations to balance the interests of the organisation with the interests of its publics and society. According to Grunig and Hunt (1984:48;52), public relations *is* the practice of social responsibility (own emphasis). They also remark that it is the publics who decide whether an organisation is behaving responsibly or not. Therefore, public relations has a dual role. First, public relations must scan the environment to establish whether publics perceive the organisation as behaving irresponsibly. Clark (2000:377) states that this role of public relations is largely unrecognised by corporate social responsibility scholars. The second role, according to Grunig and Hunt (1984:52), is to help publics understand the organisation's behaviour. Moir (2001:19) summarises these roles by noting that corporate social responsibility is built around stakeholder analysis (understanding their aspirations and needs) and engagement (communicating and interacting with stakeholder groups).

Note that the term “stakeholder” is used in the sections about corporate governance and corporate social responsibility, but that the term “public” is used in this particular section. The distinction between “stakeholder” and “public” is a difficult one, and the public relations literature is divided on the topic. However, the content of this chapter is derived from various disciplines and a distinction between “stakeholders” and “publics” will only add complexity, rather than clarity, to the discussions. Therefore, the term “publics” will only be used in the sections in which public relations literature is reviewed.

At the end of Section 4.2.3, it has been noted that corporate governance incorporates three major themes, namely corporate social responsibility, the stakeholder concept and stakeholder relationships. Although the stakeholder concept is inherent to corporate governance and corporate social responsibility, it is supported by its own body of literature, known as stakeholder theory.

4.4 Stakeholder theory

It can be said that corporate governance, and therefore corporate social responsibility as well, rest on the idea that a company has stakeholders. Edward Freeman is generally credited for popularising the stakeholder concept. Post, Preston and Sachs (2002:6) remark that the “stakeholder model” is widely accepted as a characterisation of the contemporary business organisation. But what is a stakeholder, and what does a “stake” entail?

4.4.1 Defining the concept “stakeholder”

The concept of “stakeholders” evolved from the concept of shareholders – the owners of businesses. A “stake” refers to an interest or share in an undertaking. Shareholders are therefore also stakeholders (Carroll, 1996:72). Freeman (1984:25) defines stakeholders as any group or individual who can affect or is affected by the achievement of the firm’s objectives. In other words, stakeholders have a stake in a company when they affect, or are affected by, the firm's activities. Näsi, Näsi, Phillips and Zyglidopoulos (1997:302) describe the "stake" in terms of relationships, when they define stakeholders as groups or individuals that are involved in mutually dependent relationships with a firm.

According to Moir (2001:19), stakeholders can be categorised as primary or secondary stakeholders. Primary stakeholder groups are defined as those without whose continued participation the firm cannot survive. These groups include shareholders, investors, employees, customers, suppliers, governments and communities. Secondary stakeholder groups are those who influence or affect, or are influenced of affected by the firm, but are not involved in transactions with the firm. They are therefore not essential for the firm's survival.

The 2002 King Report (King Committee on Corporate Governance, 2002:97) provides another way of classifying stakeholder groups. The first identified group is shareholders (that provide capital). The second group includes parties that contract with the firm in one of two ways: as providers of input, or as purchasers of output. These are, amongst others, customers, employees, suppliers, sub-contractors and business partners. The third group is classified as parties that are involved in a non-contractual relationship with the firm, but provides it with its "licence to operate" - civic society, local communities, non-governmental organisations (NGOs) and other special interest groups. The state as policy maker, legislator and regulator is seen as a fourth separate stakeholder group.

A similar way of classifying stakeholders is to identify the different types of linkages between an organisation and various stakeholders. Grunig and Hunt (1984:140) uses the concept of linkages to explain why Public Relations departments plan and execute government relations, community relations and investor relations programmes, to name a few. Four types of linkages are identified (Grunig & Hunt, 1984:141-142; Steyn & Puth, 2000:65). *Enabling* linkages are linkages with stakeholders that provide authority and resources that enable the organisation to exist. These include shareholders, government, the Board of Directors, community leaders or donors. *Functional* linkages refer to linkages with stakeholders that either provide input (such as employees and suppliers) or use the organisation's output (such as consumers). *Normative* linkages are connections with organisations that share similar values or face similar problems as the organisation (for example professional or industry associations). *Diffused* linkages connect the organisation with groups of individuals that are not part of any organisation (including minorities, the environment and communities).

Whichever way a company chooses to classify stakeholders, the fact is that definitions of stakeholders, such as the ones given above, allow for just about anybody to be included as a stakeholder of a company. This is one of the chief concerns highlighted in the 2002 King Report: "... to ask boards to be accountable to everyone would result in being accountable to no one" (King Committee on Corporate Governance, 2002:7). Clear guidelines are therefore necessary in order to establish whom the company must consider as stakeholders and who not.

