



# a blueprint for better business

## Purpose and Performance

### The Benefits of Following the Five Principles of a Purpose Driven Business

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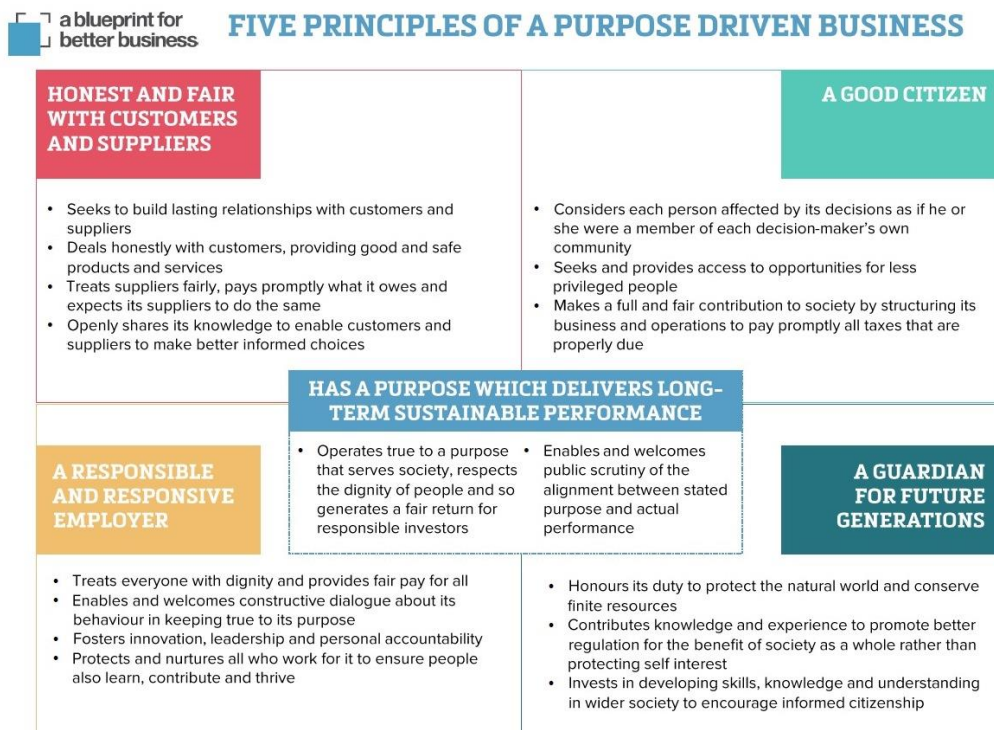
## Purpose and Performance

### The Benefits of Following the Five Principles of a Purpose Driven Business

#### Introduction

The Blueprint for Better Business (Blueprint) tools are focussed on challenging and supporting businesses to serve the societies in which they seek to prosper. It does this by encouraging companies to operate true to a purpose that serves society, respects the dignity of people and thereby generates a fair return for responsible investors. Prosperous businesses are an integral part of prosperous societies. The Blueprint tools (i.e. Five Principles of a Purpose Driven Business, A Framework to Guide Decision Making) can help businesses prosper by enriching the key relationships on which all successful businesses are founded, this can improve all aspects of the business, including financial performance. However, Blueprint's focus is not on the financial performance of business, this paper simply aims to show that there is no trade-off between the Five Principles and financial performance. In fact, the empirical research in this paper shows that there is a positive correlation between close proxies for the Five Principles and financial performance.

This paper analyses proxies for the Five Principles because the Five Principles are still relatively new and there is as of yet no research on them. There is much research focussed on what are in effect proxies for each of the Five Principles.



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### **The Benefit of the Five Principles of a Purpose Driven Business**

Employing the Blueprint tools can assist companies by highlighting key areas of business relationships, and ensuring they act as an integrated whole.

Each of the Five Principles has different benefits, which are demonstrated in this paper. In summary, there is evidence of a positive link between aspects of the Five Principles and employees who are more engaged, motivated, satisfied, with increased skills and abilities, have increased performance (on an individual and organisational level), and less inclined to shirk responsibility. Evidence shows that employees may learn more effectively and work with increased; creativity, problem solving abilities, motivated persistence, self-regulation, and self-motivation. This is alongside reduced feelings of alienation, detachment, and disengagement. Other benefits include the improved ability of the business to attract and retain the best staff, an increased relevance to the next generation, decreases in staff costs, and an increase in employee derived organisational flexibility.

The Five Principles also enriches a business's relationship with customers and suppliers. Proxies have been observed to create increased loyalty and advocacy.

Various research has noted an increase in a business's; ability to survive, succeed in emerging markets, reputational risk management, competitive differentiation within the industry, and licence to operate.

An enrichment of the dialogue between business and stakeholders has been noted which enables the business to properly understand the multiple, fast-changing and complex contexts in which it operates. This also leads to a deeper understanding of critiques, leading to more effective solutions, and general risk management.

These have been observed to lead to a decrease in risk and an increase in market value, improved financial performance and outperformance of counterparts over the long term.<sup>1</sup>

### **Purpose**

A corporations 'purpose' is the fundamental reason that the company exists. Some may say that the purpose of a business is to make profit. A business needs to make a profit otherwise it cannot survive – Blueprint, some leading business people, and academics believe that profit is not the purpose of business. Business is most successful when there is a connection between the purpose of the business, the benefit to society and to all the other stakeholders: employees want a job, customers want the right goods or services at the right price, suppliers want to be

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<sup>1</sup> Barsade & Gibson (2007); Becker & Gerhart (1996); Cohen (2015); Cohen, Cohen (1983); Deci, Koestner, & Ryan (1999); Doughty Centre for Coca-Cola Enterprises (2014); Eccles, Ioannou, and Serafeim (2012); EY & HBR (2014); Fisher (2010); Harter, Schmidt, & Hayes (2002); Harter, Schmidt, Asplund, Killham, & Agrawal (2010); Hillman & Keim (2001) p.126; Huselid (1995); Jeffery (2015); IMD (2010); Judge Bono Thoresen Patton (2001); Likert (1961); Lyubomisky, King, & Diener (2005); McGregor (1960); Mitchell, Holtom, Lee, Sablynski, & Erez (2001); Organ (1977); Ostroff (1992); Pfeffer (1994); Rosabeth Moss-Kanter (1983); Ryan & Deci (1985); Taylor, Cox and Stacy Blake (1991)

treated properly, and investors want a return. Defining and living to a purpose that serves society and respects the dignity of people aligns these various stakeholders and ensures the company creates long term sustainable performance.

By using the Five Principles in defining and living to a purpose the company will ensure that the purpose does serve society and respect the dignity of people thus actually aligning the needs of the various stakeholders. As Norman Pickavance states in his book 'The Reconnected Leader';

*"It is one thing to understand intellectually the need for an organisation to become purpose-driven. However, many business leaders may already feel that their own business already has a strong purpose. Therefore to help leaders critically appraise the degree to which their organisation is truly purpose-driven, the Blueprint for Better Business developed an independent platform, a framework of five guiding principles which are central for allowing leaders to convene an intelligent debate, not only within their own organisation, but also wider society."*

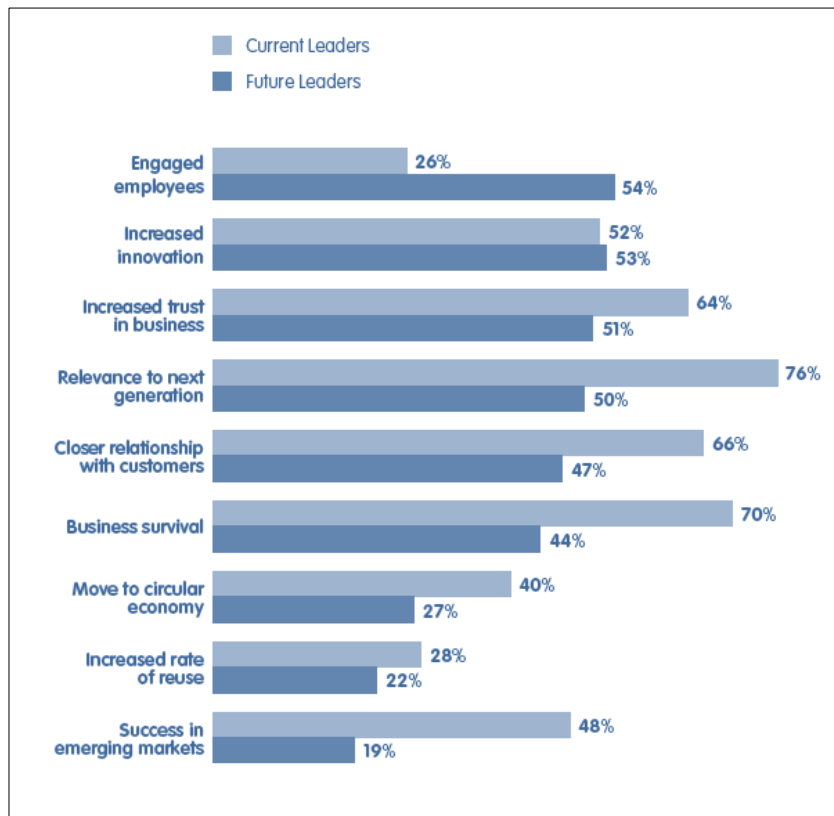
The Five Principles summarise the actions and behaviours that an organization commits to when truly committing to being led by a purpose that serves society.

There is an abundance of recent evidence suggesting an increasing recognition of the importance of a purpose that serves society in aiding long term financial performance. In 2014, Cranfield School of Management conducted a survey of over 50 European CEOs and MSc and MBA students (deemed by the paper as 'future leaders') and found that corporate social purpose is of ever increasing importance. The study demonstrated that 88% of CEOs and 90% of MSc and MBA students stated that a business must have a social purpose. One student interviewee from the Netherlands highlighted the importance of having a social purpose as *"[social purpose] is so matter-of-fact that we have moved on from questioning it. Those who do not move on won't survive."*<sup>2</sup> The importance of purpose is clearly similarly present within the upper echelons of business. As Diane Thompson, CEO of Camelot Group states *"Business should have social purpose - what this is depends on size and type of business"*<sup>3</sup>. The reasons that the respondents give for their focus on social purpose are as follows:

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<sup>2</sup> [Doughty Centre for Corporate Responsibility for Coca-Cola Enterprises \(2014\)](#)

<sup>3</sup> [Doughty Centre for Corporate Responsibility for Coca-Cola Enterprises \(2014\)](#)



Source: [Doughty Centre for Corporate Responsibility for Coca-Cola Enterprises \(2014\)](#)

In an EY and Harvard Business Review study<sup>4</sup>, 87% of respondents stated that “companies perform best over time if their purpose goes beyond profit” and over 80% stated that a purpose created; “greater employee satisfaction”, “better customer advocacy” and “higher-quality products and services.” 70% of respondents stated that they believe it is important to integrate the purpose into the core business functions and 37% responded that they thought that their company had aligned the purpose, business model and operations sufficiently.