4.4.2 A model of stakeholder identification

Mitchell, Agle and Wood (1997:869) developed a model of stakeholder identification and salience, based on the three concepts of power, legitimacy and urgency. In the context of stakeholder theory, *power* can be seen as the ability of one stakeholder to regulate or restrain the activities of other stakeholders on the grounds of access to material or financial resources, force, violence or symbolic resources (Mitchell *et al*., 1997:865). In the context of financial communication, stakeholders who can access and interpret financial information, have power over those who cannot.

Legitimacy refers to the moral claims or rights of stakeholders and also to socially accepted and expected structures of behaviours (Mitchell *et al*., 1997:866). Businesses operate under a mandate given by stakeholders, which may be withdrawn if they are seen not to be doing the "right things" (Woodward, Edwards & Birkin, 1996:329). Legitimacy is therefore "in the eye of the stakeholder". The degree of *urgency* of a stakeholder's claim depends on two factors, namely time sensitivity and criticality (Mitchell *et al*., 1997:867-868).

Moir (2001:19) concludes that firms will pay most attention to legitimate stakeholder groups who possess power and urgency. However, Gamble and Kelly (not dated) remark that the set of relevant stakeholders will vary according to the circumstances of the firm and its environment. The salience of stakeholders changes, depending on their possession and levels of power, legitimacy and/or urgency (Mitchell *et al*., 1997:879). As a result of changes in relationships, stakeholders may choose to exit or voice their concerns, depending on the degree of loyalty towards the organisation.

Mitchell *et al*.'s (1997:869) model allows for the identification of a wide range of salient stakeholder groups, including shareholders. There is, however a body of literature that suggests that organisations cannot tend to the interests of shareholders *and* stakeholders. The debate centres on the concepts of maximisation of shareholder value versus maximisation of stakeholder value.

4.4.3 Maximisation of shareholder value as an organisation's sole objective

In Section 4.2.1 it has been noted that corporate governance has evolved from the traditional "profit-centred model" to the "social responsibility model". A large component of stakeholder theory deals with the question of shareholder interests versus stakeholder interests. Perspectives surrounding this debate are important when considering an inclusive approach to financial communication.

The origins of the profit-centred model can be traced back to the Industrial Age. This model is based on the presumption that capital formation is the only legitimate role of business. Businesses are seen as mere arrangements where shareholders advance capital to managers to realise specific objectives, and for which shareholders receive an ownership interest (Halal, 2000:11; Hasnas, 1998:21). Thus, organisations have obligations to shareholders that are sacrosanct and inviolable. Any action taken by management must be justified by whether or not it enhances the wealth of the shareholders (Freeman & Reed, 1983:88; Halal, 2000:11).

It is widely recognised that Dr Albert Rappaport first created and popularised the concept of shareholder value. The sole task of management is described as maximising shareholders' economic wealth (Goldenberg, 2000:30). However, Milton Friedman is probably better known as a result of his extreme views regarding the maximisation of shareholder value (Vinten, 2000:377). The following is one of his most famous dictums:

> Few trends would so thoroughly undermine the very foundations of our free society as the acceptance of corporate officials of a social responsibility other than to make as much money for their shareholders as they possibly can (Moir, 2001:17).

Where do stakeholders such as employees, customers and others fit into the neo-classical view of a firm (maximisation of shareholder value)? According to Moir (2001:17), those who adopt this view will, at the most, accept social responsibilities in the form of provision of employment and payment of taxes. Varey and White (2000:6) and Halal (2000:11) remark that the interests of stakeholders are merely seen as a means to an end, to ultimately serve the interests of shareholders.

Although stakeholders might benefit from the profit-centred approach, their needs and interests are not really seen as part of a company's goals. Varey and White (2000:6) conclude that, if this is the case, the interests of business are opposed to the interests of society. Emiliani (2001:618) suggests that managers who strive to maximise shareholder value, will have to make trade-offs between key stakeholders, with key accountability to one stakeholder group, the shareholders. This leads to a contentious issue in the stakeholder literature: how to balance, or make trade-offs between, stakeholder interests.

4.4.4 Balancing stakeholder interests

Proponents of the neo-classical view of the firm's main criticism against stakeholder theory is that shareholders are portrayed as one of a number of equal constituencies, or stakeholders (PPFAS Strategy Report, not dated). Thus, the task of management is seen as balancing the conflicting claims of the various stakeholders (Freeman & Reed, 1983:89; King Committee on Corporate Governance, 2002:8; Post *et al*., 2002:6). This is also referred to as stakeholder symmetry (Roodt, 1996:8). According to the 2002 King Report (King Committee on Corporate Governance, 2002:99), managing this equilibrium forms an integral part of good corporate governance. However, in order to achieve and maintain this balance, trade-offs or compromises should be made between the interests of various stakeholders. This presents a major challenge to any Board of Directors.