### **Purpose and millennials**

Deloitte’s 2015 Millennials survey<sup>5</sup> shows the importance that millennials place on a social purpose. The survey collected views from 7,800 millennials (born after 1982) from 29 countries. The study surveyed those that had obtained a college or university degree and are employed full time. Among the respondents, 60% stated that they joined their current employer (in part) because of the organisation’s “sense of purpose.” The survey also attained the opinion of those who are the highest users of social media sites and thus deemed as the online face of their organisations. Amongst this group, the company’s social purpose is even more important with 77% of interviewees responding that they joined their current employer, at least, partially because of the company’s sense of social purpose. A strong sense of social purpose also

<sup>4</sup> [EY & HBR \(2014\)](#)

<sup>5</sup> [Deloitte \(2015\)](#)

positively correlated with perceived positive financial performance, and with high levels of employee satisfaction. Other research from Global Tolerance (a social change consultancy)<sup>6</sup> states that millennials are impelling the trend for socially responsible business with their choices; they want to work for, and buy from, companies that are making a difference – and they are willing to forgo salary and disposable income to do this. Where 42% of all those surveyed stated they want to work for an organisation that benefits society, 62% of millennials stated the same. Similarly, 44% of all those surveyed stated they choose meaningful work over salary whereas 50% of millennial respondents would make the same sacrifice. This is reiterated in the Deloitte research, which demonstrates that there is a gap between future and current leaders regarding the belief that the role of business is to ‘improve society’. A genuine, actioned social purpose that places society at its core is of great importance to the millennial generation. The research above, from both Global Tolerance and Deloitte, suggests that having a strong social purpose will positively affect businesses ability to attract the next generation of employees.

### Trust

Burston-Marstellar is a public relations and communications company that conducts research with a focus on the benefits of a clearly communicated purpose. Their observations prove that one of the core benefits of operating true to a purpose is the creation of trust. For a company to maintain its ‘licence to operate,’ it must gain and maintain the public’s trust. Building a strong purpose requires “*companies to be honest about what they do,*”<sup>7</sup> and honesty is a key part of being trustworthy. Enabling public dialogue around a business’s purpose is therefore a key ingredient in gaining and maintaining the public’s trust.

Trust is an important asset to companies. As part of PwC’s 17<sup>th</sup> annual Global CEO survey, David Thodey (CEO of Telstra) said; “*Trust is at the centre of running a large organisation... if you lose your trust with your customers then in many ways you lose your right to serve them*”<sup>8</sup>. Despite, already high levels of trust in business is growing, according to the 2014 Edelman Trust Barometer<sup>9</sup> with 55% of respondents stating that they trusted business compared to only 50% in 2009. Even though business increases, CEOs continue to place it as a priority. Half the CEOs interviewed in 2014 identified a lack of trust as a real threat, compared to only 37% in 2013<sup>10</sup>. PwC put forward three fundamental pillars to gain and maintain trust: behaviours, purpose, and collaboration. ‘Behaviours’ can be defined as the need for the company to exhibit actions that build trust. The central pillar is purpose, and is defined as a genuine commitment to a social good. And finally, companies must collaborate with government, NGOs, Universities and the public.

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<sup>6</sup> [Global Tolerance \(2015\)](#)

<sup>7</sup> [IMD \(2010\)](#) p.3

<sup>8</sup> [Site: pwc.com ‘17th Annual Global CEO Survey’](#)

<sup>9</sup> [Edelman.com \(accessed: 16/10/2015\)](#)

<sup>10</sup> [Site: pwc.com ‘17th Annual Global CEO Survey’](#)

## Purpose and financial performance

It is clear that current and future leaders perceive corporate social purpose to be an essential part of a successful business. But does social purpose have financial benefits? The link between business with a social purpose and financial performance is one that proves problematic to qualify, as ‘purpose’ is difficult to isolate as a factor. An interesting case study can be found in brands owned by Unilever. Unilever owns brands from Lipton, to Dove, and Ben and Jerry’s. It has been four years since they launched their ‘Sustainable Living Plan,’<sup>11</sup> a plan to make ‘sustainable living commonplace’ by doubling the size of the business, whilst reducing their environmental footprint and subsequently increasing their positive social impact. The plan sets out three primary aims to accomplish by 2020, which are: to improve the health and wellbeing of more than a billion people, halve the environmental impact of their brands, and enhance the livelihoods of millions working across their value chain. Naturally, some of Unilever’s brands are more aligned with the plan than others. The brands that most align with the ‘Sustainable Living Plan’ are also delivering the most growth. Paul Polman, CEO of Unilever said; *“purpose driven brands are growing ahead of the market”* and *“these brands accounted for half the company’s growth in 2014 and grew at twice the rate of the rest of the business”*<sup>12</sup>.

Further evidence of the empirical relationship between purpose and performance comes from a 2010 study by Burson-Marsteller and IMD business school. The study concludes that; *“a strong and well communicated corporate purpose can impact financial performance by up to 17%”*<sup>13</sup>. The study looks at a return on investment over a five year period. The paper stipulates that to reap these benefits, the company must integrate purpose with the broader corporate strategy, and attributes the benefits of operating true to a purpose as; *“a pre-emptive, defensive tool to strengthen reputation risk management”, “a competitive differentiator within an industry” and “a strategic long term asset to build competitive advantage”*<sup>14</sup>.