Halal (2000:10) maintains that, while the stakeholder management concept has been widely accepted, the idea of balancing interests has been abandoned during the 1990s. There are two main reasons for this. In the first place, there is no basis for balancing or adjudicating between the conflicting claims of stakeholder groups (Vinten, 2000:378). This concern is also expressed by Havenga (1997:137). A company's management will not be able to achieve or maintain stakeholder symmetry without clear principles for resolving the eminent conflicts. Halal (2000:10) mentions a second reason. While the profit-centred logic of business prevails, there will be no incentives for balancing stakeholder interests. Managers tend to think of stakeholders purely in terms of morality, ethics and social responsibility.

4.4.5 Towards shareholder and stakeholder collaboration

It is not only the stakeholder theory that has been criticised. Hasnas (1998:23) describes the neo-classical view of the firm (maximisation of shareholder value) as "… [a] myopic view of corporate responsibility". Cassidy (2003:32) warns that in the pursuit of shareholder value, critical relationships with employees, customers, suppliers and the community are sacrificed and long-term shareholder value is destroyed.

There is also a growing recognition that the needs of shareholders need not be at odds with the needs of the rest of the stakeholders. Rather, organisations should strive to create combined value, by implementing strategies where shareholder value and stakeholder value are mutually reinforcing (Cleland & Bruno, 1997:27). Freeman and Liedtka (1997:287) argue that the choice between shareholders and stakeholders is a false one. The interests of shareholders and stakeholders are often aligned, rather than in conflict. This sentiment is evident in three related models: the dual-investor model, stakeholder capitalism and the corporate community model.

- **The dual-investor model**

  Schlossberger (1994:459-462) has conceptualised the dual-investor model in an attempt to circumvent the problem of balancing stakeholder interests. The dual-investor model actually rejects the idea that a company has *stakeholders*, and proposes that a company rather has two types of *investors*: shareholders and society (although society is a different type of investor). Each of these investors provides a certain type of capital. Shareholders provide *specific capital* (needed for equipment, salaries, buildings et cetera), while society provides *opportunity capital*. The latter type entails the knowledge base and infrastructure that society provides and is as important as specific capital. The company therefore has a fiduciary obligation to shareholders as well as to society.

- **Stakeholder capitalism**

  The main assumption of stakeholder capitalism, according to Freeman and Liedtka (1997:286), is that organisations are an integral part of society, rather than separate and purely economic in nature. Emiliani (2001:620) states that companies function more effectively in the socio-economic environment when stakeholders are included in decision making. Firms should therefore be reorganised so that all stakeholders (such as shareholders, customers, suppliers and employees) are able to participate in decision-making (Gamble & Kelly, not dated). One of the most important decisions that any stakeholder has to make involves the allocation of scarce resources (financial and non-financial). Roodt (1996:8) therefore captures the essence of stakeholder capitalism by defining it as "... an integrated, inclusive approach to the optimum utilisation of all the resources of the enterprise."

- **The corporate community model**

Halal (2000:10) notes that corporate governance has first evolved from the profit-centred model to the social responsibility model (see Section 4.2.1), and is now moving towards the corporate community model. According to Varey and White (2000:6), the profit-centred model is limited, because it does not recognise that business is both an economic and a social institution. The social responsibility model calls for accountability in terms of economic as well as social and environmental performance. Unfortunately, it is often misunderstood as corporate charity, or a "public relations exercise".

The corporate community model overcomes the limitations of the profit-centred model. A firm is defined as a *socio-economic* system in which a coalition of stakeholders (investors, employees, customers, business partners and the public) collaborates to create wealth (Halal, 2000:12; Varey & White, 2000:6). It also overcomes the problem that the social responsibility model commonly encounters. Stakeholders are no longer seen as passive recipients of responsible treatment, but actively participate in the value creation processes of the firm (Halal, 2000:10).

But what will motivate corporations to adopt the corporate community model? Halal (2000:11-12) points out that an economic rationale is needed. The information age provides a powerful one - the rise of intellectual capital (knowledge). The biggest appeal of intellectual capital is that, in contrast to ordinary capital, it increases in value when it is shared. Thus, stakeholder collaboration has the potential to increase a firm's knowledge assets. Stakeholder collaboration is therefore not so much motivated by social responsibility considerations, but by the competitive advantage a firm can gain from it. Murphy, Murphy, Woodall and O'Hare (1999:9) note that stakeholder relationships are a company's most valuable assets. The concept of stakeholder relationships is explored in more detail in the section that follows.

4.4.6 Stakeholder relationships

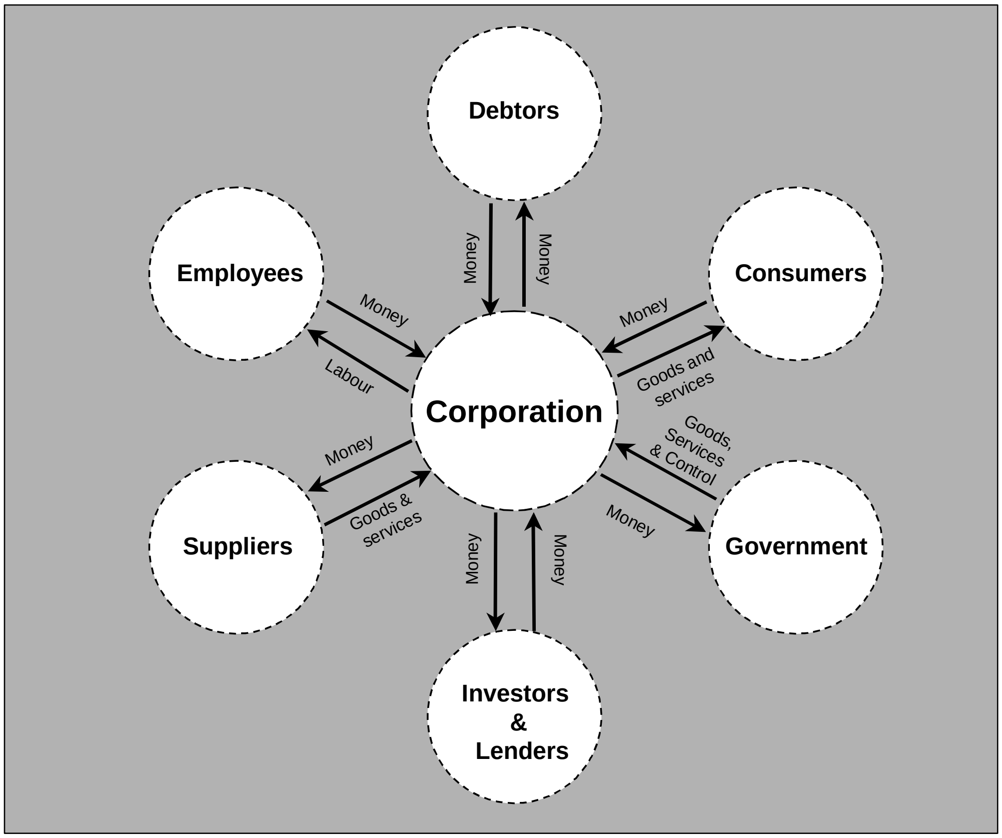
In 1993, the Royal Society of Arts initiated an inquiry to investigate how the company of the future will achieve sustainable success in an increasingly competitive, critical and vigilant business environment (Smith, 1997:289). One of the main conclusions was that deepened relationships with and between employees, customers, suppliers, investors and the community would enable tomorrow's company to anticipate, innovate and adapt fast enough.

However, this emphasis on relationships is not new to stakeholder theory. Freeman (1984:25) conceptualises his stakeholder view of the firm in terms of dyadic relationships. This is similar to Ackoff's (1994:39) systems perspective on stakeholder relationships. Ackoff explains stakeholder relationships by referring to the different types of input (which can also be interpreted as forms of investment) and output associated with these relationships:

- Employees put labour into the firm and take money out.
- Suppliers provide the firm with goods and services and receive money in return.
- Customers are supplied with goods and services in exchange for money.
- Investors and creditors put money into the firm and receive money in return.
- Debtors use the firm's resources for a fee.
- Government provide goods (water and roads) and services (police and fire protection) in exchange for licence fees and taxation.

Ackoff (1994:39) and Freeman's (1984:25) views of stakeholder relationships are illustrated in Figure 4.1

Figure 4.1 A dyadic view of stakeholder relationships



Adapted from: Ackoff (1994:39) and Freeman (1984:25)

It is evident from Figure 4.1 that the possibility of relationships among stakeholder groups themselves is not considered. Post *et al*. (2002:18) criticise this view on the grounds that dyadic linkages often result in zero-sum games. For example, if employees are given a salary increase, investors receive smaller dividends, or consumers pay more for the company's products. One stakeholder group gains at the expense of another.

In order to remedy this inherent weakness of the original stakeholder view of the firm, Post *et al*. (2002:18) propose a "new stakeholder view of the firm" which acknowledges that the firm is involved in a complex *web* of relationships. In similar fashion, Rowley

(1997:887;890) uses social network analysis to explain stakeholder relationships and points out that stakeholders have direct relationships with one another as well. Stakeholder relations are therefore multilateral, rather than dyadic. It is important to note though, that it is unlikely that all stakeholders will be linked directly to each other.