## Purpose and the Five Principles

The above shows that there is a growing call for business to operate true to a purpose, and some early research that indicates having a genuine purpose that serves society embedded in the company has a positive correlation with financial performance<sup>15</sup>. There is a need for further rigorous academic research to substantiate this link fully. It is for this reason that a Blueprint for Better Business and London Business School are organising a major academic conference in September 2016<sup>16</sup>.

Not all purposes are created equal. Not all purposes will energise the relationship between the business, society and employees ensuring reasonable growth for responsible investors and a

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<sup>11</sup> <http://www.unilever.co.uk/sustainable-living-2015/>

<sup>12</sup> [Unilever.com ‘Unilever-sees-sustainability-supporting-growth’ \(Accessed: 16/10/2015\)](#)

<sup>13</sup> [IMD \(2010\)](#) p.3

<sup>14</sup> [IMD \(2010\)](#) p.8

<sup>15</sup> [IMD \(2010\); Unilever.com ‘Unilever-sees-sustainability-supporting-growth’ \(Accessed: 16/10/2015\)](#)

<sup>16</sup> [http://www.blueprintforbusiness.org/wp-content/uploads/2015/11/Call-for-Papers\\_Purpose\\_2015.pdf](http://www.blueprintforbusiness.org/wp-content/uploads/2015/11/Call-for-Papers_Purpose_2015.pdf)

prospering society in which to live. A social purpose is only of value if the company genuinely operates true to it. Companies must “walk the talk”<sup>17</sup>. Furthermore, some purposes will be actioned but will not orientate themselves towards serving society and respecting the dignity of people. In this case the purpose will fail to energise the relationships between the business, society and employees.

The Blueprint for Better Business tools aim to help companies both develop a purpose that does energise the relationship between business, society, and employees as well as to help companies operate true to it. The Doughty and Cranfield research concludes by highlighting; “an important new tool which can provide a practical framework for companies the ‘Blueprint for Better Business’”<sup>18</sup>.

These tools have been developed with business leaders and academics and are drawn from strong foundations of learning from society including philosophy, faith teachings and social and behavioural sciences. They put the human person at the centre of business and society, naturally connecting business behaviours and the needs of society. The Five Principles help businesses to ensure that their purpose and actions live up to the expectations of society.

### **A Responsible and Responsive Employer**

The first of the Five Principles that this paper will address is “a responsible and responsive employer.” This principle has the sub points that expand what this principle means, they are; “Treats everyone with dignity and provides fair pay for all, enables and welcomes constructive dialogue about its behaviour in keeping true to its purpose, fosters innovation, leadership and personal accountability, protects and nurtures all who work for it to ensure people also learn, contribute and thrive.”

### **The importance of people**

As Harvard’s Michael Porter notes, “human resource management affects competitive advantage in any firm, through its role in determining the skills and motivation of employees”<sup>19</sup>. People’s creativity, innovation and energy are the lifeblood of any company. Being a responsible and responsive employer ensures employees have the work environment that enable them to bring this out. A McKinsey and Company study of nearly 6,000 managers concludes that ‘talent’ is of rising importance and will be the most important business resource over the next 20 years<sup>20</sup>. The cost of not being a responsible and responsive employer in the medium and long term will be the loss of an essential part of any business – its employees.

### **Research on motivation**

Increasing research shows that a business demonstrating a genuine commitment to honouring its duties as a responsible and responsive employer is an effective way to drive productivity and

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<sup>17</sup> [IMD \(2010\) p.8](#)

<sup>18</sup> [Doughty Centre for Corporate Responsibility for Coca-Cola Enterprises \(2014\) p.18](#)

<sup>19</sup> [Porter p.43 \(1985\)](#)

<sup>20</sup> [Fastcompany.com \[accessed 16/10/2015\]](#)



performance<sup>21</sup>. This trend can be explored through an examination of the effectiveness of intrinsic (the doing of an activity for its inherent satisfaction rather than for some separable consequence) and extrinsic motivation (when an activity is done for some instrumental value)<sup>22</sup>. The literature indicates that while both are important, intrinsic motivation carries the added benefits of increasing learning, creativity, motivated persistence, self-regulation, and self-motivation<sup>23</sup>. Furthermore; “many social institutions face problems including alienation, detachment, and disengagement that could be at least partially ameliorated by promoting higher levels of intrinsic motivation and self-determination”<sup>24</sup>.

Extrinsic motivators are particularly appropriate when outputs are quantitative (i.e. how many widgets an employee can make per hour). In these situation outcomes can be measured and connected to rewards. However, in post-industrial economies outputs are less quantitative and more qualitative (i.e. the quality of service, ability to retain a customer, or mentoring subordinates), harder to accurately measure and thus difficult to directly connect to rewards. In these situations benefits such as motivated persistence, improved learning, and creativity are particularly useful.

Extrinsic motivators (i.e. incentive schemes) can crowd out intrinsic motivation and negatively affect self-motivation, self-regulation and motivated persistence. Intrinsic motivators, on the other hand, work because they give people what they really want which is to build competence, form relationships and develop autonomy<sup>25</sup>. Extrinsic motivators can damage performance for qualitative activities<sup>26</sup>.