Although the dyadic view of stakeholder relationships does not portray corporate reality, Ackoff's (1994:39) system perspective presents a strong argument in favour of broadening the definition of investor relations (read financial communication) to include stakeholders, other than the financial community. It was noted in Chapter 2 that most definitions of *investor* relations only refer to communication with the financial community. However, Etzioni (1998:680) points out that all stakeholders make some kind of *investment* in the company.

The term "relationship" has appeared regularly in the preceding sections on corporate governance, corporate social responsibility and stakeholder theory. But it is not only scholars in these fields who are interested in the concept of relationships. Since the late 1990s public relations scholars have shown a keen interest in the potential of relationship management as a general theory of public relations.

4.5 Public relations and relationship management

Since Ferguson advocated that relationship management should be at the core of public relations theory and practice in 1984, various scholars have defined public relations in terms of relationship management (Ledingham & Bruning, 2000b:56; Bruning & Ledingham, 2000:85). For example, Cutlip *et al*. (1994:2) define public relations as "the management function that establishes and maintains mutually beneficial relationships between an organisation and the publics on whom its success or failure depends". Varey and White (2000:10) concur with the idea that public relations is the part of management that is concerned with relationships. Similarly, Grunig (1992a:20) declares that the main purpose of public relations is to help the organisation to build relationships with publics that constrain or enhance its ability to meet its mission.

4.5.1 Towards a relational definition of public relations

Bruning and Ledingham (2000:86-7) remark that, due to the journalistic origins and mass communication perspective of public relations, the perception exists that its sole function is the creation and dissemination of messages. However, public relations is moving away from this narrow focus of *managing* or *manipulating* public opinion by means of symbolic communication messages. The emphasis is now on *building*, *nurturing* and *maintaining* mutually beneficial relationships with publics (Bruning and Ledingham, 2000:87; Kent &Taylor, 2002:23; Ledingham, 2001:288).

Grunig (1993:122) distinguishes between symbolic relationships and behavioural relationships. In the past, when organisations were still very small, managers of organisations had personal relationships with various publics. However, as organisations increased in size, they had to use the media to build symbolic relationships, rather than behavioural relationships. This, according to Grunig (1993:136) reduces public relations to an image building exercise.

According to Bruning and Ledingham (2000:87), the current trend is towards combining symbolic communication messages and organisational behaviours. Although Grunig (1993:123) considers long-term behavioural relationships to be the essence of public relations, he also acknowledges that symbolic relationships cannot exist without behavioural relationships, and vice versa.

4.5.2 Theoretical underpinnings of the relational perspective

The relational perspective is not limited to public relations literature, theory building and research. There are a number of theories that can be used as the foundation of relationship management, but the systems, resource dependency and social exchange theories are of importance to this study.

- **Systems theory**

A system is defined as a set of objects or events that are grouped together by sets of relationships (Baskin & Aronoff, 1988:53). Systems are either open or closed, depending on the nature of their relationship with the environment. An open system actively interacts with its environment and is constantly rejuvenated by energy from it. A closed system has no interaction with its environment, and deteriorates as a result of lost energy. This phenomenon is known as entropy (Glautier & Underdown, 1995:11).

Synergy and cybernetics are two important concepts in systems theory. According to Baskin and Aronoff (1988:53) and Puxty (1998:36) synergy, or holism, means that the whole is greater than the sum of the parts. The behaviour of a system can only be understood when looking at it in its totality, and focusing on the relationships between the various parts. Cybernetics refers to the control of the direction of a system through feedback from the environment. To survive, systems must constantly adjust to changes in the environment. Cutlip, Center, Broom and Du Plessis (2002:22) refer to the paradox that open systems must constantly change in order to stay the same. This is known as a state of dynamic homeostasis.

Baskin and Aronoff (1988:52) maintain that communication operates in the form of systems. Organisations are defined as systems, as networks of interdependent relationships. Various public relations scholars recognise the importance of systems theory as an overarching construct for relationship management (Broom, Casey & Ritchey, 2000:15; Ledingham & Bruning, 2000a:xiv). Two related concepts are emphasised: interdependence and mutual benefit. Cutlip *et al*. (2002:15) argue that an open system perspective to public relations means that mutually dependent relationships are built and maintained between an organisation and its publics. Ledingham (2003:182) also expresses the view that public relations initiatives should generate mutual benefits – for the organisation and the publics.

According to Broom *et al.* (2000:15), exchange or transfer of information, energy and resources occur in relationships. These exchanges cause changes in both the organisation and the publics (Cutlip *et al.*, 2002:28). This is typical of the two-way symmetrical model of public relations, as identified by Grunig and Hunt (1984:41).

- **Resource dependency and social exchange theories**

  According to resource dependency theory, organisations enter into relationships because they need resources. The transactions involving the exchange of resources (such as money, physical facilities and materials) form the basis of these relationships (Broom *et al.*, 2000:11; Hallahan, 2000:503). Social exchange theory suggests that people or organisations decide which relationships to involve themselves in, based on a cost-benefit analysis. In other words, people or organisations expect something in return for their contribution to the relationship. If a partner in the relationship's expectations are not met or exceeded, the relationship will either not be initiated, or eventually terminated (Hallahan, 2000:503; Ledingham, 2001:289). Grunig and Huang (2000:35) declare that these theories only explain certain types of organisation-public relationships.

4.5.3 Two-way symmetrical public relations and relationship management

Grunig and Hunt (1984:21) identify four models of public relations. These are described in Chapter 2, Section 2.5. Grunig and Grunig (1992:307) contend that two-way symmetrical public relations is the ideal or excellent form of public relations. However, there are scholars that challenge the supremacy of the two-way symmetrical model. Hallahan (2000:509), for example, points out that the model is only adequate to explain a limited number of organisation-public relationships. In many instances, the organisation is more powerful than the public, which makes symmetry impossible. In response to the criticism against the two-way symmetrical model, Grunig and White (1992:49) acknowledge that the model can accommodate mixed motives in public relations. According to Grunig and Huang (2000:39), the so-called mixed-motive model can be seen as the most recent version of the two-way symmetrical model. Hallahan

(2000:512) refers to a combination of advocacy (or persuasion) and accommodation in this regard.

Nevertheless, the link between relationship management and the two-way symmetrical model is still recognised (Ledingham, 2003:181). Grunig and Huang (2000:27) maintain that organisations will be more effective in building relationships that are symmetrical (to the benefit of both the organisation and publics), than building ones that are asymmetrical (which only benefits the organisation).

4.5.4 The rationale behind adopting a relational perspective to public relations

Public relations' struggle to gain recognition for its contribution to organisational success and goal achievement is well documented. Ledingham and Bruning (2000a:xiii) propose that the relationship paradigm provides a framework to investigate the linkage between public relations objectives and organisational goal achievement. Grunig (1993:136) contends that public relations can prove its value by building long-term relationships with strategic publics. In fact, Huang (2001:61-62) reports that it has been demonstrated that positive relationships between an organisation and its publics contribute to organisational effectiveness.

Organisational effectiveness is the central tenet of the excellence theory of public relations: excellent public relations makes organisations more effective by building long-term relationships with strategic publics (Grunig, Grunig & Ehling, 1992:86). This is done by reconciling the goals of the organisation with the expectations of the publics. Grunig *et al*. (1992:70) identify four approaches to organisational effectiveness. According to the *goal attainment* approach, organisations are effective when they reach their goals, while the *systems approach* posits that organisations are effective when they survive in their environment. The *strategic contingencies* approach states that organisations are effective when they manage to satisfy the demands of those publics critical to their survival. According to the *competing values* approach, organisations are effective if they succeed in incorporating the values of strategic constituencies into their own goals (Grunig *et al*., 1992:76; Grunig & Huang, 2000:30-31). The latter approach is based on the same premise as the corporate community model of stakeholder relationships, discussed in Section 4.4.5.

Because the primary goal of business is to be profitable, an organisation's public relations function will gain the respect of senior management if it can demonstrate how it contributes to this goal. According to Grunig and Grunig (1992:308), research suggests that the two-way symmetrical model of public relations (which may lead to a relational focus) contributes to the bottom line. In similar fashion, Grunig and Huang (2000:24;32) contend that public relations' contribution to organisational effectiveness has monetary value, either by helping to save money, or by making money for the organisation. When an organisation has positive relationships with its strategic publics, costs associated with litigation, boycotts or similar campaigns are reduced, while the support of publics such as consumers, employees and shareholders can help an organisation to make money. Galbreath (2002:17) maintains that the ultimate sources of revenue and net income growth are an organisation's relationships with key publics.