As Alfie Kohn shows in a Harvard Business Review article<sup>27</sup>, companies benefit from treating employees well. One study of incentive plans in 90 major U.S. companies found zero impact on shareholder value from incentive plans<sup>28</sup>. Another study surveyed 98 previously completed studies and showed that financial incentives were unrelated to productivity, absenteeism, and staff retention. Training and goal-setting programmes had a far greater impact on all these factors (productivity, absenteeism and staff retention)<sup>29</sup>.

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<sup>21</sup> Ryan & Deci (1985); Deci, Koestner, & Ryan (1999); [Pink site: ted.com](#); [Pink 'Drive'](#)

<sup>22</sup> Ryan & Deci (1985)

<sup>23</sup> Deci, Koestner, & Ryan 'A meta-analytic review of experiments examining the effects of extrinsic rewards on intrinsic motivation', Psychol Bull. 1999 Nov;125(6):627-68; discussion 692-700.  
<http://www.ncbi.nlm.nih.gov/pubmed/10589297>

<sup>24</sup> Ibid.

<sup>25</sup> [Pink site: ted.com](#); [Pink 'Drive'](#)

<sup>26</sup> Kohn (1993); Meyer (1975); Jenkins (1986); Rich & Larson (1987); Guzzo, Jette, & Katzell (1985); Herzberg (1968); Scholtes (1990); O'Dell (1987); Pearce (1987); Haegele (1991); Pittman, Emery & Boggiano (1982); Condry (1977); Locke (1968); Deci and Ryan (1985); J. Freeman, & Cunningham, & Krismer (1992); Schwartz (1986),

<sup>27</sup> [Kohn \(1993\)](#)

<sup>28</sup> [Rich and Larson \(1987\)](#)

<sup>29</sup> [Guzzo, Jette, & Katzell \(1985\)](#); [Kohn \(1993\)](#)

## The payoff of being a responsible and responsive employer

A 2014 Meta study from the University of Oxford concluded that; “good workforce practices pay off financially in terms of better operating performance”<sup>30</sup>. Multiple studies reinforce this conclusion, showing a strong correlation between being a responsible and responsive employer, and financial performance and productivity in the short and long term<sup>31</sup>. This positive relationship is increased as the demand for highly skilled labour increases<sup>32</sup>, which is particularly pertinent for developed economies. The benefits posited include: increased skills<sup>33</sup>, performance<sup>34</sup> (on an individual<sup>35</sup> and organisational<sup>36</sup> level), motivation<sup>37</sup>, attracting<sup>38</sup> and retaining<sup>39</sup> the best staff, increased abilities of staff<sup>40</sup>, and reduced shirking<sup>41</sup>.

A study from Alex Edmans at London Business School concludes:

*“Firms with high levels of job satisfaction... generate high long-run stock returns. The results are robust to controls for risk, industries and firm characteristics, and the removal of outliers. The use of future stock returns, rather than standard performance measures, reduces concerns of reverse causality, and captures all potential channels (both benefits and costs) through which satisfaction can affect firm value. I also find that the ‘Best Companies’ systematically beat analyst earnings estimates.”<sup>42</sup>*

Alex Edmans’ research showed that companies with the highest employee satisfaction outperformed the market by 2-3% per year, over a 26-year period from 1984-2009<sup>43</sup> or as Alex Edmans puts it in a Tedx presentation; “companies that treat their employees better, do better”<sup>44</sup>. The positive effect of employee satisfaction is also undervalued by the market, and it takes the market 4-5 years to include the benefits in its evaluation. Edmans posits that this is because the traditional valuations are too heavily focused on short-term profits, and not enough on integral, though often intangible aspects, such as the businesses’ role within society, expressed social performance and, more specifically in this case, being a responsible and responsive employer.

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<sup>30</sup> [Viehs & Clark \(2014\)](#)

<sup>31</sup> [Benson and Davidson \(2010\)](#); [Hillman Keim \(2001\)](#); [Borgers, Derwall, Koedijk, and ter Horst \(2013\)](#);

<sup>32</sup> Springer.com

<sup>33</sup> [Huselid \(1995\)](#)

<sup>34</sup> [Judge Bono Thoresen Patton \(2001\)](#); [Cohen, Cohen \(1983\)](#), [Organ \(1977\)](#)

<sup>35</sup> [Barsade & Gibson \(2007\)](#); [Fisher \(2010\)](#); [Lyubomirsky, King, & Diener \(2005\)](#)

<sup>36</sup> [Ostroff \(1992\)](#); [Harter, Schmidt, & Hayes \(2002\)](#); [Harter, Schmidt, Asplund, Killham, & Agrawal \(2010\)](#)

<sup>37</sup> [Huselid \(1995\)](#)

<sup>38</sup> [Becker & Gerhart \(1996\)](#); [Likert \(1961\)](#); [McGregor \(1960\)](#); [Pfeffer \(1994\)](#); [Huselid\(1995\)](#)

<sup>39</sup> [Mitchell, Holtom, Lee, Sablinski, & Erez \(2001\)](#). The following papers find negative link between employee satisfaction and employee turnover; [Allen, Bryant, & Vardamam \(2010\)](#); [Griffeth, Hom, & Gaertner \(2000\)](#); [Lee, Mitchell, Holtom, McDaniel, & Hill \(1999\)](#)

<sup>40</sup> [Jones & Wright \(1992\)](#); U.S. Department of Labor (1993); [Huselid \(1995\)](#)