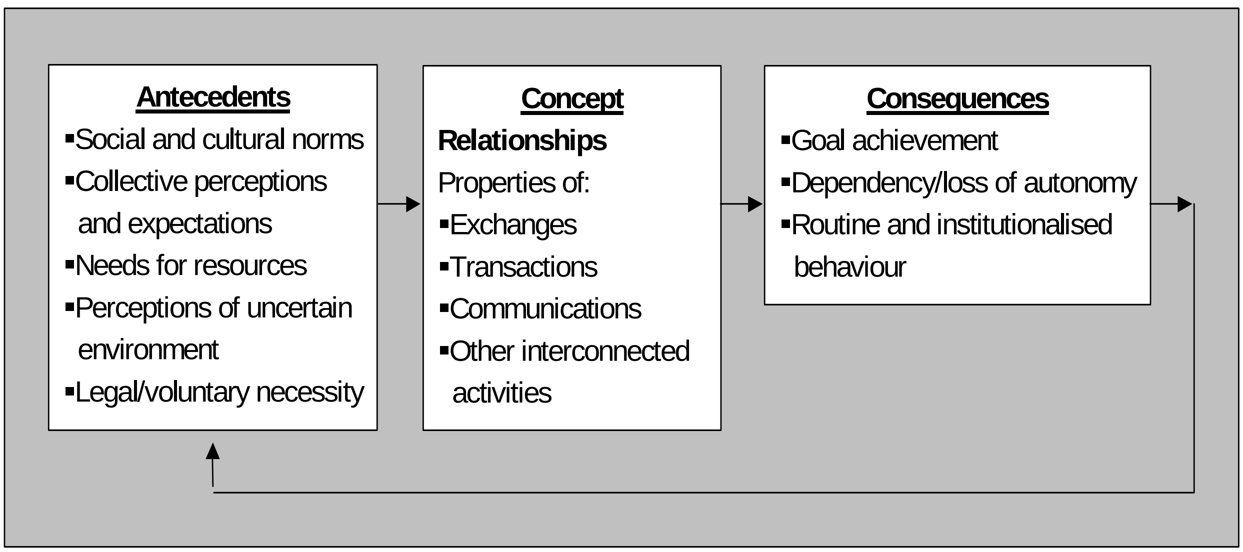
4.5.5 Two models of organisation-public relationships

In the preceding sections, the term "relationships" was used to refer to the new emphasis in public relations literature and practice. But what do relationships with publics entail? Broom, Casey and Ritchey (1997:83; 2000:5) and Grunig and Huang (2000:25) observe that, although the concept of relationships is central to public relations, neither scholars nor practitioners have succeeded in defining it in a useful or measurable way. In order to address this deficiency, Broom *et al.* (1997) conceptualised a three-stage model of organisation-public relationships, which was later reconceptualised by Grunig and Huang (2000).

- **Broom *et al.*'s (1997) model of organisation-public relationships**

  Broom *et al*. (1997:86) conceptualised a three-stage model of organisation-public relationships, based on a review of relationship literature from interpersonal and organisational communication, social psychology and other fields. The model includes antecedents, relationship concepts and consequences of relationships. The model is depicted in Figure 4.2

Figure 4.2 Broom, Casey and Ritchey's (1997) model of organisation-public relationships



Source: Broom *et al.* (1997:94)

Antecedents explain why organisations enter into relationships with certain publics (Grunig & Huang, 2000:29). Broom *et al*. (2000:16) describe antecedents as those sources of change pressure from the environment that lead to the formation of relationships. They include social and cultural norms, collective perceptions and expectations, needs for resources, perceptions of an uncertain environment and legal or voluntary necessity. *Relationship concepts* are used to define the nature of relationships in terms of exchanges, transactions, communication and other interconnected activities (Grunig & Huang, 2000:29). According to Broom *et al*., (2000:16), *consequences* are the outputs of relationships that cause changes in the environment. Figure 4.2 clearly indicates that these consequences become the antecedents of a next "cycle" of relationship formation, maintenance or dissolution.

- **Reconceptualisation by Grunig and Huang (2000)**

  Grunig and Huang (2000:29) remark that the model of Broom *et al*. (1997) provides an excellent framework for further theoretical development. Consequently, the model was reconceptualised by making the following replacements:

  - antecedents with *antecedents from general excellence theory*;
  - relationship concepts with *maintenance strategies*, derived from models of public relations and conflict resolution; and
  - consequences with *relationship outcomes*.

Figure 4.3 represents an abridged version of Grunig and Huang's (2000) model.

Figure 4.3 Grunig and Huang's (2000) model of organisation-public relationships

Situational antecedents

- Organisation affects public
- Public affects organisation
- Organisation-public coalition affects another organisation
- Organisation-public coalition affects another public
- Organisation affects an organisation-public coalition
- Multiple organisations affect multiple publics

Maintenance strategies

Symmetrical

- Be unconditionally constructive
- Disclosure
- Assurances of legitimacy
- Participation in mutual networks
- Shared tasks

Conflict resolution

Symmetrical

- Integrative strategy

Asymmetrical

- Distributive strategy

Mixed-motive

- Dual concern strategy

Relationship outcomes

- Control mutuality
- Commitment
- Satisfaction
- Trust
- Goal Attainment

Adapted from: Grunig & Huang (2000:34)

Antecedents, according to Grunig and Huang (2000:33), result from the public relations problem facing organisations: management decisions have consequences on publics inside or outside the organisation, or the behaviour of internal or external publics have consequences on the successful implementation of management decisions. The *maintenance strategies* have been adapted from Stafford and Canary's five maintenance strategies for romantic relationships (Grunig & Huang, 2000:37). Table 4.1 illustrates this adaptation. Note that all the maintenance strategies are symmetrical in nature.