<sup>41</sup> [Jones and Wright \(1992\)](#); U.S. Department of Labor (1993); [Huselid \(1995\)](#)[Huselid \(1995\)](#)

<sup>42</sup> [Edmans \(2011\)](#) p.17, [Edmans \(2012\)](#) p.16

<sup>43</sup> [Edmans \(2011\)](#) p.1, [Edmans \(2012\)](#) p.1

<sup>44</sup> [Edmans \(2015\)](#)

These research findings bring sharply into question the traditional theory of human resource management, which regards people as commodities and suggests that the role of management is to extract as much output as possible whilst paying the minimum price. Counter to this view, and evidenced by Alex Edmans and various other work<sup>45</sup>, long term financial performance is delivered through the more humanist view<sup>46</sup> which treats employees as ends in themselves. The Five Principles and particularly being a responsible and responsive employer sees people as key to driving innovation, inventing new products, ensuring the quality of existing products and building client relationships. Under a more humanist view, job satisfaction can improve financial performance.

### **Being Honest and Fair with Customers and Suppliers**

The second Principle that this paper will analyse its relationship to financial performance is 'honest and fair with customers and suppliers' the sub points elucidate what this means, they are: "Seeks to build lasting relationships with customers and suppliers, deals honestly with customers, providing good and safe products and services, treats suppliers fairly, pays promptly what it owes and expects its suppliers to do the same, openly shares its knowledge to enable customers and suppliers to make better informed choices"

### **The importance of stakeholders**

The Blueprint Principles do not use the term 'stakeholder'. Instead they focus on the various communities that are affected by business. However, we can note that customers, and suppliers, can be regarded as a company's stakeholders<sup>47</sup>. 'Stakeholder relations' as a concept is therefore a useful proxy for 'Being Honest and Fair with Customers and Suppliers'. There are myriad sources of research that address the link between financial performance and stakeholder relations. A resource based view of the firm<sup>48</sup> shows that relationships with stakeholders are a key intangible resource that will create value and give businesses competitive advantage<sup>49</sup>.

### **The benefits**

The Doughty Centre for corporate responsibility, is a centre within Cranfield School of management, puts forward the benefits of stakeholder management as:

- Reducing constraints on business
- Increasing the licence to operate

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<sup>45</sup> [Judge, Bono Thoresen Patton \(2001\)](#); [Cohen Cohen \(1983\)](#); [Organ \(1977\)](#); [Barsade & Gibson \(2007\)](#); [Fisher \(2010\)](#); [Lyubomisky, King, & Diener \(2005\)](#); [Ostroff \(1992\)](#); [Harter, Schmidt & Hayes \(2002\)](#); [Harter, Schmidt, Asplund, Killham, & Agrawal \(2010\)](#); [Mitchell, Holtom, Lee, Sablynski, & Erez \(2001\)](#); The following papers find negative link between employee satisfaction and employee turnover; [Allen, Bryant, & Vardamam \(2010\)](#); [Griffeth, Hom, & Gaertner \(2000\)](#); [Lee, Mitchell, Holtom, McDaniel, & Hill \(1999\)](#)

<sup>46</sup> <http://www.blueprintforbusiness.org/the-provenance/>

<sup>47</sup> [Clarkson \(1995\)](#); [Starik \(1995\)](#); [Hillman & Keim \(2001\)](#)

<sup>48</sup> [Barney \(1991\)](#); [Penrose \(1959\)](#); [Wernfelt \(1984\)](#)

<sup>49</sup> [Atkinson, Waterhouse, and Wells, \(1997\)](#); [Barney \(1991\)](#); [Teece \(1998\)](#)

- Allowing to plan for the future
- Minimising risks and enhancing opportunities through understanding the fast- changing PESTE (political, economic, social, technological and environmental) contexts in which the business operates
- Enabling the business to properly understand critiques and potentially refute, convince or address criticisms
- Reassure stakeholders that they are on top of issues
- Essentially enrich the dialogue around problems making the solutions more effective.<sup>50</sup>

It should be of no surprise that highly successful companies such as Google<sup>51</sup> and 3M<sup>52,53</sup> take stakeholder management particularly seriously. 3M state; *“Memberships and partnerships help provide us with diverse viewpoints on sustainability, a better understanding of the positions of our stakeholders, and a mechanism to learn from the successes and failures of our peers.”*

### **The link with financial performance**

There appear to be clear benefits, but are these benefits tangible enough to translate into improved financial performance? Many studies show a positive correlation<sup>54</sup>.

In the Journal of Banking and Finance, Yawen Jiao argues that stakeholder relationships are a channel for investing in essential intangible assets of a company. The research examines the correlation between Tobin’s Q (a measure of firm assets in relation to a firm's market value)) and a stakeholder welfare score (which measures the extent to which companies meet the expectations of communities, the environment, employees and customers). Tobin’s Q is used as a way to measure the valuation of both observable and unobservable effects of the relationship with stakeholders. The study finds that an increase of 1 in the stakeholder welfare score leads to an increase of 0.587 in the Tobin’s Q. The paper concludes that; *“overall, the study provides direct evidence on the causal effects from stakeholder welfare to firm value”*<sup>55</sup>.

A study from the Ivey School of business similarly shows that improved stakeholder management leads to improved shareholder value creation<sup>56</sup>. The factors that mediate the relationship are stated as; increased customer and supplier loyalty, reduced turnover among employees and improved company reputation<sup>57</sup>.

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<sup>50</sup> Jeffery (2015)

<sup>51</sup> [Jiao \(2010\)](#) p.2549

<sup>52</sup> [3m.com ‘engaging-our-stakeholders’ \[accessed: 20/10/2015\]](#)

<sup>53</sup> [Jiao \(2010\)](#) p.2549

<sup>54</sup> [Benson and Davidson \(2010\)](#); [Garcia-Castro, Arino, and Canela \(2010\)](#); [Hillman, Keim \(2001\)](#), [Jiao \(2010\)](#); [Preston and O’Bannon \(1997\)](#)

<sup>55</sup> [Jiao \(2010\)](#) p.2560

<sup>56</sup> [Hillman & Keim \(2001\)](#) p.128 & p.132

<sup>57</sup> [Hillman & Keim \(2001\)](#) p.126

## **A Good Citizen**

The Principle ‘a good citizen’ puts forward three aspects of being a good citizen. These focus on those affected by decisions and ensuring decisions are made with consideration for those who the decisions will affect, opportunities for less privileged people, and contributing to society through taxes. To measure effectively assess whether there is a link between this principle and financial performance this paper finds proxies for each of the three sub points.

### **Considers each person affected by its decisions as if he or she were a member of each decision-maker’s own community**

Community and stakeholder relations and the degree to which a company considers the effects on communities and stakeholders before it acts is an effective proxy for the sub-point: “Considers each person affected by its decisions as if he or she were a member of each decision-maker’s own community.”

Numerous papers show that there is a positive link between effective community and stakeholder engagement and financial performance.<sup>58</sup> W. G. Simpson, and T. Kohers in the *Journal of Business Ethics*, analyse the extent to which Community Reinvestment Act ratings correlate with financial performance. Community Reinvestment Act ratings measures the degree to which financial institutions serve and consider their community. The institutions are judged on a range of measures, including; “communication with members of the community to ascertain credit needs” and “participation in community development projects or programs.” The study’s test subject was 385 U.S banks in 1993 and 1994, the research found that banks rated as ‘outstanding’ had a mean return of assets on 1.750 percent compared to 0.984 percent for those deemed as needing improvement. This research finds a positive link between the Community Reinvestment Act ratings and financial performance.

### **Seeks and provides access to opportunities for less privileged people**

The second sub-point for a good citizen stipulates that the company; “seeks and provides access to opportunities for less privileged people.” A research paper published in the ‘*Strategic Management Journal*’ by Orlando, Richard, Murthi and Kiran Ismail states that; “the most valued natural resource in the world is not oil, diamonds, or even gold; it is the diverse knowledge, abilities, and skills that are immediately available from cultural diversity”<sup>59</sup>.

Rosabeth Moss Kanter, professor of business at Harvard Business School, in her book *The Change Masters* studies innovation in organisation and reveals that the most innovative companies establish heterogeneous teams that “create a marketplace of ideas, recognising that a multiplicity of points of view need to be brought to bear on a problem”<sup>60</sup>, Kanter also

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<sup>58</sup> Benson and Davidson (2010); Hillman and Keim (2001); and Borgers, Derwall, Koedijk, and ter Horst (2013); Borgers et al. (2013)

<sup>59</sup> Richard, Murthi and Kiran Ismail (2007)

<sup>60</sup> Rosabeth Moss-Kanter, (1983).

notes that companies with high levels of innovation had also done better than most at eradicating racism, sexism, and classism.

A different study from Academy of Management Executive Journal reviews arguments and research data on how managing diversity can create a competitive advantage. The paper puts forward six areas of competitive advantage; “1) cost, 2) resource acquisition, 3) marketing, 4) creativity, 5) problem-solving, 6) organisational flexibility.”<sup>61</sup> The cost savings come from reducing staff turnover amongst less privileged people. The paper quotes research that shows that different socio-economic groups have varying staff turnover rates. Companies that have effectively orientated their internal systems to suit the needs of the varying socio-economic groups have saved money on re-hiring and re-training. Resource acquisition is defined in this paper as an inevitable outcome of providing opportunities to those who are less-privileged. This comes from widening the net for talent which therefore brings in talented yet less privileged employees who may be overlooked without measures put in place to draw them into the company. The improvement in marketing, creativity, and problem solving comes from the ability of diverse groups to draw on a broader range of knowledge and experience.

**Makes a full and fair contribution to society by structuring its business and operations to pay promptly all taxes that are properly due**

The third sub-point focusses on making a full and fair contribution to society through corporation’s tax arrangements. Taxes are part of the obligation that society expects from business and ensures business retains support and a licence to operate from society. Contributions to society (paying taxes) and the pursuit of profits are not binary, a company can do both. As John Kay said at the Blueprint for Better Business conference in 2014; business is about “managing a balance between the whole range of characteristics that make a good business ... the firm has obligations to customers to suppliers, to employees, to society as a whole and to the environment. The job of the manager is not to maximise anything but to steer a course”<sup>62</sup>. Society benefits from business through employment, savings, pensions, and tax revenues to government. Business gains from the building of trust within the society that gives it its freedom to operate and supports its actions.