Table 4.1 Adaptation of romantic relationship maintenance strategies to organisation-public relationship maintenance strategies

STAFFORD AND CANARY (IN GRUNIG & HUANG, 2000)	GRUNIG AND HUANG (2000)
▪ Positivity	▪ Unconditional constructiveness
▪ Openness (disclosure of thoughts and feelings)	▪ Openness (disclosure of information)
▪ Assurances of love and commitment	▪ Assurances of legitimacy
▪ Networking (having common friends)	▪ Building networks with publics
▪ Shared tasks (such as household duties)	▪ Shared tasks (problem solving in the interest of either the organisation or public, or both)

In addition to these maintenance strategies, Grunig and Huang (2000:38-39) also include three conflict resolution strategies, reflecting assumptions of the symmetrical, asymmetrical and mixed-motive models of public relations. The *integrative* strategy is symmetrical in nature and emphasises the reconciliation of interests in order to obtain joint benefits. The asymmetrical *distributive* strategy typically results in a win-lose situation, while the *dual concern* strategy seeks to balance the interests of publics with the interests of the organisation. In other words, all parties concerned need to make compromises. The integrative strategy is based on similar assumptions as the corporate community model which calls for stakeholder collaboration. The dual concern strategy also reflects one of the major debates in stakeholder theory (see Sections 4.4.4 and 4.4.5).

According to Huang (2001:65), four dimensions of relationships represent the essence of organisation-public relationships. The dimensions are trust, control mutuality, commitment and satisfaction. Control mutuality refers to the degree of symmetry or asymmetry of power in relationships. Commitment is understood as the degree of resource interchange in relationships. Grunig & Huang (2000:37) view these dimensions as the *outcomes* of relationships, and add goal achievement - one of the consequences identified by Broom *et al*. (2000:16) - to the list.

Both these models are useful for understanding the nature of organisation-public relationships. In Chapter 5 a synthesis of these models is used to conceptualise financial communication as the management of relationships with a wide range of publics (stakeholders).

4.6. Conclusion

From the discussions in Chapters 2 and 3, it has become evident that current approaches to financial communication focus primarily on communication with the financial community. This is identified as a major shortcoming of the current approach to financial communication. But is it really a shortcoming? After all, it makes sense to communicate *financial* information to *financial* audiences. Do other "non-financial" stakeholders need financial information? Based on the foregoing review of corporate governance, corporate social responsibility, stakeholder and public relations literature, the answer is yes.

The 2002 King Report on Corporate Governance is a very influential document in South Africa. Companies listed on the JSE are expected to adhere to the principles stipulated in the report. Besides providing clear guidelines in terms of the roles of the Board of Directors, financial reporting and auditing, it also dedicates an entire chapter to stakeholder relationships. The King II calls for an inclusive approach that recognises the interests of stakeholders, identified by the company as important to its business and long-term sustainability (in more than financial terms). It emphasises accountability to stakeholders in terms of a company's financial, social and environmental performance.

This three-dimensional accountability, also referred to as the triple bottom line, is the main theme of corporate social responsibility. Contrary to the perception that corporate social responsibility is about corporate charity, or a "public relations exercise", the literature emphasises that it should be seen as a "corporate way of life". The rationale behind corporate social responsibility is that society (consisting of various stakeholders) grants organisations their "licence to operate" by providing them with resources and infrastructure. Organisations therefore need to account how these resources were utilised to the benefit of itself and society.

Ackoff's (1994) systems perspective of the organisation provides another angle to the justification of an inclusive approach to financial communication. According to this perspective, all stakeholders need to make decisions regarding the allocation of their resources (financial and non-financial). These decisions can be seen as investment decisions. Although all these investments are not financial in nature, they do have financial implications. For example, employees need to decide in which company to invest their skills and resources. To do that, they need financial information about salaries and benefits. Therefore, stakeholders need information that will help them to make optimal decisions regarding the allocation of their resources.

There is also the argument that stakeholder relationships are the contemporary company's most valuable asset. But what motivates the company and stakeholders to engage in relationships with each other? Broom *et al.* (1997) identify certain antecedents to relationships, including the need for resources. This is especially significant for financial communication, as it facilitates decisions regarding the allocation of resources.

Corporate governance, corporate social responsibility and stakeholder literature provide compelling reasons for the acceptance of a broader, inclusive approach to financial communication, by emphasising the importance of stakeholder relationships. However, these perspectives fail to explain how these relationships should be built and maintained. The public relations literature that concentrates on relationship management addresses this problem.

In Chapter 5, a conceptual model is developed, based on an integration of theoretical perspectives from this chapter, as well as from Chapters 2 and 3. The aims of the conceptual model are, amongst others, to:

- acknowledge each perspective's unique contribution to a broader understanding of financial communication; and
- establish a broad framework within which future research can be conducted.