Whilst John Cridland was the director-general of the CBI he agreed that paying a fair contribution is important; "A company may be making good revenues but pay lower amounts of tax for completely legitimate business reasons. But if it's doing this by using so-called 'black-box' arrangements, where transactions are designed for no commercial purpose at all, other than to avoid tax, then the CBI does not condone it, even if it is legal."<sup>63</sup>

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<sup>61</sup> Taylor, Cox and Stacy Blake, *Managing Cultural Diversity: Implications for Organizational Competitiveness*, The Executive, Vol. 5, No. 3 (Aug., 1991), pp. 45-56,

<sup>62</sup> Site: [BlueprintforBusiness.org](http://BlueprintforBusiness.org) 'Conference 2014' Accessed: 12/02/2016

<sup>63</sup> Site:BBC, *'Google, Amazon, Starbucks: The rise of 'tax shaming''*, Accessed: 09/02/2016

In recent years corporate tax has come to the fore and spurred significant public outcry. In the past, articles on tax avoidance would have been buried in the business section of newspapers, now these headlines consistently reach the front page. Tony Blair, highlighted the risks of failing to make a full and fair contribution to society through tax; “the availability of information is a revolutionary phenomenon, politically and in corporate life. You can see this in the rows over whether companies are paying tax or not, these can very quickly spiral into major problems, where if consumers have any choice they are inclined to exercise it. As a result of social media you get a multiplying effect, as waves of opinion reach tsunami force level very quickly and they can be incredibly destabilising for companies. The consequences of a consumer revolt could be devastating.” Dr Sue Bridgewater, a marketing expert at Warwick Business School, noted the same phenomena; “Customers have very long memories and their emotional tie to a brand is a very important part of the loyalty,” and that damaging this image can also damage their financial “value”<sup>64</sup>.

### **A Guardian for Future Generations**

#### **Proactive rather than reactive**

The world faces enormous environmental challenges from a growing population and subsequent resource scarcity. We are currently on track to miss the carbon target to keep temperatures from rising less than 2°C by 2034<sup>65</sup>. Even more alarming are the predictions stating that we only have 50 years of oil reserves left, and that 3.5 billion people will experience water scarcity by 2025. As Dennis Nally, Chairman of PwC international states; “*sustainability is the lens by which every company will be judged by its consumer, workforce, society and even its investors*”<sup>66</sup>. It is essential that companies take a proactive, and not a reactive, stance in their relationship with the environment – both for the sake of the world in general, and for their own business reputation. Research from Goll and Rasheed (2003) shows that discretionary environmental action has a stronger correlation with financial performance than non-discretionary action. Furthermore, inaction can carry with it great costs; “*on average, firms have a 380 million dollar reduction in market value that can be attributed to environmental concerns. This constitutes approximately 9.0%*”<sup>67</sup>. This study was conducted in 2000 by Konarand Cohen, and looked at the S&P 500 the findings are both statistically and economically significant.

#### **A link with financial performance**

Practices in line with being a guardian for future generations are seen as a best practice in cutting costs and spurring innovation. As Michael Porter states; “*when scrap, harmful substances, or energy forms are discharged into the environment as pollution, it is a sign that*

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<sup>64</sup> Ibid.

<sup>65</sup> [Site: pwc.com](http://pwc.com) ‘17th Annual Global CEO Survey’

<sup>66</sup> [Site: pwc.com](http://pwc.com) ‘17th Annual Global CEO Survey’

<sup>67</sup> Cohen (2015) p.2

*resources have been used incompletely, inefficiently or ineffectively*<sup>68</sup>. Indeed, companies that focus on sustainability have historically also been successful. Lecturers Robert G. Eccles, Ioannis Ioannou, and George Serafeim from London Business School and Harvard Business School conducted research on 180 US companies between 1993 and 2009. The research dividing the test group into 'high sustainability' and 'low sustainability' companies based on the degree to which they voluntarily adopted sustainability practises and policies. Those deemed as high sustainability companies; "significantly outperform their counterparts over the long-term, both in terms of stock market as well as accounting performance"<sup>69</sup>. The research shows that \$1 invested in the high sustainability companies in 1992 was worth \$23 in 2010, whereas the low sustainability companies would have given a return of only \$15. Additionally, a study on 'beyond compliance' activities of S&P 500 businesses on environmental issues found that "a 10% reduction in emissions of toxic chemicals results in a \$34 million increase in market value"<sup>70</sup>.

Environmental sustainability is one of the most active areas of corporate action regarding social issues, but there are arguments for a more purpose led approach. The Ivey School of Business' Hillman and Keim found that engagement in social issues outside the companies' direct stakeholders has a negative impact on financial performance. As Harvard Business School lecturers R. Eccles and G. Serafeim put it:

*"By now most companies have sustainability programs. They're cutting carbon emissions, reducing waste, and otherwise enhancing operational efficiency. But a mishmash of sustainability tactics does not add up to a sustainable strategy. To endure, a strategy must address the interests of all stakeholders: investors, employees, customers, governments, NGOs, and society at large."*<sup>71</sup>

Other Harvard lecturers and competition and strategy specialists, M. Porter and C. Linde show in two papers<sup>72</sup>, there is undoubtedly competitive advantage in aligning strategy with sustainability action.

This highlights the point that corporate action in social issues is better the more it sits at the core of the company. Operating true to a purpose, that both serves society and respects the dignity of the human person, can maintain engagement in social issues in line with the company's strategy and core activities.

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<sup>68</sup> [Porter and van der Linde \(1995a\)](#)

<sup>69</sup> Eccles, Ioannou, and Serafeim, (2011)

<sup>70</sup> Cohen (2015) p.2

<sup>71</sup> Site:HBR 'The Performance Frontier: Innovating for a Sustainable Strategy' Accessed: 17/02/2016

<sup>72</sup> Porter & Linde ([1995b](#)) and ([1995a](#))



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